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# GLOBALISATION AND RELATED FLOWS-THE IMPACT FACTOR

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**Abstract**

A key aspect of globalization concerns international financial flows. Such flows can be divided into two separate types. Whether Foreign Direct Investment in terms of Direct Investment or Portfolio Investment, the impact on economic growth and exports, the accompanying knowledge and technology that results in related flows and the impact on population migration has resulted in transformational shifts in major sectors. It has resulted in new strategies being conceptualized to take up fresh opportunities and has given rise to new enterprise that gears itself to the changing external environment.

As an economy opens up, the impact of competition on innovation and growth is an important area for consideration. As an economy opens up to globalization the competitive pressure on domestic firms tends to increase. This can be due to greater openness to imports or from increased TNC production in the country.

Economists' most basic and oldest theory of international trade is the theory of comparative advantage. This states that when countries engage in trade, each country will specialize in the goods in which it has a relative, or comparative, advantage. For Ricardo, there were geographical differences between countries, such as climate or mineral deposits, and these led to persistent differences in productivity and the production of tradeable goods and services. For Heckscher and Ohlin, and also for Samuelson, whose theories are collectively known as the HOS model, the source of comparative advantage is not productivity, but rather the country's factor endowments (such as labor and capital) and the differential need for these factors to produce different products. In the HOS model of trade all countries are assumed to have access to identical production technology.

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Moreover, Innovation, Diffusion and related Platform Creation have been leveraged by technology to not only make major strides but also to identify gaps and areas for inclusion. Strategic decision making coupled with strategic choice has a strong correlation with the impact factor. As issues relating to inequalities, widening gulfs and embittered economies co-exist on the same platform as self-sufficiency, accelerated growth and affluence; we discern emerging trends in impact assessment that bespeaks of the need to relook with new strategic dimensions into the global economic frontiers.

**Keywords:** globalization, competition, innovation

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## 1. Introduction and Literature Review

### 1.1 Brief Background:

As the world has emerged as a single market-place of goods and services, bridges of economic relations have been built across frontiers, borderless and multi-dimensional functioning has led to co-creation of processes, values and functions, while simultaneously posing a challenge to core competencies and their retention. Within the external façade, a horde of complexities relating to regulations, currency strengths, trading powers, trading blocs, taxation regimes and funding aspects permeate the dealings between entities and nations. Competition combined with need-based evolution and sustenance has thrown into sharp focus the strengths derived from innovation, re-invention, integration and governance. Countries like Japan, Germany and the USA have trebled their spending on R& D. From developing economies to emerging economies, nations have evolved as part of a whole wherein cost-effectiveness and skill-sets have provided that extra thrust to growth. India emerged as a major outsourcing hub mainly because of her ability to send error-free messages across the globe. China developed her manufacturing potentials to such an extent that she stands a class apart in strategizing with effective delivery modules and competitive pricing. The extra mileage provided by nurturing and planning can become a fait accompli if the systems that bespeak of good governance are in place. If not, setbacks are posed in multi-various ways and although we analyse every step ahead, plans may be thwarted and mid-course correction becomes a difficult proposition.

The related trade flows, currency flows, human capital flows, technology flows, etc that provide the building blocks sometimes meet with a lot of resistance and often results in lopsided growth, imbalances, deficits and unhealthy symptoms that may be the impact of certain forces that need to be analysed, certain imbalances that have to be ironed out, understood in the proper perspective and taken cognizance of. Having analysed several instances where the various flows have had diverse impacts, sometimes positive and sometimes adverse, this study attempts to focus on some of the areas.

### 1.2 Literature Review:

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The Goldman Sachs Report titled, "Dreaming with BRICs: The Path to 2050" said: "India has the potential to show the fastest growth over the next 30 to 50 years. Growth could be higher than 5% over the next 30 years and close to 5% as late as 2050 if development proceeds successfully….While growth in the G6, Brazil, Russia and China is expected to grow significantly over the next 50 years, India's growth rate remains above 5% throughout the period. India's GDP outstrips that of Japan by 2032…India has the potential to raise its US dollar income per capita in 2050 to 35 times current levels."

