International Business 7e

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(adapted for LIUC09 by R.Helg)

Chapter 1

Globalization

Introduction

Agenda:

- Market and production globalization
- Historical digressions
- 3 drivers of globalization
- Changing demographics in global economy
- Pro and contra globalization

What Is Globalization?

- The world is moving away from self-contained national economies toward an interdependent, integrated global economic system
- Globalization refers to the **shift toward a more integrated and interdependent world economy**

Globalization has two facets:

1) the **globalization of markets**
2) the **globalization of production**

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The Globalization Of Markets

- The globalization of markets refers to the merging of historically distinct and separate national markets into one huge global marketplace
- In many industries, it is no longer meaningful to talk about the “German market” or the “American market”
- Instead, there is only the global market

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The Globalization Of Markets

- **Falling trade barriers** make it easier to sell internationally
- The **tastes and preferences** of consumers are **converging** on some global norm
- Firms help create the global market by offering the same basic products worldwide (**standardization**)

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The 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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The 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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The Globalization Of Production

- The globalization of production refers to the sourcing of goods and services from locations around the globe to take advantage of national differences in the cost and quality of factors of production like <u>land, labor, and capital</u>

- Companies compete more effectively by lowering their overall cost structure or improving the quality or functionality of their product offering

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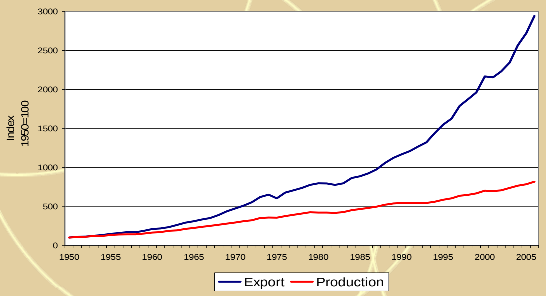
The Globalization Of Production



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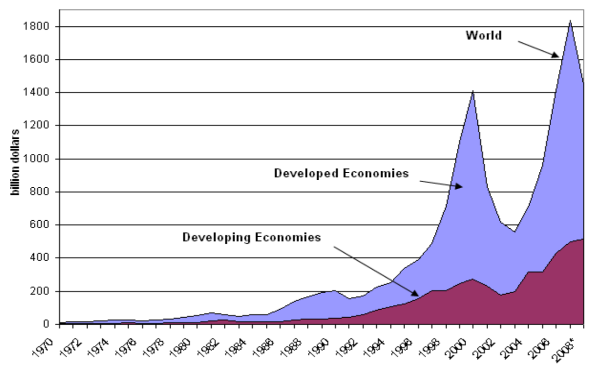
The Globalization Of Production

FDI inflow



The 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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The Globalization Of Production

Some definitions:

Figure 1.1. Outsourcing and offshoring

Source: Van Welsum and Vickery (2004).

The 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.)

The 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

The 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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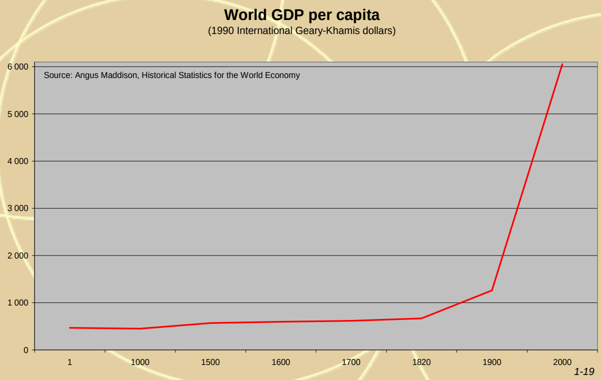
Globalization and the capitalistic system of production



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Drivers Of Globalization

Three macro factors underlie the trend toward greater globalization:

- emergence of **global institutions**
- the **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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The Emergence Of Global Institutions

Institutions are needed to:

- help manage, regulate, and police the global marketplace
- promote the establishment of multinational treaties to govern the global business system

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The Emergence Of Global Institutions

Institutions created over the past half century include:

- the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO)
- the International Monetary Fund (IMF)
- the World Bank
- the United Nations (UN)

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The Emergence Of Global Institutions

- The World Trade Organization (like its predecessor GATT) is primarily responsible for policing the world trading system and making sure that nation-states adhere to the rules laid down in trade treaties signed by WTO members
- In July 2009, the 153 WTO members accounted for 97% of world trade
- The WTO promotes lower barriers to trade and investment

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The Emergence Of Global Institutions

- The International Monetary Fund and the World Bank were created in 1944
- The IMF was established to maintain order in the international monetary system
- The World Bank was established to promote economic development

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The Emergence Of Global Institutions

The United Nations was established in 1945 to:
- maintain international peace and security
- develop friendly relations among nations
- cooperate in solving international problems and in promoting respect for human rights
- be a center for harmonizing the actions of nations

