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**Foreign Direct Investment, Technology Transfer to the South
and Competition for the North:**

**Towards Co-operative Institutional Arrangements Between the
North and the South?**

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1. The context

The last decade has witnessed a very fast growth of foreign direct investment (FDI) - this both reflects and extends the globalization of production. Although the greater part of FDI is still carried out by multinationals of one advanced country investing in another, a significant and perhaps increasing proportion of multinationals' investment is now taking place in developing countries (the South).

In the orthodox view, the liberalisation of trade and capital movements, and the associated phenomena of the globalization of markets and production, lead to a more efficient allocation of the world's resources and faster world growth rates¹. Specifically in relation to Northern multinational investment in the South, both the North and the South are thought to gain from it. Developing countries are supposed to benefit in a number of different ways, including notably the transfer of technology from the North to the South. The shareholders of multinationals in the advanced countries ostensibly gain from the higher returns in developing countries than they otherwise might earn. The North's workers, it is suggested, benefit from the export of capital goods which investment by multinationals invariably involves.

To consolidate the benefits of liberalization and globalization, the OECD countries are currently negotiating a binding multilateral agreement on investment (MAI) which would remove most of the remaining constraints on the free flow of FDI. Developing countries are being invited to accede to the final negotiated agreement -an agreement in whose formulation they will have had no say -- and it is possible that some Latin American countries will be early joiners. It is expected that this will generate an irresistible momentum with other low income countries feeling impelled to join also. The OECD's objective is that the MAI should become a global policy framework, based on high standards with regard to the rights and treatment of FDI.

The orthodox thesis on FDI has in the past been challenged by developing countries who, while fully recognizing certain advantages to be gained from multinational investment, have been concerned among other things by the enormous economic and political power of multinationals, their potential for monopolistic abuse and practices such as transfer pricing which reduce the net benefits to the country. However in the current era of liberalization and globalization, under the guidance and advice of the multilateral financial institutions, there has been a sea-change in the attitude of developing countries towards FDI. Today these countries are competing strongly with one another to offer incentives to attract such investment.

1. See for example World Bank (1996); IMF (1997)

The main criticism of multinational investment nowadays comes from workers and the general public in developed countries, who attribute their high unemployment levels to the relocation of enterprises in low-wage developing countries and increasing competition from such countries. This criticism has been given academic expression by some economists who identify increased competition from the South, due in part to investment there by multinationals, as being a main cause of (a) de-industrialization, (b) growing inequality in income distribution as well as (c) unemployment in many Northern economies.

In this overall context, this paper has the following objectives:

(a) to discuss the question of technology transfer by the multinationals to developing countries and specifically to explore the conditions under which it is most likely to occur;

(b) to examine the validity of the theses which attribute recent observed unfavourable labour market outcomes in the North, i.e de-industrialization, unemployment and growing dispersion, largely to multinational investment and to the consequent competition from low-wage countries.

(c) to examine how the proposed OECD MAI or a similar treaty would affect technology transfer to the South or aid the South's development effort in other ways, and how will it affect overall welfare in the North.

It will be argued in this paper that, on balance, the proposed OECD treaty will not be helpful either to countries in the South or in the North. It is suggested that the question of FDI needs to be considered in relation to the overall growth of the world economy.

2. FDI: Recent trends

1.a. There has been a very rapid growth of FDI during the last ten years or so. FDI inflow rose from \$77.5 billion during 1983-87 to \$177.3 billion in 1988-92, and to \$315 billion in 1995. This represents an increase over the period 1985-1995 of about 400 percent in nominal US dollar terms; the increase was just under 200 percent in real terms (adjusted by the deflator for the OECD gross fixed investment). [UN,1996; WTO,1996].

1.b. Compared with other relevant variables, the growth of FDI has also been quite fast. Between 1980 and 1994, the ratio of FDI flows to world gross domestic capital formation doubled. The world gross product of foreign affiliates (a value measure of their output produced abroad) accounted for 6% of world GDP in 1991 (the latest year for which data are available), compared with 2% in 1982.

1.c. In absolute terms, as at 1993, multinational companies are estimated to have employed 73 million people worldwide. The global sales of multinational affiliates, again worldwide, in that year was US\$6 trillion. This compares with the value of US\$4.7 trillion of goods of non-factor services delivered through exports. More significantly, of the latter figure, about a quarter represented intra-firm exports.

