To conclude: fundamental Keynesians have been critical, and rightly so, of neoclassical methods of analysis. To the extent that this criticism is grounded on Keynes's detailed analysis of probability, long-term expectations and equilibrium, the fundamentalists are not nihilistic but rather should be seen as providing the foundations for the construction of a truly radical Keynesian alternative.

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See also:

Equilibrium and Non-equilibrium; Expectations; Keynes's *General Theory*; Non-ergodicity; Time in Economic Theory; *Treatise on Probability*; Uncertainty.

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Globalization

Globalization is not a term invented by economists, and thus it is one of which all economists – Post Keynesian and mainstream alike – are suspicious, despite (or, in some cases, because of) the fact that it is at the centre of many contemporary economic policy debates. To the extent that globalization is considered synonymous with liberalization, Post Keynesians have been outspoken sceptics. In the face of the dominant neoliberal economic model with its call for financial market deregulation and fiscal and monetary austerity, Post Keynesians have insisted instead on expansionary macroeconomic policies and controls on international capital movements.

Globalization can be seen as a two-part process – the globalization of production and the globalization of finance. While both parts are the result of heightened international capital mobility, the globalization of finance is understood through the Post Keynesian theory of markets, while the analysis of the globalization of production requires the Post Keynesian theory of the firm and oligopoly. The globalization of production comprises international trade and foreign direct investment, and while the Post Keynesian theory is less well developed in these areas than in the area of finance, it none the less provides the building blocks for a rich description and policy-relevant theory of globalized production. Below we consider each of the aspects of globalization in turn.

Post Keynesians are generally sceptical of the global benefits of international financial market liberalization for two basic reasons. The first follows from the general Post Keynesian view that market flexibility does not bring optimality (for example, full employment) since the problem of unemployment is the result neither of market rigidities nor of information distortions resulting from government intervention or imperfect competition. Failures of effective demand can exist in the absence of either of these conditions. Moreover, price movements alone (through wages or exchange rates) are unlikely to bring about large adjustments in international payments imbalances and are swamped by the effect of changes in income and demand. Accordingly, international differences in the rate of economic growth – and thus international divergence of incomes – are explained in Post Keynesian theory by international differences in the income propensities to export and import.

The second is related to the risk of capital flight that comes with capital market liberalization. Post Keynesians have relied on Keynes's distinction between 'speculation' and 'enterprise', the former referring to 'the activity

of forecasting the psychology of the market' and the latter 'the activity of forecasting the prospective yield of assets over their whole life' (Keynes 1936 [1964], p. 158). Keynes noted that capital markets – national or international – can at times be dominated by speculative behaviour that can move the economy away from full employment. In an oft-cited passage, he wrote:

> Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done. (Keynes 1936 [1964], p. 159)

Keynes saw the effects of speculation to be particularly detrimental in an open economy context when there is a risk of capital flight. In his 1933 essay, 'National self-sufficiency', Keynes argued that the ability of the state to pursue full employment (monetary and fiscal) policy may be jeopardized by international capital mobility. Thus, Keynes wrote, '[L]et goods be homespun wherever it is reasonably and conveniently possible, and, above all, let finance be primarily national' (Keynes 1933 [1982], p. 236).

For these two reasons, Post Keynesians have been sceptical of flexible exchange regimes and of capital market liberalization generally. Price inelasticity of trade explains the inefficiency of exchange rate adjustment, while the volatility of liberalized capital markets gives support to the policy of capital controls. Post Keynesians make the empirical argument that the rapid rates of economic growth experienced during the era of Bretton Woods resulted, in part, from the *limits* on the international mobility of capital and the relative fixity of exchange rates. Post Keynesians have typically found the source of Asian economic crises of the 1990s in the excessive (or too rapid) liberalization of foreign capital markets and have supported the use of bank-based rather than equity-based financing for economic development on the grounds that the latter encourages excessive speculation (and capital flight) rather than entrepreneurship.

Scepticism towards capital market liberalization has led to a variety of proposals for the regulation of international capital flows, including a transactions tax on international capital flows, an international reserve and capital adequacy requirement on all financial corporations, international procedures for the orderly sorting out of competing claims in the case of default on sovereign debt, or the establishment of a new central bank clearing unit to promote expansionary payments adjustment rather than the contraction that occurs in the current system.

The starting-point of the Post Keynesian theory of the globalization of production is the recognition that, in a market economy, unemployment, excess capacity and international payments imbalances have no natural tendency to reverse themselves. For a country operating at full employment, a payments imbalance can be expected to bring pressure for a change in the price level, as posited by the price-specie-flow mechanism. In the presence of persistent unemployment, trade imbalances will bring about movements in the rate of interest rather than in the price level. Trade imbalance results not in a change in the price level but in a potential liquidity problem for the deficit country by reducing the monetary base. This, in turn, will alter the interest rate. A surplus on current account will, by similar logic, reduce the rate of interest. Interest rate increases might, of course, move the economy further from full employment. Keynes himself argued that under certain conditions the balance of payments is the main determinant of the rate of interest, in which case improving the balance of payments is essential for the attainment of full employment.

