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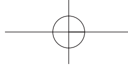

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The Limits to Economic Globalization

Paul Hirst and Grahame Thompson

The 'globalization' of economic activity and the governance issues it raises are often thought to have appeared only after the Second World War, and particularly during the 1960s. The post-1960s era saw the emergence of MNC activity on the one hand and the rapid growth of international trade on the other. Subsequently, with the collapse of the Bretton Woods semi-fixed exchange rate regime in the 1971–3 period, the expansion of international securities investment and bank lending began in earnest as capital and particularly money markets rapidly internationalized, adding to the complexity of international economic relations and heralding what is often thought to be the genuine globalization of an integrated and interdependent world economy. In this chapter we scrutinize this popular history and trace the main periods of the internationalization of economic activity, which will be shown to have developed in a cyclical and uneven fashion. The key issue at stake in our assessment is the changing autonomy of national economies in the conduct of their economic activity.[1]

MNCs, TNCs and International Business

The history of the internationalization of business enterprises is a long one, in no way confined just to the period since 1960. Trading activities, for instance, date from the earliest civilizations, but it was the Middle Ages in Europe that marked the initiation of systematic cross-border trading operations carried out by institutions of a private corporate nature (though often with strong state backing and support).

[. . .]

However, it is the development of international manufacturing as the industrial revolution took hold that presents the closest precursor to the modern-day MNC. Here the early pre-eminence of British firms as multinational producers becomes apparent. Initially North and South America presented the most favourable investment opportunities, but these were soon followed by Africa and Australasia. There is some dispute as to whether 'colonial investments' should be considered a true precursor of foreign direct investment, but production abroad for the local market began in this way. Technical and organizational developments after the 1870s allowed a wider variety of similar products to be produced domestically and abroad within the boundaries of the same firm, while the exploration and development of minerals and other raw material products also attracted large amounts of FDI (Dunning 1993: ch. 5).

[. . .]

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[It] is generally agreed that manufacturing multinationals appeared in the world economy after the mid-nineteenth century and that they were well established by the First World War. International business activity grew vigorously in the 1920s as the truly diversified and integrated MNC matured, but it slowed down during the depressed 1930s and war-torn 1940s, and began a fluctuating expansion again after 1950.
[. . .]

Trade and International Integration

A better statistical base is available for exploring the trends in international trade. Again the history of this part of international economic activity goes back a long way. [. . .] A similar pattern emerges here as in the case of FDI, though perhaps more pronounced in its features. The volume of world foreign trade expanded at about 3.4 per cent per annum between 1870 and 1913. After 1913 trade was adversely affected by the growth of tariffs, quantitative restrictions, exchange controls and then war, and it expanded by less than 1 per cent per annum on average between 1913 and 1950. After 1950, however, trade really took off to grow at over 9 per cent per annum until 1973. Between 1973 and the mid-1980s the growth rate fell back to nearer the late nineteenth-century levels, with expansion at a rate of only 3.6 per cent [. . .].
[. . .]

The relationship between growth in output and in trade is a central one for international economics analysis. It is not our intention to explore the theoretical links between these here (see Kitson and Michie 1995). However, trade growth from 1853 to 1872 was already faster than the growth in world production, while from 1872 to 1911 it grew at about the same rate. Between 1913 and 1950 there was a devastating decline in both the rate of growth of trade (0.5 per cent per annum) and of output growth (1.9 per cent per annum). Only since 1950 has there been a consistent expansion of trade relative to production, even during the cyclical downturn after 1973 [. . .].

Migration and the International Labour Market

A third broad area of analysis in the context of the history of the international economy concerns migration and its consequences for the integration of the global labour market. It is generally agreed that migration is becoming (or has become) a 'global phenomenon' (see, for instance, Serow et al. 1990: 159; Segal 1993: ch. 7; Castles and Miller 1993: ch. 4). However, by global these authors mean that, since the mid-1970s in particular, many more countries have been affected by migration, that there has been a growing diversity of areas of origin for migrants, and that migrants are of a wider range of socioeconomic statuses than ever before. Thus for these authors globalization registers a quantitative change in the extent and scope of migration rather than a feature of a potentially different socioeconomic order.

