

# Globalization: An Analytical Framework

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The paradigm example of globalization is the global integration of financial markets. Globalization has significant implications for New Zealand—a small island nation far from the centers of world capital—that flow from the particular characteristics of New Zealand's economy. In order to sustain current levels of economic growth, the New Zealand government has adopted a liberal policy to attract foreign capital. In the future, a major task for New Zealand is to align further the internal logic of the deregulatory process as expressed in domestic legislation with an international environment in which domestic economies are more globally integrated. This article argues that the concept of globalization provides a new analytical framework for accomplishing that task.

The article commences by identifying different meanings of globalization and key drivers in the globalization of the financial markets. Because globalization is an ambiguous concept, the second half of the paper attempts to sharpen understanding of the concept by considering concrete instances in which globalization has affected New Zealand. Examples provided are: the "crash" of 1987; the improvement of New Zealand's international investment position through a noticeable increase in foreign investment; capital shortage; capital flight; political debate in New Zealand; New Zealand's tax treatment of foreign investors; and exemptions for foreign issuers. Here, it is argued that as far as domestic policymakers are concerned, globalization demands, first, a clear set of priorities in the particular area (a "microscopic" view), and, second, a global view of the subject matter (a "macroscopic" view).

The article concludes by suggesting an analytical framework for domestic policymakers and legislators addressing globalization issues. Complex systems can be viewed as the subject of macroscopic knowledge; hence, globalization can be characterized as macroscopic knowledge since it is complex, conceptual, and fuzzy. By contrast, domestic legislation can be characterized as microscopic knowledge; i.e., focused on one domain in which there is little or no contradiction. On this view, globalization can be used as a tool to examine the context of any given domestic legislation, thereby enriching our understanding of specific legislation by introducing dynamic and predictive criteria.

The concept of globalization radiates the possibility of a new analytical framework for policymakers. Coupled with the macroscopic/microscopic viewpoint, it enables us to avoid the pitfall of domestic introspection by introducing criteria of internal and external coherence. Internal coherence asks whether a proposed domestic policy is congruent with policy in related areas. For example, is there regulatory symmetry between domestic legislation in taxation, securities, and foreign investment areas? External coherence asks the globalization question: How should domestic legislation reflect change in the international context?

## I. Introduction

A master metaphor for our times is the "Information Age,"<sup>2</sup> a phrase which denotes the "information revolution" and connotes the "end of geography."<sup>3</sup> These terms underlie (and to some extent are subsumed by) the ambiguous concept of "globalization." The concept of globalization has gained considerable strength in recent years; its meaning, however, is often obscured in its application.<sup>4</sup> Likewise, the policy implications of globalization are not always clearly enunciated or understood. Since the integration of financial markets on a global basis is the paradigm example of the movement toward globalization,<sup>5</sup> an examination of globalization and its policy ramifications in this area is one way of delineating the shifting meanings of the concept. In this article, we consider these issues with reference to New Zealand.

Globalization has significant implications for New Zealand—an island nation in the South Pacific far from the centers of world capital—that flow from the particular characteristics of New Zealand's economy: the country is an exporting nation; its major companies operate in many countries; it requires foreign investment for economic growth and is, thus, a net capital importer; it has undertaken rapid deregulation since 1984 and now has one of the most open economies in the world.<sup>6</sup> In order to sustain current levels of economic growth, the New Zealand government has adopted a liberal policy to attract foreign capital. The reforms following deregulation in 1984 are now firmly in place; the domestic economic context is, therefore, "a rapidly liberalising, small open economy with light-handed regulation."<sup>7</sup> In the future, a major task for New Zealand is to align further the internal logic of the deregulatory process as expressed in domestic legislation with the international environment in which domestic economies are more globally integrated. The principal thesis of this article is that the concept of globalization provides a new analytical framework for accomplishing this task.

In Part II, we examine some meanings of globalization. In Part III, we identify and briefly examine key drivers in the globalization of financial markets. In Part IV, we discuss policy implications for regulators and participants in

the financial markets. Part V considers globalization as a business mandate. In Part VI, the "crash" of 1987, capital shortage, capital flight, political implications, the taxation treatment of foreign investors, and unilateral exemptions for foreign issuers in New Zealand are offered as examples of globalization in practice. One suggestion here is that globalization has significant political implications in New Zealand which will increase in importance with the advent of the new electoral system in New Zealand, Mixed Member Proportional Representation (MMP).<sup>8</sup> In conclusion, Part VII attempts to open up a new framework for domestic policymakers addressing globalization issues.

## II. Some Meanings of "Globalization"

The origins of the concept "globalization" can be traced back to the writings of Wendell Wilkie and the Club of Rome.<sup>9</sup> These early formulations, however, occurred prior to the collapse of Bretton Woods and the development of the new global communications technology. The macroeconomic and technological preconditions for globalization were not in place until the late-1970s and early-1980s. With these preconditions now firmly in place, the modern meaning of "globalization" implies a global perspective of the particular area of study, a perspective which arises from the increased interdependence of national institutions and national economies.<sup>10</sup>

Globalization of the financial markets is the "factual process based on the dynamics of . . . the markets."<sup>11</sup> The massive increase in global financial flows is made possible by the new technology, by traditional and novel market activities, and by macroeconomic change.<sup>12</sup> Other connotations of the term globalization are particular to their subject matter;<sup>13</sup> for example, global culture ("McWorld" as Benjamin Barber has described it),<sup>14</sup> global threats to peace and security, problems of global underdevelopment and poverty, threats to the global environment,<sup>15</sup> and mass migration.

Globalization should be distinguished from "internationalization." Sometimes, the term globalization is used synonymously with internationalization.<sup>16</sup> This is because globalization means "different things in different contexts;<sup>17</sup> it is a portmanteau word.<sup>18</sup> To equate globalization with internationalization, however, is to miss the distinct meaning of globalization.<sup>19</sup> The essential distinction is that globalization denotes a process of *denationalization*, whereas internationalization refers to the cooperative activities of *national* actors.<sup>20</sup> In some instances, the concerns of globalization may be motivated by the common good of humanity, whereas internationalization fulfills the national interest.<sup>21</sup> The key feature which underlies the concept of globalization and distinguishes it from internationalization is the erosion and irrelevance of national boundaries in markets which can truly be described as global. For example, globalization aptly describes the growing irrelevance of borders in international financial transactions. Because capital flows are being denationalized, national sovereignty is becoming increasingly irrelevant in this area.<sup>22</sup>

By contrast, many domestic matters have become "internationalized," the subject of bilateral or multilateral cooperation. This type of collaboration falls under the term internationalization. Memoranda of Understanding between regulatory agencies in distinct jurisdictions on aspects of securities regulation provide examples of internationalization. This can also be observed in the work of the International Organisation of Security Commissions (IOSCO).<sup>23</sup> IOSCO and organizations such as the Bank for International Settlements and the Organization for Economic Cooperation and Development (OECD) are not part of the process of *globalization* because they bring together *national* actors on a cooperative level.

