DEVELOPMENTS IN THE GLOBAL ECONOMY

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5.1 The International Political Context

Post-World War II international relations were dominated by the 'cold war' between the world's two superpowers, the United States and the USSR. This east-west political divide led to a build up of military power and periodic tensions between the two sides. It also created two separate economic spheres, one where the United States traded mainly with its partners in Western Europe and Japan (sometimes known as the 'Triad'), the other where the USSR and its satellite states traded in the CMEA area that was largely cut off from the rest of the world. Most of the world's economic activity was dominated by the Triad, while the economies of the Soviet bloc gradually fell behind. Even in 2008 the Triad accounted for a significant share of world and foreign direct investment.

However, a number of other events have had a major impact on the international business environment since the 1980s. The collapse of communism in the Soviet bloc, at the end of 1989 in much of Eastern Europe and in 1991 in the USSR, brought about the end of the cold war. These events were accompanied by a wave of optimism as old enmities were forgotten and the 'iron curtain' between east and west was torn down. On 9th November 1989 the fall of the Berlin Wall, which had divided East and West Berlin since 1961, came to symbolise the reuniting of Eastern and Western Europe. The end of almost seventy-five years of communism in the USSR, or over forty years in most of Eastern Europe, would have been unimaginable only a few years earlier.

The period of optimism that followed the end of the cold war brought democracy to much of the former Soviet bloc, enthusiastically in Western Europe's closest neighbours such as Poland or the former Czechoslovakia, more reluctantly in many of the former Soviet republics like Belarus or Kazakhstan. The 1990s also witnessed a transition from state planned economies to market economies in this region. Most of the Central European states, as we now call them, and the three Baltic republics that were formerly part of the USSR have made relatively good progress and joined the EU in 2004. Most of the other former Soviet republics have made more faltering progress, though after a difficult initial transition in the 1990s the Russian economy grew much faster during the 2000s.

Even before the collapse of Soviet communism, China had already embarked on its policy of economic reform in 1978 after Deng Xiaoping came to power. China's 'economic revolution' has been more gradual than Central and Eastern Europe's, but its impact on international business has been more significant. Both these developments have led to the opening up of important regions of the world that had been largely closed to international business during most of the post-World War II years. The opening up of Central and Eastern Europe also brought political fragmentation and the creation of new states such as Slovakia and Slovenia. The new political map of the world is also changing the patterns of international business activity.

Along with these events, several East and Southeast Asian developing countries (formerly known as the 'tiger economies') have been expanding rapidly since the 1980s and 1990s, or earlier in the case of South Korea. In Vietnam's case, a communist country has achieved rapid economic growth by following China's example in introducing gradual market reforms. Economic development in Latin

America has been more fitful, though Mexico and Brazil have been attracting large amounts of foreign investment since the 1990s, along with Argentina until its financial crisis came to a head in December 2001. On the other hand, the world's least developed countries, many of them in Africa, have been lagging behind. These countries are not excluded from international business but they have been unable to enjoy many of the benefits in terms of their economic development.

The emerging economies of Central and Eastern Europe, Asia and Latin America, together with the renewed vitality of the US economy in the 1990s, all contributed to a massive growth in international trade and investment and an acceleration of the forces of globalization up to the year 2000. Optimism rarely lasts indefinitely, however. Even before globalization had apparently reached its peak, the chorus of 'anti-globalization' protestors was becoming more audible. Protest groups, from anti-capitalists to environmentalists and campaigners against Third World poverty, were berating multinational companies and rich nations for the perceived inequalities and injustices of the world trading system. This pessimism was soon accompanied by a slowdown in world economic growth and the collapse of 'new economy' share prices and businesses at the end of 2000 and beginning of 2001. World trade fell briefly in 2001 then quickly recovered. Foreign direct investment took longer to recover after falling in 2001-03 but gradually began to grow as investor confidence returned in 2004.

Pessimism took hold in earnest after the terrorist attacks of '9/11' (September 11th 2001). Despite the relative resilience of the world economy, 9/11 signified a growing divide between the Islamic and western worlds. Although most Muslims condemn the atrocities of 9/11, there has been increasing awareness of a rift between western and Muslim perceptions of the world. There was a measure of tolerance for the US-led retaliatory invasion of Afghanistan in October 2001, but Muslims were almost universally opposed to the invasion of Iraq in March 2003. The tensions that underlie these differences are deep-rooted, especially Muslim perceptions of the west's role in the failure to find a solution to the Palestinian question in the Middle East. The events that began with 9/11 have brought these tensions to the surface.

The period since the end of the cold war has given rise to two main alternative interpretations of world events: Francis Fukuyama's view of the 'end of history' and Samuel Huntington's 'clash of civilizations'. Fukuyama argues that democratic capitalism has triumphed and that successful states will gradually adopt this system, while Huntington is more sanguine about the difficulties that will accompany the resurgence of diverse civilizations. International business flourished under post-cold war optimism in the 1990s and has remained remarkably resilient during the tense years that followed 2001. Most of the indicators of international business activity have been healthy. National governments and international institutions have also been more supportive towards international business in recent years, though the regulatory environment has become more complicated. International relations are rarely straightforward, but the years since the end of the cold war have added new dimensions to our study of the international business environment.

5.2 Nature and Patterns of International Business Activity

5.2.1 The Location of Business Activity

For much of the latter half of the twentieth century international business activity was predominantly based in the Triad countries of North America, Western Europe and

Japan. At the beginning of the twenty-first century this is still broadly true, though the Triad are now being joined by some of the other East Asian countries, notably China and South Korea, and gradually by India and the larger Latin American countries, especially Brazil and Mexico. Most of these countries are developing countries, as can be seen by their GDP per capita in Table 5.1, but their economies are large.

Using the purchasing power parity method of measuring GDP, China, India, Brazil and Russia were among the ten largest economies in the world in 2008 (see table 5.1). However, it would be wrong to suggest that they have almost caught up with the world's leading economies as their economic wealth is consumed by large populations, leaving them well behind in terms of their standard of living. Nevertheless, as locations of economic activity, these countries are becoming increasingly significant. Given their generally faster rates of economic growth, they are also gradually converging with the richer economies. This is especially true in the case of China and, to a lesser extent India. Brazil has a large economy but has been growing more slowly and Russia has been recovering its position after a period of economic decline during most of the 1990s.

Until recently, much of the world's international business activity was located in North America, Western Europe and Japan. These countries are still the richest nations but their dominance is gradually being challenged by the emerging economies of Asia and Latin America.

Table 5.1: The World's Leading Economies, 2008

Rank	Country	GDP ppp basis ($ billion)	GDP current prices ($ billion)	GDP per capita ppp basis ($)	Annual Average GDP Growth Rates 1997-2006 (%)	
1	United States	14265	14265	46859	2.7	
2	China	7916	4402	5963	10.0	
3	Japan	4354	4924	34100	1.5	
4	India	3288	1210	2762	6.4	
5	Germany	2910	3668	35442	1.9	
6	Russia	2261	1677	15922	-3.8[a]	6.9[b]
7	United Kingdom	2231	2674	36523	2.4	
8	France	2130	2866	34208	1.9	
9	Brazil	1981	1573	9747	2.6	
10	Italy	1815	2314	30581	1.3	

Some of the above data are based on IMF estimates.

a. 1993-99 b. 2000-08

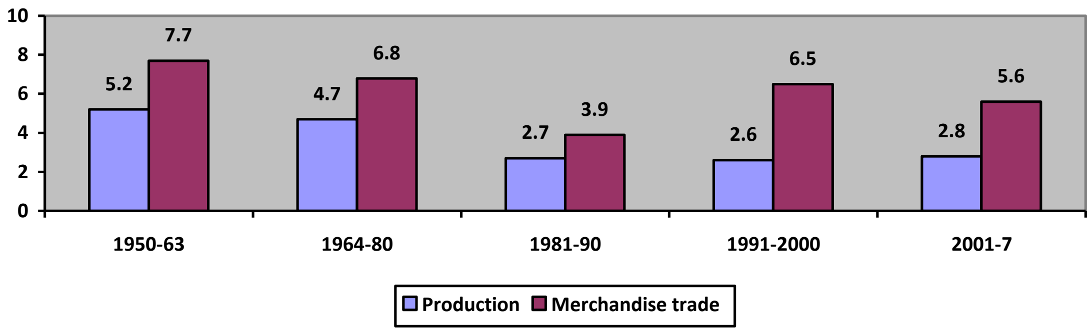
Source: IMF World Economic Outlook Database, April 2009

5.2.2 International Trade

For many centuries international trade has been the mainstay of cross-border business activity. In terms of the value of world exports and imports this is still true today, though international trade's share of international business activity has declined as foreign direct investment and other international market entry strategies have become more popular. Despite this, there has been a persistent increase in the proportion of world output traded internationally since the 1950s (see figure 5.1). Between 1950 and 1990 the rate of increase in trade was on average half as much again as the rate of increase in production. In the 1990s the increase in trade was about two and half times the increase in output and from 2001-07, despite the world slowdown in 2001, it was twice as much.

