

**International Business**  
Global Edition

by Charles W.L. Hill  
(adapted for LIUC2017 by R.Helg)

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Chapter 1

**Globalization**

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**Introduction**

Agenda:

- Market and production globalization
- Historical digressions
- International institutions
- 2 drivers of globalization
- Changing demographics in global economy
- Pro and contra globalization
- Globalization and world poverty and inequality

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## 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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## What Is The Globalization of Markets?

- Historically distinct and separate national markets are merging
- It no longer makes sense to talk about the “German market” or the “American market”
- Instead, there is the “global market”
  - **falling trade barriers** make it easier to sell globally
  - consumers’ tastes and **preferences are converging** on some global norm
  - firms promote the trend by offering the same basic products worldwide (**standardization**)

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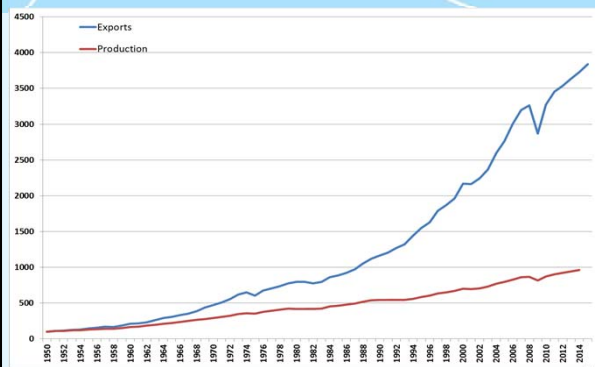
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## The Globalization of Markets

(1950-2015, 1950=100; volume data; source:WTO)




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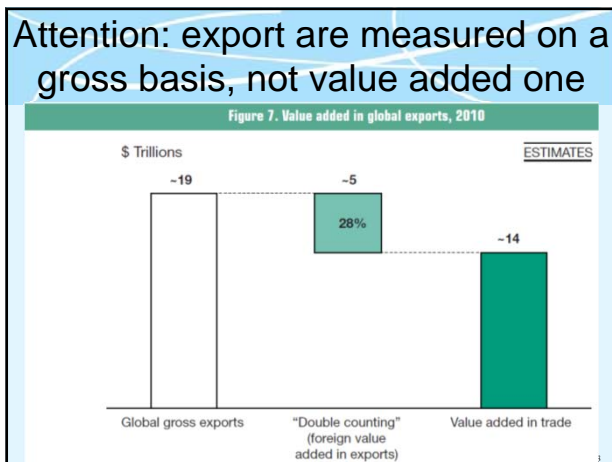
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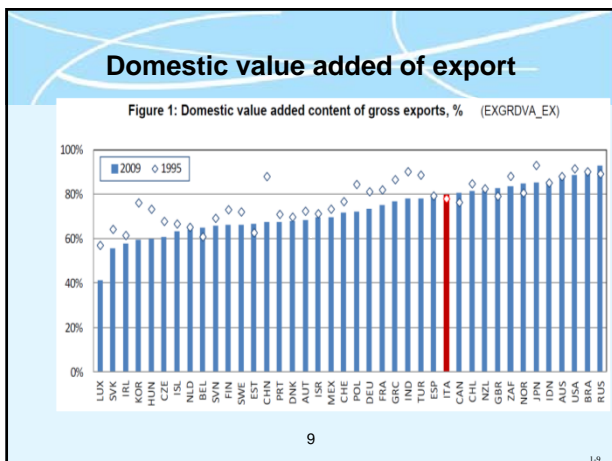
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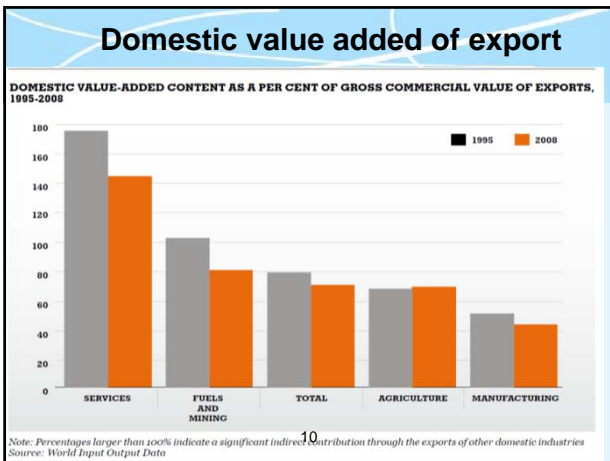
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### The Globalization of Markets