Conceptual blurring occurs in some instances. Consider the activities of a multinational corporation (MNC).<sup>24</sup> On the one hand, an MNC operating in many nations and integrating its activities globally is an example of globalization. On the other hand, an MNC pursuing a strategy of maximising the interests of each corporate entity within the MNC and within the national boundaries in which it operates could be viewed as an example of internationalization. This illustrates the fundamental difference between the two concepts—the relevance or irrelevance of national boundaries to the activity under examination. Part III of this article argues that technological and macroeconomic developments have been the main reason for the growing irrelevance of national boundaries in the financial markets and that the globalization process has extended to domestic economies.

## III. Key Drivers in the Globalization of the Financial Markets

From the extant literature, the main areas of change in the international financial markets have been the international financial system,<sup>25</sup> advances in and the fusion of information technology and telecommunications,<sup>26</sup> the rise of global business strategies and the MNC,<sup>27</sup> new political and economic structures,<sup>28</sup> new political imperatives, such as economic liberalization, privatization and deregulation,<sup>29</sup> and the rise of the institutional investor.<sup>30</sup> Together, these changes have produced an overwhelming trend towards international financial integration. As Gerald Corrigan stated, "[W]hether we like it or not, the globalization of financial markets and institutions is a reality. . . . And . . . cannot be reversed in any material way by regulation or legislation.<sup>31</sup> Thus, one end result of these changes is a particular form of globalization, namely, international financial integration.

Technology and macroeconomics underlie the events described above and have been the main drivers of change in the international financial markets since the early-1970s. The technological drivers comprise cumulative developments in information technology (IT), telecommunications, the convergence or fusion of IT and telecommunications, end-user demand for the integration of IT and telecommunications, and the impact of these factors on organizational structures and strategies.<sup>32</sup> The macroeconomic drivers include the collapse of the Bretton Woods system (in particular, the shift to flexible exchange rates), international capital imbalances in the 1980s and beyond, and deregulation.<sup>33</sup>

The most important factor in the globalization of financial markets is technological change.<sup>34</sup> New global communications technology has facilitated the globalization of capital flows.<sup>35</sup> The process of capital globalization has two distinct dimensions—stretching (or scope) and deepening (or intensity). Thus, economic activities are stretched across the world as geographical constraints recede and deepen in the sense of increased interconnectedness.<sup>36</sup> An important qualification here is that this form of globalization is confined to the developed nations. "It is the globalization of markets within the framework of GATT, OECD, and to some extent the [European Community]. The rest of the world is either only loosely linked to the world of globalizing economies or left out altogether.<sup>37</sup> Thus, globalization of financial markets extends only to the domestic economies of developed nations.

An economic interpretation of globalization requires a focus on market-driven processes for determining the allocation and pricing of economic resources. As Bijit Bora stated, "Market policies designed to allow firms the freedom to make decisions about the allocation of resources . . . resulted in globalization."<sup>38</sup> This interpretation implies a decrease in the relevance of national borders as economies become globally integrated.<sup>39</sup> There are various reasons for this phenomenon. The liberalization/deregulation movement in OECD countries has removed many of the capital and foreign exchange controls and barriers which existed as an impediment to a globally integrated economy.<sup>40</sup> Coupled with the removal of many protectionist trade restrictions, the free flow of capital across national borders has been enhanced.<sup>41</sup> This process has been accompanied by deregulation of domestic financial markets in OECD countries, further facilitating a rapid increase in cross-border transactions.<sup>42</sup>

The events described above opened markets and economies and facilitated the process of globalization and integration. The same process has decreased the importance of national boundaries in the raising of capital. Financing for new projects is no longer restricted (by regulatory barriers and their associated compliance costs) to domestic institutions. U.S. companies can raise capital in Europe through a Eurobond issue, while New Zealand companies raise debt capital in the United States.<sup>43</sup> The economic interpretation of globalization identifies liberalization/deregulation as the catalyst for the free-flow of capital across national borders. The salient factor is the increasing irrelevance of geographical boundaries in the financial markets.<sup>44</sup> We address some regulatory implications flowing from this process in Part IV.

#### IV. Implications for Regulators in the Information Age

Globalization has implications for both financial markets and those who regulate these markets. As noted, financial markets are now largely integrated and linked through technology on a global basis.<sup>45</sup> Such integration means that regulators no longer have sovereignty over the movements of capital across their national boundaries. "Just where is the market when it exists in the computer system? Who regulates a market when its geographical coordinates can no longer be pinned down easily?"<sup>46</sup> Indeed, international capital markets, such as the Eurodollar market, were created in response to the failed attempts of regulators to assert control over cross-border capital flows, casting doubt as to the outcome of any further attempts to regulate on a strictly national basis. Put another way, money is fungible and will gravitate to those jurisdictions offering the most attractive return.<sup>47</sup> Rules based solely on geographical bases do not recognize this fact. The problem is exacerbated in the case of MNCs. The nationality of such corporations may be difficult to ascertain, raising questions as to regulatory sovereignty. Mergers and alliances between corporations from different geographical centers will only accentuate this trend.<sup>48</sup>

A further implication for regulators is that harmonizing relationships and rules with regulators in other jurisdictions is of utmost importance.<sup>49</sup> Although governments and regulators will continue to pursue the perceived national interest, this cannot be done in a vacuum.<sup>50</sup> The process of harmonization will enhance the erosion of national sovereignty brought about by globalization. National sovereignty is further eroded by the restrictions on policy which the global financial markets have imposed.<sup>51</sup> Government policy is now influenced and dictated by the free and massive flow of capital worldwide. Those countries with an open market approach to regulation (such as New Zealand) and harmonized rules are more likely to prosper in the global economy as capital, both human and financial, increasingly ignores national boundaries.