The increase in trade during the post-war years may be attributable to a period of relative peace and stability among the major trading nations, to a general reduction in trade barriers (encouraged by GATT and the World Trade Organization), and to the exchange rate stability and trade financing facilities of the IMF, among other factors. However, there was a marked increase in the proportion of goods traded after 1990. This corresponds with the opening up of China and Central and Eastern Europe, as well as the rapid development of information and communication technology which has largely eliminated distance as a barrier to international business. Indeed, it was about this time that the term 'globalization' started to come into widespread use.

Figure 5.1: World Production and Merchandise Exports, 1950-2007 (Average Annual Change in Volume, %)



Source: WTO International Trade Statistics 2008, table A1, p. 174

Table 5.2: World Merchandise Exports by Region and Selected Economy, 1948-2007

	1948	1953	1963	1973	1983	1993	2003	2007
	Exports ($ billion)							
World	59	84	157	579	1838	3675	7375	13619
	Share of World Exports (%)							
N. America	28.1	24.8	19.9	17.3	16.8	18.0	15.8	13.6
United States	21.7	18.8	14.9	12.3	11.2	12.6	9.8	8.5
S. & C. America	11.3	9.7	6.4	4.3	4.4	3.0	3.0	3.7
Europe	35.1	39.4	47.8	50.9	43.5	45.4	45.9	42.4
Germany[a]	1.4	5.3	9.3	11.6	9.2	10.3	10.2	9.7
CIS	-	-	-	-	-	1.5	2.6	3.7
Africa	7.3	6.5	5.7	4.8	4.5	2.5	2.4	3.1
Middle East	2.0	2.7	3.2	4.1	6.8	3.5	4.1	5.6
Asia	14.0	13.4	12.5	14.9	19.1	26.1	26.2	27.9
China	0.9	1.2	1.3	1.0	1.2	2.5	5.9	8.9
Japan	0.4	1.5	3.5	6.4	8.0	9.9	6.4	5.2

a. Federal Republic of Germany from 1948-83

Source: WTO International Trade Statistics 2008, table 1.6, p. 10

The relative importance of international trade to different countries and regions can be seen in Table 5.2, as well as the massive increase in the value of world exports since World War II. Although US exports have been increasing, its share of world exports has declined as Europe's and especially Asia's shares have increased. In Europe's case the growth reflects its post-war recovery and the success of the European Union in generating intra-EU trade. In Asia's case, the growth is a reflection of the rapid development of China and the South-East Asian tiger economies. It is also worth noting that international trade is still dominated by the North America and Europe, including some of the smaller European countries, though China continues to rise up the rankings (see table 5.3).

Table 5.3: Leading Exporters and Importers in World Merchandise Trade, 2007

Rank	Exporters	Value ($ bn)	Share (%)	Rank	Importers	Value ($ bn)	Share (%)
1	Germany	1326.4	9.5	1	United States	2020.4	14.2
2	China	1217.8	8.7	2	Germany	1058.6	7.4
3	United States	1162.5	8.3	3	China	956.0	6.7
4	Japan	712.8	5.1	4	Japan	621.1	4.4
5	France	553.4	4.0	5	United Kingdom	619.6	4.4
6	Netherlands	551.3	4.0	6	France	615.2	4.3
7	Italy	491.5	3.5	7	Italy	504.5	3.5
8	United Kingdom	437.8	3.1	8	Netherlands	491.6	3.5
9	Belgium	430.8	3.1	9	Belgium	413.2	2.9
10	Canada	419.0	3.0	10	Canada	389.6	2.7
	Extra-EU (27)	1697.8	16.4		Extra-EU (27)	1952.0	18.4

Source: WTO International Trade Statistics 2008, tables 1.8 and 1.9, pp. 12-13

Table 5.4: Leading Exporters and Importers in Commercial Services, 2007

Rank	Exporters	Value ($ bn)	Share (%)	Rank	Importers	Value ($ bn)	Share (%)
1	United States	456.4	13.9	1	United States	335.9	10.9
2	United Kingdom	273.0	8.3	2	Germany	250.5	8.1
3	Germany	205.8	6.3	3	United Kingdom	194.1	6.3
4	France	136.7	4.2	4	Japan	148.7	4.8
5	Spain	128.3	3.9	5	China	129.3	4.2
6	Japan	127.1	3.9	6	France	124.1	4.0
7	China	121.7	3.7	7	Italy	118.3	3.8
8	Italy	110.5	3.4	8	Spain	98.4	3.2
9	India	89.7	2.7	9	Ireland	94.5	3.1
10	Ireland	89.0	2.7	10	Netherlands	86.8	2.8
	Extra-EU (27)	667.2	27.7		Extra-EU (27)	544.9	24.0

Source: WTO International Trade Statistics 2008, tables 1.10 and 1.11, pp. 14-15

Broadly the same picture applies to trade in commercial services, though the ranking of countries is slightly different and the Triad have a larger share of world trade (see table 5.4). It is interesting to note that India, Spain, and Ireland appear among the top ten exporters of commercial services. India's recent development has been predominantly in the service sector, especially in IT services, Spain is a major player in tourism and financial services, and Ireland has attracted inward investment in financial and telecommunication services. It is perhaps surprising that international trade is still predominantly in merchandise goods rather than commercial services (see table 5.5), despite the developed countries' increasing reliance on services in their domestic economies. This is likely to change gradually in the next few years, though for the time being manufacturing and other merchandise trade remain an important component of most countries' balance of payments.

Table 5.5: World Exports of Merchandise Trade and Commercial Services, 2007

	Value ($ billion)	**Share (%)**
Merchandise trade	13950	80.9
Commercial services	3290	19.1

Source: WTO International Trade Statistics 2008, tables 1.8 and 1.10, pp. 12 and 14

Practical Insight: Changing Patterns of Trade

Despite the fact that multinational companies are increasingly using alternative modes of entry when venturing abroad, both the volume and value of international trade have grown significantly since the late 1940s. Trade has also been important for the world's rapidly growing economies in various parts of the world, from Ireland to Vietnam, and remains important for Germany and other leading economies.

Questions:

- Why do you think international trade has generally increased at a faster rate than world output throughout the post-war period (figure 5.1)?
- How would you explain the changes in Europe's share of world exports between 1948 and 2007 (table 5.2)?
- China has been rapidly climbing up the table of the world's leading exporters and importers of merchandise trade in recent years. What other countries would you expect to be following on behind (table 5.3)? Try checking the latest edition of the WTO International Trade Statistics to verify your answer.
- Why do you think the United States now has a larger share of exports of commercial services than of merchandise trade (tables 5.3 and 5.4)?
- Why do you think the value of world merchandise trade still far outweighs trade in commercial services, despite services representing a larger share of the economies of most of the major trading nations (table 5.5)?

5.2.3 Foreign Direct Investment

Foreign direct investment (FDI) is by no means a new international business activity, but it has become much more prominent in recent years. This has been especially true since 1990. As table 5.6 illustrates, the cumulative world stock of FDI increased dramatically from 1990-2007. Whilst the rate of growth of international trade also accelerated during the 1990s, the growth of FDI might be described as an 'explosion'. The world economic slowdown in 2001 led to a significant decline in FDI flows from 2001-03, but a steep recovery had occurred by 2007. The slowdown affected FDI more than trade, probably because decisions to invest abroad have longer term implications and are influenced by investor confidence which was badly damaged after the events of 9/11. This effect is likely to be mirrored during the 2008-9 world recession when figures become available. However, the decline in FDI in the early 2000s was more marked in the developed countries than in the developing countries, where it recovered more quickly.

Multinational companies have been locating their activities abroad at an unprecedented rate in recent years. FDI involves the establishment or acquisition of production or other facilities in a foreign country over which the investing firm has some degree of control. It may involve a greenfield investment, a take-over, or partial equity ownership in a joint-venture. ‘Control’ is what distinguishes direct investment from portfolio investment (discussed in section 5.2.4 below), though control is sometimes defined as an equity stake as low as 10 per cent. For a variety of reasons multinational companies have been wanting greater control over their foreign operations rather than simply exporting at a distance. At first sight, this seems surprising at a time when technology is reducing the impact of distance. However, it makes more sense when we consider the increasing importance attached to knowledge of local markets and culture and the global aspirations of many companies.

Table 5.6: World FDI Stock, 1990-2007
($ billions)

	FDI Inward Stock			**FDI Outward Stock**		
	1990	**2000**	**2007**	**1990**	**2000**	**2007**
World	1941	5787	15211	1785	6148	15602
Developed economies	1413	3988	10459	1640	5265	13042
European Union	762	2190	6882	810	3051	8086
France	98	260	1026	112	445	1399
Germany	111	272	630	152	542	1236
United Kingdom	204	439	1348	229	898	1705
Japan	10	50	133	201	278	543
United States	395	1257	2093	431	1316	2791
Developing economies	529	1738	2707	145	862	2288
Asia	357	1079	1279	67	613	1722
China	21	193	327	4	28	96
India	2	18	76	-	2	29
Latin America & Car.	111	503	1140	58	205	493
Brazil	37	122	328	41	52	130
Mexico	22	97	266	3	8	45
Africa	59	153	393	20	44	73
South Africa	9	43	93	15	32	55
CIS	-	55	434	-	20	268
Russia	-	32	324	-	20	255

Source: UNCTAD World Investment Report, 2008, Annex Table B.2, pp. 257-60

It is clear from Table 5.6 that most FDI is undertaken by the developed countries (84 per cent of FDI stock up to 2007) and that most FDI goes into developed countries (69 per cent of FDI stock up to 2007). Among individual countries, the United States, United Kingdom, France, Germany, and Japan have been the leading outward investors, though Japanese investment has fallen well behind the others in recent years. With the exception of Japan, they have also been the main recipients of inward investment, though China, Brazil, and Mexico have been closing the gap. FDI flows are gradually being attracted to the emerging economies of Asia and Latin America, but the majority of FDI has flowed from one developed country to another. However, the figures for FDI stock mask a slightly more significant shift in the annual flow of FDI into the developing countries which reached 27 per cent of total FDI flows in 2007.