The degree of openness =  $(Exp+Imp)/GDP$

	1960	1970	2010
Japan	..	20.1	25.0
United States	..	11.3	25.2
Australia	27.0	25.2	39.9
Turkey	..	8.0	47.7
Russian Federation	..	..	48.1
China	..	..	49.1
Greece	28.8	27.2	50.4
France	27.2	31.3	53.3
New Zealand	..	47.5	54.4
Spain	..	25.8	54.7
South Africa	..	47.1	54.9
Italy	..	31.4	55.3
Mexico	..	17.4	56.9
Canada	..	42.1	59.1
United Kingdom	..	43.6	62.3
Portugal	..	44.1	69.1
Norway	..	74.1	70.6
Finland	..	50.0	75.1
Germany	..	34.3	87.0
Sweden	45.9	48.2	94.0
Denmark	..	59.8	95.4
Switzerland	..	64.4	96.4
Korea	..	36.7	102.0
Austria	..	56.6	105.8
Netherlands	..	90.7	148.7
Belgium	..	95.7	159.6
Ireland	..	77.0	166.1
Luxembourg	..	162.6	318.3

source: OECD

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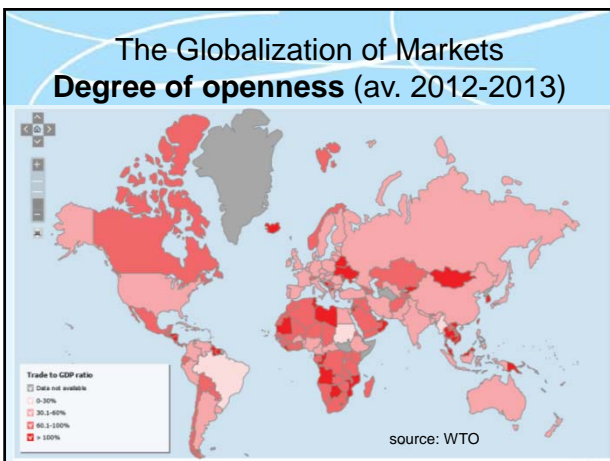
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### The Globalization of Markets

- 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 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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### What Is The Globalization of Production?

- Firms source goods and services from locations around the globe to capitalize on national differences in the cost and quality of **factors of production** like land, labor, energy, and capital
- Companies can
  - lower their overall cost structure
  - improve the quality or functionality of their product offering

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### The Globalization of Production

One mode of international production is the Foreign Direct Investment (FDI).  
 In the last 30 years FDI increased a lot.  
 They are also very volatile

Portfolio Investment      Direct Investment

0%      10%      50%      100%

passive      "Control" (majority-ownership)      "Voice" (active)

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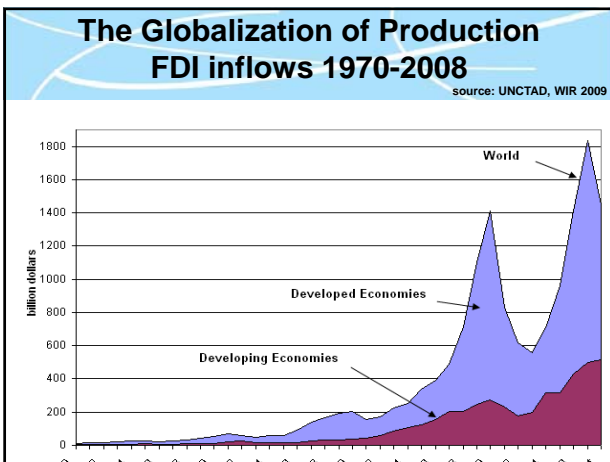
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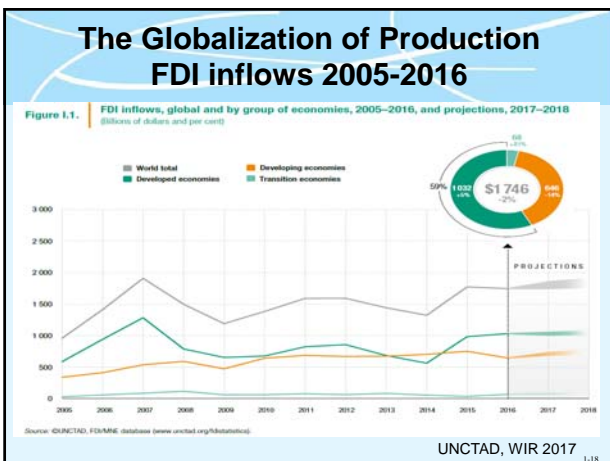
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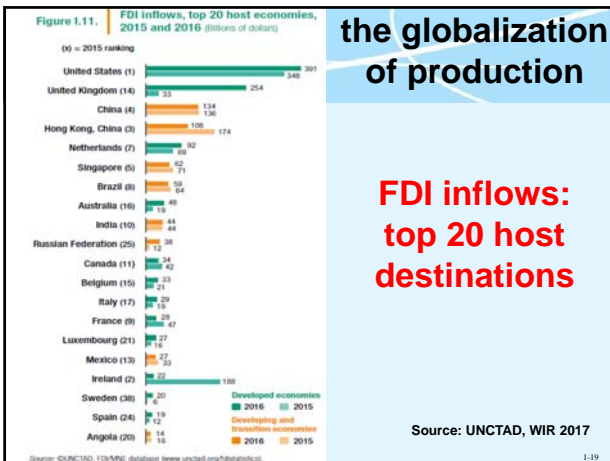
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**the globalization of production**