The bulk of FDI² originates in OECD countries and goes to other OECD economies: in recent years the approximate magnitudes are 85 per cent of all outflows and 65 per cent of all inflows, the USA being the major host as well as home (source) country.

2. As Table 1 indicates, FDI flows to developing countries nearly doubled between 1981-1985 and 1986-1990 from US\$13 billion a year to US\$ 25 billion. The inflows more than doubled again over the next four years to over US 63.4 billion a year between 1991-1994.

Although there are significant fluctuations, there has been a trend increase in the 1990s in

² 95% of FDI consists of transactions between multinationals and their subsidiaries. For the purposes of this paper, FDI and multinational investments are synonymous.

developing country share in total FDI inflows. The share more than doubled between 1986-1990 and 1991-1994, from 16% to 33.3%. However, between 1981 and 1985, the developing country share was 25.9%

3. Most FDI flows to developing countries have been concentrated in a small number of developing countries. In 1993, 81 per cent of FDI inflows went to 10 countries: China, Singapore, Argentina, Mexico, Malaysia, Indonesia, Thailand, Hong Kong, Taiwan and Nigeria, in descending order of magnitude. Over the past decade, these ten countries have consistently attracted between two thirds and four fifths of developing country inward investment. (see UNIDO, 1996).

4. Developing countries, during the last ten years, have also become important in FDI outflows. Between 1983 and 1987, these outflows accounted for about 5% of the total world outflows. The corresponding average figure for 1993-95 is about 16%, i.e. more than three times larger.

5. Not only has there been a large trend increase in FDI flows to developing countries during the last ten to fifteen years, but these flows have also been subject to considerable fluctuations. The fluctuations can have significant consequences for macro-economic management in these countries.

3. Multinationals, technology transfer and economic development: analytical issues and evidence

Analytical issues

In considering the issue of technology transfer, it is useful to bear in mind the following analytical points:

a. by saving time and resources otherwise devoted to re-inventing known technology, the transfer of

technology from advanced industrial economies normally speeds up the industrialization of developing countries.

b. investment by multinationals is only one way of obtaining technology: other methods include the import of capital goods; licensing and reverse engineering. The choice as to which method is adopted in any particular case depends on the specific country circumstances and the relative cost of each method.

c. FDI can be a relatively expensive method of obtaining technology. This is due to the fact that compared with other sources of capital such as portfolio investment and long-term loans, FDI, other things being equal, is likely to be relatively more risky from the perspective of the investor. Of the three, the form of investment which has the most certain return is long-term loans, because the return is fixed. Portfolio investment and FDI have more uncertain returns, but portfolio investment has the advantage of being more liquid. Consequently, investors would expect to receive a higher return on FDI. So if the same technology could be obtained through FDI, the purchase of capital goods, or through licensing, the latter two may be less expensive. However, if the technology is not the same, in that to make it fully operational it requires organisational and management skills which are provided by the multinationals and which can have important spill-over effects, this argument is less likely to apply. To the extent that the multinational has a “monopoly” of knowledge over such skills, it may be able to gain 'monopoly' rents. Whether or not the latter can be whittled away depends on the degree of competition from enterprises with more or less substitutable products also requiring similar specialised knowledge. It will also be a function of the bargaining power of the host country, which in turn will depend among other things on the country's level of development and the quality of its human capital resources.

Empirical evidence

With respect to empirical evidence, we concentrate here on the experience of East and South East

Asian countries. This is for three reasons:

- i) many of these countries have been major recipients of FDI;
- ii) they display a diversity of experience with respect to the role of FDI.
- iii) they have been highly successful economically.