FDI is an indicator of the level of multinational production and service operations around the world. Until recently, these multinational operations were predominantly in the manufacturing sector, especially in the electronics, motor manufacturing, and oil industries. Companies like General Electric, Toyota, and BP still rank among the world's largest multinational companies, but they are increasingly being joined by companies such as Vodaphone, Wal-Mart Stores, and Citigroup in the telecommunications, retail, and financial services industries. Even more than international trade, FDI seems to symbolize the interconnectedness of the global economy and the important role played by multinational companies.

Practical Insight: China's FDI

Table 5.6 clearly indicates the huge growth of inward FDI in China since 1990. Whilst outward FDI is still much lower, as in most of the developing countries, the rate of increase of China's outward FDI has been significant during this period. Much of the inward investment has been in manufacturing industries and some of China's indigenous companies have also grown rapidly in recent years. One of the main reasons for the growth in outward investment has been cross-border mergers and acquisitions, including Nanjing Automobile Group's acquisition of the UK's MG Rover from BMW in 2005. However, the vast financial surpluses generated by China's rapid export growth have also facilitated large investments in the property market in other Asian countries, in natural resources and infrastructure projects throughout Africa, and increasingly in Latin America's natural resource industries.

Questions:
What are the implications of the increase in Chinese investment in Africa, Asia, and Latin America for China's role in the world economy?

Despite its importance, the measurement of FDI is notoriously difficult. Whilst the overall scale of FDI is clearly evident, even the most authoritative figures may sometimes be misleading. FDI figures are taken from national balance of payments accounts and are converted into US dollars at the prevailing exchange rate. It involves the ownership of equity capital in a foreign operation, but it also includes the international transfer of funds within multinational companies as well as profit made and reinvested in foreign operations. The treatment of these components leads to a variety of interpretations of the scale of a particular firm or country's FDI. In addition, the 10 per cent minimum definition of control used in the World Investment Report is not applied uniformly by every country. The result is that the value of FDI flowing between two countries may be reported quite differently by each country involved. For example, FDI flows into China in 2002 were reported as $21.8 billion by the major investing countries but $31.0 billion by China itself. This problem also accounts for the discrepancies between inward and outward stocks in Table 5.6. Worldwide inward and outward investments should of course be equal as the same investment leaves one country and enters another, but this is rarely the case in the recorded statistics. Notwithstanding the measurement problems, however, there has clearly been a significant increase in the importance of FDI since 1990. Nowhere has this been more evident than in China.

5.3 Regional integration

An important feature of the international business environment in recent years has been the development of regional economic groupings in many parts of the world. By far the most integrated grouping is the European Union, which has not only expanded to include twenty-seven countries, but has also developed an extensive range of policies and a high level of policy coordination. Other well-established regional groupings include the North American Free Trade Agreement (NAFTA), the Association of South East Asian Nations (ASEAN), and the Common Market of the South (Mercosur) in South America. A large number of other groupings also exist in most regions of the world. Extensive discussion of regional integration in Europe, the Americas, Asia, and Africa can be found in the four geopolitical chapters in Part 3 (see sections 13.2, 14.3, 14.4, 15.5, and 16.2). Regional integration normally involves cooperation and trade within a group of neighbouring countries, but the type or level of integration varies considerably. The main levels of regional integration are now considered in turn (see also figure 5.2).

- Preferential trading agreement (PTA) – This is an agreement allowing preferential access for the exports of a particular country or group of countries. Typically, this type of agreement enables developing countries to sell their goods in the markets of developed countries. The most widely used form of PTA is the Generalized System of Preferences (GSP), which is a scheme operated under the auspices of the WTO by the EU, United States, and several other countries, granting reduced tariffs and other preferential arrangements to the products of a large number of developing countries. Other PTAs include the Cotonou agreement between the EU and the African, Caribbean, and Pacific (ACP) group, and the US African Growth and Opportunity Act (AGOA).

- Free trade area – This is the first level of more formal regional integration, involving a tariff-free area between a group of countries. Other barriers such as quotas are also likely to be eliminated. This type of integration forms the basis of NAFTA, ASEAN, and the recently formed Africa Free Trade Zone (AFTZ), for example – though free trade is a more distant prospect in the case of the AFTZ. The EU is also a free trade area, though it is much more than this. The most ambitious attempt to create a free trade area is being made by Asia Pacific Economic Cooperation (APEC), which is made up of a diverse group of countries around the Pacific rim, though progress to date has been limited. APEC is a loose grouping, including the United States, China, Russia, and a number of smaller countries, which aims to achieve free trade by 2010 and 2020 for its developed and developing member countries respectively.

- Customs union – The next level of integration combines a free trade area with a common external tariff. This means that the member countries forego the right to set their own national tariffs, but it avoids the problem of importers trying to find the lowest-tariff entry point into the trading area. Customs unions normally have arrangements to share the tariff revenues. This requires them to establish more formal institutional processes. Examples of customs unions include the EU, Mercosur, and the Caribbean Community (Caricom), though in each case steps have been taken to progress to higher or deeper levels of integration.

- Common market – This was the term used by the European Economic Community (EEC) before it became known as the EU to describe its original economic aim and was widely used to describe the EEC as a whole in its early years. However, it is also the textbook name for the next level of integration. It incorporates a customs union as well as the free movement of goods, services, people, and capital (the *four freedoms*). It therefore goes beyond the removal of tariffs and quotas to tackle non-tariff barriers such as restrictions on the supply of services, the failure to recognize qualifications, or restrictions on foreign ownership. Mercosur, Caricom, and the African Union have all been attempting to create a common market, with varying degrees of success, but the most extensive common market has been achieved by the EU. The European single or internal market, as it is known, has created something approaching a common market, though complete free movement has proved difficult to achieve when there are significant economic and cultural differences between countries.

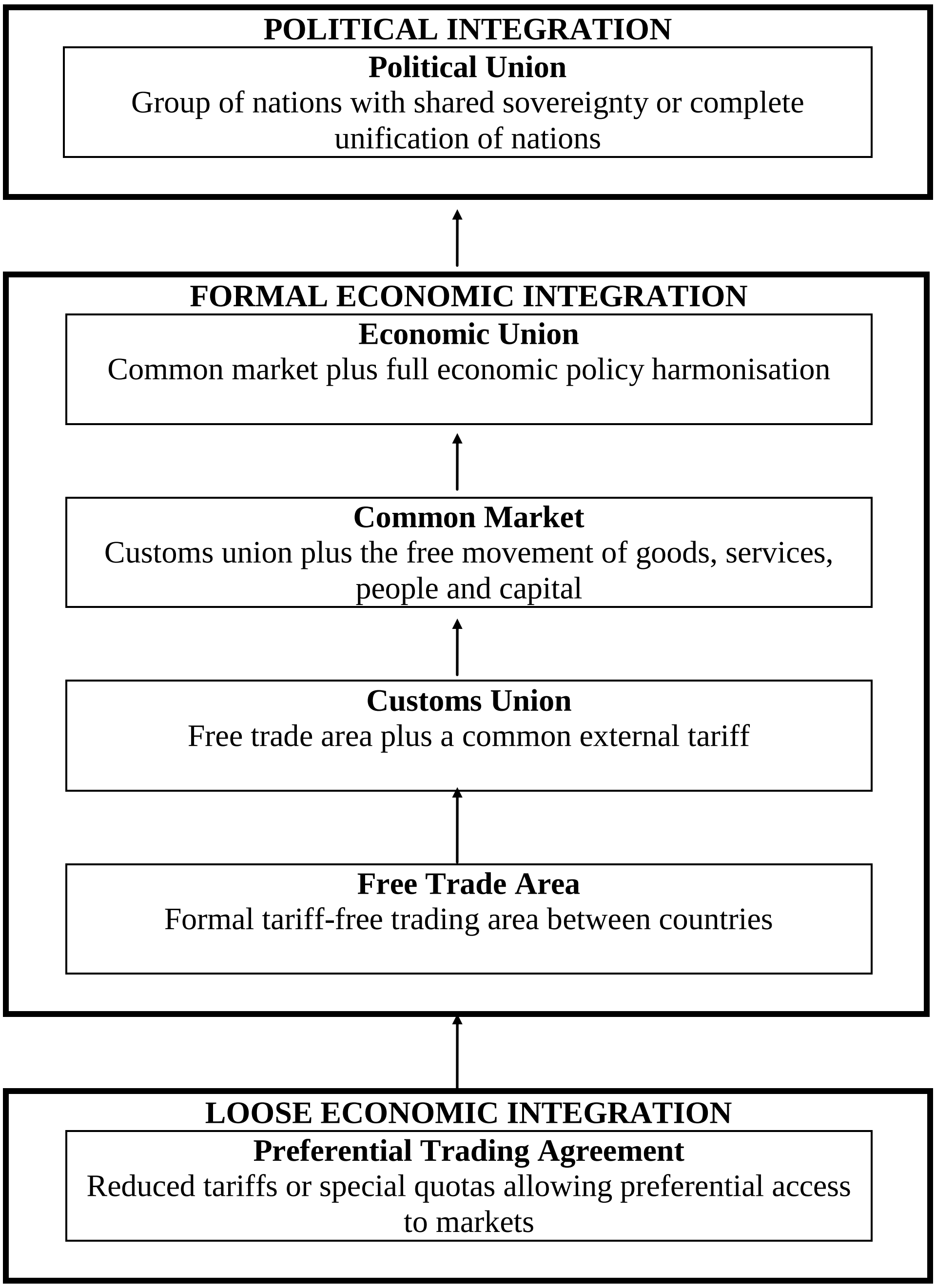
- Economic union – This is the most comprehensive level of economic integration between a group of independent nations. It involves a common market and the harmonization of economic policies. The EU is the closest example of an economic union, having a number of common policies, but it has only achieved a partial monetary union (a subset of economic union) and has not yet achieved tax harmonization, among other things. A higher degree of political integration is also required as a regional grouping progresses to the higher levels of economic integration.