**FDI inflows: top 20 host destinations**

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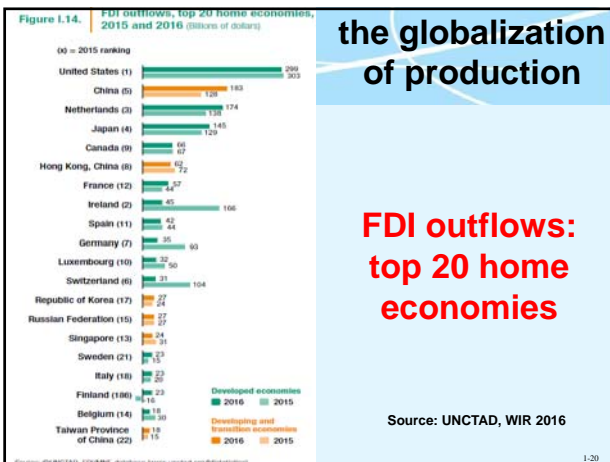
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**the globalization of production**

**FDI outflows: top 20 home economies**

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**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
- The production process has been **fragmented internationally**

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### The Globalization Of Production

Some definitions:

Figure 1.1. Outsourcing and offshoring

		Location	
		National	International
Control	Outsourced	Domestic outsourcing	International outsourcing
	In-sourced	Domestic supply	International insourcing

Offshoring

Source: Van Welsun and Vickery (2004).

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### 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.)

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### The Globalization of Production

Barbie: an early example of international fragmentation of production



- Barbie produced by the American company Mattel is considered a global good (Tempest, 1996; Feenstra, 1998).
- Mattel does not own production plants in the USA.

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### Barbie and international fragmentation of production

- Plastic for the body and hair comes from **Taiwan** and **Japan**.
- Moldes and colors from **USA**.
- Assembly used to take place in **Philippines** and **Taiwan**, but it was then moved to other countries in South-Est Asia (**Indonesia, Malaysia, China**).
- Cotton cloth for dresses comes from **China**.
- Most Barbie dolls are shipped to **USA** from **Hong Kong**.
- **Value of the doll** in Hong Kong (1995) was 2\$: 35 cents labor, 65 cents materials, 1\$ intermediation and transport.
- Sale price in USA was about 10\$: 1\$ Mattel profits and the rest general overhead and distribution costs and margins, etc.

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### The Globalization of Production

A more recent example: Boeing 787 Dreamliner

- Offshore production accounts for 70% of parts
- 43 suppliers in 135 sites
- Most tasks performed in high-income countries
- No clear pattern of technological advantage; experience and local knowledge play central role

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### International fragmentation of production: a complex example

"Spiders" involve multiple parts coming together from a number of destinations to a single location for assembly of a new component or final product. Most production processes are complex mixtures of the two.

#### Fragmentation of production: the example of the Boeing 787 Dreamliner

The diagram shows a Boeing 787 Dreamliner with numerous callouts pointing to different parts of the aircraft and their respective suppliers. The suppliers are listed as follows:

- Wing box: Mitsubishi Heavy Industries (Japan)
- Wing air products: CAI/Aerospac (UK)
- Vertical stabilizer: Boeing Commercial Airplanes (USA)
- Raked wing tips: Korean Air Lines Aerospace (Korea)
- Horizontal stabilizer: Alenia Aerospazio (Italy)
- Aux. power unit: Hamilton Sundstrand (USA)
- Passenger doors: Leonardo-Finmeccanica (France)
- Cargo doors: Saab (Sweden)
- Freight compartments: Topy (Japan)
- Forward fuselage: Alenia Aerospazio (Italy)
- Door & window: Zodiac Aerospace (USA)
- PTO/Aerospac (USA)
- Engine nacelles: Goodrich (USA)
- Engine: GE (USA), Rolls-Royce (UK)
- Batch/Software: Dassault Systemes (France)
- Navigation: Honeywell (USA)
- Wing: Airbus (France)
- Final assembly: Boeing Commercial Airplanes (USA)
- Wing air products: CAI/Aerospac (UK)
- Forward fuselage: Kawasaki Heavy Industries (Japan), Spirit AeroSystems (USA)
- Escape slides: Air Creators (USA)
- Flight deck seats: Spirit (UK)
- Flight deck controls: Embraer (USA), Moog (USA)
- Engine: GE (USA), Rolls-Royce (UK)
- Engine nacelles: Goodrich (USA)
- Batch/Software: Dassault Systemes (France)
- Navigation: Honeywell (USA)
- Wing: Airbus (France)
- Final assembly: Boeing Commercial Airplanes (USA)