There are a number of different kinds of migrants. Clearly the early slave trade was a form of 'involuntary' migration (it is estimated that 15 million slaves were moved from Africa to the Americas before 1850: Castles and Miller 1993: 48). Refugees and asylum seekers can also be considered as migrants. But for the purposes of our analysis we focus on 'voluntary' migration. The period considered extends from the

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'mass migration' after 1815 (mainly from Europe) to the emergence and extension of labour migration of the 'guest worker' variety after the Second World War.

It is difficult to judge exactly how many migrants there have been since 1815, so all the following numbers should be treated with some caution. Castles and Miller (1993) report that there could have been as many as 100 million migrants of all kinds in 1992 (including some 20 million refugees and asylum seekers, and 30 million overseas workers). They point out, however, that this represented only about 1.7 per cent of the world population. Thus the vast majority of the world's population remain in their country of origin.

The greatest era for recorded voluntary mass migration was the century after 1815 [. . .]. Around 60 million people left Europe for the Americas, Oceania, and South and East Africa. An estimated 10 million voluntarily migrated from Russia to Central Asia and Siberia. A million went from Southern Europe to North Africa. About 12 million Chinese and 6 million Japanese left their homelands and emigrated to East and South Asia. One and a half million left India for South East Asia and South and West Africa (Segal 1993: 16 – the statistics for Indian migration are probably severely underestimated here).

Between the two world wars international migration decreased sharply. To a large extent this was in response to the depressed economic conditions during much of the interwar period, but it was also due to restrictive immigration policies instigated in many of the traditional recipient countries, particularly the United States.

An upsurge in international migration began in the post-1945 period, particularly involving Europe and the United States once again (Livi-Bacci 1993). This was the period, however, of the relative growth of migration from the developing countries to the developed ones [. . .] and the introduction of the 'guest worker' phenomenon. During the 1970s and 1980s global trends favoured the controlled movements of temporary workers on a 'guest' basis, with entry for immigrants restricted to the highly skilled or those with family already in the country of destination.

[. . .]

The Relative Openness and Interdependence of the International System

A key question posed by the preceding analysis is whether the integration of the international system has dramatically changed since the Second World War. Clearly, there has been considerable international economic activity ever since the 1850s, but can we compare different periods in terms of their openness and integration?

One way of doing this is to compare trade to GDP ratios. Table 1 provides information on these for a range of countries. Apart from the dramatic differences in the openness to trade of different economies demonstrated by these figures (compare the US and the Netherlands), the startling feature is that trade to GDP ratios were consistently higher in 1913 than they were in 1973 (with the slight exception of Germany where they were near enough equal). Even in 1995, Japan, the Netherlands and the UK were still less open than they were in 1913, with France and Germany only slightly more open. The US was the only country that was considerably more open than it was in 1913. [. . .]

Table 1 Ratio of merchandise trade to GDP at current prices (exports and imports combined), 1913, 1950, 1973 and 1995

	1913	1950	1973	1995
France	35.4	21.2	29.0	36.6
Germany	35.1	20.1	35.2	38.7
Japan	31.4	16.9	18.3	14.1
Netherlands	103.6	70.2	80.1	83.4
UK	44.7	36.0	39.3	42.6[a]
US	11.2	7.0	10.5	19.0

[a] 1994.
Sources: Figures from 1913 to 1973 derived from Maddison 1987, table A-23, p. 695; figures for 1995 derived from *OECD National Accounts, 1997*, country tables

[. . .] [C]oncentrating on just the period after the Second World War shows a steady growth in trade openness, with a particularly dramatic entry of the East Asian economies into the international trading system.