- Political union – Complete political union would involve the unification of one or more formerly independent states, such as the unification of East and West Germany in October 1990. However, in the context of regional integration, it is more likely to involve close political coordination supported by a unified decision-making structure.

The primary purpose of regional integration is to achieve economic benefits. The potential benefits include a combination of static and dynamic effects. Static effects are those which create once-for-all benefits. Dynamic effects are those which create recurring benefits. Static effects of regional integration include the cost savings and other benefits that result from the removal of border controls, the simplification of trade documentation, and the adoption of harmonized standards, as well as the economies of scale and changing patterns of trade that arise in a large barrier-free market.

Changing trade patterns include *trade creation*, involving new trade previously prevented by trade barriers, and *trade diversion*, where trade is diverted from countries outside the trading area to countries inside. If the level of external trade barriers is no higher than it was for each individual country before integration occurred, the trade effects will generally be positive, allowing goods and services to be sourced from the most efficient producers. Dynamic effects include the way in which competitive pressures cause price reductions and stimulate efficiency, innovation, and overall economic growth in a large internal market. Efficiency applies not only to production methods, work practices, and competitive sourcing at the level of the firm, but also to the way in which industrial reorganization occurs through mergers, alliances, and other market entry strategies.

Figure 5.2: Levels of integration between countries



Source: Harrison, A., Dalkiran, E., and Elsey, E. (2000), International Business, Figure 7.1, p.150

It should be noted, however, that these benefits are likely to be greater where there is a high level of integration, where the countries concerned have similar economic and political structures, and where goods, capital, and labour markets operate flexibly enough to enable the necessary adjustment processes to work effectively.

Practical Insight 5.6: A Trans-Pacific Free Trade Area

APEC Member Countries

Australia	Indonesia	Papua New Guinea	South Korea
Brunei	Japan	Peru	Taiwan
Canada	Malaysia	Philippines	Thailand
Chile	Mexico	Russia	United States
China	New Zealand	Singapore	Vietnam
Hong Kong			

Asia Pacific Economic Cooperation (APEC) is a loose grouping of Pacific-rim countries. Although not a formal regional economic grouping like the EU or NAFTA, it is nevertheless attempting to create free trade and investment by the years 2010 and 2020 for its developed and developing economy members respectively. However, this is no mean task given the diversity of its members' economies and political systems. A number of APEC countries have been trying to speed up the integration process and a Trans-Pacific Strategic Economic Partnership Agreement was signed by four APEC members, Brunei, Chile, New Zealand, and Singapore in 2005. By the end of 2008, Australia, Japan, Peru, Vietnam, and notably the United States had expressed an interest in joining this group to create a Trans-Pacific free trade area. Other members may follow suit. If successful, this free trade area will be unique in including developed and developing countries in Asia, Oceania, and both North and South America. There is clearly a desire for more open trade among APEC members, but the practical difficulties will be considerable.

Questions: To what extent is a Trans-Pacific free trade area likely to bring mutual benefits for APEC member countries? Do you think trade agreements of this type are a useful stepping stone or a hindrance to global free trade?

2.1 Globalization as a Process

Globalization describes a process, not a completed state. It implies that the world is 'globalizing', not necessarily that it is fully 'globalized', though descriptions such as the 'global village' suggest that, in some respects, the process has been completed. So what does this process involve? It is probably more accurate to describe it as a set of interrelated processes rather than a single process. At its core, there is what the New York Times journalist and author, Thomas Friedman, calls a 'flattening' process. According to Friedman, the world is being flattened in the sense that technology is creating a 'flat' or level playing field by allowing developing countries like China and India to become participants in international business on a par with the richer developed countries. This view implies that all countries could potentially participate in globalization, though in practice a number of obstacles may prevent this.

The idea that globalization involves the removal of barriers between countries is widely held. In a purely economic sense, a barrier-free world economy is effectively a world of free trade or laissez-faire as it was described in the nineteenth century. In this sense, the concept is not new, though the fact that free trade has gone further than before, both in volume terms and in its geographical spread, makes it different in degree at least. The idea of a borderless world can be extended to include the breaking down of political, social, and cultural borders, allowing the international movement of people, policies, ideas, customs, and beliefs and making nation states more interdependent in a political as well as an economic sense.

Globalization also seems to imply that the whole world is becoming involved in this process, for example that business activity is becoming 'global', with global resources being used by global companies that sell their products in global markets. This picture of globalization is of course exaggerated, as many companies and markets are not global, though resources seem to possess more of the characteristics of a global economy. This is especially true of capital, which flows apparently seamlessly from one country to another. Even bulk raw materials like coal or oil can easily being transported around the world at relatively low cost. People can also be transported quickly and easily and do so in large numbers for business and pleasure, though international labour migration is proportionately less today than it was in the latter half of the nineteenth century when many Europeans were emigrating to the 'new world'.

Another aspect of globalization is the growth of supranational activities, especially through organizations such as the United Nations, International Monetary Fund (IMF), World Bank, and World Trade Organization (WTO). In this respect, globalization seems to be at least partially replacing 'territorialism' and the sovereignty of the nation state, with increasing political and social connections between states and their people.[6] Sometimes this argument is extended to suggest that nations have limited power in a globalizing world, particularly smaller states, and that multinational companies wield the real power. Comparisons between the worldwide turnover of some of the world's largest multinational companies and many countries' GDP seem to support this argument, but in the main the influence of companies is in a more limited sphere of activity than that of countries (commercial activities rather than defence, law and order, education, etc.).

Underlying many of these features of globalization is technological change. This is particularly true of information and communication technology. The widespread use of personal computers, the Windows operating system, and standard business software packages, coupled with the development of the internet and the worldwide web, has enabled businesses and individuals to communicate and share information across the world. It has increased the connections between different parts of the world, making the world appear smaller (reinforcing the concept of the global village). This characteristic of globalization has been described as the 'death of distance', implying that distance or spatial separation no longer has any significance when conducting business or personal affairs.[7] Whilst this is largely true in relation to communication and information flows, it does not necessarily apply to all areas of business or personal activity. For example, where face-to-face contact is required, as in conventional retailing, or physical goods have to be transported, distance and location still matter. There may also be a number of other reasons why proximity to the customer is important, including the need for cultural awareness. Nevertheless, technology has allowed us to overcome many of the barriers that distance used to present.

2.2 Drivers of Globalization

The search to identify the forces driving globalization has exercised many minds since the early 1990s. To some extent, our view of globalization will influence the priority we attach to particular drivers. A broad view of globalization as a set of political, economic, and social processes might lead to the conclusion reached by the sociologist, Anthony Giddens, that globalization is an inevitable consequence of the historical processes of modernization in contemporary society. In what follows we view globalization as essentially an economic process, though one which is driven by political and technological as well as economic forces. We also recognize that it is a complex set of processes involving many poorly understood interactions and feedback mechanisms, and that economic processes may have far-reaching political and social consequences. A popular view is that multinational companies are the main drivers of globalization, though most analysts consider that these companies are responding to global forces rather than driving them. Broadly speaking, the key drivers of globalization are political, technological, and economic drivers, though the economic drivers are separated into their main components in the following subsections.

2.2.1 Political Drivers

Numerous political forces are at work in the modern world. One of the most important is the relative peace and security that has existed in much of the world since 1945. Of course, there have been many localized wars during this period, which is no doubt a reason why some of the world's poorest countries remain relatively isolated from globalization. Among the major trading nations, however, peace and security has brought opportunities to do business with much of the world in a relatively safe environment. There is nothing like good international relations for promoting economic prosperity. The opening up of China and the countries of the former Soviet bloc has also been a significant driver of trade and investment between regions formerly closed to each other. It is reassuring to note that the fall of the Berlin Wall, which symbolized the end of communism in eastern Europe, took place on 9th November 1989 – 11/9, signifying the dawn of a new era after the end of the 'cold war' – in contrast to 9/11 (11th September 2001), the date of the Al-Qaeda attacks in New York, Washington, and Pennsylvania. A number of transnational and supranational organizations may also be regarded as helping to drive globalization. The former category includes a large number of regional groupings such as the European Union (EU) or North American Free Trade Agreement (NAFTA), which promote integration within regions though arguably at the expense of inter-regional integration; the latter includes organizations such as the IMF or WTO.