Japan and the first tier NICs

We consider first the case of Japan and Korea. A striking fact about these two countries in relation to FDI is that, as Table 2 indicates, FDI has not been significant in quantitative terms -- its share in gross domestic capital formation has been and continues to be very small. In order to upgrade their technological level, these countries have relied largely on imported purchases of capital goods and on licensing arrangements. These were regarded as a cheaper means of importing particular pieces of technology than FDI. [Okimoto,1989; Chang,1996]

As importantly, these countries built up a national system of technological development as part of their industrial policy, in order to enhance their own capacity to adapt and develop technology³. Freeman (1989) has described in detail the main components of this integrated system of national technological development in Japan and in Korea. He notes, among other things, that during its high growth phase (1950-1973) Japan was producing relatively more engineers than the United States in the same period. More recently, Korea and Taiwan have been outdoing Japan in this respect. Freeman suggests that one reason Korea and Japan discouraged FDI was that foreign multinationals would not have been so readily amenable to the system of administrative guidance in these countries, which was central to the implementation of their industrial policies. Furthermore, using the non-FDI route to achieving technology placed full responsibility for assimilating imported technology on domestic enterprises. This, he argues, is far more likely to lead to “total system

³ Frederick List had advocated such a system for Germany in the nineteenth century in order to improve its capacity to compete with the UK. Many of his insights remain relevant today.

improvements than the turn-key plant mode of import or the foreign subsidiary mode.”

With respect to Korea, UN (1993) suggests that there is a link between the national ownership of large firms (chaebols) and the level of investment in research and development. Korea has in relative terms by far the largest expenditure on R& D among developing countries -- 1.9 per cent of GDP in 1988, compared with 0.5 per cent for Argentina, (1988) and 0.6 for Mexico (1984) and 0.4 for Brazil (1985). Korea outperformed even many developed countries in in this sphere. (Belgian 1.7 per cent in 1987, Denmark 1.5 per cent in 1987 and Italy 1.2 per cent in 1987). Korea’s expenditure on R&D was, of course, still below that of industrial superpowers: Japan 2.8 per cent in 1987 and Germany also 2.8 per cent in 1987.

Nevertheless, despite its relatively small magnitude, in qualitative terms, FDI has been important in both Korea and Japan. It was used to develop certain key industries regarded by the authorities as critical to their development efforts, when this was seen to be the only means of obtaining the required technology⁴. FDI projects were therefore carefully screened to achieve the national industrial policy objectives.

Turning to Taiwan, Table 2 above suggests that that as a proportion of gross domestic capital formation Taiwan has used relatively more FDI than Korea and Japan. But it will be noted that Taiwan’s resort to FDI was well below the industrial country average. More importantly, in Taiwan’s case too, FDI has been used purposefully under government guidance as part of a conscious effort to upgrade the technological level of the country’s production and export structure. (Wade, 1990)

The highly successful economic development of the other two countries among the first tier Asian NICs -- Singapore and Hong Kong -- is of limited general relevance because they are small city states. Nevertheless, it is significant that these two countries followed very different policies with respect to FDI. In the case of Singapore, there has been a high level of FDI, but this has been an

⁴ See further Chang(1996).

integral part of the government's long term programme of industrial and technological upgrading. Hong Kong, on the other hand, attracted a large amount of FDI but this was essentially on a laissez-faire basis. Lall (1996) has argued that the lack of an industrial policy has disadvantaged Hong Kong's industrial development. It has suffered massive de-industrialization over the last 10 years to a much greater extent than would be expected at the colony's level of per capita income. Lall reports that there are now influential voices in Hong Kong calling for an industrial policy in order to reverse this detrimental trend. The city has so far been able to cope with this situation by its development of a high productivity financial services sector. This however, may not be a feasible strategy for larger economies since this sector is unlikely to generate sufficient foreign exchange for imported manufactured goods for which income elasticity tends to be very high. [See further Singh, 1987, Rowthorn and Wells, 1987]

Second tier NICs: Indonesia, Malaysia and Thailand

It is widely believed that these three countries have relied on large amounts of FDI for their development as compared with the first tier NICs. But, as Chang 1996 has pointed out (see also figures in Table 2) Thailand and Indonesia, though resorting to more FDI than the first tier NICs in relation to gross domestic capital formation, used about the same or less than the average for developing countries. Only in the case of Malaysia, has FDI been relatively much more important.

Significantly, in all three countries FDI has been used as part of an industrial policy and has involved, among other things, the use of performance requirements. As Jomo and his colleagues, (1997) note however, the effectiveness of the industrial policy as an instrument of national development has been diluted in these countries at times by its use for political and rent-seeking ends.