Three important implications emerge for the understanding of globalization. First, without a well-functioning price-specie-flow mechanism, trade imbalances may persist over long periods of time. The balanced trade implication of the principle of comparative advantage is, in this way, equivalent to Say's Law in an open economy, whereby export growth automatically generates an equivalent increase in imports, or vice versa. Second, the direction of international trade, and thus the international division of labour, will be determined by *absolute* rather than comparative advantage since the mechanisms which would otherwise transform a situation of differential comparative costs into one of differences in absolute money costs and prices no longer operate. That is, the adjustment is simply not adequate to guarantee that the principle of comparative advantage will determine the direction of trade and a zero payments balance for all countries (Milberg 2002). According to Robinson (1973, p. 16), 'The comforting doctrine that a country cannot be "undersold all round" was derived from the postulate of universal full employment. The argument consists merely in assuming what it hopes to prove.' Finally, if trade is determined by absolute advantage and countries can indeed be 'undersold all round', then free trade is not necessarily the first-best policy, since infant industry protection may be needed to spur technical change needed for international competition.

The other aspect of globalized production is foreign direct investment, and Post Keynesian pricing theory provides some relatively untapped insights. Hymer, building on Ronald Coase's emphasis on transactions costs and Alfred Chandler's focus on the historical evolution of corporate capitalism, was the first to understand that the phenomenon of foreign direct investment was necessarily driven by oligopolistic firms. The high volume of 'cross-hauling' (that is, simultaneous inward and outward foreign direct investment in one country) implies that the process is not driven simply by

arbitrage of temporarily high profit opportunities in one location compared to another. Hymer, and later others, argued that the transnational firm is a non-market institution, and its desire to *internalize* international operations constitutes a market failure, but is the prime reason for firms to invest abroad rather than serve foreign markets in other ways, such as exports. In oligopoly, firms are large and few, or as Hymer puts it, 'the size of the market is limited by the size of the firm' (Hymer 1970, p. 443).

The oligopoly corporation emerged in the late nineteenth century as the organizational form that best captured economies of scale, best avoided the otherwise destructiveness of price-based, 'perfect' competition, and insulated investment from cyclical downturns. Transnational corporate investment began as oligopolies matured in the 1920s. Over time, foreign direct investment became 'a new weapon in the arsenal of oligopolistic rivalry' (Hymer 1972, p. 444) as firms sought new markets, and the control of resources and cheap labour – all the while conserving their transactions cost advantage over market-based operations such as through exports.

Post Keynesians have long recognized the ruinous nature of price competition and thus the necessity of oligopoly over the long run (Eichner 1976, p. 11). More important, such a recognition has led to an alternative theory of price determination in capitalism, in which the firm, rather than market forces of supply and demand, plays the dominant role. According to Shapiro and Mott (1995, p. 38), 'The prices derived in the mark-up models of the [Post Keynesian] theory are not the prices that serve the unconscious ends of the market (the allocative efficiency of the neoclassical theory or the systemic reproduction of the Ricardian conception) but the ones that serve the conscious ends of the enterprise.' In Eichner's (1976, chapter 2) theory of the 'megacorp', firms use pricing as a means to generate finance for future investment. From the perspective of the transnational corporation, international investment allows the internalization not only of firm-specific advantages related to technology, management, marketing and so on, but also the internalization of the pricing decision on international (intra-firm) transactions.

Does the recent trend towards outsourcing and subcontracting constitute a reversal of the oligopolistic trend identified by Chandler, Hymer, Eichner and others? The process has become so prevalent that the contemporary manufacturing firm often does no manufacturing at all. Most outsourcing relations today are 'arm's length' in a formal sense only. The rise in outsourcing and subcontracting constitutes a sharpening of the hierarchical structure that Hymer identified with the modern corporation, due to the added flexibility that outsourcing provides and the selective competition (among suppliers) that it promotes. Subcontracting is driven by the desire of firms to increase flexibility and lower unit labour costs. Cost

reduction can come with increased productivity or lower wages. In this sense, the rise of international outsourcing reintroduces the ruinous competition from which capitalism escaped in the late 1800s. The expansion of sweatshop labour is thus an integral part of the globalization of production, and is another source of rising income inequality in developing countries.

The insights of Hymer and Eichner can form the foundation of a Post Keynesian theory of international production, but the full theory remains undeveloped and untested. Moreover, a truly Post Keynesian theory will make a connection between the finance and production processes in the global economy. This becomes especially important as firms outsource production operations and focus increasingly on financial management. Investment location decisions may themselves be influenced by foreign exchange portfolio considerations, for example. That is, the manufacturing firm is increasingly a financial unit. Keynes's distinction between speculation and enterprise is being blurred further as foreign direct investment can increasingly be hedged with the build-up of domestic liabilities.

In the conclusion of *The General Theory*, Keynes wote that 'The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes' (Keynes 1964, p. 372). These faults are arguably worse today than they were 25 years ago, when the current wave of globalization began. The global economy suffers chronic unemployment, excess capacity in most manufacturing sectors and growing income inequality. Real wage suppression and lax social standards in poor countries has not brought them a degree of international competitiveness sufficient to generate economic development; financial liberalization has hastened economic crises in East Asia, Russia and Central and South America; and austerity imposed by the International Monetary Fund has tended to worsen these problems. The economic logic of a policy of sustained global demand expansion with regulated international capital mobility is reasonably well established, but the political obstacles to its implementation remain large.

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See also:

Bretton Woods; Competition; Economic Policy; Exchange Rates; International Economics; Pricing and Prices; Tobin Tax.

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