2.2.2 Technological Drivers

Some people regard technology as the main driver of globalization. Certainly its impact is all-pervasive, from the alarm clock that wakes us up in the morning to the car we drive to work, the computers we use at work, and the automatic timer that switches on the oven for our evening meal. Technology has numerous applications, but information and communication technology almost certainly has the most widespread implications, allowing worldwide communication, information sharing, and the operation and control of remote activities (including outsourcing and offshoring). Above all the microprocessor, facilitating the development of ever more powerful computers, and the internet, enabling global communication and the creation of the worldwide web, have been of enormous significance. The establishment of a network such as the internet involves high initial fixed costs, but additional users, both businesses and consumers, incur falling variable costs as the network size increases. These increasing returns to scale create huge benefits, known as network externalities, as the network expands.

2.2.3 Economic Liberalization

One of the features modern globalization has in common with earlier periods of internationalization, especially in the late nineteenth century, is greater economic openness or free trade. Economic liberalization, in its modern form, usually describes internal economic reform such as deregulation and privatization and the removal of barriers to trade in services as well as the more conventional view of free trade as the removal of tariffs on physical imports. Economic liberalization has come about as a result of the following: the succession of trade rounds since 1948 under the General Agreement on Tariffs and Trade (GATT), incorporated into the policies of the WTO from 1995, which have brought a gradual reduction in trade barriers between the main trading nations; the revival of free market policies under Margaret Thatcher in the UK (1979-90) and Ronald Reagan in the USA (1981-89), supported by renewed interest in free market economics generally and the adoption of a free market approach by the IMF and, to a lesser extent, the World Bank (the so-called Washington consensus) during the 1980s and 1990s; and the apparent triumph of free market capitalism after the collapse of communist central planning in the Soviet bloc in 1989-91, together with China's gradual but growing success in its experimentation with free market economics after 1978. Each of these events was of course politically driven, but the forces unleashed were undoubtedly economic. In effect, economic liberalization enables a business to take advantage of resources outside its traditional industrial or geographical boundaries, facilitating a global reallocation of resources.

2.2.4 Market Drivers

As domestic sales growth in the more developed countries slows down or these markets become saturated, businesses increasingly rely on international markets to allow continued expansion. Rising income in international markets will inevitably encourage this expansion. Two of the world's most rapidly growing markets are China and India, though companies were initially attracted to these countries by the ready supply of low-cost skilled labour. World population growth may also be a significant factor in the growth of world markets. World population more than doubled from 3 billion in 1960 to 6.8 billion in 2009, though the rate of growth is now slowing down. More specifically, proximity to markets seems to have become the most important driver of foreign direct investment, one of the key components of economic globalization. A joint-venture or alliance with a foreign partner provides an alternative method of entry into a foreign market. This suggests that, despite the distance-reducing effects of globalization, location is still important.

2.2.5 Cost Drivers

The increased openness of the world economy exposes the differences in resource costs in different countries. This allows companies to search for lower costs, either by purchasing raw materials or components abroad, relocating a production process or service operation abroad, or outsourcing some of its activities abroad.

Internationalization also enables a firm to take advantage of economies of scale, with the larger international market allowing increased scale of operations, hence lower average production costs. This is especially important in industries like motor manufacturing where product development costs are high. This helps to account for the large number of alliances in the car industry, where companies share common production platforms, research and development costs, and purchasing and distribution costs.

2.2.6 Competition Drivers

International competition also drives cost reductions, but its impact is more far-reaching, prompting improvements in quality, efficiency, and productivity in all aspects of a firm's activities. The need to be internationally competitive, even in the home market, increases as international barriers come down and the world's economies become more interdependent. Competitive pressures may not have initiated the process of globalization, but they undoubtedly drive companies to become more international in order to be internationally competitive. The drive to create internationally competitive products and services through differentiation is a powerful force. Even smaller companies can engage in this kind of specialized competition, helping to dispel the idea that only large multinational companies can be successful in international markets.

2.3 Globalization and the Changing World Order

Globalization is connecting the world's economies, but countries do not of course play an equal role in this process. Throughout much of the period since 1945, international business activity has been dominated by the Triad: North America, Western Europe, and Japan. The relative importance of these economies has changed over time, but even today the Triad account for just over half of world merchandise exports, almost two thirds of world exports of commercial services, and just over 80 percent of world FDI outflows. The dominant position of the Triad in world economic activity is gradually declining, but it would premature to suggest that these countries are no longer important. What is clear, however, is that countries like China and India are becoming gradually more important in the world economy. In 2001, Goldman Sachs coined the term 'BRICs' to describe the world's four largest emerging economies, Brazil, Russia, India, and China. These economies have all been growing rapidly and, in a subsequent paper, Goldman Sachs estimated that by 2039 the BRIC economies may have overtaken the G6 (France, Germany, Italy, Japan, UK, and USA) and that by 2050 they were likely to be the world's largest group of economies by a considerable margin.

Of course, these projections depend on the BRICs' ability to sustain something like their recent economic growth performance for the next thirty or forty years, but even if the projections are optimistic, there is likely to be change in the balance of economic power during the first half of the twenty-first century. Arguably, China is already beginning to assume a more prominent role, having become the world's second largest economy on a purchasing power parity basis (see section 4.1) and second largest exporter of merchandise goods, and having survived the 2008-9 world recession in a stronger economic and financial position than any of the Triad countries. Other countries beyond the BRICs could also be considered to be potential economic leaders of the future. Goldman Sachs have proposed a further list of eleven large emerging economies with growth potential, described as the Next Eleven (N-11), though apart from South Korea and Mexico, these countries are generally less developed. It should also be recognized that most of these economies, including the BRICs, although large, will have considerably lower GDP per capita than the Triad even in 2050.

The world political order has been somewhat different. The post-war settlement left the world divided between the North Atlantic Treaty Alliance (NATO), led by the United States, and the Warsaw Pact countries, led by the USSR. This bi-polar world order continued until the collapse of the Soviet Union in 1991. Since then, the United States has been dominant politically and militarily. For the United States, political power has been reinforced by economic power, but this was not the case with the Soviet Union, whose economic power was largely confined to the group of countries in its own sphere of influence, mainly in Central and Eastern Europe. Since 1991, not only has the United States confirmed its political and economic position, but some of the countries formerly under Soviet influence have joined NATO and the European Union. Whilst NATO's role is now less clear than it was during the cold war, the EU has become a powerful economic force alongside the United States. This is not, however, true to the same extent in the political sphere, except perhaps in relation to their influence over trade policy at the WTO.

Fig 1: The Changing World Order: An Emerging Scenario

Key Dates	**Global Governance: Key International Institutions**	**Political Power: Key Countries and Groupings**	**Economic Power: Key Countries and Groupings**
1945 End of World War II	United Nations, IMF, World Bank G7 (1975/76)	Bipolar world: USA (Nato), USSR (Warsaw Pact)	Triad: N. America, W. Europe, Japan
1991 End of the 'Cold War'	United Nations, IMF, World Bank, WTO (1995) G7/G8 (1997) G20 (1999)	Unipolar world: USA	USA, EU, Japan
2010 Recovery from world Recession	United Nations, IMF, World Bank, G20 G7/G8?	USA (end of unipolar world?) Growing influence of China (and BRIC?)	USA, EU, China, Japan
2050 A new order?	New institutional arrangements?	Multipular world: USA, China, India (?), Russia (?), Brazil (?), Others (?)	China/BRICs, USA, EU, Japan (?), Others?

How long the US unipolar world order will continue is uncertain. It is clear that China is now becoming a significant economic power and, despite its current reluctance to play a global role comparable to that of the United States, it is likely that Chinese political influence will gradually increase over the coming years. The extent to which China will be joined by the other BRIC countries or other emerging economies to create a multi-polar world order is less clear. What is clearer, however, is that the world political and economic order is likely to change significantly during the next few decades. This has potentially huge implications for international economic activity, the policies of the major international institutions, and the relative importance of different regions of the world.

2.4 Global Governance and the Need for International Regulation

The immediate post-World War II years heralded a move towards multilateralism in world political and economic affairs. The League of Nations, an earlier attempt to establish a framework for multinational co-operation and security, had failed to prevent World War II, but renewed efforts were made after the devastation of two world wars in less than half a century. The United Nations (UN) was formed in 1945 and the International Monetary Fund (IMF) and International Bank for Reconstruction and Development (now part of the World Bank Group) came into operation in 1946. Multilateral co-operation on trade began with the General Agreement on Tariffs and Trade (GATT), which came into effect in 1948, and a variety of other international organizations were set up during the early post-war years, most notably the Council of Europe in 1949 and the European Coal and Steel Community in 1951 (which led to the formation of the European Economic Community, now known as the EU, in 1957).

Multilateralism has become more established in recent years, reinforced by the belief that international problems require international rules enforced by international authorities. This system of global governance, as it is sometimes known, is not without its critics, both because of its inability to enforce compliance when individual countries flout its rules and because of the alleged unfairness of the rules themselves. This is a particular concern in the area of trade policy, which now comes under the remit of the World Trade Organization (WTO). The WTO, IMF, and World Bank, are discussed in more detail below.