#### V. Implications for Business:

Globalization as a Business Mandate

The focus of Part V is globalization as a business concept.<sup>52</sup> Following the economic processes previously outlined and the globalization of financial markets, globalization is being increasingly adopted as a business mandate. This form of globalization has relevance for banks,<sup>53</sup> securities firms, and stock exchanges,<sup>54</sup> which compete in many countries.<sup>55</sup> Examples include: moves to allow interstate banking in the United States;<sup>56</sup> the decision of the Society for Worldwide Interbank Financial Telecommunications to install sophisticated integrated systems to compete in the international market for securities message traffic;<sup>57</sup> and the creation of the Stock Exchange Automated Quotations (SEAQ) International market in London.<sup>58</sup>

The globalization mandate animates business texts<sup>59</sup> and official discourse.<sup>60</sup> Stephen Bradley, Jerry Hausman, and Richard Nolan describe globalization as a business concept in this way:

Globalization is an important emerging business mandate relevant to virtually all businesses. It is an Information Economy, as opposed to an Industrial Economy, business concept. Modern communications enable businesses to operate in multiple countries with diverse shapes and forms of organization and control. They make it possible to send information to any part of an organization instantaneously, enabling every part to know what every other part—and the organization as a whole—is doing all the time. Moreover, global businesses can link directly to their customers, suppliers, and partners around the world . . . .

Globalization of business has continued to the point that a new, more sophisticated set of management principles is emerging. Christopher Bartlett and Sumantra Ghoshal's research on the trend . . . is described in *Managing Across Borders* [footnote omitted]. They advocate that transnational corporations attempt to maximize global economies of scale and scope while being locally responsive to customers in the countries in which they operate. As companies become more global, and especially when a transnational strategy is attempted, there develops a great demand for improved communications both in capacity and sophistication. There is no end in sight for this trend.<sup>61</sup>

This quote focuses on multinational corporations. As Bijit Bora observes, in the context of a discussion of foreign direct investment (FDI), multinationals are the "vehicle" for globalization; "A key element of the structural transformation into the global company town was the role played by the multinational corporation and foreign direct investment . . . . Technological advances have played a part in triggering the global revolution, but the multinational corporation has evolved to become an important vehicle for allocating resources."<sup>62</sup>

The rise of multinationals has impacted heavily on the strategies and decision-making processes of the managers of such corporations. The interests of the multinational group as a whole need to be reconciled with the individual interests of each affiliate corporation. In other words, there is a need to integrate or harmonise the decision-making process across affiliates. As part of this process, a distinction can be made between simple and complex integration strategies.<sup>63</sup> A complex strategy, "requires a willingness to locate various functional activities . . . wherever they can be done best to fulfil [*sic*] the firm's overall strategy."<sup>64</sup> Again, the relevance of national boundaries is diminished because the whole world is seen as both a potential market and as a potential site for activities. Richard O'Brien illustrates the strategy in the context of a financial services firm: "[T]he choice of geographical location can be greatly widened . . . for example, 'back office' functions may be in one location, sales forces may be spread widely across the marketplace, and the legal domicile of the firm may be elsewhere."<sup>65</sup>

These business strategies are both a cause and result of globalization because they would not have been possible without the economic process of globalization outlined above and a distinct interpretation of globalization in the business context. Indeed, Peter Lloyd defines globalization as: "the set of activities associated with the multinational-direct foreign investing firm which integrates its activities across national borders in the sense of making decisions to maximise the profits or interests of the group."<sup>66</sup> An example of this interpretation of globalization is given by Walter Wriston in describing the origins of the component parts of an IBM computer:

The popular IBM PS/2 Model 30-286, for example, contains a microprocessor from Malaysia, oscillators from either France or Singapore . . . diskette controller, ROM, and video graphics array from Japan; VLSI circuits and video digital-to-analog converter from Korea . . . and all this is put together in Florida.<sup>67</sup>

This trend can also be observed in the increase of transnational corporate strategic alliances and mergers, resulting in difficult questions as to the nationality and origins of a corporation and its products.<sup>68</sup> Once again, the emerging theme is the decreasing importance of national boundaries. In summary, globalization, as distinct from internationalization, involves a variety of considerations in an economic and business sense. The dominant interpretation, however, which underlies its various manifestations, is the erosion of national sovereignty and national boundaries as reference points for the analysis and practice of the financial markets. Some qualifications on the magnitude of the trend to globalization are required. First, national structures are still of great importance.<sup>69</sup> Domestic politicians and regulators may have a vested interest in retaining the status quo. Also, nationalism has re-emerged as a strong countervailing force to globalization<sup>70</sup> although some argue that local nationalism is the consequence of the global spread of institutions of national self-determination, democratization, and administrative rationalization.<sup>71</sup> In the result, however, Wriston's argument that the continued existence of purely national structures is in doubt in the very near future must be viewed as hyperbole.<sup>72</sup> Second, the process of globalization does not extend to all countries in the world. Many underdeveloped countries and countries with protectionist regimes do not share in the technological and economic reforms outlined above and, therefore, do not form part of the globalization process.<sup>73</sup> Hence, there are good reasons which preclude the use of the term globalization as an exclusive and comprehensive description of the *present* international system. Nonetheless, as the preceding analysis has illustrated, globalization will be of considerable importance in the future; regulators and policymakers need to be aware of its various implications.

## VI. Globalization in Practice

### A. Introduction

Part VI of the article considers specific instances where globalization has influenced a particular area in New Zealand. Instances where globalization have impacted include the "crash" of 1987; the improvement of New Zealand's international investment position through a noticeable increase in foreign investment; capital shortage and capital flight; political debate in New Zealand; New Zealand's tax treatment of foreign investors and exemptions for foreign issuers. The conclusion to Part VI attempts to synthesize some lessons from these examples.