Although these second tier NICs have been very successful over the last fifteen years in terms of GDP growth, there are questions about the sustainability of their growth record. There are

weaknesses in their national technological systems, such that their domestic firms do not yet have a strong capacity to assimilate and develop technology. This renders the countries heavily dependent for their technological development on continuing large inflows of FDI. In addition, Thailand and Malaysia currently have huge current account deficits which are relatively larger than even that of Mexico prior to the crisis in 1994. This also makes them vulnerable to any sudden withdrawal of large amounts of FDI.

China

China has been by far the largest developing country recipient of FDI in the recent period. Although in the 1980s in relative terms FDI inflows into China were quite small, there has been a sharp quantum leap, in the 1990s. Table 2 shows that in 1994 and 1995 FDI amounted to almost 20 per cent of China's gross domestic capital formation. This figure may somewhat overestimate true FDI because of "round-tripping" that is, counting in FDI statistics domestic investment routed via a foreign country in order to seek fiscal advantages. More significantly, FDI in China differs in an important way from that in other developing countries. It consists largely of capital investment by overseas Chinese from Hong Kong, Macao, Taiwan and Singapore. It is estimated that between 1979 and 1993 Hong Kong alone accounted for nearly 70 per cent and Hong Kong and Taiwan together nearly 80 per cent of the total cumulative FDI during that period. The corresponding FDI figures for the US and Japan were by comparison, 5.4 per cent and 4.8 per cent respectively.

Case studies suggest that much the larger part of overseas Chinese investment is directed towards technological upgrading and development.⁵ This is achieved either by the overseas Chinese establishing their own subsidiaries in China or more frequently by means of them establishing joint ventures in China with other foreign firms whose technology is sought after. To some extent, therefore, the overseas Chinese act as a bridge and/or intermediary with non-Chinese multinationals and technology providers.

⁵ As Dhanin Chearavanont, the overseas Chinese chairman of Charoen Pokphand observes: "if you want to invest in China you must bring technology China needs. The Chinese government is not stupid. If they suspect that we were only there to make a profit, they would not be happy." [Vatikiotis,1997]

To sum up, the experience of East and South East Asian countries suggests that, in order for FDI to be most effectively used for technological and economic development, there are three important requirements⁶. First, the governments need to be selective with respect to the choice of products and industries in which FDI is to play a role. Second the government must pay attention to the timing and phasing-in of foreign investment. Thirdly and importantly, the best use is made of FDI when governments have a national technology system of the kind implemented in Japan and Korea as mentioned earlier.

4. Multinationals, Outsourcing and Competition for the North from the South

Wood (1994) in an important but contentious contribution has argued that most of the recent unfavourable developments in the labour market in the North referred to earlier are caused largely by competition from the South. Manufactured imports from the South into Northern markets have increased at a very fast rate in the 1980s and the 1990s, a period during which there has also been faster pace of de-industrialization, a large rise in unemployment and increasing inequality in the wages of skilled and unskilled workers. Wood regards these latter events as being caused by the former.

Wood himself does not deal with the question of Northern FDI in the South in great detail. It is however widely believed in industrial countries that multinational investment and outsourcing in developing countries has been an important factor in contributing to the rapidly increasing competitive capacity of the South and is detrimental to the interests of the North's workers. Thus Bluestone and Harrison (1982) in their influential contribution on US de-industrialisation: 'In

⁶ In Latin American and Caribbean countries there is long-held view that FDI does not lead to substantial technological spill-over and that often its main benefit has been to generate employment, as in the case of the maquiladora industries on the Mexican border with the US. Recent evidence comparing multinational investment in Mexico, Venezuela and the United States suggests that very low spill-overs occur in the former two countries. There is a much greater incidence in the United States because of the availability of the necessary human capital and infrastructure facilities. See further Aitken, Harrison and Lipsy(1996).

seeking to escape a "pro-union" or "anti-business" climate inside the United States, large corporations ... can build, expand, or acquire facilities outside the country altogether. In fact, all the strategic innovations devised by multi-plant companies for playing off one group of workers against another ... have become standard operating procedure in the global economy.' Similarly in a special report in the mid eighties Business Week bemoaned the 'hollowing' of US corporations: 'By shifting production overseas, US companies are whittling away at the critical mass essential to a strong industrial base. If globalisation of industry means that US manufacturers will wind up simply licking the labels and sticking them on products that are made abroad, the nation can look forward to a declining standard of living'⁷ More recently there has been great concern in Germany with the phenomenon of "standortwettbewerb" (locational competition) under which German firms have been increasingly outsourcing production especially to eastern European countries.