In his remarkable speech to the European Parliament in 2005, Tony Blair called upon politicians to respond to the challenges of the 21st century. He emphasized the need for keeping pace in a changing world and reminded the OECD countries that today USA was the world's only super power but in a few decades from now, China and India would be the world's largest economies, with populations three times that of the whole EU.[1]

Ron Krate, Professor and Founder, International Professors Project opines that "Increased demand of globalization can lead to two types of inequality – benefitting select industries or, worse, only the highly skilled who can cross..."
Technological advances in all industries have spurred globalization, expanding wealth and connections. But distrust is intense as financial turbulence is anticipated as globalization leads to "a new form of systemic risk – one that threatens to devastate political institutions and national economies," writes Ian Goldin for Project Syndicate. "Greater openness and integration necessarily increase the potential for cascading crises and amplification of shocks." The world must slow the pace of some globalization, he argues, pointing out how overconsumption in any one area – whether overuse of life-saving antibiotics by the meat industry, draining water supplies or release of carbon emissions by manufacturers – without checks and accountability pose different kinds of threats. The world's financial resources are increasingly directed toward war and security; weapons are rushed to trouble spots whereas infrastructure, education, health, scientific research and other uplifting endeavours are reminisced to the background on account of the widespread disruptions in peace and stability. As government fails huge segments of the

population, polarization emerges, and regions and communities try to break away. Regulations, oversight, cooperation, and new priorities are required to restore trust.[2]

Systemic risk is intrinsic to globalization. Greater openness and integration necessarily increase the potential for cascading crises and amplification of shocks. Equally problematic, the world has largely failed to learn from globalization's most obvious and far-reaching consequence yet: the 2008 financial crisis. While it is impossible to safeguard the system fully, sound regulation and effective oversight could have prevented the crisis, or at least reduced its impact on millions of people's livelihoods. The problem was that central banks, finance ministries, and multilateral organizations like the International Monetary Fund who constitute the pillars of the global economy's institutional framework, failed to grasp globalization's emerging characteristics and effects, owing partly to the difficulty of discerning structural shifts in the huge mass of data now available.

It's not that IMF and rest of the global regulatory Institutions have failed to recognize and understand the impact of globalization; Clinton/Rubinomics sought and fought hardball during the end of Uruguay round of GATT Multilateral Trade Negotiations (Morocco) to supplant national sovereignty of FX markets and unleash international financial transactions without (regulatory) frontiers. US Treasury (weighted) voting rights impose policy constraints on IMF. Thus, under WTO, Asian Financial Meltdown was followed by Russian and ultimately 2008 global financial meltdown…Few nations (i.e.India and China) were still able to impose domestic currency control on FX markets. [3]

## 2. Hypothesis, Objectives and Research Methodology

### 2.1 Formulation of the Hypothesis:

Based on the background of the study and analysis of the external environment at both the national and international level, the hypothesis as formulated as follows:

The impact of globalization and related flows on the economic propositions of nations, the future of various entities and the sustainability of not only the enterprises but the environment and the

ecosystems must be studied in a systematic manner and a planned approach developed for collective benefit.

### 2.2 Objectives of the study:

i) To analyse the various flows such as financial, trade related, human capital related, technology related, etc that arise as a consequence of globalization.
ii) To study the impact on nations, communities and organizations on an overall basis.
iii) To discern trends in the various flows and identify the impact thereof.

### 2.3 Research Methodology:

Primary data was gathered from experts in various fields spanning diverse industries by means of a well-drafted questionnaire. Secondary data from reliable sources such as governmental organizations, related websites, bulletins, editions, newspapers, magazines and journals as well as reference books and research articles formed the basis for gathering data, analyzing, interpreting and drawing conclusions.

## 3. Findings, Analysis and Interpretation

### 3.1 A Brief Perspective:

In the coming decades, rising longevity, falling fertility rates and the retirement of the baby boom generation will substantially raise age-related government spending in G-7 countries. By 2050, the populations in most G-7 countries are expected to be smaller and considerably older, with old-age dependency ratios projected to double. These trends will put national fiscal positions under substantial additional pressure. According to the projections submitted by national authorities, general government age-related spending in these countries is expected to rise by an average of 4 percentage points of GDP over the next 45 years with substantial cross-country variation.[4]

The Global Fiscal Model (GFM), is a general equilibrium overlapping-generations model developed at the IMF to examine macroeconomic and structural fiscal policy issues, including pension reform, in a multi-country setting.