2.4.1 The World Trade Organization

The WTO has its origins in the General Agreement on Tariffs and Trade. GATT was an attempt by some of the developed countries to encourage free trade by lowering the level of tariffs on industrial goods and the general level of tariffs has been significantly reduced since the 1940s. GATT operated through a series of trade rounds or negotiations, the last completed round being the Uruguay Round (1986-94). The Uruguay Round led to a reduction in tariffs on industrial goods in developed countries from an average of 6.3 to 3.8 per cent. It also included negotiations on agricultural products for the first time. Sometimes member countries slip back on their commitment to reduce trade barriers and there has also been a tendency to rely on non-tariff barriers such as product regulations in place of tariffs. The most important outcome of the Uruguay Round was the establishment of the WTO in January 1995. This has formalized the process of multilateral trade negotiations and strengthened the disputes procedure when things go wrong.

As well as GATT, which continues to be one of the agreements managed by the WTO, there is also a General Agreement on Trade in Services (GATS), an agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), and an agreement on Trade-Related Investment Measures (TRIMS). The GATS framework was agreed during the Uruguay Round, but subsequent agreement has been reached by a number of member countries, though not all, on the liberalization of telecommunications and financial services. Although merchandise goods still dominate international trade, access to international service sectors is becoming an important issue. Less progress has been made on intellectual property rights, including patents, copyright, trademarks, and geographical indications (names linking a product to a place such as Champagne or Scotch). The TRIMS agreement is designed to prevent investment rules, such as local content requirements, being used to circumvent trade rules.

In each of these areas, the WTO applies a number of important trade principles:

- trade *without discrimination*, including the most favoured nation (MFN) principle, whereby every WTO member is expected to treat all other members in the same way as it treats its most favoured partner, and equal national treatment of foreign and local products, services, and people;
- gradual movement towards *freer trade* through negotiation;
- binding and transparent trade agreements that are *predictable*;
- a *more competitive* trading system without distorting subsidies or dumping (selling exports below cost in order to gain market share); and
- a trading system which is *more beneficial for less developed countries*.

There are inevitably some exceptions to these principles, most notably the recognition of regional economic groupings like the EU as well as many bilateral agreements between individual countries or groups of countries. However, preferential trading agreements that provide favourable market access to developing countries are covered by the final principle above; these include arrangements such as the generalized system of preferences (GSP) or the Cotonou Agreement between the EU and the African, Caribbean, and Pacific (ACP) group of countries.

Although dominated by the large developed countries, the WTO had 153 members in July 2008, including many developing countries. After almost fifteen years of negotiations, China was finally admitted to the WTO in December 2001. This marked a major step towards the WTO becoming a global institution, though China's reluctance to remove obstacles to its domestic market made WTO entry negotiations a tortuous process. The developing member countries are increasingly exerting their influence over trade negotiations and the latest trade round, the Doha Round, has a strong focus on what is known as the Doha Development Agenda. The Doha Round began in Qatar in November 2001 and was originally supposed to be completed by 1st January 2005, but tensions between the developed and developing countries have brought progress virtually to a halt. The developing countries had experienced difficulties in implementing agreements on agricultural tariffs made under the Uruguay Round, but a major stumbling block under the Doha Round has been the reluctance of the EU and United States to reduce their agricultural support policies. These policies have restricted access to the world's largest internal markets and, more controversially, have sometimes distorted international trade through the use of export subsidies. Progress will depend on the willingness of both sides to reduce their long-established dependence on agricultural protection.

The fact that almost three quarters of the world's nations belong to the WTO suggests there is broad support for free trade, or at least the necessity of gaining access to other countries' markets. The WTO also requires commitment to a rule-based multinational trading system. Sometimes the rules are broken or tested to the limit, as when the EU defended its preferential treatment of Caribbean bananas from

1995-99 or when the United States resisted attempts to remove its emergency steel tariffs from 2002-03 (see Practical Insight 2.3). On the whole, the multinational trading system has helped to open the world's markets to freer competition, though often painfully slowly. However, the actions of many of the WTO members suggest an ambivalent attitude towards free trade, supporting the ideal but often resisting the removal of their own trade barriers with an apparently unshakable belief that protection is normally in their national interests, despite frequent evidence to the contrary.

The WTO has come under increasing criticism for its stance on free trade. Critics argue that the organization is controlled by the developed countries, whose interests and those of the major multinational companies tend to dominate its policy agenda. Whereas free trade may be good for the mature developed economies, some form of import protection may be necessary for the weaker economies of the developing countries, an issue that is discussed at greater length in section 5.4.1. A more serious criticism is that the developed countries do not always practice what they preach. The EU Common Agricultural Policy (CAP) provides a good example of this, though the USA, Japan, and other developed countries also have extensive agricultural protection policies. The CAP offers price support for some agricultural products (though not as many as formerly), allowing farmers to gain high prices, but restricts foreign access to this lucrative market through import levies. If farmers are unable to sell all their produce at the high support prices, the EU provides export subsidies to allow them to sell off their surplus production on world markets. This policy limits access to the EU market for some of the developing countries (others have preferential access agreements such as the Cotonou Agreement), but more importantly some of the world's poorest producers find it difficult or even impossible to compete with the EU's subsidised export prices. The reluctance of some EU member states and the USA to reduce their reliance on agricultural protection has been a major stumbling block during the Doha Round negotiations.

Practical insight: US Steel Tariffs

In March 2002, the US government imposed tariffs on imported steel to provide temporary protection for its domestic steel producers. The measure was a response to lobbying by US steel producers and trade unions and the intention was to keep the tariffs in place for three years, allowing the US steel industry time to restructure. However, there was also pressure on the US government to remove the tariffs. This came from US steel consumers, including the automotive and construction industries, and from steel producing countries around the world, including the EU, India, and China. In certain circumstances, WTO rules allow a member country to use temporary safeguard measures to protect a vulnerable industry from a sudden increase in imports, but in this case the WTO was broadly critical of the US decision and the complainant countries threatened to impose sanctions on US goods if it did not remove the tariffs. The dispute was finally resolved when President Bush withdrew the tariffs in December 2003, but the case raised questions about the role and authority of the WTO and the dangers both for trade policy and international relations when powerful member countries are in dispute with each other.[16]

Question: What lessons can be learned from this case for the conduct of international trade policy?

The WTO is at the centre of two major debates. Firstly, at its core is a belief that economic liberalism is good for the world economy and that developing countries will gain as much as developed countries from free trade and liberal domestic economic policies such as privatization and deregulation. This view is widely held in economic and political circles, especially by those on the right and centre-right of politics, but it is challenged by those on the left and centre-left, including a number of influential charities such as Oxfam and Christian Aid. This debate is explored more fully in section 5.4.1. The second debate is about the need for supranational or global governance. Some free market economists and politicians argue that trade relations are best left to market forces or that countries should be left to make bilateral agreements where it is in their mutual interest, a system that existed before 1945. Others believe that international co-operation is essential but do not always agree on the form it should take. Failure to make progress in the Doha Round has led some people to question whether the WTO will continue to exist in its present form.

2.4.2 The International Monetary Fund and World Bank

The IMF and World Bank Group play a major role in promoting international financial stability. The IMF was originally set up to establish a fixed exchange rate system between the major trading nations and to provide financial assistance to countries with short-term balance of payments difficulties. This helped to create the conditions for increased international trade during the 1950s and 1960s. However, a period of exchange rate volatility, rising inflation, and economic stagnation in the 1970s, exacerbated by soaring oil prices, helped to bring about a refocusing of the IMF's role. Since the 1980s the IMF has turned its attention more towards longer term finance for countries facing financial turbulence or economic transition. Like the WTO, the IMF operates largely on free market principles and has therefore been subject to similar criticisms. In particular, its insistence on liberal economic reforms as a precondition for financial assistance, even in the poorest countries, has brought considerable criticism.

The World Bank Group includes the International Bank for Reconstruction and Development (IBRD), its original branch set up to help with European reconstruction after World War II, the International Development Association (IDA), which provides subsidized loans to the poorest countries, and the International Finance Corporation (IFC), which provides finance for private businesses in developing countries. The World Bank has received some of the same criticisms as the IMF, though on the whole it has been less doctrinaire in its approach to free market reforms. The World Bank Evaluation Group, set up to monitor the activities of the World Bank, has commended the Bank for helping to remove obstacles to trade in developing countries, but argues that the Bank's policies have been less effective in boosting export growth and alleviating poverty in these countries.