Wood's thesis is challenged by a number of economists on several points. The main criticism levelled against his conclusions is that they are implausible because imports from the South account for only a small proportion of domestic demand in the North. (See Table 3) Wood uses the same data to suggest that although the import penetration has been small overall, there has been a very rapid increase since 1978, particularly in products produced by low-skill labour. His estimates suggest that imports from the South have led to a net reduction of 12 percent in manufacturing employment in the North. Further, to the extent that Southern competition induces labour-saving technical progress in the North, Wood suggests that this may have resulted in additional job losses of equal magnitude. Thus for Wood the fast growth of imports from the South, is a main cause of both de-industrialization and overall unemployment in industrial countries. He also assembles considerable evidence to suggest that the rising inequality between skilled and unskilled workers in the North is due largely to Southern competition rather than technical change.

However, in overall macro-economic terms the attribution of the large observed variations in manufacturing employment experienced by industrial countries during the last two decades to

⁷ 'The Hollow Corporation', Business Week, March 3, p.60, 1986.

changes in manufacturing trade with the South is problematical. Table 4 indicates that from 1970 to 1993, manufacturing employment in the G-7 countries fell by 15 per cent, whilst there was only a very small decline in the North-South manufacturing trade balance. Moreover, as UNCTAD (1995) notes, the timing of these losses did not systematically coincide with either a decline in the North's overall trade surplus with the South or in the rise in imports from developing countries. Manufactured imports from developing countries into the North in fact grew more rapidly in the 1970s than in the 1980s -- but the job losses occurred mostly in the latter decade. Moreover, the main reason for the decline in the North's manufacturing trade balance with the South in the 1980s was the fall in the North's exports due to the debt crisis in the South.

In contrast to the above macro-economic considerations, the important part of Woods empirical analysis is based on a modified Heckscher-Ohlin model and is carried out in micro-economic terms. He uses factor-content methodology to argue that even with balanced trade between the North and the South, there would be huge job losses in the North because of the differing factor intensities of the North's exports and imports.

On the question of wage dispersion, the mainstream view is that Wood is wrong to ascribe most of the increased inequity in wages to trade with the South. Woods critics concede that such trade has led to increased wage dispersion but suggest that no more than ten to twenty per cent of it can be attributed to competition from developing countries, the rest being due to the nature of technical change. In relation to the effects of multinationals and their outsourcing of inputs to developing countries, IMF(1997) summarises the available evidence as indicating that workers in the home ("parent") country and workers employed in foreign subsidiaries either are only weak substitutes for one another in the production process or might even be complements, so that employment tends to rise or fall together in the parent and subsidiaries. In either case, although there may be some adverse effects in some industries, it does not appear that firms have substituted foreign for domestic workers on a large scale.

In a significant contribution Feenstra and Hanson(1996) provide a model in which outsourcing by

multinationals leads to increased intra-industry wage dispersion. In this model Northern firms respond to import competition from low wage countries by moving to them non-skill intensive activities. This results in a relative increase in demand for skilled labour within industries. Feenstra and Hanson's analysis undermines the technology hypothesis for increased wage dispersion since the latter is normally invoked as a 'residual' explanation after eliminatin other possible theories. In the mainstream contribution it has been argued that since trade can only explain inter-industry but not intra-industry wage dispersion, the latter must be due to other factors such as technology. By linking the observed increase in the intra-industry wage dispersion in the North to multinational investment and southern competition,Feenstra and Hanson's research greatly weakens the technology hypothesis.

It is not the purpose of the present paper to contibute to the debate on methodology and the details of the empirical analysis between Wood and the mainstream economists⁸ but rather to make a different kind of point. This is that the supposed negative effects of competition from the South are due, in part, to the fact that overall economic growth in advanced industrial countries has been much slower than previously.UNCTAD(1995) provides evidence to show that in the 1950s and 1960s there was a fast increase in import penetration of the US and other leading advanced country markets by products of the then newly industrialising economies, namely Italy and Japan. This rise in import penetration was as fast as that achieved by the late industrialisers in the advanced country markets in the 1980s. Yet, in this earlier period, Northern countries sustained full employment, rising real wages and falling inequality in wages. In addition, during this boom period the percentage of overseas workers in the labour force was increasing.