Most G-7 countries recently have undertaken substantial reforms to contain the growth of age-related spending. While pension and health care reforms undertaken in G-7 countries in recent years have generated substantial savings, fiscal sustainability overall deteriorated in most G-7 countries during 2001-2005. This deterioration mainly reflects deteriorating primary fiscal balances. Ensuring fiscal sustainability would require an average improvement in the primary balance of about 4 percentage points of GDP. Analysis using the Global Fiscal Model suggests that there are significant growth benefits to putting public finances on a sustainable footing in the near term versus delayed adjustment.[5]

Inspite of the futuristic studies, India presents a dismal rate of growth, compounded by several inefficiencies and systemic ills. In comparison, China, following the country's accession to the World Trade Organisation, picked up considerable momentum in financial liberalization. Wide-ranging reforms introduced encompass deregulation in the Banking sector and refinements in various financial markets, as well as allowing more freedom for Chinese and foreign investors to participate and interact domestically and overseas. The result reflects not only an improvement in capital allocation efficiency in China's equity market but, from a financial stability point of view, also a reduction in its vulnerability. Financial liberalization has transformed into economic growth and has the potential for further growth over time.[6]

### 3.2 Responding to crisis:

Under the Greenspan-Bernanke conceptual framework, Federal Reserve officials exercise "constrained discretion" in responding to disturbances arising from macro structural changes in the financial sector. The two key concepts are the Greenspan-Bernanke doctrine on how the Federal Reserve officials respond to financial asset price bubbles and their collapses, and Bernanke's financial accelerator. Policy errors made by Alan Greenspan were attributable to identifiable biases in his intuitive judgment. In addition, Bernanke's response to the financial

crisis of 2007-2009 was based on his interpretation of the Great Depression as a natural experiment. But that interpretation was heavily biased by the influence of Milton Friedman on Bernanke's intuitive judgment. While Federal Reserve officials will need to exercise discretionary judgment in responding to financial crises, the potential for errors due to biases in that judgment can be reduced through regulatory reforms that lessen the potential for financial crises to occur.[7]

The recurrence of banking crises throughout the 1980s and 1990s, and in the more recent 2008-09 global financial crisis, has led to an expanding empirical literature on crisis explanation and prediction. A comprehensive analysis of measurements of banking crises, credit growth, financial liberalization and banking regulations sheds light on the fact that vast interlinkages due to globalization and therefore unplanned growth is also one of the contributory factors.

The IMF and the World Bank too play a major role through continuous efforts to tackle fiscal imbalances and ensure financial stability. The World Bank stated that it would lend between $3 billion to $5 billion annually to India under a new four-year plan that focuses development projects on the country's poorest states. The World Bank further expressed that 60 percent of the financing would go to government-backed development projects and half of this, or 30 percent, would go to the country's poorer states. Under the previous strategy, about 18 percent of lending went to these states. It is of paramount importance that earlier, World Bank President Jim Yong Kim urged the international community to take a hands-on approach to eradicate global poverty by 2030. He envisaged a strategy for India wherein the Bank would hone in on areas where developing financing would have the biggest impact on India's poorest. The Bank said the plan aims to cut poverty in India to 5.5 percent of the population by 2030 from an estimated 29.8 percent in 2010.[8]

The World Bank said that Asia's emerging economies should consider reining in monetary stimulus to curb the risks of asset bubbles and inflation as policy easing in developed countries spur capital inflows. Demand-boosting measures that helped sustain growth "may now be counterproductive," the Washington-based lender said in its East Asia and Pacific Economic Update. "As the global economy recovers, an emerging issue is the risk of overheating in some

of the larger economies," it said in a release accompanying the report. The World Bank report states that gross capital inflows into the East Asia and Pacific Region has surged 86% in the first quarter from a year earlier. This has added to the pressure on inflation and asset prices. Moreover, near-zero interest rates and new and protracted rounds of quantitative easing in the United States, European Union and Japan are inducing large capital inflows into emerging markets, including in East Asia and simultaneously, therefore, the World Bank opines that there is the risk of an asset boom in the markets, with global liquidity spillover and asset valuations moving ahead of fundamentals and possibly a correction down the road. Some countries in the region, which accounted for 40 percent of global growth last year, need to manage renewed capital inflows through "an appropriate macroeconomic stance and sufficient flexibility in the exchange rate," the lender said.