2.5 The Impact of Globalization

Globalization is moving the world's economies closer to being a single, interconnected global economy. Of course, in reality there are still numerous barriers between the world's economies, including a plethora of import and investment restrictions, market regulations, and many other discriminatory government policies as well as natural barriers imposed by history, culture, or geography. However, there is plenty of evidence of increased global economic activity, international competition, and interdependence between national economies. Some of the main economic effects of globalization on the business environment are as follows:

- The internationalization of markets, including the development of increasingly global products and the use of global marketing strategies.
- The internationalization of production**,** including global production strategies such as outsourcing and the offshoring of manufacturing and service operations.
- Rapid international communication, data transmission, and technology transfer.
- Increasing opportunities for economies of scope (adopting common production platforms to produce differentiated variants of standardized products).
- Changes in the relative importance of economies of scale at plant and organizational levels – shifting the focus away from conventional large-scale production towards scale economies in global sourcing, marketing, and strategic planning at the level of the organization as a whole.
- The changing structure of industry, as the relative share of manufacturing in national output and employment declines in developed 'industrialized' countries and increases in newly industrializing countries. 'De-industrialization' in developed countries generally gives way to an increase in service industries, though India is also developing a large service sector, especially in services linked to information technology (as discussed in the opening scenario to this chapter).
- Changes in the demand for labour. As the structure of industry changes, developed countries increase their demand for educated and skilled labour in high-tech and service industries but reduce their demand for low skilled labour, while traditional manufacturing jobs are created in developing countries.

These effects of globalization help to increase efficiency in the global allocation of resources, but bring a number of transitional problems and life-style changes in their wake. The ability of people, organizations, and economies to adapt is clearly crucial. In the next section we explore the economic principles underlying globalization.

Practical Insight: De-industrialization

The proportion of the working population employed in manufacturing and construction industry in the developed countries fell from an estimated 28.5 to 24.7 per cent between 1996 and 2006. In the developing countries the corresponding proportion increased from 18.5 to 20.5 per cent. These changes are part of a long-term trend, indicating both the higher level of historical industrialization in the developed countries and the recent global shift in manufacturing towards the developing countries. Of course, industrialized countries are now able to produce more goods with fewer workers because of technological progress, but a gradual change in the relative importance of manufacturing in different parts of the world is also under way. The loss of manufacturing jobs has caused considerable concern in some of the 'de-industrializing' countries and this issue became a hot topic among the candidates during the 2008 US presidential election campaign.

Question: Were some of the US presidential election candidates right to argue that the US government should do more to prevent the loss of manufacturing jobs?

2.6 The Economics of Globalization

There is no specific economic theory of globalization. However, there are various theories we can use to shed light on the processes involved. Conventional economic theory provides a useful starting point for our analysis. The conventional theory of market economics is derived from neoclassical microeconomics, that is, principles explaining the detailed working of markets that have been developed from the ideas of 'classical' economists like Adam Smith (1723-90) and Alfred Marshall (1842-1924).[20] The basic idea is that markets allocate resources by equating supply with demand. If demand is high, producers will be attracted into a market by the prospect of profit. If demand is low, producers will leave the market and pursue opportunities for profit elsewhere. If the market is free from entry restrictions, competition between suppliers will normally be intense, which will drive down prices and production costs. In pure economic theory price plays an important role, acting as a signal to both consumers and producers, and market equilibrium is reached where demand and supply are equal at a particular price. As firms enter or leave the market they are allocating resources to the production of different goods and services. This process of resource allocation is known as the market mechanism.

We can now extend the concept of market equilibrium to an economy as a whole or indeed to the global economy. An economy is made up of many different markets, including markets for goods, services, labour, and capital. If all these markets are free from entry barriers, one of the characteristics of globalization, competition will drive prices and costs down and firms will move from one market to another in search of profit. When market equilibrium is reached in all markets throughout an economy, general equilibrium has been achieved. General equilibrium means that competition has promoted efficient resource allocation on a national or even global scale. Clearly, general equilibrium analysis relies on a number of restrictive assumptions. In the real world, competition is on product differentiation and quality of service, not just on price and costs, and not all markets are free from barriers and other restrictions. However, the outcomes of conventional microeconomic theory are not very far removed from some of the effects of globalization. Global competition does in fact force prices and costs down. This is why Marks and Spencer replaced some of its high-cost British suppliers with low-cost foreign suppliers when faced with falling profit, why Dyson transferred its vacuum cleaner production to Malaysia, or why Norwich Union Direct transferred its call centre to India.

Price and cost pressures do indeed seem to be significant features of globalization, but they are not the only pressures. Competitive firms are continually innovating by developing new products, using new technology, and improving customer service. These are dynamic features of competition and globalization is above all a dynamic process. Its effects are changing constantly as the drivers pull in different directions and interact with each other. Dynamic theories of competition help to explain how this process works. Instead of seeing competition as a process leading to a state of market equilibrium, dynamic theories view competition as a process of continual turbulence and change. Entrepreneurs develop new products or differentiate their products from their competitors. Sometimes they succeed, sometimes they fail. Through experience they learn how to do things better as good decisions are more often rewarded than bad ones. Markets are imperfect but competition gradually makes them work better. The result is not a steady state of equilibrium, but a process of continual change. However, although this view of the competitive process is very different from the conventional view, the pressures on firms to be competitive are very much the same.

It is also important to note that globalization is not a zero-sum game. A zero-sum game is one where one player can only gain at another's expense as the size of the pay-off is fixed (i.e. zero growth). In the game of globalization the players are consumers, producers, workers, and governments. Let us consider the example of offshoring introduced in the opening scenario on India. Offshoring helps to reduce a firm's production costs to enable it to remain competitive. It results in a loss of jobs in the home country and the creation of jobs in the host country. But this is not simply one country's loss and another country's gain. Lower production costs mean that the firm can reduce its price. Consumers will therefore have to pay less for its products. This may increase the company's sales, but consumers will also have more disposable income to spend on a variety of other goods and services, which will create jobs in these other industries, some of them at home and some abroad. Of course, the workers who lost their jobs through offshoring may not be the ones who gain the new jobs. The jobs could be anywhere in the country. However, if an economy is functioning well, jobs are being lost and created continually, so the net effect may well be at least neutral for the home country and positive for the host country. This is an increasing sum game.

There are of course a number of problems with this scenario. For a variety of reasons displaced workers do not always find jobs quickly and their new jobs are not always as well paid as their old ones. This is a transitional problem of globalization and may become a longer term problem for the workers concerned and their families. There is also a fear that manufacturing, and increasingly, service jobs are disappearing from developed to developing countries. This is part of a process of changing industrial structure as countries like China and India develop the skills to perform these activities at lower cost. On the whole, however, the developed countries have been successful in adjusting to manufacturing and services that create higher added value. China is already finding that its labour costs are rising as the demand for labour increases (even with its huge population). Its future success will then depend on its ability to improve productivity and product quality, and other countries will take over as lower-cost producers. Again, it is a mistake to think of China's gain, as an exporter of cheap manufactured goods, as the old industrialized countries' loss. After all, China's cheap exports benefit Europe and North America's consumers, giving them surplus income to spend on other goods and services, thus increasing their standard of living. As China's income per capita rises, world demand will also increase and competition from Chinese goods will encourage other countries to improve the quality of their goods – as competition from Japanese cars and electronic goods did in the 1970s and 1980s. This is clearly not a zero-sum game.

Despite the economic benefits of globalization, industrialized and newly industrializing countries alike are wrestling with the problems of change. The developed countries have to come to terms with their changing industrial structure and labour markets, the developing countries with the problems of industrialization: poor factory working conditions, urban congestion, air and river pollution, and associated social problems. Basically, there are two options for the developed countries in response to globalization: either they attempt to slow down or prevent the impact of globalization using protective measures such as import controls, regulation, or financial subsidies, or they accept that globalization is inevitable and take measures to improve competitiveness by promoting education and training, research and development, productivity, and market reforms. For political and social reasons most governments use a combination of these approaches, though the logic of the economics of globalization clearly points in the latter direction.

Practical Insight: Changing Views on Free Trade and Protection

During the 1970s and 1980s many North American and Western European industrialists argued for import protection when faced with intense Japanese competition, especially in the car and electronics industries. Governments were also persuaded by this argument and imposed quotas or voluntary export restraints (agreed rather than imposed quotas) on Japanese goods. By the 1990s many of these industrialists were arguing for free trade, often in the face of opposition from consumer organizations and trade unions.

Question: What do you think had changed?

6.6 Alternative Socio-Economic Models

Despite the cultural variation that exists within most countries, it is common to use typologies of national culture as a basis for analysing cultural differences in the business environment. Whilst imperfect, comparisons of national culture generally provide a useful indication of the different ways of doing business in different parts of the world. When the countries of the world could be divided into 'centrally planned economies' and 'market economies', the study of comparative economic systems provided an explanation of the economic theory underpinning state planning and market systems and the policy regimes in place to support these systems. With the demise of the main state planning systems in the former Soviet bloc and, to an increasing extent, in China, such studies have largely become redundant. This has left the way open for a variety of approaches to the classification of national differences. In the main, however, these approaches focus on the influence of culture and institutions on a country's business environment. The term 'socio-economic model' is used in this section to categorize these cultural and institutional influences in a number of countries. The models have been selected not because they represent a complete typology, but because they include many of the main trading nations of the world and have been the focus of intensive study in recent years.

6.6.1 Varieties of Capitalism

Peter Hall and David Soskice have been among the most influential researchers in this field.[33] They suggest a basic typology of 'coordinated market economies' and 'liberal market economies', with Germany and Japan as the former and the United States and UK as the latter. Although the essential distinction is between non-market coordination and market coordination respectively, Hall and Soskice's main contribution is their emphasis of the role of institutions in determining relationships within and between firms in the private sector, that is, relationships with employees, customers, suppliers, government, and a variety of other groups. They also recognize the importance of culture in shaping the institutional framework. Thus, for example, they focus on national differences in labour markets, social protection, or corporate governance and the way in which laws and other institutions are influenced by different cultural perspectives.