Source: www.boeing.com

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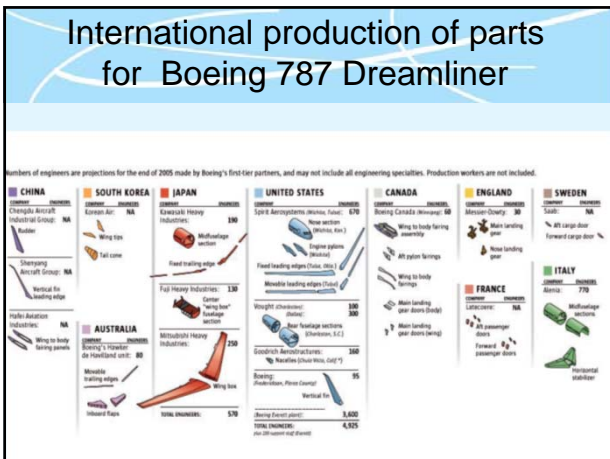
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### Trade in value added

- The goods and services we buy are composed of inputs from various countries around the world. However, the flows of goods and services within these global production chains are not always reflected in conventional measures of international trade.
- The joint OECD – WTO Trade in Value-Added (TiVA) initiative addresses this issue by considering the value added by each country in the production of goods and services that are consumed worldwide. TiVA indicators are designed to better inform policy makers by providing new insights into the commercial relations between nations.
- <https://youtube/RZKX-0SK41U>

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### Trade in value added

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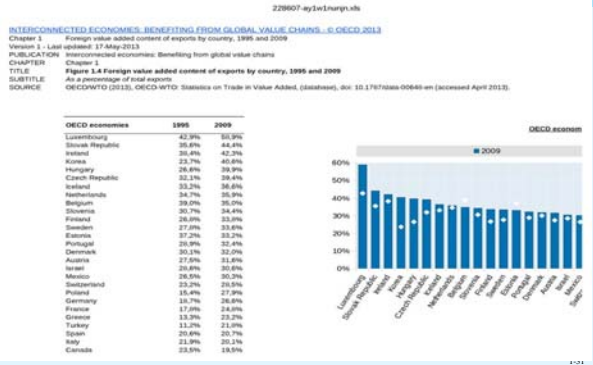
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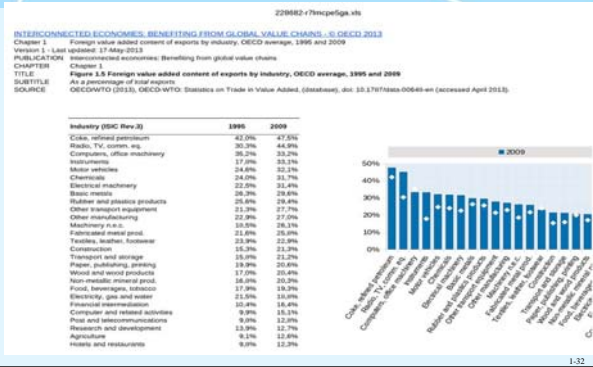
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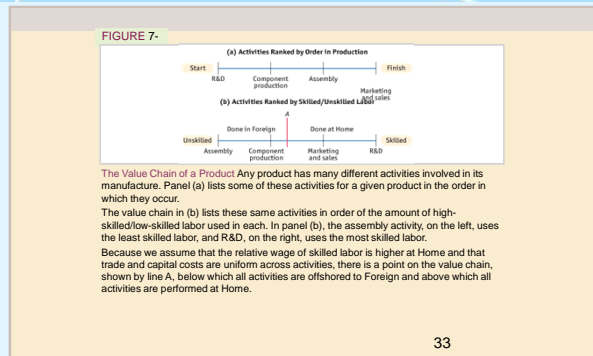
## Foreign value added content of exports by country



## Foreign value added content of exports: industries



## The Globalization of Production Value Chain of Activities



## 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

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## 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 and the labour market

Goods, services, capital markets have become less regulated over the last 50 years.  
What about the labour market?