The International Monetary Fund warned that risks from the easing policies of central banks around the world are increasing as the Bank of Japan joined its counterparts in the U.S. and Europe in unleashing monetary stimulus to end 15 years of deflation.

The World Bank comments are substantiated by the viewpoints of the International Monetary Fund Managing Director Christine Lagarde and the Asian Development Bank. In a speech in Boao, Southern China, on April 7th 2013, Lagarde said, "Central banks in Asia should "think about the timing and pace of withdrawing monetary support" as strong credit growth has seen a buildup of financial imbalances." In an April 9th Report the ADB stated that the region's growth recovery faces the risk of asset bubbles from rising capital inflows.[9]

### 3.3 Handling financial and other flows:

Post the global crisis, financial sector regulators and policy makers have been focusing on the objective of "financial stability" to bring back sanity and normalcy to the global financial system. That financial inclusion, financial education and consumer protection, form the three essential pillars on which financial stability rests, has been universally endorsed and accepted. Banking the unbanked, providing access to financial services, educating the consumers and

creating a sense of safety in their minds are necessary for the governments and regulators alike, both in India and elsewhere. With nearly 4.5 billion people on this planet owning a mobile phone, there is a very strong likelihood of financial inclusion being pushed through the mobile phone and mobile payments medium. This is likely to be more so in the developing countries where mobile phone penetration is 8 – 10 times the penetration of the basic bank account. The lack of formal financial services infrastructure and widespread financial activity limits market exchanges, increases risks and curtails opportunities to save. Without access to formal financial services, the households are forced to rely on informal sources that are high costs. The protection, safety and security of this important class of customers cannot be wished away. In this context, the regulators and governments can play an important role by providing an efficient infrastructure for mobile payments. This framework might include regulation of low – risk money transfer services, enabling non-bank organizations to facilitate low-risk / low value transactions and wherever possible, implementing regulations at the system level (without interfering with the customer interface). On the part of banks, rather than treating mobile payments as a threat, they need to see it as an opportunity to access otherwise unprofitable low-income segments market. Banks will need strong partners and a strong platform to succeed. In India also, we have been proactively pursuing the three objectives and are even exploring the possibility of enshrining financial inclusion in the Code of Banking Practices (in India referred to as the Code of Commitments). The retail distribution of financial products and services was subject to review in Australia and United Kingdom alike and the issues thrown up by these reviews have great lessons for consumer protection. The retail distribution, as is now being carried out, may not necessarily be in the best interest of the consumers. There are certain issues, particularly from the perspective of incentive structures for sale of financial products, monitoring of AML requirements, risks of mis-selling, inadequate understanding of risks by the sales persons, etc. that make it important that financial service providers and regulators to have a close look at the practices followed in retail distribution of financial products.[10]

The valuation of intra-firm transactions itself is often mentioned as a particular concern when