Getting back to the longer-term trends, however, the evidence also suggests greater openness to capital flows in the pre-First World War period compared to more recent years. Grassman (1980), measuring 'financial openness' in terms of current account balance to GNP ratios, finds no increase in openness between 1875 and 1975: indeed there is a decline in capital movements for his leading six countries (Great Britain, Italy, Sweden, Norway, Denmark and the US). This is even the case for the post-Second World War period, though from the mid-1970s there is some sign of an increasing trend in financial openness. [. . .]

In addition, Lewis reports that capital exports rose substantially over the thirty years before the First World War, though they were subject to wide fluctuations. But when a comparison is made with the years 1953–73, the order of magnitude of capital exports was much lower in the latter period (Lewis 1981: 21). Finally, in a comprehensive comparison of the pre-1914 Gold Standard period with the 1980s, Turner (1991) also concludes that current account imbalances and capital flows, measured in relation to GNP, were larger before 1914 than in the 1980s.

Thus, using gross figures for ratios of trade and capital flows relative to output confirms that 'openness' was greater during the Gold Standard period than even in the 1990s. But these gross figures could disguise important differences between the periods. [. . .] [The] composition of output might be important in judging the real extent of interdependence. In the case of financial flows we should also recognize the change in their character and the significance of the financial regimes under which they took place. In the high Gold Standard period long-term capital dominated international capital flows. In the recent period there has been a switch to shorter-term capital. In addition, a wider range of countries have now been included under the international capital movement umbrella. [. . .]

Moving away from trade and capital flows for the moment, we can now look at the implications of the trends in international migration. First, it must be emphasized that these are contained within the twin considerations of the labour market and governmental policy. A world market for labour just does not exist in the same way that it does for goods and services. Most labour markets continue to be nationally regulated

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and only marginally accessible to outsiders, whether legal or illegal migrants or professional recruitment. Moving goods and services is infinitely easier than moving labour. Even a rapid and sustained expansion of the world economy is unlikely to significantly reduce the multiple barriers to the movement of labour. Other than in the context of regionally developing free trade agreements of the EU type, freedom of labour movement still remains heavily circumscribed. Even the NAFTA explicitly excludes freedom of movement of persons, though there is *de facto* freedom between Canada and the US, and enormous illegal flows between Mexico and the US. Extraregional migration of all kinds is a small percentage of global labour movements. Most migration is of the country next door variety. During the nineteenth century the mass movement of workers to the sources of capital was accepted and encouraged; now it is rejected except as a temporary expedient.

In as much as there is global international migration for employment, it is concentrated on the Gulf states, North America and Western Europe. A crude estimate of this category gives a figure of about 20 million in 1990 (prior to the Gulf War, which saw a massive return home, particularly of Third World migrant workers, from the Gulf states). This form of international labour force reached its peak in the early 1970s. The worldwide recession and subsequent developments like the Gulf War interrupted the growth of temporary migrant employment. A large proportion of these workers are illegally residing and working abroad. Legal expatriate workers tend to be in the managerial, skilled and technical employment categories.

[. . .]

Two sets of more general points are worth making in the light of these remarks. The first is that there have been phases of massive international migration over many centuries and there seems nothing unprecedented about movements in the post-Second World War period, or those in more recent decades. The second related point is that in many ways the situation between 1815 and 1914 was much more open than it is today. The supposed era of 'globalization' has not seen the rise of a new unregulated and internationalized market in labour migration. In many ways, the world's underprivileged and poor have fewer international migratory possibilities nowadays than they had in the past. At least in the period of mass migration there was the option to uproot the whole family and move in the quest for better conditions, a possibility that seems to be rapidly shrinking for equivalent sections of the world's population today. They have little choice but to remain in poverty and stick it out. The 'empty lands' available to European and other settlers in the US and Canada, South America, southern Africa and Australia and New Zealand just do not exist today, with a concomitant loss of 'freedom' for the world's poor.