The existence of international capital markets is not a recent phenomenon. Larry Neal, for example, has demonstrated the existence of a sophisticated and smoothly functioning system of financial markets in the mercantile states of northwestern Europe in the 1700s, and, in particular, in the international capital markets of Amsterdam and London.<sup>74</sup> In *The Internationalisation of Stock Markets*, David Ayling traces the history of internationalization in stock markets through to the deregulation explosion of the 1980s, and concludes that "the engines of change in the financial markets are: firstly, the expanding Euromarkets; secondly, advances in market technology; and, thirdly, the host of innovations in the markets."<sup>75</sup> It is well recognized that the torque of these engines is international and directly affects securities markets in Australia and New Zealand.<sup>76</sup>

Globalization impels global trading facilitated by computer technology and deregulation. Australia and New Zealand have learned this the hard way. As Malcolm Smith has reflected:

The trend towards "globalisation" of the securities markets was dramatically highlighted on "Black Monday," 19 October 1987, when a major correction in the American market swept around the world with tidal wave proportions.

....

When the tidal wave moved out from Wall Street in the United States and into the region, it highlighted differences in the economic environments of the region's capital markets. The tidal wave ran into different kinds of barriers which channelled its full impact unevenly into those markets which were most open.

The Seoul Exchange was virtually quarantined, since there was little foreign activity allowed and the country was awash with domestic funds. As a further corrective measure, the Korean governmental regulations controlling market activities required the Exchange to suspend trading in a security when its price moved more than five per cent in one day.

The Tokyo Exchange was also awash with domestic funds and, with government encouragement, the leading broking houses initially stemmed the tide. They were assisted by government regulations

....

The new Hong Kong Exchange simply closed for four days, thereby postponing the full impact until the following Monday, when market capitalisation fell a record 33 per cent. .

..

With Hong Kong, [Seoul] and Tokyo sheltering behind effective barriers, the selling tidal wave flowed down into Australia, Singapore and New Zealand, producing record declines in the various indices

.... <sup>77</sup>

One implication of the link between globalization and regulation is that lawmakers and regulators need to consider the possible existence of extraterritorial regulatory asymmetries, and, where feasible, devise domestic controls which avoid such asymmetry or enable counteractive steps to be taken if necessary. Technological imperatives increasingly push regulation towards convergence not only at the level of electronic information and trading systems, but also on the plane of global regulatory coherence and compatibility.<sup>78</sup>

#### B. New Zealand's International Investment Position

As Table 1 indicates, there has been a significant increase in foreign investment in New Zealand in recent years (from \$60.5 billion in 1990 to \$89.4 billion in 1994—an increase of around forty-eight percent). The governmental body, Statistics New Zealand, reports that foreign equity investment in New Zealand companies was \$9.8 billion in the year to March 1989 but increased to \$28.0 billion for the year to March 1994. This is an increase of some 186 percent (see Table 2).

The data for FDI in New Zealand companies is particularly interesting.<sup>79</sup> FDI increased from \$8.4 billion in 1989 to \$26.5 billion in 1994, an increase of some 215 percent (see Table 2). By contrast, portfolio investment—which is non-direct investment in, for example, stocks and bonds—declined from \$1.4 billion in 1989 to \$0.9 billion in 1992, a decline of some thirty-eight percent. Portfolio investment increased significantly between 1992 and 1993, but dropped again for the year ending March 1994. Nevertheless, there has been an overall increase in the years 1989 to 1994 (see Table 2). Changes in equity investment have increasingly resulted in foreign investors gaining some form of control in New Zealand companies.<sup>80</sup> This is because New Zealand has adopted the reforms most closely associated with globalization— deregulation, a liberal FDI regime and the removal of capital controls.

Table 1

New Zealand's International Investment Position  
(\$NZ Millions)

	1990	1991	1992	1993	1994
<b>Direct Investment</b>	7,585	13,108	14,323	14,246	14,680
Equity	-1,936	-2,959	-2,817	-6,221	-5,205
Net Lending					
<b>Portfolio and Other Investment</b>	248	461	918	1,138	1,848
Equity	3,247	3,680	4,069	3,592	5,873
Lending	5,612	6,608	5,789	6,171	6,909
official Reserve Assets					
<b>New Zealand Investment Abroad</b>	14,756	20,897	22,283	18,926	24,106
<b>Direct Investment</b>	12,293	13,294	17,750	21,035	26,494
Equity	1,427	5,055	4,993	6,775	7,140
Net Borrowing					
<b>Portfolio Investment</b>	1,561	1,766	850	2,483	1,532
Equity	45,202	48,242	50,964	51,166	54,185
Borrowing					
<b>Foreign Investment in New Zealand</b>	60,484	68,357	74,558	81,460	89,350
<b>Net International Investment Position</b>	-45,728	-47,460	-52,274	-62,534	-65,245

Source: Statistics New Zealand, *Hot off the Press* (1995).

**Table 2**

Foreign Equity Investment in New Zealand Companies  
(\$NZ Millions)

	1989	1990	1991	1992	1993	1994
Direct Investment	8,412	12,293	13,294	17,750	21,035	26,494
Portfolio Investment	1,378	1,561	1,766	850	2,483	1,532
Total	9,790	13,854	15,060	18,600	23,518	28,026

Source: Statistics New Zealand, *Hot off the Press* (1995).

In Table 1, we observe that New Zealand investment abroad has also increased markedly, from \$14.8 billion in 1990 to \$24.1 billion in 1994, an increase of sixty-three percent. Overall, New Zealand is a net capital importer; in 1990 New Zealand's net international investment position was  $\frac{3}{4}$ \$45.7 billion, compared to  $\frac{3}{4}$ \$65.2 billion in 1994 (a change of approximately forty- three percent).

Reasons for the observed increase in foreign investment in New Zealand listed companies can largely be attributed to aspects of globalization. The main reason is the process of economic deregulation which has taken place in New Zealand, a process which started in 1984 under Sir Roger Douglas, then the Minister of Finance. Economic deregulation has resulted in New Zealand moving from one of the "most regulated societies in the free world, to the world's freest market economy."<sup>81</sup> Deregulation, and in particular the Employment Contracts Act of 1991, has made New Zealand companies more competitive and drawn the attention of foreign investors.<sup>82</sup> New Zealand's manufacturing sector is now seen to be "on average, fifteen percent more competitive than those of its major trading partners and thirty per cent more cost advantageous over its leading trade partner, Australia."<sup>83</sup> New Zealand's current FDI regime has been described as very liberal with a lack of restrictions on capital inflows.<sup>84</sup> From a policy viewpoint, high levels of overseas debt have led various governments to encourage FDI. As Pat Colgate and Kathryn Featherstone write:

... the combination of low economic growth and relatively small domestic capital markets makes FDI an attractive option to help fund investment growth. Second, FDI provides an alternative to the use of debt to finance New Zealand's persistent current account deficits, and could therefore be seen as part of a strategy to reduce overseas debt ratios to more acceptable levels.<sup>85</sup>

Another factor leading to increased foreign portfolio investment in New Zealand is the increasingly global nature of investment by fund managers, especially by fund managers in the U.S. This diversification of global investment has occurred for several reasons including the increasing attractiveness of countries in Asia for investment and the growth of pension funds in the United States.<sup>86</sup>

The increasing international exposure of some large New Zealand companies has led to an improved international awareness of New Zealand as an investment destination. Some of New Zealand's largest companies are listed on overseas exchanges: Brierley Investments Limited shares are traded on the Australian and London stock exchanges; Fletcher Challenge common shares are traded on the Australian, London, Toronto, Montreal, Vancouver and Frankfurt stock exchanges. In particular, the local and international listing of Telecom Corporation of New Zealand Limited (Telecom)—Telecom is also listed on the Australian and New York stock exchanges—and the high profile acquisition of a major stake in this company by two large U.S. telecommunications companies, Ameritech and Bell Atlantic, increased awareness among international investors of New Zealand as an investment destination. The increase in foreign investment in New Zealand is also due to the increasingly global nature of fund management.<sup>87</sup>

### C. Capital Shortage

On the demand side of the equation, New Zealand needs foreign capital. Two related areas where globalization has been influential—capital shortage and capital flight—must be considered. Each of these phenomena has consequences for New Zealand.

Since 1993, the popular press and business journals have speculated about a scarcity, in both industrial and developing countries, of sufficient capital for investment purposes.<sup>88</sup> Factors driving world-wide demand for capital include: emerging capital markets in developing countries,<sup>89</sup> large numbers (estimates range from two to three billion) of persons enfranchised from former Marxist economies,<sup>90</sup> capital requirements of former communist countries,<sup>91</sup> infrastructure requirements in Asia and Latin America,<sup>92</sup> deficit financing by governments,<sup>93</sup> and privatization.<sup>94</sup> Some writers dispute the proposition that there is a capital shortage.<sup>95</sup> They argue that creative financing solutions, domestic sources of funding, and mobile international capital will provide a solution.

An obvious and immediate problem here, however, is that mobile international capital is taking a hard line on government economic policies, especially deficits: "what the market wants is simple: less debt or higher interest rates."<sup>96</sup> Given this fact, we should perhaps be talking about *comparative* capital shortage. A graphic example is provided by the sell-down of the Australian dollar in April 1995, prompted by concerns over high levels of overseas debt.<sup>97</sup> The reason behind this phenomenon was highlighted by Walter Wriston in his prescient discussion of the Information Age.<sup>98</sup> Wriston's central thesis is that the marriage of computers and telecommunications decentralizes power and knowledge. It erodes the traditional concept of sovereignty powerfully affecting, for example, the power of the state to issue currency and mandate its value. To this extent, globalization imposes a potential constraint on government economic policy:

The new international financial system was built not by politicians, economists, central bankers, or finance ministers but by technology. Today information about the diplomatic, fiscal, and monetary policies of all nations is instantly transmitted to electronic screens in hundreds of trading rooms in dozens of countries. . . . The entire globe is now tied together in a single electronic market moving at the speed of light. . . .

This enormous flow of data has created a new world monetary standard, an Information Standard, which has replaced the gold standard and the Bretton Woods agreements. [footnote omitted] The electronic global market has produced what amounts to a giant vote-counting machine that conducts a running tally on what the world thinks of a government's diplomatic, fiscal, and monetary policies. That opinion is immediately reflected in the value the market places on a country's currency.<sup>99</sup>

Even if capital shortage fears are groundless or exaggerated, capital mobility in the Information Age operates to prefer recipients whose governments pursue prudent economic goals, and the immediate indicator of such preference is the value placed on a country's currency by the international market. Hence, a more useful way of viewing the capital shortage argument is to see it as a matter of capital competition: "The real competition in the future will be to get investments . . . . There's just so much capital . . . and it's going to be spread very thin."<sup>100</sup> Where is New Zealand positioned in this scenario? New Zealand has long been a net capital-importing nation, particularly in the nineteenth century<sup>101</sup> (see Table 1 for recent data). Initially, the main source of foreign capital was Britain.<sup>102</sup> In the 1950s and 1960s, however, foreign investment came increasingly from Australia and the United States.<sup>103</sup> In the 1990s, there have been numerous public and private sector statements regarding New Zealand's needs for foreign capital.<sup>104</sup> Because the country suffers from endogenous capital constraints, raising finance is seen to be particularly difficult in New Zealand.<sup>105</sup> Some of these constraints are illustrated by the following observations: "New Zealand lacks much of the financial expertise and advanced specialized-capital markets that have helped industry in other nations,"<sup>106</sup> and

Large and sophisticated capital markets by definition offer a broad range of sources of debt and equity funding. The New Zealand market, however, is limited in size. Consequently, a small company seeking capital can soon eliminate possible sources which in a larger market might be willing, due to competitive pressures, to accept [at] higher levels of risk.<sup>107</sup>

The problem of raising initial finance is particularly noticeable for large raisings of capital. Graham Crocombe, Michael Enright, and Michael Porter have commented, "Limited capital availability in New Zealand constrains business development and economic growth. Lenders and investors have limited amounts of capital to invest."<sup>108</sup> It is beneficial for New Zealand public companies, and in particular large public companies, to be able to raise equity through share placements to foreign investors.

