

Robert Rowthorn and Richard Kozul-Wright. 1998. Globalisation and Economic convergence: an assessment. UNCTAD discussion paper 131 (February).

Characteristics of the process of globalisation

The quality (nature) of globalisation has been changing (as globalisation, by itself, is a long standing process). The recent changes are:

- exports of manufactures from low wage to high wage countries, particularly in light, standardised consumer goods industries;
- increase in intra-firm trade;
- shift away from bank lending to portfolio and equity investment, particularly with respect to flows of foreign capital to developing countries, and the associated financial innovation;
- increase in the services share of FDI, mostly associated with exports of manufactures.

These changes generated two more fundamental changes in the economic process:

- the triumph of the market over the state;
- and increasing complexity of the international organization of production, trade and specialisation.

As a result, development in any one country are increasingly more influenced by developments elsewhere. But the magnitude and impact of this influence still depends on the country's endowments, institutional arrangements and domestic policy choices.

What has the impact of globalisation been for different countries? In particular, are all countries benefiting from globalisation in such a way as the poorest to be able to catch up with the richest? Which are the domestic conditions that may favour faster growth and convergence? In particular, which are the policy conditions more likely to favour faster growth and convergence?

Is globalisation generating convergence?

Growth/convergence literature

Growth theories state that poorer economies have the potential to grow faster than richer economies. The reasons for that depend on the specific theory, but they are based either on the assumption of higher returns to capital in poorer economies, on the assumption that trade and specialisation brings about convergence, or on the assumption that catching-up is easier than leading. In either case, growth will bring about convergence.

There are two types of convergence, beta and sigma.

Beta (absolute or conditional) convergence establishes an inverse relationship between the initial value of a variable and its future growth prospects. The absolute beta convergence is observed in the real world, such that poor countries grow richer. The conditional beta convergence refers to economies converging to their respective steady-state, rather than to the income level of another economy with a different steady-state, and also considers that the potential to grow faster may or may not be realised depending on a set of conditions (policy regime, institutions, etc.). Beta convergence captures the catching-up effect.

Sigma convergence discusses the dispersion of values of a variable around some reference point. This type of convergence is not so much concerned with the actual values taken by a variable, but whether the dispersion of the values taken by the variable is increasing or decreasing or, in other words, whether the different values are converging, over time, towards a single value.

The growth/convergence literature also attempts to establish the conditions that have to be met for the potential to grow faster towards the economy's steady-state to be realised. The policy advice varies, as the different models emphasise different aspects of the process of economic growth, but most mainstream models mention that openness of the economy (involving greater liberalisation) is the single most important of such conditions for growth.

Critique of the growth/convergence literature

- theoretical critique:
 - β convergence is not sufficient for σ convergence. If β and σ are associated in such a way that the future growth prospects of a variable are inversely associated with dispersion (how far that variable is from some optimum); then as dispersion declines β convergence slows down and will eventually be reversed because stochastic shocks that create dispersion will offset β convergence effects;
 - conditional β convergence, by focusing on the steady-state of the economy, ignores the long term determinants of growth, in particular the development of technological capabilities and abilities to absorb and use new technologies efficiently. Given that technology and technological capabilities are strongly associated with, though not restricted to, investment in physical and human capital, the study of long term growth brings back the role of capital accumulation in economic development;
 - once capital accumulation returns as a central element in economic growth, one has to be able to theorise how a capital and knowledge poor economy may acquire capital and knowledge to grow faster. Rather than openness and liberalisation *per se*, this raises the question of which policies, and by which mechanisms, are more likely to develop such capabilities in the shortest possible period.