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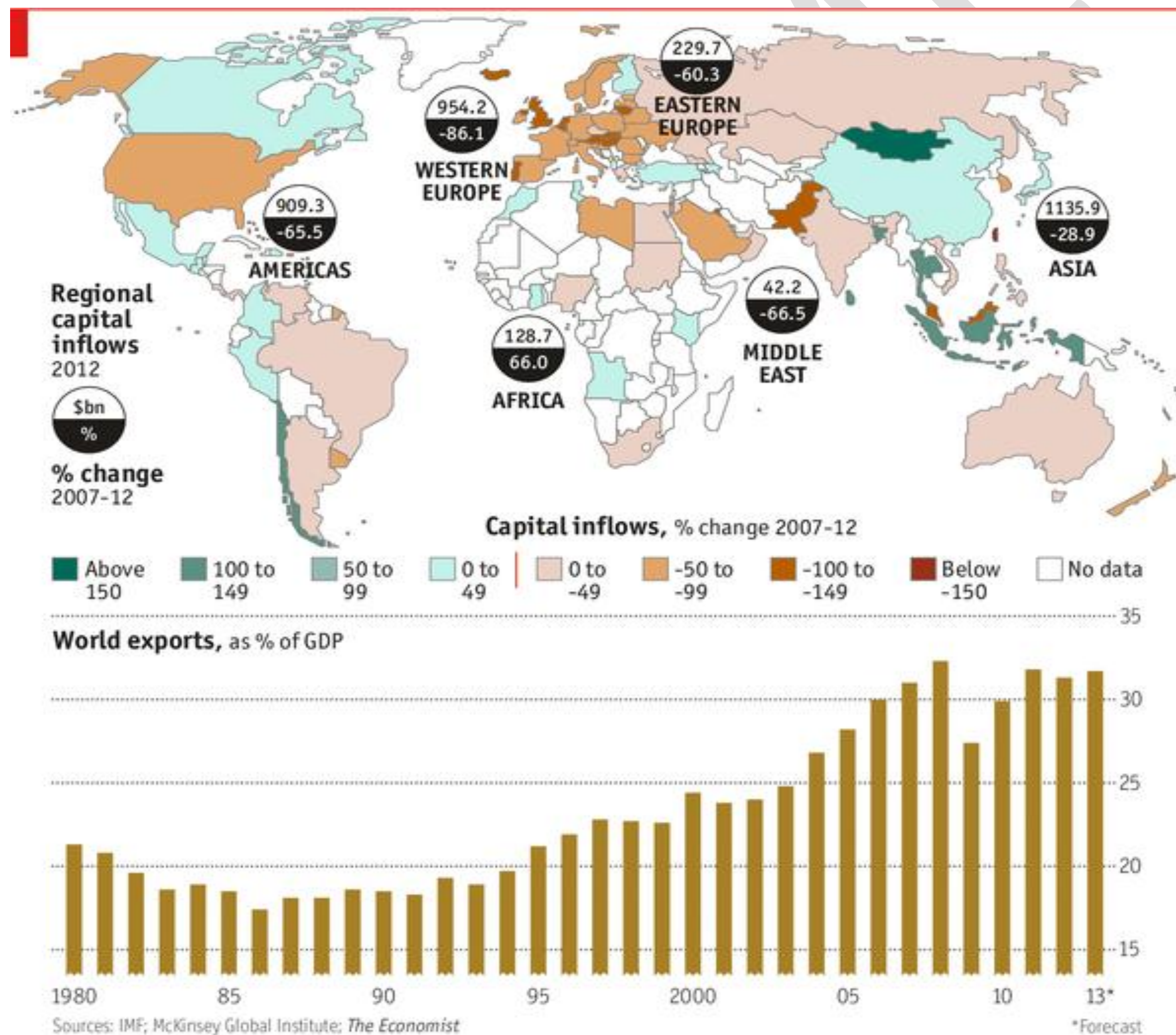
measuring international trade flows as they may not reflect full market prices to take advantage of fiscal or tax regulations. Transfer pricing is a complex issue. The concept of transfer pricing refers to both the issue and the solution of a valuation problem in international transactions. On one hand, it means the allocation of profits for tax and other purposes between affiliates of a multinational enterprise, using artificial prices (over or under invoicing). On the other hand, transfer pricing refers to the valuation methods used by tax authorities to avoid taxes. However, it is difficult for statisticians to correct these distortions which arise from the companies' shifting assets, income and profits for reducing tax burdens. International guidelines on such transactions are available from either the OECD or the WCO, the question being to which extent these are implemented, for example, outside the OECD region. Vertical fragmentation of production is a phenomenon of globalization that affects both goods and services-producing industries. It leads to an increase of trade flows in intermediate products (parts and components) in the manufacturing sector and also to increased services content in goods ("trade in tasks"). Industrial supply chains may blur the country of origin concept as part of the commercial value of an imported good may not originate in the "country of origin" mentioned in the custom documents. Consequently, what part of value is a country adding to an exported product and which part is coming from an earlier imported product?

Goods shipped for processing, increasing intra-firm trade of multinationals or transfer pricing are inter-related phenomena which are growing with an increasing fragmentation of production chains. This adds to the difficulty to determine a product’s origin and reply to the question of “Who produces for whom in the world economy?”[11]

The developed economies of Japan and the US present comparable shares of imported inputs in exports for 2008 (16.9 per cent and 15.2 per cent). Those shares increased significantly between 2000 and 2008, most probably due to the expansion of off-shoring and intra-firm activities of Japanese and US multinational companies. The derived domestic value added content of these economies' exports is inversely high, respectively 83.1 per cent and 84.8 per cent in 2008, reflecting the high content of national inputs and services embedded in their manufacturing exports as well as the increasing weight of commercial services exports. Surprisingly, the

vertical specialization observed in 2008 for Indonesia (13.5 per cent) is lower than that of Japan and the US. The reason for this low figure lies with Indonesia's export structure which is mainly composed of primary products that do not require intensive use of foreign inputs (agricultural and oil exports of Indonesia amounted to 61 per cent of total exports in 2008).