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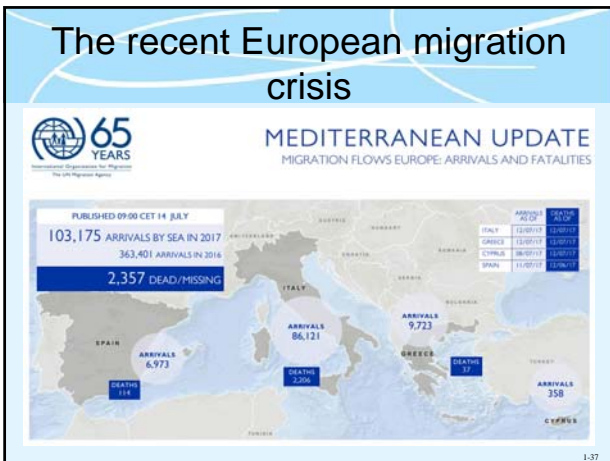
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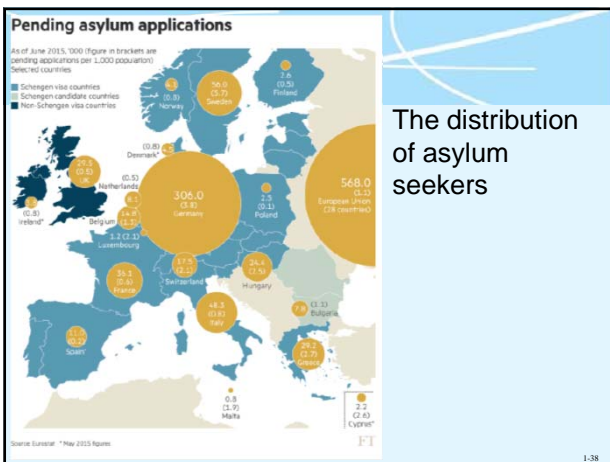
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The distribution of asylum seekers

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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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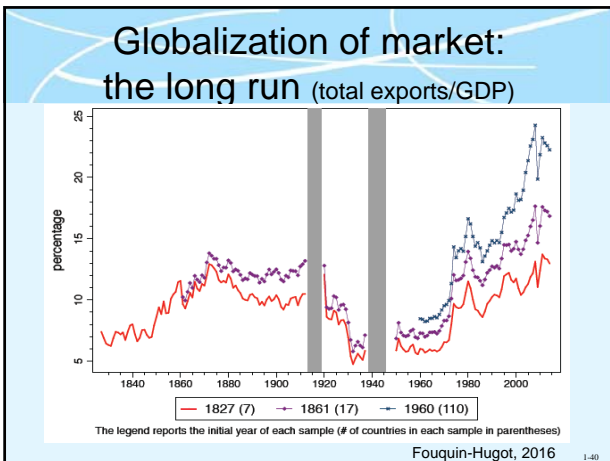
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### Globalization (source WTO 2008)

Table 1  
Globalization waves in the 19<sup>th</sup> and 20<sup>th</sup> century  
(Percentage change unless indicated otherwise)

World	1850-1913	1950-2007	1950-73	1974-2007
Population growth	0.8 <sup>a</sup>	1.7	1.9	1.6
GDP growth (real)	2.1 <sup>a</sup>	3.8	5.1	2.9
Per capita	1.3 <sup>a</sup>	2.0	3.1	1.2
Trade growth (real)	3.8	6.2	8.2	5.0
Migration (net) Million				
US, Canada, Australia, NZ (cumulative)	17.9 <sup>a</sup>	50.1	12.7	37.4
US, Canada, Australia, NZ (annual)	0.42 <sup>a</sup>	0.90	0.55	1.17
Industrial countries (less Japan) (cumulative)	...	...	...	64.3
Global FDI outward stock, year			1982	2006
FDI as % of GDP (world)	...	...	5.2	25.3

<sup>a</sup> Refers to period 1870-1913.  
Source: Maddison (2001), Lewis (1981), UNCTAD (2007), WTO (2007a).

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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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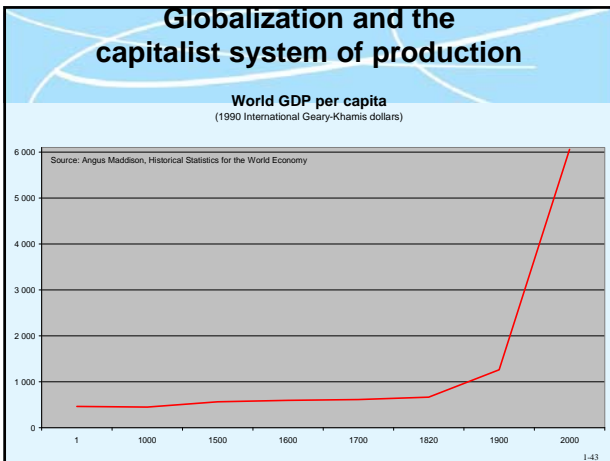
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### Globalization and the capitalist system of production

Is the recent slow economic growth simply a result of the Great Recession (and, as for all recessions, we will recover) or is there something more?