Things look different for the well off and privileged, however. Those with professional qualifications and technical skills still have greater room for manoeuvre and retain the option to move if they wish. The 'club class' with managerial expertise, though relatively few in number in terms of the global population, are the most obvious manifestation of this inequity in long-term migratory opportunities.

Another strong contemporary feature of the international system that is often invoked as an indicator of 'globalization' is the emergence of large discriminatory regional trading blocs like the EU, NAFTA and APEC (Asia-Pacific Economic Cooperation). [. . .] [H]ere it is worth pointing to the historical precedents for these kinds of bodies. A marked discrimination in trade and investment patterns was produced during the colonial empire period in the nineteenth century. For the French and British empires

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the biases to trade between the colonial power and its colonies were between two and four times greater than would have been expected given the 'natural' economic fundamentals that determine trade, such as the size of the countries involved, GDP per capita, proximity and common borders. The biases were even higher for Belgium, Italy and Portugal and their overseas dependencies. In fact, the concentration of trade with the countries that made up British and French empires did not peak until 1938; it declined steadily following the independence movements after the Second World War, but did not reach unity until as late as 1984 (Frankel 1997: 126). Trade within the Austro-Hungarian Empire, before it broke up at the end of the First World War, was also four or five times what it would have been if determined simply by the natural fundamentals (Frankel 1997: 119). [. . .]

Thus it was in the 1930s that regionalism was probably at its height. There was a definite discriminatory sterling bloc, overlapping imperfectly with the British Empire/Commonwealth. Then there was a group of countries that remained on the Gold Standard, and a subsection of central and south-eastern European countries that gravitated towards Germany. The US erected trade barriers, and formed a partial dollar bloc with the Spanish-speaking countries adjacent to North America. According to Frankel, all these were heavily discriminatory – though some more than others – except for the partial dollar bloc (Frankel 1997: 127–8). The differences between the blocs have, however, been emphasized by Eichengreen and Irwin (1995, 1997). Sterling bloc countries traded disproportionately among themselves, and discrimination increased during the 1930s, while those remaining on the Gold Standard were more disparate. In as much as they erected barriers between themselves, this reduced trade discrimination.

There have thus been several earlier periods of regionalization, some of which were more intense than the present period. What is distinctive about the present situation, however, is the formation of larger formal *de jure* free trade area (FTA) blocs, and the extension of their *de facto* influence over a wider range of countries and areas. For the first time there are three almost continent-wide blocs (that is the EU, NAFTA, and Japan plus some of East Asia) either firmly established or in proto-existence.

As a preliminary conclusion, then, we can say that the international economy was in many ways more open in the pre-1914 period than at any time since, including from the late 1970s onwards. International trade and capital flows, both between the rapidly industrializing economies themselves and between these and their various colonial territories, were more important relative to GDP levels before the First World War than they probably are today. Add to this the issue of international migration just explored and we have an extraordinarily developed, open and integrated international economy at the beginning of this century. Thus the present position is by no means unprecedented.

[. . .]

Openness and Integration: What is at Stake?

Returning to the broad issue of integration preliminarily discussed above, the actual measurement of the degree of integration in financial markets is difficult both theoretically and empirically. Economic analysis in this area tends to be driven by the

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idea of 'efficient (international) financial market' theory; that is, that capital markets operate competitively to allocate (international) savings and investment so as to equalize returns on capital. Thus key indicators of the degree of integration would be measures such as interest rates as between countries or the value of the same shares on domestic and international stock markets: the nearer these are to equality as between different national financial markets, the more integrated the international economy has become. With a fully integrated capital market there would be single international rates of interest on short-term and long-term loans, and a single share or bond price, other things remaining equal.