An important limitation of Wood's analysis is that it is based on the traditional Hecksher-Ohlin model,which abstracts from aggregate demand and capital accumulation. If a rise in real global demand (as a result, for instance, of better policy coordination among industrial countries) leads to a higher trend rate of growth of output, the negative impact of Southern competition on unskilled

⁸There is voluminous literature on this subject. Significant contributions include Lawrence and Slaughter(1993); Sachs and Shutz(1994); Neven and Wyplosz(1996); Leamer(1996).

workers in the North may be more than outweighed by what Bhagwati calls the lift-all-boats effect of faster overall growth. In this scenario unskilled labour shifts from manufacturing to non-traded services. Singh(1995). Therefore, even if Wood is wholly correct in his argument and all the underlying economic processes to which he refers operate in the way he describes, faster economic growth in the North could over-ride their negative impact.

5. The OECD's multilateral agreement on Investment (MAI)

The OECD countries -- the major host and home countries for FDI -- are working to establish a comprehensive investment agreement among themselves. Briefly, the aim is to establish a binding treaty outside of the WTO framework. This will subject foreign investment to a regime which removes all or most of the remaining restrictions on FDI. It will also ensure that FDI is treated by national authorities no differently from domestic investment. In brief, the proposed regime would be based on the following principles.

- the right of establishment for foreign investors;
- the principle of "most favoured nation" (mfn) treatment;
- the principle of "national treatment";
- investment protection, including matters relating to expropriation and the transfer of capital;
- additional disciplines relating to, among other matters: entry, stay and work of key personnel;
- performance requirements imposed by host governments on

foreign investors in order to secure economic benefits for
the country as a whole;

- rules on investment incentives;
- binding rules for settling disputes.

There is consensus within the OECD on a single broad definition of investment, which goes "beyond the traditional notion of FDI to cover virtually all tangible and intangible assets, and which applies to both pre-establishment and post-establishment (OECD, 1997)." The definition therefore embraces intellectual property and portfolio investment.

As noted in the introduction, the OECD's evident intention is to make the MAI eventually into a universal treaty. If this were to happen, what would be its impact on developing and developed countries? We briefly examine these topics in turn below.

MAI and developing countries

It is clear from the discussion in section 3 that, to gain the maximum benefit from FDI, it is important for countries to be selective with respect to FDI and for them to have an integrated industrial and technology development policy. Therefore from the perspective of achieving technological development in developing countries a regime of free capital flows would be a retrograde step. It will prevent these countries from being selective with respect to either projects or phasing. Furthermore the OECD's MAI proposes to proscribe a number of national industrial policy measures such as performance requirements. Indeed the intention is to make the rules in this respect even more stringent than those agreed in the Uruguay Round Agreement on Trade-Related Investment Measures.

It is sometimes suggested that although developing countries may not be able to be selective as a

consequence of a treaty of this nature they may nevertheless attract more FDI under such a regime. Several points may be made in response.

Firstly, the large trend increase in FDI to developing countries in the recent period has occurred without any such treaty. Apparently, the existing bilateral treaties between developed and developing countries are regarded as providing adequate protection by multinational investors - for those countries where there are good economic reasons for FDI in any case. Secondly, there are many countries, particularly in Africa, which have attracted little multinational investment even though they have introduced on the whole extremely liberal regimes with respect to FDI. Thirdly, to the extent that FDI inflows may occur in surges which under a global MAI, developing countries will not be able to regulate, there will be greater instability in the host country economy which is likely to make it less attractive to FDI.

MAI and developed countries

Turning to advanced countries, will these countries benefit from unfettered FDI? There are important considerations which suggest that the net impact on advanced countries may be negative rather than positive.