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Declining Trade And Investment Barriers

- International trade occurs when a firm exports goods or services to consumers in another country
- Foreign direct investment (FDI) occurs when a firm invests resources in business activities outside its home country
- After World War II, advanced countries made a commitment to lower barriers to trade and investment
- Since 1950, average tariffs have fallen significantly and are now at about 4%
- Countries have also been opening markets to FDI

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Declining Trade And Investment Barriers

Table 1.1: Average Tariff Rates on Manufactured Products as Percent of Value

	1913	1950	1990	2005
France	21%	18%	5.9%	3.9%
Germany	20	26	5.9	3.9
Italy	18	25	5.9	3.9
Japan	30	—	5.3	2.3
Holland	5	11	5.9	3.9
Sweden	20	9	4.4	3.9
Great Britain	—	23	5.9	3.9
United States	44	14	4.8	3.2

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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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Declining Trade And Investment Barriers

Lower barriers to trade and investment mean:

- that firms can view the world, rather than a single country, as their market
- that firms can base production in the optimal location for that activity

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The Role Of Technological Change

Technological change has made the globalization of markets a reality

Important advances have occurred in:

❖ microprocessors and telecommunications

❖ the Internet and World Wide Web

❖ transportation technology

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The Role Of Technological Change

Implications of technological change for the globalization of production include:

❖ lower transportation costs that enable firms to disperse production to economical, geographically separate locations

❖ lower information processing and communication costs that enable firms to create and manage globally dispersed production systems

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The Role of Technological Change

Implications of technological change for the globalization of markets include:

❖ low cost global communications networks help create electronic global marketplace

❖ low-cost transportation help create global markets

❖ global communication networks and global media are creating a worldwide culture, and a global market for consumer products

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The Changing Demographics Of The Global Economy

- There has been a drastic change in the demographics of the world economy in the last 30 years

Four trends are important:
a) the Changing World Output and World Trade Picture
b) the Changing Foreign Direct Investment Picture
c) the Changing Nature of the Multinational Enterprise
d) the Changing World Order

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a) The Changing World Output And World Trade Picture

- In 1960, the United States accounted for over 40% of world economic activity
- By 2006, the United States accounted for less than 20% of world economic activity
- A similar trend occurred in other developed countries
- The share of world output accounted for by developing nations is rising and is expected to account for more than 60% of world economic activity by 2020

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a) The Changing World Output And World Trade Picture

Table 1.2: The Changing Demographics of World GDP and Trade

Country	Share of World Output, 1963	Share of World GDP, 2006	Share of World Exports, 2006
United States	40.3%	19.7%	9.8%
Germany	9.7	3.9	8.9
France	6.3	2.9	4.3
Italy	3.4	2.7	3.5
United Kingdom	6.5	3.2	4.6
Canada	3.0	1.7	3.1
Japan	5.5	6.3	5.0
China	NA	15.1	7.2

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b) The Changing Foreign Direct Investment Picture

- In the 1960s, U.S. firms accounted for about two-thirds of worldwide FDI flows
- Today, the United States accounts for less than one-fifth of worldwide FDI flows
- Other developed countries have followed a similar pattern
- In contrast, the share of FDI accounted for by developing countries has risen from less than 2% in 1980 to almost 12% in 2005
- Developing countries, especially China, have also become popular destinations for FDI

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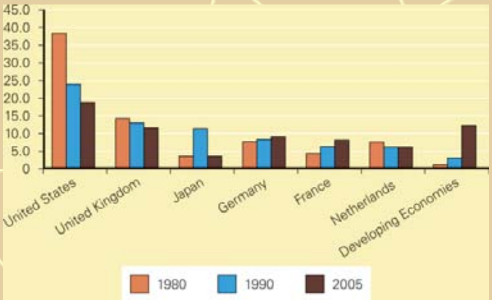
b) The Changing Foreign Direct Investment Picture

Figure 1.2: Percentage Share of Total FDI Stock 1980-2005



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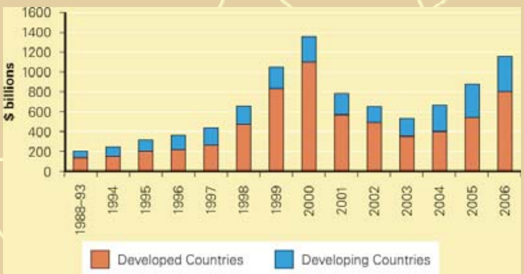
b) The Changing Foreign Direct Investment Picture

Figure 1.3: FDI Inflows 1988-2006



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c) The Changing Nature Of The Multinational Enterprise

❖ A multinational enterprise (MNE) is any business that has productive activities in two or more countries

❖ Since the 1960s, there has been a rise in non-U.S. multinationals, and a growth of mini-multinationals

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d) The Changing World Order

❖ Many former Communist nations in Europe and Asia are now committed to democratic politics and free market economies and so, create new opportunities for international businesses

❖ China and Latin America are also moving toward greater free market reforms

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The Global Economy Of the Twenty-first Century

❖ The world is moving toward a more global economic system, but globalization is not inevitable

❖ Globalization also brings risks like the financial crisis that swept through South East Asia in the late 1990s

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The Globalization Debate

Is the shift toward a more integrated and interdependent global economy a good thing?

