



# Chapter One

## Globalization

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Adapted by R. Helg for LIUC 2007

### Opening Case: The Globalization of Health Care

- There is a shortage of radiologists in the United States and demand for their services is growing twice as fast as the rate of graduation
- Solution to the problem: Send images over the Internet to be interpreted by radiologists in India

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### Opening Case: The Globalization of Health Care

- Outsourcing health care is not only limited to radiology; we are beginning to see patients travel internationally for treatments as well as surgery
- In 2004 some 170,000 foreigners visited India for medical treatments; the number is expected to grow at 15% for the next several years
- Question: Will demand for American health services soon collapse as work moves offshore to places like India?

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### What is Globalization?

- The shift toward a more integrated and interdependent world economy
- Two components:
  - The globalization of markets
  - The globalization of production

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### Globalization of Markets



- The merging of distinctly separate national markets into a global marketplace
  - Tastes and preferences converge onto a global norm
  - Firms offer standardized products worldwide creating a world market

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### Globalization of Markets

- But don't exaggerate the degree of homogenization. Significant differences still exist among national markets. As a consequence for many products firms still adopts
  - Country-specific marketing strategies
  - Varied product mix

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## Globalization of Markets

- The most global markets are not consumer markets
- The most global markets are for industrial goods and materials that serve a universal need the world over



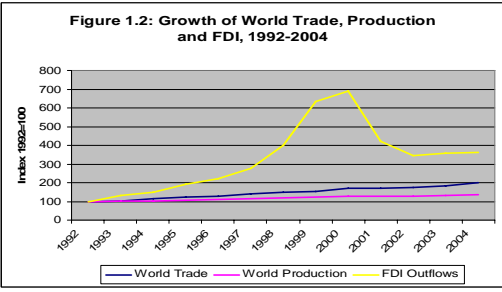
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## Globalization of Production

- Refers to sourcing of goods and services from locations around the world to take advantage of
  - differences in cost or quality of the factors of production
    - Labor
    - Land
    - Capital
  - the economies of scale in the production process

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## Globalization of Production



**Figure 1.2: Growth of World Trade, Production and FDI, 1992-2004**

Year	World Trade (Index)	World Production (Index)	FDI Outflows (Index)
1992	100	100	100
1993	110	110	110
1994	120	120	120
1995	130	130	130
1996	140	140	140
1997	150	150	150
1998	160	160	160
1999	170	170	170
2000	180	180	700
2001	185	185	400
2002	190	190	350
2003	195	195	350
2004	200	200	350

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## Globalization of Production

- Historically this has been primarily confined to manufacturing enterprises
- Increasingly companies are taking advantage of modern communications technology, and particularly the Internet, to outsource service activities to low-cost producers in other nations

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## Globalization of Production

- Outsourcing of productive activities to different suppliers results in the creation of products that are global in nature (ex. Boeing 777, IBM - now Lenovo-Thinkpad X31 etc.)


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## Globalization of Production

- Again, don't exaggerate the degree of production globalization. Obstacles remains:
  - Formal and informal barriers to trade
  - Barriers to foreign direct investment
  - Transportation costs
  - Issues associated with economic risk
  - Issues associated with political risk

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## Globalization of Production


A group of economist (see Gene Grossman and Rossi-Hansberg, 2006 and the presentation by Richard Baldwin, 2006)) have introduced the idea that with outsourcing globalization has entered a new phase.

The idea is that in the first phase globalization has been characterized by a first unbundling: end of the necessity of making goods close to the point of consumption. In this first phase we had **trade in goods**.

Recently, started a second unbundling: the end of the need to perform most production stages near each other. In this second phase we have **trade in tasks**.

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## Globalization

### Historical digression 1:


Taking a longer historical perspective, it should be stressed that between 1870 and 1914 the world experienced another period of globalization.

After this first period, the process of global economic integration quickly reversed.

With 1945 the process started again

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## Globalization

### Historical digression 2:


Fast economic growth is a feature of the last 200 years. It is a product of the capitalistic production system.

Globalization is an intrinsic feature of the capitalistic production system

*(on this, see page 27 from Maddison, 2001)*

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## The Emergence of Global Institutions

- Globalization (and the bad experience between the two world wars) has created the need for institutions to help manage, regulate and police the global marketplace
  - WTO (previously only GATT)
  - IMF
  - World bank
  - United Nations

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## Drivers of Globalization

- Two macro factors seem to underlie the trend toward greater globalization
  - Decline in barriers to the free flow of goods, services, and capital that has occurred since the end of World War II
  - Technological change

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## Declining Trade and Investment Barriers

- During the 1920s and '30s, many of the nation-states of the world erected formidable barriers to international trade and foreign direct investment
- Advanced industrial nations of the West committed themselves after World War II to removing barriers to the free flow of goods, services, and capital between nations.