Some economists have pointed to the latter direction, introducing the «**Secular Stagnation**» idea. We might have entered in a period in which growth will be lower than in the past. Two interpretations:

- Larry Summers: it's mainly a demand problem, US GDP growth is below potential growth
- Robert Gordon: it's a supply problem. Productivity growth is and will be permanently lower than in the past. This implies that potential GDP growth is lower than in the past.

The two interpretations are not in contrast.

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### What Is Driving Globalization?

- **Declining barriers** to the free flow of goods, services, and capital (Institutions important role)
  - average tariffs are now at just 4%
  - more favorable environment for FDI
    - global stock of FDI was \$15.5 trillion in 2009
  - facilitates global production
- **Innovation**
  - microprocessors and telecommunications
  - the Internet and World Wide Web
  - transportation technology

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## What Does Globalization Mean For Firms?

- Lower barriers to trade and investment mean firms can
  - view the world, rather than a single country, as their market
  - base production in the optimal location for that activity
- But, firms may also find their home markets under attack by foreign firms

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## Declining Trade And Investment Barriers

Average Tariff Rates on Manufactured Products as Percent of Value

	1913	1950	1990	2010
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

### 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

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### Why Do We Need Global Institutions?

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

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### Why Do We Need Global Institutions?

- Examples include
  - the General Agreement on Tariffs and Trade (GATT)
  - the World Trade Organization (WTO)
  - the International Monetary Fund (IMF)
  - the World Bank
  - the United Nations (UN)
  - the G20

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### What Do Global Institutions Do?

- The World Trade Organization (like its predecessor GATT)
  - polices the world trading system
  - makes sure that nation-states adhere to the rules laid down in trade treaties
  - promotes lower barriers to trade and investment
  - 155 members in May 2012

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### What Do Global Institutions Do?

- The **International Monetary Fund** (1944)
  - maintains order in the international monetary system
  - lender of last resort for countries in crisis
    - Argentina, Indonesia, Mexico, Russia, South Korea, Thailand, Turkey, Ireland, and Greece
- The **World Bank** (1944)
  - promotes economic development via low interest loans for infrastructure projects

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### What Do Global Institutions Do?

- The **United Nations** (1945)
  - maintains international peace and security
  - develops friendly relations among nations
  - cooperates in solving international problems and in promoting respect for human rights
  - is a center for harmonizing the actions of nations
- The **G20**
  - forum through which major nations tried to launch a coordinated policy response to the 2008-2009 global financial crisis

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### What Does Globalization Mean For Firms?

- Technological change means
  - lower transportation costs
    - help create global markets and allow firms to disperse production to economical, geographically separate locations
  - low cost information processing and communication
    - firms can create and manage globally dispersed production
  - low cost global communications networks
    - help create an electronic global marketplace
  - global communication networks and global media
    - create a worldwide culture and a global consumer product market

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## The Changing Demographics Of The Global Economy

- Four trends are important:
  1. The changing world output and world trade picture
  2. The changing foreign direct investment picture
  3. The changing nature of the multinational enterprise
  4. The changing world order

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## How Has World Output And World Trade Changed?

- In 1960, the U.S. accounted for over 40% of world economic activity, but by 2012, the U.S. accounted for just 23%
  - a similar trend occurred in other developed countries
- In contrast, the share of world output accounted for by developing nations is rising
  - expected to account for more than 60% of world economic activity by 2020

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## How Has World Output And World Trade Changed?

The Changing Demographics of World Output and Trade

Country	Share of World Output, 1960 (%)	Share of World Output, 2011 (%)	Share of World Exports, 2012 (%)
United States	38.3	21.4	8.7
Germany	8.7	5.1	7.9
France	4.6	4.0	3.3
Italy	3.0	3.1	2.8
United Kingdom	5.3	3.5	2.6
Canada	3.0	2.5	2.5
Japan	3.3	8.4	4.5
China	NA	10.5	11.4

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## Economic power is shifting

Figure 0.1. Share of the global economy in purchasing power parity terms  
% of global GDP, PPP basis



Note: These data apply Maddison's long-term growth projections to his historical PPP-based estimates for 29 OECD member countries and 129 non-member economies.

Source: Authors' calculations based on Maddison (2007) and Maddison (2010).

StatLink <http://dx.doi.org/10.1787/888932287957>

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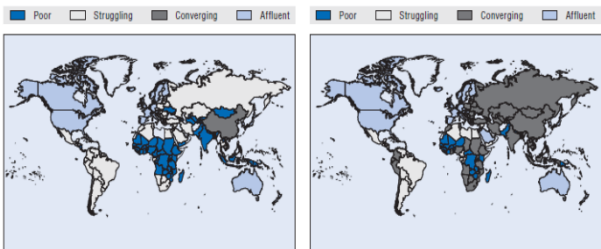
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## ... and this implies convergence

Figure 0.2. The four-speed world in the 1990s

Figure 0.3. The four-speed world in the 2000s



Note: See Chapter 1 for a detailed description of the country classification used.