Of course, the key constraint here is the 'other things remaining equal' one. In reality they just do not, so the task of empirical analysis from within this dominant perspective is to account for, and then adjust for, these 'imperfections' so as to arrive at a proxy measure of the degree of 'true' integration. [. . .] As might be expected, all this requires some formidable assumptions to be made, ones that few other than the truly converted *cognoscenti* might either appreciate or accept. However, despite some scepticism about this underlying approach, it is worth considering its main results. [. . .]

The degree of international financial integration could be analysed in a number of forms and at a number of levels (Frankel 1992; Herring and Litan 1995; Harris 1995). These can be grouped under three overlapping headings: those associated with interest rate differentials; those associated with differential prices of securities; and those associated with real resource flows and capital mobility. We deal with each of these in turn, beginning with a discussion of the relationships between interest rates and exchange rates.

One of the most straightforward indicators of financial integration concerns offshore markets like that for Eurocurrencies. Formally, measures of offshore financial market integration can be established in terms of covered interest rate parities. This implies that depositors can receive the same return on whatever Eurocurrency they hold, taking into account the cost involved in protecting against possible exchange rate changes. Such interest rate parity seems to hold in the Eurocurrency markets. A more developed form of integration would be when offshore and onshore markets are closely linked, but it is here that difficulties begin to arise. Banking regulations and capital controls establish a separation between these two spheres, and these have often been introduced and maintained for public policy reasons. But with the progressive harmonization of banking regulations and the abandonment of capital controls this form of integration was effectively established between the advanced countries by 1993: thus covered interest rate parity between national rates has now also been more or less achieved.

Deeper forms of integration would be signalled by first uncovered interest rate parity and then real interest rate parity between deposits in different currencies. [. . .] While tests to measure the presence of these latter two forms of integration are complex and controversial, real interest rate parity seemed far from established by the mid-1990s, so that the level of international financial integration fell short of what would prevail in a truly integrated system. By contrast, the Gold Standard period was one where short-term interest rates were closely correlated, and there was a strong tendency for real rates of return to be equalized internationally (Turner 1991: 16–17).

The second broad approach is to focus on asset prices in different national financial systems. Here one problem is to distinguish domestic influences on prices from

international ones, but there is a *prima facie* case that stock markets are closely linked, with disruption in one being quickly transmitted to others (so-called 'contagion'). In this context it is changes in the 'volatility' of price movements that would represent an indicator of increased globalization, not the existence of links as such, and the evidence on this score remains at best ambiguous (Harris 1995: 204–6). In fact, historically based studies have reinforced the impression of greater financial integration, measured in these terms, in the pre-First World War period. [. . .] Zevin [1992], in his survey of a wide range of the financial integration literature, reports on a number of measures supporting the highly integrated nature of the pre-First World War international economy. [. . .] The Gold Standard period was thus also the one displaying the most interdependent and integrated international economy in terms of security markets, the extent of which seems yet to have been repeated.

How did the international financial system adjust so rapidly when technological developments were so primitive? In fact, the idea that the contemporary era of communications technology is unprecedented again needs to be challenged. The coming of the electronic telegraph system after 1870 in effect established more or less instantaneous information communications between all the major international financial and business centres (Standage 1998). By the turn of the century a system of international communications had been established that linked parties together much in the way that the contemporary Internet does. Although the networks were not so developed in terms of individual subscribers, corporate and institutional linkages were dense and extensive. Compared to a reliance on the sailing ship (and even steam propulsion), the telegraph marked a real qualitative leap in communications technology, in many ways more important than the shift into computer technology and telematics after 1970.

A third important related approach in trying to identify the extent of financial integration involves measuring real resource flows: can increased financial integration be implied from increased capital mobility? In this case it is the relationship between national savings and investment that becomes the object of analysis. This approach has generated the most extensive literature, but its results remain controversial.