- evidence:
 - globalisation is not linked to either β or σ convergence, and there is plenty of clear and irrefutable σ evidence of divergence:
 - the ratio $\frac{GDP_{\max}^{pc}}{GDP_{\min}^{pc}}$ has more than doubled in the last 40 years, such that economies do not seem to be absolute beta converging;
 - $\sigma \frac{\log GDP_{\max}^{capita}}{\log GDP_{\min}^{capita}}$ rose by 20% in the last 40 years, meaning that rates of growth of per capita income are scattered further away from each other, and therefore economies may not be conditional beta converging to their steady-states, whatever it means;
 - between 1960 and 1990, the number of developing countries (out of 98) with 40% and 20% of the average GDP/capita of developed countries fell from 14 and 40 to 11 and 29 respectively;

- in all developing countries that in 1960 had reached 80%, 60% and 40% of the average GDP/capita of the developed countries, by 1990 the relative GDP/capita had fallen significantly;
 - dispersion also occurred amongst developing countries, with the ratio $\frac{GDP_{ldc}^{max}}{GDP_{ldc}^{min}}$ more than doubling;
 - convergence of GDP/capita and productivity amongst OECD countries, and between these countries and the USA has stopped and in some cases been reversed;
 - the link between income convergence and increasing trade with major trading partner is found only amongst developed economies;
 - evidence of wage convergence as trade with major partner expands is very limited and only present amongst developed economies.
 - links between globalisation and growth: evidence also shows that the only strong and irrefutable link between globalisation and fast growth is through capital accumulation:
 - even in the case of static comparative advantages, exporters need finance, ability to penetrate international markets and even export subsidies to expand their market access;
 - the static industries (usually labour intensive and knowledge saving activities) have little room for improving and soon their expansion boom runs out of steam as productivity and quality standards fall behind;
 - long term, accelerated growth prospects depend on the ability and opportunity to continuously nurture a new generation of industries with more room for innovation, productivity increase, product differentiation and export expansion;
 - hence, trade expansion favours accelerated long term growth only if resulting from strong, specific performance targeted capital accumulation. Evidence on trade-led growth is weak and ambiguous, and causality, when found, seems to run from growth to trade. This reinforces till further the role of capital accumulation;
 - finally, wage increase has been found to be strongly correlated with industrialisation, employment in industry and productivity growth, which are associated with capital accumulation.
- financial flows from increasing liberalisation have been singled out as a major contribution of globalisation towards capital accumulation. However:
 - it is important to distinguish between the types of financial flows, namely real investment and speculative money:
 - real investment (FDI) has potential to accelerate growth. However, it should be noted that:
 - Greenfield FDI (new money) can be volatile, particularly with respect to the share of non-repatriated earnings that form an increasing share of new money;
 - the impact (positive or negative) of Greenfield FDI depends on how it relates to the domestic economy, the capabilities of domestic firms, the effectiveness of technology transfers, etc, which require that selective policies towards technology, capital and intermediate goods industries, training and R&D are pursued;

- and increasing component of FDI (2/3 of FDI implemented in 1999) is not even new money but mergers and acquisitions (M&A). M&A may be a simple transfer of ownership over acquired assets, without involving real addition of resources. Shareholders who sell may become richer, but there is no guarantee that they are not going to acquire financial assets instead of making real investment. For M&A to contribute to capital accumulation and growth it requires specific, performance oriented, investment, ownership and competition policies;
 - a large chunk of international flows of capital are in the form of speculative finance (or asset speculation). These flows are extremely volatile and short-term, do little to reallocate savings, contribute nothing to transfers of technology and to raising income per capita, and their typical impact on the economy is a de-stabilising one.
- most of the developing countries remain outside the process of international organization of production, trade, technology transfers and finance. This is happening despite increasing liberalisation of their current and capital accounts, because:
 - static costs advantages are insufficient to attract FDI and other flows of foreign capital;
 - other fundamental issues (productivity, infra-structures, productive and technological capabilities and capacity to complement FDI) are more important than static costs advantages that liberalisation may help to reveal;
 - in the manufacturing sector, the expectation of monopoly rents is not as high as in natural resource industries (like oil, coal, gas). Hence, risks cannot be offset by expectations of higher than normal profits;
- there is no evidence that FDI is attracted by liberalisation of the current and capital accounts. In most of the studies that are part of a hugely vast literature on the determinants of FDI, it has been shown that FDI follows high rates of growth, large markets or easy access to foreign markets, infra-structures and technological capabilities that can support and complement foreign investment (as MNEs are not only looking forward to generating positive externalities, but also to benefiting from positive externalities) and relatively stable macroeconomic and political conditions. Beyond de-regulation of extremely regulated and anti-FDI environments, liberalisation does not form part of what investors consider as important determinants of their investment decisions.