In April 1995, the President of the American Chamber of Commerce in New Zealand stated that the expansion of foreign capital investment was fundamental to New Zealand's development.<sup>109</sup> The majority in New Zealand share this view. This perspective is evidenced by the National Government's recent liberalization of the overseas investment regime<sup>110</sup> and the introduction of taxation legislation designed to put foreign investors on the same footing as resident New Zealand investors. These efforts will ensure that all investors, whether domestic or foreign, will face the same top tax rate of thirty-three percent.<sup>111</sup> Further liberalizing the overseas investment regime and aligning the taxation regime in order to treat foreign and domestic investors equally may significantly enhance New

Zealand as an investment destination. These initiatives, coupled with microeconomic reform and a commitment to reducing overseas borrowing, can be seen as ways of enhancing New Zealand's competitive advantage in the country's quest for investment capital in the era of globalization.<sup>112</sup>

#### D. Capital Flight

The flip-side of capital shortage is capital flight, a concept which is both difficult to define and measure.<sup>113</sup> As Kamal Fatehi recently commented:

[N]o consensus exists on its definition. More importantly, there is no universally accepted method of measuring it. The term could refer to all private capital outflows from developing countries, whether they are short- term or long-term portfolio or equity investments . . . . A more practical definition would take into account only that portion of the capital outflow that is triggered by an imbalance between the risks associated with investing in the domestic market versus foreign market risks. Usually, the term capital flight indicates the exodus of capital, often through surreptitious means, from developing countries to more advanced, industrialized countries.<sup>114</sup>

There are several causes of capital flight, foremost among which are "political and financial instability, underdeveloped domestic financial market and inadequate domestic investment opportunities, capital control, heavy taxes, the prospect or actual devaluation of domestic money, actual and incipient hyper-inflation."<sup>115</sup>

Capital flight provides a graphic example of Wriston's concept of a new world monetary standard—an "Information Standard." Just as prudent economic management will attract capital, imprudent policies may cause capital flight. The most well-known recent example is Mexico in December 1994.<sup>116</sup> At that time, the Mexican government announced a change in the stabilization rate for the peso. This resulted in a dramatic market reaction leading to the collapse of the peso-dollar exchange rate and the peso's devaluation by more than fifty percent. Subsequently, the Mexican stock market collapsed, dragging down stock markets in many other emerging markets by ten to thirty percent within a month.<sup>117</sup>

As far as New Zealand is concerned, political uncertainty following (or before), the first Mixed Member Proportional Representation (MMP) general election in November 1996 is the sort of event which might prompt capital flight.<sup>118</sup> Capital flight could occur if the ruling pro-business National Party did not obtain a majority and was forced to govern in coalition with a minority party or where two or more minority parties formed a coalition to govern. Certainly, the general consensus in New Zealand business circles is that New Zealand's country risk premium has risen as a result of this electoral uncertainty.<sup>119</sup> There is some evidence that foreign investors will react differently to political instability depending on the industry or industries in which they invest.<sup>120</sup> Hence, the extent to which perceived political instability has negative consequences for New Zealand companies is likely to reflect the perceived impact on the industries in which these companies operate.

Capital flight is inextricably tied to international competition for capital. For example, if relative returns in other investment destinations become more appealing than returns available in New Zealand, capital flight may occur. Capital flight would have a major detrimental effect on New Zealand companies and investors alike. Approximately half the equity in New Zealand listed companies is foreign owned.<sup>121</sup> If a significant proportion of this was liquidated, share prices would drop until local investors entered the market. Such phenomena lead us to consider the political implications of globalization.

#### E. The Political Dimension

The political dimension of globalization and its importance is highlighted by the following remarks of Andrew Meehan, Executive Chairman of Brierley Investments Limited, a large New Zealand listed multinational company:

There exists a powerful and unstoppable movement in terms of world dynamics—that of "globalisation." In its simplest form, this means the removal of boundaries and barriers to the pursuit of economic well being and social improvement . . . .

. . . .

Nations face a very simple choice—to accept the reality of globalisation—or to attempt to fight against it. Those who accept globalisation will reap the benefits of technology transfer, skills transfer, diversity of choice, capital for adding value and ultimately an increased level of national income.

Those that fight globalisation will forego such benefits and be increasingly marginalised, leading ultimately to a reduced level of national income.

New Zealand is currently faced with this choice. Over the past ten years, we epitomised the nation willing to recognise and accommodate globalisation. It would indeed be a tragedy to turn away from this universally acknowledged leadership role.<sup>122</sup>

Meehan's comments reflect two underlying concerns. First, New Zealand has only recently begun to reap the gains of economic restructuring in the mid- 1980s enabling a reduction of public sector debt.<sup>123</sup> The second concern is that these gains will be threatened in the first MMP general election in or before November 1996 because of the policy platforms of the Alliance Party and the New Zealand First Party. The Alliance Party, which is certain to be significantly represented in the new parliament, proposes high spending on social welfare, the imposition of new tariffs, and controls on foreign investment. The New Zealand First Party also seeks reductions in foreign investment. The tariff and foreign investment controls proposed run directly against the trend toward globalization in the OECD countries.

The use of globalization as a tool in a domestic political debate seems particularly significant. From one perspective, this demonstrates the tension between globalization and nationalism, thereby derogating from Wriston's assertion that the continued existence of purely national structures is in doubt. From another perspective, Meehan's invocation of globalization shows that the term has moved from being a convenient shorthand for global financial integration to a term which encompasses a national economic strategy. The content of that strategy fits well with observable changes in the international financial markets since the 1970s, but its implementation carries political implications.<sup>124</sup>

An analogous comparison can be made to China. In recent times, China has actively sought foreign capital for domestic growth.<sup>125</sup> It has been argued that more than eighty percent of investment capital into China since 1979 came through or from overseas Chinese sources.<sup>126</sup> The overseas Chinese are well known for pulling their capital out in reaction to political and other forms of uncertainty. To this extent, the political dimension of globalization may have a disciplining effect on future political change in China. In both New Zealand and China, management of the political implications of globalization is a major challenge.

As far as domestic policymakers are concerned, globalization demands: first, a clear set of domestic priorities in the particular area (a microscopic view); and, second, a global view of the subject matter (a macroscopic view). To illustrate the microscopic view, suppose New Zealand taxation policymakers resolve as follows: the country needs foreign capital for growth; inefficiencies in the domestic tax regime may deter foreign investors and increase the cost of capital for domestic businesses; thus, the tax regime should be amended to achieve these ends. A macroscopic view would then suggest: international investment capital is mobile; there is competition for investment capital; and the domestic tax treatment of dividends payable to off-shore investors may be a disincentive to investment in the particular country. A concrete example of this approach is offered in the next section.