The more integrated the capital markets, the more mobile capital will become internationally and the more likely it is that domestic savings and investment will diverge. If there were a completely integrated global financial system, domestic investment would not be fundamentally constrained by domestic savings, and the correlation between savings and investment would be broken. Thus national economies will lose their ability to 'regulate' or 'determine' domestic investment. In fact, this is just another way of pointing to the key role of interest rate differentials as a measure of integration and as the determinant of investment. As openness increases, domestic savings become irrelevant to domestic investment since interest rates converge and savings and investment adjust accordingly.

But national savings–investment correlations have not unambiguously declined in the 1980s and 1990s, during the period of capital market liberalization and floating exchange rates. Careful analysis by Bosworth (1993: 98–102) and by Obstfeld (1993, e.g. p. 50) shows this not to be the case [. . .]. The persistence of the correlation between national savings and investment, first established in 1980 (Feldstein and Horioka 1980), well into a period of financial liberalization, deregulation and supposed global integration, testifies to the continued robust relative autonomy of financial systems, and this despite the (sometimes desperate) attempts by conventional economic analysts to prove otherwise (e.g. Bayoumi 1990).

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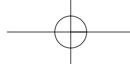


[. . .]

So long as governments continue to target their current accounts, retain some sovereignty within their borders (so that at least the threat of government intervention in cross-border capital movements remains) and differentially regulate their financial systems, investors cannot think about domestic and foreign assets in the same way. Different national financial systems are made up of different institutions and arrangements, with different conceptions of the future and assessments of past experience, and thus operate with different modalities of calculation. All these features factor into a continued diversity of expectations and outlooks which cannot all be reduced to a single global marketplace or logic. What is more, even the most committed of the integrationists who have looked at national savings–investment correlations tend to conclude that the less developed countries (LDCs) and most NICs remain largely out of the frame as far as this form of financial integration is concerned. Thus, even for the integration enthusiasts, there are limits to the extent of the 'globalization' of financial markets.[2]

[. . .]

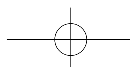
The importance of this assessment of openness and integration is obvious. It has to do with the ability of distinct national economies to devise and regulate their own economic policies. The fact that the degree of constraint on national economies in the Gold Standard period seems to have been consistently greater than at any time since should not blind us to the problems and issues facing economies because of the level of integration at the present time. It is certainly the case that, on the basis of some of the measures discussed above, the level of economic integration has increased since 1960 – though this is not obvious on just the savings–investment measure, except perhaps for the most recent period. In addition, it would be difficult to accept that the qualitative dimension has been constant over the entire period since 1870. The number and range of financial instruments has changed dramatically since 1960, for instance, and with them new problems of management and regulation have arisen (Turner 1991; Cosh et al. 1992). Before we look at the internationalization of money and short-term capital markets, however, we need to look to the more mundane areas of financial integration to see whether the underlying framework for the operation of capital markets has radically changed in the recent period. Money markets are probably more highly integrated than are capital markets. But it is capital markets that most immediately affect the economic prospects for the long-term growth of national economies.

Recent Developments in International Financial Market Activity

These issues can be first approached by investigating the cross-border transactions and holdings of bonds and equities between countries and in various domestic financial institutions. As a percent of GDP the cross-border *transactions* in bonds and equities have escalated since the mid-1970s [. . .]. But if this is looked at from a slightly different angle, changes may not appear quite so dramatic.

[. . .]

What the figures [. . .] demonstrate, however, is the enormous variation between countries in terms of the importance of foreign holdings. Some financial systems are



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clearly much more 'open' than others on this measure. Of the G5 countries, the UK and Japan are much more 'open' than are the US, Germany and France.
[. . .]

[W]hat is clear is that there is no obvious convergence of all the advanced countries to a common openness position. By and large the differences between them seem to have been maintained, indicating continued variation in the characteristics and structures of their domestic financial systems. Thus, up to the mid-1990s at least, the operation of 'globalization' did not seem to have forced the domestic financial institutions of the advanced countries to have fundamentally broken with the historical variation in their character, though there had been some increase in their overall internationalization.
[. . .]