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## Declining Trade and Investment Barriers

Some stylized facts:

- After WWII substantial reduction in trade barriers (tariffs and non-tariffs barriers)
- On average less developed countries are more protectionist than industrialized countries (IC)
- South-South trade is characterized on average by higher trade barriers than South-North trade
- IC have peaks of protectionism in some sectors (ie agriculture and textile and clothing) in which many emerging economies have a comparative advantage  
(see Panagariya, 2003 and Handout-Protectionism)

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## Average Tariff Rates on Manufactured Products

	1913	1950	1990	2002
France	21 %	18 %	5.9 %	4.0 %
Germany	20 %	26 %	5.9 %	4.0 %
Italy	18 %	25 %	5.9 %	4.0 %
Japan	30 %	--	5.3 %	3.8 %
Holland	5 %	1 %	5.9 %	4.0 %
Sweden	20 %	9 %	4.4 %	4.0 %
Great Britain	--	%	5.9 %	4.0 %
United States	44 %	14 %	4.8 %	4.0 %

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## Average Tariff Rates

TABELLA 8.1  
Livello medio dei dazi nel mondo (%).

	Anno	Tutti i beni	Beni agricoli	Manufatti
Paesi in via di sviluppo (134)	98-04	11,8	16,3	11,0
di cui: Brasile	2004	10,9	10,4	11,0
Cina	2004	10,3	15,0	9,5
India	2004	28,3	30,0	25,3
Paesi industrializzati (23)	02-04	5,5	9,5	4,8
di cui: Corea del Sud	2004	11,9	42,5	6,6
Giappone	2004	4,7	10,4	3,3
Stati Uniti	2004	4,3	8,2	3,7
Svizzera	2003	1,9	15	1,1
Unione Europea	2004	4,5	9,5	3,6

Note: media aritmetica dei dazi applicati su base MFN.  
Fonte: Banca Mondiale, Trade database, sito web WB.

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## Effects of Lowering Trade Barriers

Figure 1.1: Volume of World Trade and World Production, 1950-2004

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## The Role of Technology

- Lowering of trade barriers made globalization possible; technology has made it a reality
- Since the end of World War II the world has seen advances in
  - Communication
  - Information processing
  - Transportation technology

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## Internet Usage Growth

Figure 1.3: Internet Users per 1000 People, 1990-2003

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## The Changing Demographics of the Global Economy

- World output and trade
- Changing foreign direct investment
- Changing nature of multinationals

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## The Globalization Debate

- Anti-globalization Protests
- Globalization, Jobs, and Income
- Globalization, Labor Policies, and the Environment
- Globalization and National Sovereignty
- Globalization, Inequality and the World's Poor (*see Handout, Poverty\_Inequality and Economist's article Catching up*)

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## Managing in the Global Marketplace

- Much of this book is concerned with the challenges of managing an international business (any firm that engages in international trade or investment)

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## Managing in the Global Marketplace

- Managing an international business is different from managing a purely domestic business in four areas:
  - Countries are different
  - Range of problems confronted by a manager in an international business is wider and the problems themselves are more complex than those confronted by a manager in a domestic business
  - An international business must find ways to work within the limits imposed by government intervention in the international trade and investment system
  - International transactions involve converting money into different currencies

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## Looking Ahead

- Chapter 2: National Differences in Political Economy
  - Political Systems
  - Economic Systems
  - Legal Systems
  - The Determinates of Economic Development
  - Development
  - States in Transition
  - Managerial Implications

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## World Trade Organization

- The successor of the General Agreement on Tariffs and Trade (GATT)
- Primarily responsible for:
  - Policing the world trading system
  - Promoting the lowering of barriers to trade
- As of September 2007 there were 151 member nations that collectively accounted for 97% of world trade (Vietnam and Tonga are the last entries)

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## IMF and World Bank

- Both the International Monetary Fund (IMF) and the World Bank were created in 1944 by 44 nations that met at Bretton Woods, New Hampshire
- The IMF was created to maintain order in the international monetary system
- The World Bank was created to promote economic development through low-interest loans

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## United Nations

- The United Nations was established October 24, 1945 by 51 countries committed to preserving peace through international cooperation and collective security
- Membership is now at 191 countries
- Four main purposes of the UN are:
  - To maintain international peace and security
  - To develop friendly relations among nations
  - To cooperate in solving international problems and in promoting respect for human rights
  - To be a center for harmonizing the actions of nations


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## International Trade

- Occurs when a firm exports goods or services to consumers in another country



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## Foreign Direct Investment



- Occurs when a firm invests resources in business activities outside its home country

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## World Output and Trade

Country	Share of World Output 1963	Share of World Output 2004	Share of World Exports 2004
United States	40.3%	20.9%	10.4%
Germany	9.7%	4.3%	9.5%
France	6.3%	3.1%	4.8%
Italy	3.4%	2.9%	3.8%
United Kingdom	6.5%	3.1%	4.7%
Canada	3.0%	3.5%	3.4%
Japan	5.5%	6.9%	5.7%
China	NA	13.2%	5.9%