#### F. Tax Treatment of Foreign Investors

This section considers the taxation treatment of foreign investors in New Zealand as influenced by globalization. New Zealand's international tax regime has been progressively reformed since the Labour Government's Economic Statement of December 17, 1987.<sup>127</sup> The final chapter in the current round of reforms occurred in December 1995 when the Taxation (International Tax) Bill of 1995 was passed as The Income Tax Act 1994 Amendment Act (No. 3) 1995. The Bill was preceded by the publication in February 1995 of *International Tax—A Discussion Document*.<sup>128</sup> In August 1995, *Commentary on the Bill* was published.<sup>129</sup> In discussing the policy framework of the amending legislation, both the *Discussion Document* and the *Commentary* explicitly or implicitly recognize the concept of globalization. In passing, it can be noted that the recent amendments to the Overseas Investment Act of 1973 embodied in the Overseas Investment Amendment Act of 1995 are predicated on similar considerations. To this extent, we are now witnessing proposed domestic legislation based on an explicit or implicit recognition of globalization. Another way of viewing the proposed changes to the taxation of foreign investors and the FDI regime is to regard them as attempts at domestic regulatory symmetry between the securities, taxation, and FDI regimes.<sup>130</sup> This search for symmetry can be regarded as pursuit of the national interest that reflects the realities of globalization.<sup>131</sup>

The *Discussion Document* operates from the premise that New Zealand's current high rate of economic growth can only be sustained by continued investment in business and increased participation in the world economy. An open economy and growth are explicitly connected.<sup>132</sup> It is recognized that New Zealand is a capital importer which requires foreign investment:

Continued investment, necessary to support sustainable economic growth, demands that New Zealand businesses be able to satisfy their requirements for capital, either from New Zealand or overseas. *Policies that give domestic producers access to capital at low cost will enhance the competitiveness of New Zealand business and are consistent with the Government's policy of repaying public debt to remove the risk premium for New Zealand.*<sup>133</sup>

One of the earlier steps in the reform process was the introduction (effective September 28, 1993) of the Foreign Investor Tax Credit (FITC), directed toward non-resident portfolio investors. The *Discussion Document* commented:

The introduction of the FITC removed the double imposition of New Zealand taxes on dividends paid to foreign portfolio investors. Foreign portfolio investors are no longer required to pay full tax at the New Zealand company level as well as Non-Resident Withholding Tax. That puts a foreign investor in a similar position to a domestic investor as far as the maximum New Zealand tax payable is concerned. *The change had an immediate positive effect on the New Zealand share market. (One large New Zealand business estimated that this one measure reduced its cost of capital by about 8%).*<sup>134</sup>

The Income Tax Act 1994 Amendment Act (No. 3) 1995 extends the existing FITC regime to all non-resident shareholders of New Zealand companies. In other words, the present exemption from Non-Resident Withholding Tax (NRWT), which applies to certain non-resident shareholders (investors holding less than ten percent interest in a company, i.e., non-resident portfolio investors), is extended to all non-resident shareholders of New Zealand companies. The effect of the proposed FITC is to reduce the effective New Zealand tax rate on corporate earnings distributed to non-New Zealand resident investors to thirty-three percent (down from forty-three percent when NRWT applied). The proposed reforms provide an example of globalization considerations influencing domestic policy. A similar trend is now evident in New Zealand securities regulation as discussed in the next section.

#### G. Unilateral Exemptions for Foreign Issuers

Securities regulation in New Zealand is principally governed by the Securities Act 1978 and the Securities Amendment Act 1988.<sup>135</sup> Offers to the public are prohibited in the absence of a registered prospectus or authorized advertisement;<sup>136</sup> the Securities Commission, however, possesses a discretionary exemption power in section 5 (5) of the Securities Act 1978 to alleviate this prohibition. Recognition of foreign issuers is a matter which the Securities Commission has generally dealt with on a case-by-case basis. Thus, the Securities Commission may give an exemption from the requirements of the New Zealand legislation where prospecti, which generally conform to the requirements of New Zealand law and are made available to investors in New Zealand, have been issued overseas. Hence, an exemption might be granted in a specific case and an exemption notice gazetted pursuant to section 5 (5) in respect of an off-shore issuer. There are, however, three exemption notices which have a wider application and relate to Australian issuers, overseas companies, and overseas listed issuers. Although the Securities Commission has used its discretionary exemption power in respect of these entities, the notices are better viewed as "accommodation by recognition," a term used by Bevis Longstreth, former Commissioner of the Securities and Exchange Commission, to describe one strategic response to the globalization of securities markets.<sup>137</sup> We suggest that together these three notices can be viewed as just such a strategic response by the New Zealand Securities Commission to the globalization of securities markets.

The first notice was The Securities Act (Australian Issuers) Exemption Notice 1994. This notice exempted Australian incorporated companies or companies incorporated in countries other than Australia and admitted to or having made application to be admitted to the official list of the Australian Stock Exchange from compliance with certain of the prospectus provisions of the New Zealand legislation where the "Australian prospectus" (as defined in the notice) is lodged in New Zealand with the Registrar of Companies in Wellington together with supporting documentation. While this notice can be viewed as the outcome of traditional links with Australia, it also marks the first instance of accommodation by recognition. The second notice was The Securities Act (Overseas Companies) Exemption Notice 1995. This notice was designed to cover rights issues and takeovers of other overseas companies by an overseas company. The third and most significant notice is The Securities Act (Overseas Listed Issuers) Exemption Notice 1995 which came into force in October 1995. It does not apply in relation to offers to which the two previous exemption notices apply. The notice allows companies incorporated in the United Kingdom and listed on the London Stock Exchange to use their overseas prospecti to make offers of securities in New Zealand. In a media release dated 9 October, 1995, the Securities Commission stated that the general purpose of this notice was to

provide increased opportunity for New Zealand investors to participate in overseas issues while substantially lowering compliance and transaction costs for overseas issuers. Both purposes can be seen as ways of responding to the globalization of securities markets.<sup>138</sup> In addition, the Securities Commission has stated that this exemption notice provides a base from which the Commission may seek to negotiate the cooperation of overseas jurisdictions to reciprocal arrangements for New Zealand issuers. Accommodation by reciprocity is also viewed by Longstreth as a key strategic response to global market pressures on securities regulators.<sup>139</sup>

#### H. Conclusions

In this section, we attempt to draw some conclusions from our discussion of globalization in practice. As a preliminary observation, we appear to be witnessing a Kuhnian paradigm shift<sup>140</sup> in New Zealanders' attitudes and beliefs about their place in the world. The old paradigm was "Fortress New Zealand"; the new paradigm is globalization. Recent evidence of this change is provided by Michael Clark's and Alan Williams' full-blown analysis of New Zealand in the new global environment, *New Zealand's Future in the Global Environment?: A Case Study of a Nation in Transition*.<sup>141</sup> This study examines the New Zealand economy in light of the challenges posed by globalization. There is an implicit recognition of the macroscopic/microscopic framework for analysis early in the text when the authors state: "This book is . . . about both the changes taking place in the world outside New Zealand and . . . about the way in which this country has been . . . affected by events which have begun to shape our future as a small, open economy . . ." <sup>142</sup> Clark and Williams concern themselves with the "big picture" implications of globalization for New Zealand. Our concern in Part VII of this article is to suggest an analytical framework for domestic policymakers and legislators to address globalization issues.