Source: Authors' calculations based on World Bank (2009).

StatLink <http://dx.doi.org/10.1787/888932287976>

StatLink <http://dx.doi.org/10.1787/888932287995>

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## How Has Foreign Direct Investment Changed Over Time?

- 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 (since 2010, together with transition economies they account for more than 50% of world FDI inflows)

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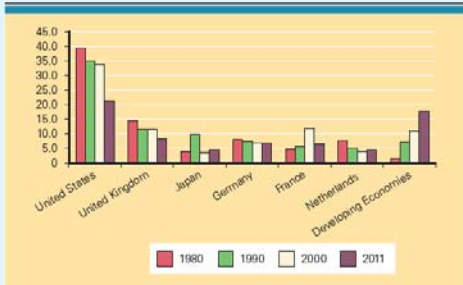
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## How Has Foreign Direct Investment Changed Over Time?

Percentage Share of Total FDI Stock 1980-2011



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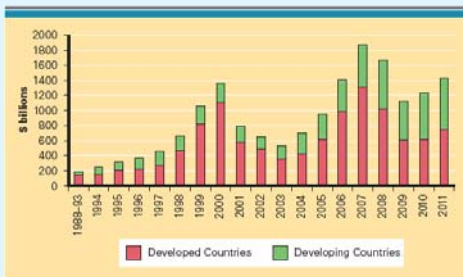
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## How Has Foreign Direct Investment Changed Over Time?

FDI Inflows 1988-2011



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## What Is A Multinational Enterprise?

- Multinational enterprise (MNE) - any business that has productive activities in two or more countries
- Since the 1960s
  - the number of non-U.S. multinationals has risen
  - the number of mini-multinationals has risen

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## The Changing World Order

- Many former Communist nations in Europe and Asia are now committed to democratic politics and free market economies
  - creates new opportunities for international businesses
  - but, there are signs of growing unrest and totalitarian tendencies in some countries
- China and Latin America are also moving toward greater free market reforms
  - between 1983 and 2010, FDI in China increased from less than \$2 billion to \$100 billion annually
  - but, China also has many new strong companies that could threaten Western firms

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## How will the Global Economy of the 21st Century Look?

- The world is moving toward a more global economic system...
- But globalization is not inevitable
  - there are signs of a retreat from liberal economic ideology in Russia and other countries
- Globalization brings risks
  - the financial crisis that swept through South East Asia in the late 1990s
  - the recent financial crisis that started in the U.S. in 2007-2008, and moved around the world

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## Is an Interdependent Global Economy a Good Thing?

- Supporters believe that increased trade and cross-border investment mean
  - lower prices for goods and services
  - greater economic growth
  - higher consumer income, and more jobs
- Critics worry that globalization will cause
  - job losses
  - environmental degradation
  - the cultural imperialism of global media and MNEs
- Anti-globalization protesters now regularly show up at most major meetings of global institutions and is a common element among populist-nationalistic-identitarian political parties.

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### How does Globalization Affect Jobs and Income?

- Critics argue that falling barriers to trade are destroying manufacturing jobs in advanced countries
- Supporters contend that the benefits of this trend outweigh the costs
  - countries will specialize in what they do most efficiently and trade for other goods—and all countries will benefit
- But now there is a new threat to human jobs: machines (robot)

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### How does Globalization affect Labor Policies and the Environment?

- Critics argue that firms avoid the cost of adhering to labor and environmental regulations by moving production to countries where such regulations do not exist, or are not enforced
- Supporters claim that tougher environmental and labor standards are associated with economic progress
  - as countries get richer from free trade, they implement tougher environmental and labor regulations

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### How Does Globalization Affect National Sovereignty?

- Is today's global economy shifting economic power away from national governments toward supranational organizations like the WTO, the EU, and the UN?
- Critics argue that unelected bureaucrats have the power to impose policies on the democratically elected governments of nation-states
- Supporters claim that the power of these organizations is limited to what nation-states agree to grant
  - the power of the organizations lies in their ability to get countries to agree to follow certain actions

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## How Is Globalization Affecting The World's Poor?