Similar comments could be made about the operation of commercial banks. An increase in the importance of foreign assets and liabilities in their balance sheets is [. . .] mainly attributable to a growth between 1960 and 1980, since when the positions have tended to stabilize. [. . .] But there remains a great variation between [. . .] economies [. . .] largely based on entrenched historical differences.

The final point to make here is to look at the 'bottom line', as it were, of the internationalization of financial systems by assessing the importance of foreign assets ultimately owned by households as a proportion of their total financial assets. Thus we are still concentrating on the holdings only of financial assets, but looking at their importance in household wealth. The problem with the figures presented so far is that they do not cover the entire financial system. [. . .]

[. . .] A variation between countries similar to the patterns outlined above emerges, and with great diversity among them. But only two countries show a foreign proportion of over 15 per cent. Around 10 per cent and below is the norm. Broadly speaking, then, people's financial wealth still remains a domestic affair: it stays at home.
[. . .]

Short-term Lending

Broadly speaking, the period since the liberalization moves of the 1970s has seen an upsurge in international financial activity associated with three developments: increased extent of international lending, financial innovation and financial agglomeration. [. . .]

[. . .] In 1998 it was anticipated that total loans would be over US$2,000 billion – a 2,000-fold increase on the late 1970s position. A key development is the growth of 'securitization': the displacement of conventional loan business (traditionally conducted by banks) by the issue of marketable bonds and other securities. [. . .]

[. . .] Since most of these are derivative of the move towards security lending – they provide borrowers and lenders with the possibility of hedging against the risk of interest rate and exchange rate movements – they are collectively termed 'derivatives'.
[. . .]

[. . .] By 1991 their worth was larger than that of exchange-traded instruments and was more than 50 per cent that of the total of foreign currency claims of all banks reporting to the Bank for International Settlements (BIS). They have shown spectacular

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growth during the 1990s. Such instruments are often traded 'off-balance sheet' – they earn a fee income rather than constituting part of a financial institution's asset or liability structure. These developments provide opportunities for intermediaries to engage in risk arbitrage in a lower-cost and less regulated environment, but they thereby raise important new problems of systemic exposure to risk. [. . .]

Financial innovation continues apace. The latest developments represent a resurgence of bond instruments with so-called 'dragon bonds' and 'global bonds'. 'Dragon bonds' are issued and traded simultaneously just on East Asian markets, while their 'global' counterparts are issued and traded in all major international financial centres on a round-the-clock basis. After the first global bond was marketed by the World Bank in 1989, this market expanded to over US$100 billion by mid-1994, capturing 8 per cent of total external bond issue in that year (OECD 1994: 57, table 1).

This latest development in bond markets testifies to the strength of the trend towards internationalization in the world's financial systems. But as mentioned above, the penetration of foreign assets into domestic institutional investment markets is still relatively light. The US, in particular, remains highly undiversified and autonomous on this score. In as much as global trading of securities and derivatives exists, it still tends to remain within a single region (North America, Europe or Asia-Pacific).

But again there is a trend in the government bond market towards further openness. The average foreign penetration of national government bond markets in advanced countries increased from 10 per cent in 1983 to 15 per cent in 1989 (Turner 1991); for the EU countries, it increased only from 19 per cent in 1987 to 26 per cent in 1993 (European Union 1997: 14, table 13).

The final issue to discuss in this subsection is the development of financial conglomerates. The international financial services industry is increasingly characterized by a small number of highly capitalized securities and banking houses which are global players with diversified activities. In part this is the result of the continuing trend towards predominantly institutional investment. 'Collective saving' is a strengthening feature of all OECD countries, so the institutions managing these funds could become key international players.