From what we observe in the political life of our countries we know that the answer is controversial at the level of public debate.

For example, more than 40,000 anti-globalization protesters took to the street at the WTO meeting in Seattle in 1999

Protesters now regularly show up at most major meetings of global institutions

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The Globalization Debate

The most common areas of debate are:

- 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)*)

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Globalization, Jobs, And Income

- Globalization critics argue that falling barriers to trade are **destroying manufacturing jobs** in advanced countries.
- Supporters of globalization contend that the benefits of this trend outweigh the costs—that countries will specialize in what they do most efficiently and trade for other goods—and all countries will benefit.
- Moreover, not only changes in the trade regime have income distribution effects. Changes in the technological regime (i.e. technological revolutions) have distributional consequences.

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Globalization, Labor Policies, And The Environment

❖Globalization critics argue that firms avoid costly efforts to adhere to **labor and environmental regulations** by moving production to countries where such regulations do not exist, or are not enforced. This might bring to a **race to the bottom.**

❖Globalization supporters claim that tougher environmental and labor standards are associated with economic progress, so as countries get richer from free trade, they get tougher environmental and labor regulations.

Moreover, a race to the bottom has not been observed I the recent past.

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Globalization And National Sovereignty

❖Critics of globalization worry that today's interdependent global economy is **shifting economic power away from national governments** toward supranational organizations like the WTO, the EU, and the UN

❖Supporters of globalization contend that the power of these organizations is limited to what nation-states agree to grant, and that the power of the organizations lies in their ability to get countries to agree to follow certain actions

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Globalization And The World's Poor

❖ Critics of globalization argue that the **gap between rich nations and poor nations is getting wider**

❖ Supporters of globalization claim that the best way for the poor nations to improve their situation is to reduce barriers to trade and investment and implement economic policies based on free market economies, and to receive debt forgiveness for debts incurred under totalitarian regimes. Moreover we have to **distinguish between inequality and poverty.**

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Globalization And Extreme Poverty

World Poverty 1a: World population with less than 1.08 US$ (PPP) per day (old estimates)

	1820	1929	1950	1960	1970	1980	1987*	1992	1998*	2005°
%	83,9	56,3	54,8	44	35,6	31,5	28,3	23,7	23,4	17,2
ml	886,8	1149,7	1175,7	1230,7	1342,6	1431,2	1183,2	1176,0	1175,1	931,3

ource: Bourguignon e Morrison (2002), for *Chen e Ravallion (2001), for ° Chen,Ravallion (2008)

World Poverty 1b: World population with less than 1.25 US$ (PPP) per day (new estimates)

						1981	1987	1993	1999	2005
%						52,2	41,8	38,9	33,7	25,7
mil						1913,3	1718,2	1785,1	1695,4	1399,6

Source: Chen e Ravallion (2008)

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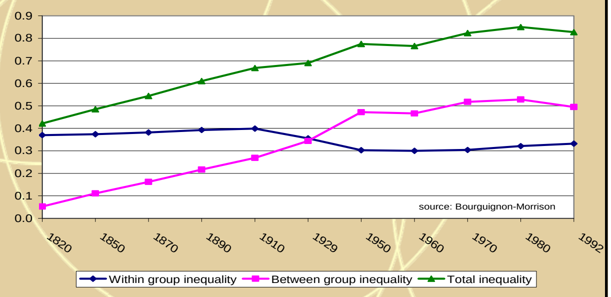
Globalization And Inequality

World Income Inequality 1: the long run (mean logarithmic deviation)



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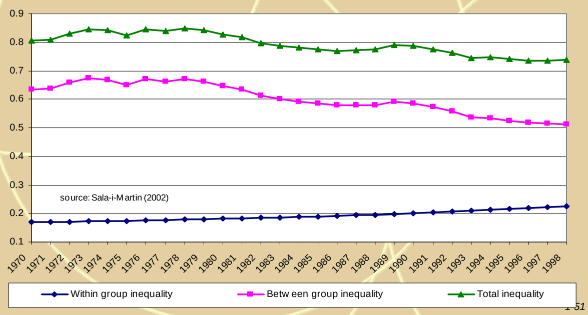
Globalization And Inequality

World Income Inequality 2: the last 30 years (mean logarithmic deviation)



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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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Managing In The Global Marketplace

- An international business is any firm that engages in international trade or investment

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Managing In The Global Marketplace

Managing an international business differs from managing a domestic business because:

- countries are different
- the range of problems confronted in an international business is wider and the problems more complex than those in a domestic business
- firms have to 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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