As noted earlier, the first best solution to the North's labour market problems, including those arising from actual or potential competition from the South lies in achieving a large trend increase in the rate of economic growth such that prevailed in these countries in the 1950s and 1960s. Singh (1997a, 1997b) provides detailed analysis and evidence to suggest that the present liberal global regime of more or less free trade and capital movements is unlikely to be successful in such an endeavour. Very briefly, the essential arguments of these papers can be summarized as follows:

1. That advanced economies have basically operated under such a regime for about the last fifteen years. Their performance in terms of either output or productivity growth has been less than

impressive. The trend rate of OECD GDP growth during this period has been approximately half of what it was during the illiberal 1950s and 1960s. The most important failure of the current market supremacist regime lies of course in the existence of mass unemployment in many industrial countries today, whereas there was more or less full employment in the earlier period.

2. That the failures of the current regime are not due to exogenous factors but are intrinsic to the regime itself. Free capital movements and the supremacy of the financial markets in a variety of ways make it difficult to attain a high rate of growth of real demand in the world economy.

3. The central constraint on fast economic growth in the world economy does not lie on the supply side. Not only are there unutilized human resources, but also, significantly, there is a huge backlog of technology. The information and technological communications revolution is regarded by leading scholars on the subject as equivalent in its potential to that of steam engines and electricity. But its full potential has not as yet been realized because of insufficient growth of demand.

The central constraint on fast economic growth is therefore not failure on the supply side but that on the demand side. To that extent, it is a self-inflicted wound arising from the failure of coordinating economic mechanisms.

To the extent that all that MAI will do will be to accentuate such a regime, the prospects are of continuing slow growth of the OECD economies. With such slow growth, the negative aspects of Southern competition on the North's labour market will become progressively more pronounced, particularly as countries like China and India fully enter the global marketplace.

The North's workers, particularly the unskilled, will be the real losers. Apart from the effects of slow growth they will also be disadvantaged through another channel. Workers will be obliged to bear the full burden of terms of trade shocks to an economy to the extent that mobility of capital will promote a risk-adjusted world rate of return and therefore narrow the range of variations of returns to capital within a country. With greater inflexibility in rates of return, skilled and

unskilled workers will have to absorb more of the impact of any product price changes. This will either be reflected in greater volatility and dispersion of workers earnings or greater unemployment, depending on the country's labour market institutions.⁹

In conclusion, an essential argument of this paper is that in order to permit developing countries to reap the full benefits of FDI for their technological development, it is necessary for them to retain their current options of selectivity in determining the form and composition of capital flows. From the perspective of workers in advanced countries, what is required is not restrictions on FDI, but rather faster rates of economic growth.

The salient question is whether a faster growth of real demand, output and productivity is feasible in the world economy today under any reasonable set of policies. Or, is it simply the case that there is no viable alternative to liberalisation and globalisation as the Bretton Woods Institutions insist? It was suggested in Singh (1995) that there does exist an alternative policy programme, but this would involve a decisive move away from the present market supremacist model towards one based on social consensus between as well as within countries. However, in order to obtain a trend increase in the rate of growth of real demand (rather than simply money demand) in the OECD countries, new institutions and institutional mechanisms would be necessary both at the national and international levels. These are required to achieve international macro-economic policy coordination and to maintain wage-price restraint during the growth process.¹⁰

⁹ It may be argued that FDI flows are also relatively immobile because they represent bricks and mortar. This is, however, less and less valid in a world of derivatives and ever-increasing ingenuity of financial markets. The MAI, by covering FDI as well as portfolio flows, will make all investment more liquid and all would be hedged to some extent.

¹⁰ These institutional changes were analyzed and examined at length in Singh (1995). Very briefly, what is required at the international level is for governments to agree to (a) give chief priority to the employment problem; (b) symmetrical adjustment in deficit and surplus countries; (c) macro-economic policy coordination particularly between industrial countries via a multilateral mechanism. Originally this was the intended role of the IMF, instead of which it has mostly been used to discipline the South.

Parallel to these external coordinating mechanisms, it is also necessary to have appropriate national pay coordinating mechanisms in industrial countries, rather than policies of labour market flexibility and deregulation. Such incomes policies only work, however, if they are not seen simply as a mechanism to reduce workers' real wages but are regarded as fair and redistributive in a progressive direction. Indeed, James Meade regarded these internal mechanisms in leading industrial countries to be more important than external ones.

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