Conversely, the exports of goods and services originating from Singapore, Taipei Chinese and Malaysia are the most intensive in imported content amongst the AIO countries (respectively 57.9 per cent, 46.7 per cent and 41 per cent in 2008), thus leading to a low magnitude of their trade in value added. [12]



Virtually all countries still embrace the principles of international trade and investment. They want to enjoy the benefits of globalisation, but as much as possible they now also want to insulate themselves from its downsides, be they volatile capital flows or surging imports.

Globalisation has clearly paused. A simple measure of trade intensity, world exports as a share of world GDP, rose steadily from 1986 to 2008 but has been flat since. Global capital flows, which in 2007 topped $11 trillion, amounted to barely a third of that figure last year. Cross-border direct investment is also well down on its 2007 peak.

Much of this is cyclical. The recent crises and recessions in the rich world have subdued the animal spirits that drive international investment. But much of it is a matter of deliberate policy. In finance, for instance, where the ease of cross-border lending had made it possible for places like America and some southern European countries to run up ever larger current-account deficits, banks now face growing pressure to bolster domestic lending, raise capital and ring-fence foreign units.[13]

Capital controls, which were long viewed as a relic of a more regulated era, have regained respectability as a tool for stemming unwelcome inflows and outflows of hot money. When Brazil imposed a tax on inflows in 2009-10, it was careful to emphasise that not all foreign investment was unwelcome. The world has not given up on trade liberalisation, but it has shifted its focus from the multilateral WTO to regional and bilateral pacts. Months before Lehman Brothers failed in 2008, the WTO's Doha trade talks collapsed in Geneva largely because India and China wanted bigger safeguards against agricultural imports than America felt able to accept. Shortly afterwards America joined talks to form what is now called the Trans-Pacific Partnership, which also includes Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. Barack Obama has held up the TPP as the sort of agreement China should aspire to join. The trend in foreign direct investment, too, is still towards liberalisation, but a tally by the UN Commission for Trade and Development shows that restrictions are increasing. Last December Canada allowed a Chinese state-owned enterprise to buy a Canadian oil-sands company, but suggested it would be the last. "When we say that Canada is open for business, we do not mean that Canada is for sale to foreign governments,"



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explained Stephen Harper, the prime minister. The flow of people between countries is also being managed more carefully than before the crisis. Borders have not been closed to immigrants, but admission criteria have been tightened. At the same time, however, many countries have made entry easier for scarce highly skilled workers and for entrepreneurs.[14]

## 4. Conclusion

In the past decades, increased vertical integration of multinational enterprises and the expansion of processing zones, mostly in developing economies, led to significant changes in trade patterns. One of the most noticeable features of this evolution is the increasing trade in intermediate goods in the manufacturing sector. Intermediate inputs are intensively exchanged within international production chains and imported in processing zones for the production of goods to be exported. The boundary between goods and services is not always apparent, the magnitude of trade flows therefore at times misleading. In short, current trade recording systems struggle with the adequate reporting of globalisation phenomena in respect to goods for processing, merchanting, intra-firm trade, valuation (transfer pricing) which may introduce some bias in these aggregates. Revisions of international statistical standards were approved for correcting some of these aspects and to account for new driving forces observed in international exchanges.

Many CEOs believe that the global economy will improve in the next 12 months. Although optimistic, there are undercurrents of turbulence emanating from over-regulation as well as the looming question-mark over the ability of Governments to tackle debt and fiscal levels. Advanced economies face challenges including sluggish growth while emerging economies are slowing down in certain quarters.

Various tools and techniques are increasingly being used to gauge the flows and to institute corrective mechanisms wherever required and possible. In addition, discerning the trends and adequately building on efficiencies to benefit from global flows as well as to absorb shocks through sufficient buffer planning is a necessary adjunct to manage the varied impacts.

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