- Is the gap between rich nations and poor nations getting wider?
- Critics believe that if globalization was beneficial there should not be a divergence between rich and poor nations
- Supporters claim that the best way for the poor nations to improve their situation is to
  - reduce barriers to trade and investment
  - implement economic policies based on free market economies
  - receive debt forgiveness for debts incurred under totalitarian regimes

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### Globalization and Extreme Poverty

**Monetary Poverty**  
 Extreme poverty around the world has been reduced since 1820 if we control for population increase. In absolute terms it has continuously increased between 1820 and 1980. After it has reduced

**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
mil	866.8	1149.7	1175.7	1230.7	1342.6	1431.2	1183.2	1178.0	1175.1	931.3

Source: 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 (old estimates - 2005 PPP prices)**

	1981	1987	1993	1999	2005	2008	2010	2011
%	52.7	43.0	41.6	34.2	24.8	21.8	19.1	17.0
mil	1958.3	1798.6	1938.9	1751.2	1371.5	1255.4	1127.8	1010.4

Source: Chen e Ravallion (2008), WB (2010), WB (2013), WB (2014)

**World Poverty 1c: World population with less than 1.90 US\$ (PPP) per day (new estimates - 2011 PPP prices)**

	1990	1999	2011	2013	2015*
%	35.0	28.1	13.5	10.7	9.6
mil	1850.1	1692.9	946.3	766.6	702.1

\* = projection  
 Source: World Bank (2016), Coy, Foster, Quillin, Schallke (2015)

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## Globalization and Extreme Poverty

**Non-Monetary Poverty**  
 Continuous reduction in all regions

**World Poverty 2: Human Development Index for geographic areas (weighted average)**

	1870	1913	1950	1995
Australasia	0.539	0.784	0.856	0.933
North America	0.462	0.729	0.864	0.945
Western Europe	0.374	0.606	0.789	0.933
Eastern Europe		0.278	0.634	0.786
Latin America		0.236	0.442	0.802
Eastern Asia			0.306	0.746
China			0.159	0.650
Sourth Asia		0.055	0.166	0.449
Africa			0.181	0.435

Source: Crafts (2000)

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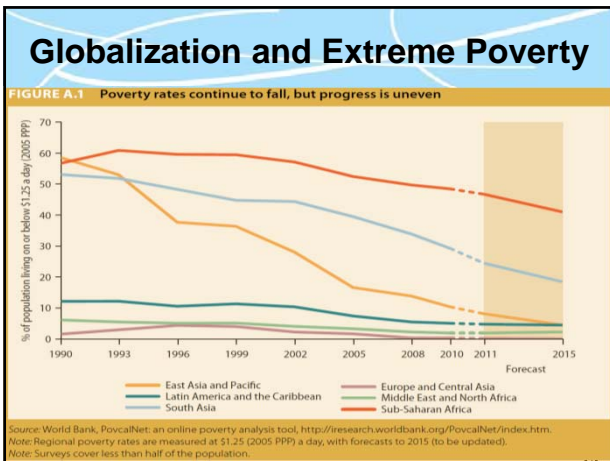
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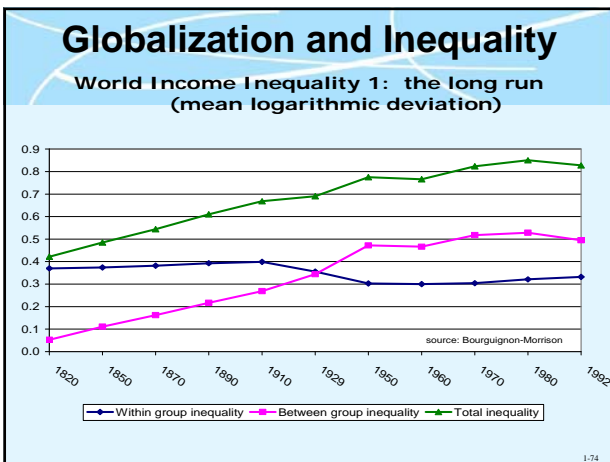
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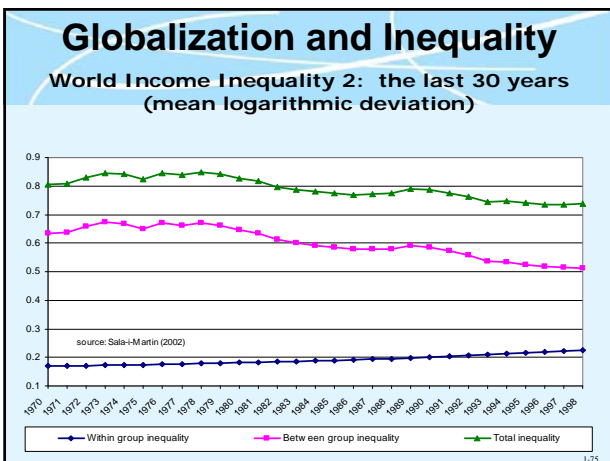
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## Global inequality: 1998 -2008

source: Milanovic, 2016

Figure 1. Cumulative real income growth between 1998 and 2008 at various percentiles of the global income distribution



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## The dynamics of globalization and health

See what the [BBC](#) produces

and also what the [IMF](#) has to say

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## How Does The Global Marketplace Affect Managers?

- 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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