One way of drawing conclusions from the discussion in Part VI is to place globalization and New Zealand in a historical context. We can do this by focusing on one key phenomenon—the fact that New Zealand has always been a capital importing nation—and linking that phenomenon with the globalization of capital facilitated by the new global communications technology. In Part VI (B and C) above, we noted that New Zealand has long been a net capital importer. In the nineteenth century, New Zealand relied on its historical links with Great Britain and Australia for foreign capital. Today, with the abolition of foreign exchange and overseas borrowing controls in 1984 and the floating of the New Zealand dollar in 1985, New Zealand is competing world-wide for such capital.<sup>143</sup> This economic imperative, however, is profoundly influenced by globalization.

In summary, New Zealand's equity markets and international investment position reflect a rapid increase in foreign investment. To attract foreign capital in a time of comparative capital shortage and to avoid capital flight means that New Zealand must pursue prudent economic policies that meet the expectations of foreign investors (in short, higher interest rates or less debt). Such policies, however, always carry a political cost, and this applies *a fortiori* to New Zealand with its new MMP electoral system. Notwithstanding such political pressures, legislators in New Zealand have begun to fine-tune FDI and international tax legislation to reflect the facts of globalization. Part VII of this article suggests that our examination of globalization can be taken a stage further to provide a framework for policy analysis of domestic legislation.

#### VII. Globalization: An Analytical Framework

Domestic legislation in New Zealand exists in a context of rapid international and domestic change; that is, it operates within a "complex system." Such a complex system requires the adoption of an innovative method for its explication. In *Chaos Theory in the Financial Markets*, Dimitris Chorafas proposed one method of analysis which can be fruitfully used for the type of problems raised in this article.<sup>144</sup> His argument runs as follows: simple constructs can be understood by reference to deterministic laws. By contrast, complex behaviour implies complex causes that make the system unstable and unpredictable. Chorafas thinks that such a system is governed by a multitude of independent factors and is subject to random exogenous influences. Earlier, Toshiro Tenaro suggested the use of a "macroscope," a view able to discern the grand design of such complex systems.<sup>145</sup>

Drawing on complexity theory and Tenaro's insight, Chorafas distinguishes "macroscopic" from "microscopic" knowledge. The former is conceptual and fuzzy; the latter tends to be crisp and analytical.<sup>146</sup> Globalization can be characterized as macroscopic knowledge. By contrast, domestic legislation can be characterized as microscopic knowledge, being "focused on one domain in which there is little or no contradiction."<sup>147</sup> Chorafas describes macroscopic knowledge:

The macroscopic view is in essence an integrated set of microscopic views but macroscopic knowledge is . . . fuzzy and so are the models it uses. An example is 24-hour banking, with the financial markets operating around the clock. . . . Seen from the macroscopic viewpoint, 24-hour banking is a reality, but it is a fuzzy concept as well . . . . Macroscopic knowledge concerns not only the grand design but also projections,

extrapolations, inference . . . . By consequence it deals with *soft-data*—which is sometimes vague and uncertain. . . . It is long experience crystallised into qualitative rules. Furthermore, macroscopic knowledge is essentially philosophical and interdisciplinary. Since it is qualitative and logical, it is often suggestive, allowing for contradiction in concepts and references . . . . But it is also *flexible* and *adaptive* to the changing environment.<sup>148</sup>

Chorafas' concept of a macroscopic level is another way of characterizing globalization. On this view, globalization can be used as a tool to examine the context of any given domestic legislation. Such analysis can enrich our understanding of specific legislation by introducing dynamic and predictive criteria. This is important for two reasons. First, we have witnessed dramatic change in the international context since the 1970s and global processes affecting domestic law.<sup>149</sup> Alfred Aman explains this assertion as follows:

We have moved from local and state common-law, regulatory regimes that dominated the 19th and early 20th centuries, to national regimes that dominated the public law of the 1930s to 1980s, to the present global era. *In the present era, law formulated solely in terms of purely state or national entities, without taking into account the significant role played by transnational forces embodied in multinational corporations, global capital markets, and rapidly advancing technologies . . . is likely to be not only ineffective, but counterproductive.* Today, the line between domestic and international is largely illusory. As a result, we need fresh assessments of issues such as the role and theory of the nation-state in the twenty-first century . . . and . . . the kinds of domestic legal reforms necessary to mesh with or respond to global economic and political forces.<sup>150</sup>

The second reason is that deregulation in New Zealand has profoundly altered the domestic economic context within which much financial legislation operates. To ignore these changes is to examine domestic legislation in a vacuum. The concept of globalization radiates the possibility of a new analytical framework for policymakers. Coupled with the microscopic/macroscopic framework, globalization enables us to avoid the pitfall of domestic introspection by introducing criteria of internal and external coherence. The hypothetical taxation policy at the end of Part VI (D) illustrates the application of the microscopic/macroscopic framework. Now add the additional criteria of internal and external coherence deriving from the positivist distinction between what the law is and what the law ought to be. Internal coherence asks "is" questions: Is the existing legislation achieving its expressed purpose as reflected in the case law? Is the proposed policy congruent with policy in related areas? Is there regulatory symmetry between legislation in taxation, securities, and FDI? External coherence asks the "ought" globalization question: How should domestic legislation reflect change in the international context? We have seen examples of how domestic legislation in New Zealand has addressed the globalization question in the areas of FDI, international tax, and securities regulation. But these are areas in which the globalization question is unavoidable. Now the task is to apply the analytical framework elsewhere. The suggestions we make are admittedly modest but to ignore such analysis is to run the risk, identified by Aman, of producing law which is "not only ineffective, but counterproductive."<sup>151</sup>

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