Broadly speaking, there is worldwide excess capacity in this industry, leading to intense competitive pressures to which cost-cutting and diversification are the strategic commercial responses. As a result, the financial conglomerates operate through very complex and often opaque corporate structures. Attempts at risk transfer between a shrinking number of players are legion, and even between the different components of the companies themselves. Thus contagion risk, market risk and systemic risk have all increased, presenting new and important regulatory problems for governments and international bodies [. . .].

An important point to note about the present era as compared with the Gold Standard period is that the recent growth of international lending has not just dramatically increased the range of financial instruments: it has changed the whole character of capital flows. As mentioned above, late nineteenth-century lending was mainly long term in nature, going to finance investment in real assets. Even that part of total flows consisting of investment in financial assets was mainly used to finance real investment. This is no longer so. The explosion of aggregate lending had until very recently been made up almost exclusively of financial assets. Only since the mid-1980s has substantial real investment reappeared with the growth of FDI [. . .].

[. . .]

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Conclusion

We have striven to argue a number of points [here]. First, that the level of integration, interdependence, openness, or however one wishes to describe it, of national economies in the present era is not unprecedented. Indeed, the level of autonomy under the Gold Standard in the period up to the First World War was much lower for the advanced economies than it is today. This is not to minimize the level of integration now, or to ignore the problems of regulation and management it throws up, but merely to register a certain scepticism over whether we have entered a radically new phase in the internationalization of economic activity.

The second point has been to argue that governance mechanisms for the international economy have been in place over almost the entire twentieth century, in one form or another. This is just as much the case today as it was at the turn of the century. We may not like the particular mechanisms that are established now and how they work, but they are there all the same. The issue then becomes how to devise better or more appropriate ones.

Thirdly, we have argued that there are some new and different issues of economic interdependence in the present era which are particular to it. Our argument is not that things have remained unchanged: quite fundamental reorganizations are going on in the international economy to which an imaginative response is desperately needed. [. . .]

Finally, we have traced the trajectory of 'national economic autonomy' through the various regimes of governance operating over the twentieth century. This has shown that such autonomy has oscillated between periods of strong and then weak forces, and that it has operated with various degrees of effectiveness. Perhaps the overall trajectory of this assessment is to point to the impossibility of complete national economic autonomy as the twentieth century has progressed. The debacle of the floating rates regime of 1974–85 seems, if nothing else, to have confirmed the demise of this form of governance as a viable long-term objective in the present era. [. . .]

Notes

1 By the term 'autonomy' we mean the ability of the authorities in a national economy to determine their own economic policy and implement that policy. This is obviously a matter of degree. Autonomy is closely linked to 'openness', 'interdependence' and 'integration', three other categories used [here]. Openness implies the degree to which national economies are subject to the actions of economic agents located outside their borders and the extent to which their own economic agents are orientated towards external economic activity. This is in turn linked to the degree of interdependence of the economic system in which these agents operate. Thus interdependence expresses the systemic links between all economic activity within a system or regime. Integration is the process by which interdependence is established.

2 Of course this emphasis on the relationship between domestic savings and domestic investment might seem to reinforce the neoclassical view of investment determination. The critique of this from an essentially post-Keynesian perspective is that the constraint on investment is not savings but the ability to raise finance for investment. In an advanced industrial economy with a developed financial system, credit creation is the key to investment; it is the access to 'liquidity' that determines economic activity, and this is endogenously created.

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Formally we would agree with this analysis for mature advanced economies with a developed banking system operating efficiently in an essentially stable financial environment. However, we would emphasize that there are two exceptions to this image. The first is for those societies that remain less developed, that have an *underdeveloped* banking system in particular. The second is for those economies that have an *overdeveloped* financial system typified by speculation and instability. In both these cases, the 'normal' financing system for investment either just does not exist, or breaks down in the face of speculative pressures. In addition, we would argue that it is this second case that increasingly typifies the position faced in the advanced industrial countries. In both of these cases, however, we are thrown back on to a more 'primitive' conception of what determines investment, namely the brute fact of national savings.

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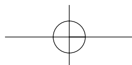

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