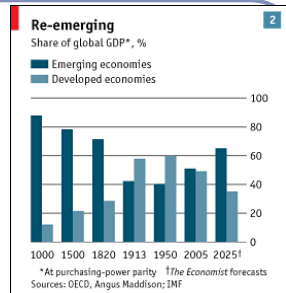
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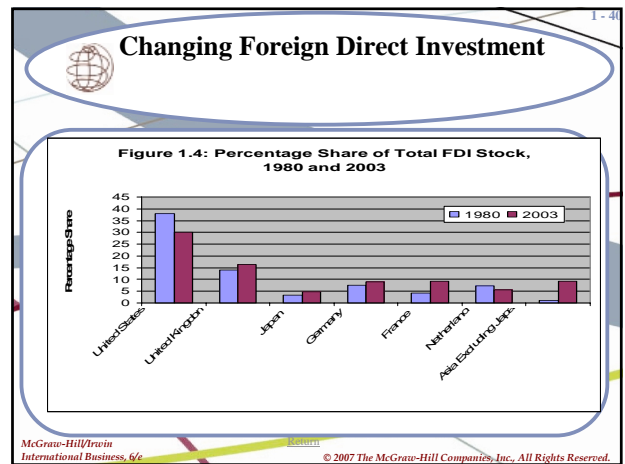
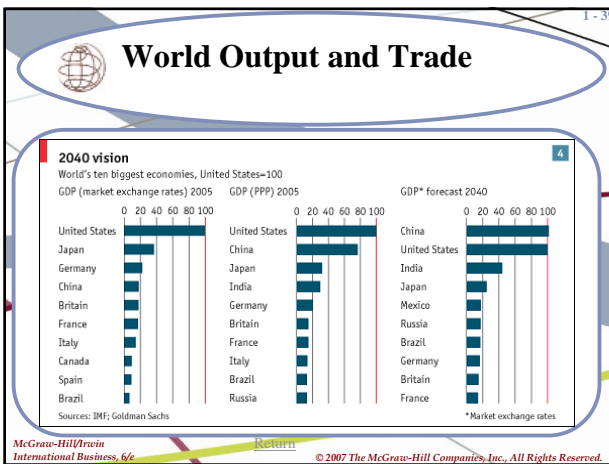
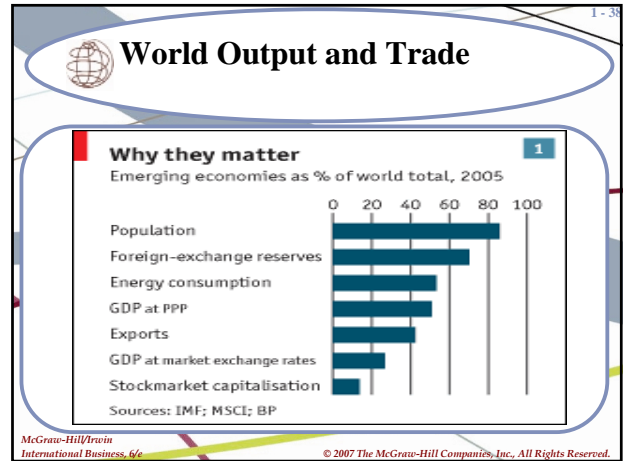
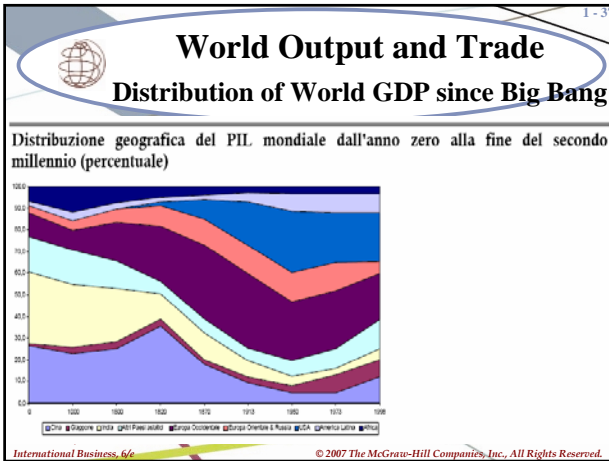
## World Output and Trade

- Recent data show that the so-called “emerging economies” account for a larger part of global production than “industrialized countries” (see for example The Economist, January 21<sup>st</sup>, 2006)



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## Changing Nature of Multinationals

- **Non-U.S. Multinationals**
  - In the 1960's global business activity was dominated by large U.S. multinational corporations
  - In 1973 48.5% of multinationals were U.S. firms
  - In 2002 28% of largest multinationals were U.S. firms
  - Globalization of the world economy has resulted in a relative decline in the dominance of U.S. firms in the global marketplace
- **Rise of Mini-Multinationals**
  - Growth of medium-size and small multinationals has become a trend in international business
  - Consider Lubricating Systems Inc. which employs 25 people and generates sales of \$6.5 million, of which \$2 million are from global sales
  - International business is conducted not just by large firms but also by medium-size and small enterprises

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