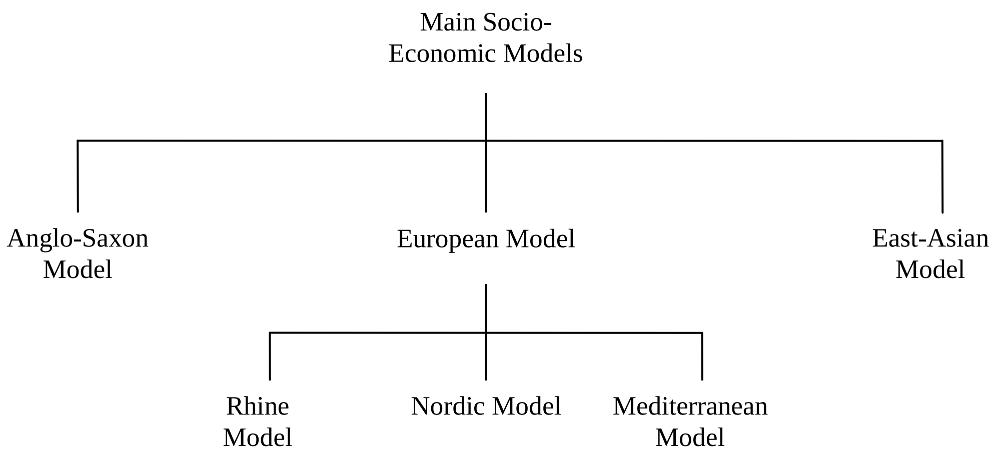
A more extensive typology is provided by Bruno Amable, who identifies five models of modern capitalism: market-based capitalism, Asian capitalism, continental European capitalism, social democratic capitalism, and Mediterranean capitalism.[34] Table 6.2 provides examples of each model, though the list of countries is not necessarily exhaustive. Market-based capitalism corresponds closely to Hall and Soskice's liberal market economies and this group was found to be the most homogeneous in Amable's study. The other four models were found to have more diverse characteristics. The socio-economic models described below, and represented in figure 6.2, are broadly similar to Amable's typology, with some variation in the names and classification of the models.

Table 6.2: Amable's Five Models of Modern Capitalism

Market-Based Capitalism	**Asian Capitalism**	**Continental European Capitalism**	**Social-Democratic Capitalism**	**Mediterranean Capitalism**
Australia	Japan	Switzerland	Denmark	Greece
New Zealand	S. Korea	Netherlands	Finland	Italy
UK		Ireland	Sweden	Portugal
USA		Belgium		Spain
		Norway		
		Germany		
		France		
		Austria		

Source: Amable, B. (2003), The Diversity of Modern Capitalism, Oxford University Press, extracted from Table 5.1, p. 173.

Figure 6.2: The Main Socio-Economic Models in the Global Economy



6.6.2 The Anglo-Saxon Model

The Anglo-Saxon model is almost synonymous with the English-speaking countries; in particular, it includes the USA, UK, Australia, and New Zealand, though Anglo-

Saxon policies have also been used elsewhere, for example in Chile since the 1970s and some of the countries of Central and Eastern Europe since 1989. In some ways, the term ‘Anglo-Saxon’ is a curious one as it describes the early English settlers who originated from the area that is now northern Germany and Denmark, and many other cultures have also influenced the present-day English-speaking countries. Nevertheless, the term is widely understood in this context, though other terms such as ‘Anglo-American’ or ‘neo-American’ have also been used.

The Anglo-Saxon countries are broadly characterized by free product and labour markets, free trade in international markets, a market-based system of corporate finance and corporate governance, extensive property rights, relatively low levels of social protection, and a competitive mass higher education system. Of course, not all these characteristics apply equally to each country. The USA is generally seen as having the purest form of Anglo-Saxon capitalism and fits the model quite closely, though even here examples of market intervention can be found in the form of minimum wages or trade protection policies. The UK pioneered free trade (or ‘laissez-faire’) in the latter half of the nineteenth century, but adopted continental European welfare policies and nationalization after World War II, only to return to more liberal economic policies under Margaret Thatcher in the 1980s. Even today, the UK National Health Service is more ‘European’, in the sense of non-market social protection, than the health services of many continental European countries. Despite this, UK economic policy since 1979 has been distinctly less interventionist than most of its continental neighbours.

A particular feature of the Anglo-Saxon countries is their individualism. This provides the basic rationale for free markets, the priority of individual freedom over collective action, and the need for property rights to protect individual freedom and enforce individual responsibilities. In recent years, policies of privatization, market deregulation, trade liberalization, and flexible labour markets have come to be associated with the Anglo-Saxon approach. Indeed, some of these policies have been adopted by non-Anglo-Saxon countries, often at the behest of the IMF, World Bank, or WTO. The European Union has also embraced a number of liberal economic policies to complement its more conventional regulatory approach, notably policies associated with competition in the single European market. These policies have often received support not only from the UK, but from its Nordic members, some of its ‘Rhine’ members (especially the Netherlands and Germany) and from some of the newer members in Central and Eastern Europe.

6.6.3 The European Model and its Variants

The term ‘European model’ may be used as a loose designation for the common characteristics of the continental Western European countries. To a greater or lesser extent, these countries tend to use more active government intervention than the Anglo-Saxon countries, their labour and product markets are more regulated, companies are more dependent on loan capital from banks, there is a higher level of social protection, and policy decisions are more likely to be based on public consensus. However, the differences between the ‘Rhine’, Nordic, and Mediterranean countries may be considered significant enough for them to be described as distinct socio-economic models.

- **The Rhine Model**

Michel Albert, a French writer and businessman, coined the term ‘Rhine model’, essentially to describe Europe’s social market economies as typified by post-war Germany.[35] Albert then extended this concept to Japan and contrasted the Rhine model with the ‘neo-American model’ exemplified by the United States. In its original European context, the term ‘Rhine model’ is derived from Europe’s longest and most prominent river which passes through or borders Switzerland, Liechtenstein, Austria, Germany, France, and the Netherlands before reaching the North Sea at Rotterdam. Here we use the Rhine model to describe the above list of countries, together with the neighbouring countries of Belgium and Luxembourg. Albert is less convinced that France is included in this model (though he wishes it were). A more dispassionate assessment would probably consider France to have more in common with the Rhine model than with the Anglo-Saxon model which Albert decries.

The core of the Rhine model is Germany’s post-war social market economy. Germany’s economy is essentially a market economy coupled with strong social protection for individuals and companies. The labour market provides the best example of social protection, with its long-term job security, extensive vocational training, generous sickness, unemployment and retirement benefits, and internal company promotion structures. Consumer and environmental protection laws are among the strongest in the developed world and companies enjoy greater protection from hostile takeovers than in the Anglo-Saxon countries. Social consensus is strongly embedded in Germany’s political system, with its proportional representation and coalition governments, and in its approach to industrial relations, especially the system of codetermination or *Mitbestimmung* where workers participate in company decision making. German companies are generally more dependent on bank finance than on equity capital and it is common for banks to play an active role in corporate governance, especially among the many middle-ranking firms (or *Mittelstand*), but also in some of Germany’s larger companies.

When applied to the other ‘Rhine’ countries, the model varies to some extent in each case. Even in Germany itself, recent governments under both the left-of-centre Social Democrat, Gerhardt Schröder (1998-2005), and the right-of-centre Christian Democrat, Angela Merkel (from 2005), have been introducing market reforms to liberalize the country’s rigid labour markets and reduce the heavy cost of taxation needed to pay for social protection. A similar reform process began in the Netherlands in the 1980s, though public support for social protection remains strong in most of the Rhine countries. France has its own distinctive version of the Rhine model, with a more centralized political and educational system, and close links between government and industry – a feature that has sometimes led to comparisons with Japan. There is often strong support for government intervention to protect French industry and the media from foreign dominance and a tradition of *dirigisme* (literally ‘direction’ or ‘management’, sometimes described as ‘indicative planning’), initiated during France’s post-war reconstruction when governments actively promoted industrial development.

• The Nordic Model

In many respects the Nordic model is similar to the Rhine model, with its regulated product and labour markets and its reliance of bank finance. However, the state welfare system is if anything more extensive and is based on a strong sense of shared responsibility for the wellbeing of society. This social partnership also translates into economic policy, where industrial and labour market decisions are determined by a process of collective negotiation between government and organisations representing the various interested parties. This process is sometimes described as the 'negotiated economy'.

As with the other models, there is significant variation between countries. Sweden responded to the problems of inflation and economic stagnation in the 1970s by attempting to rein in its high public spending and dismantle some of its cooperative institutional arrangements, while Denmark extended these arrangements in an attempt to strengthen its collective efforts. The Nordic countries have also followed different political and economic paths. Whilst they all belong to the Nordic Council, which allows free movement across its borders, Norway and Iceland have remained outside the European Union and Finland has broken with its fellow EU members, Denmark and Sweden, by joining the single currency. However, their common emphasis on generous state provision for higher education and scientific research has remained largely intact.

- **The Mediterranean Model**

The Mediterranean countries, Spain, Portugal, Italy, and Greece, share the regulated labour markets and bank-based corporate finance system of the other European models, but generally have more limited welfare systems and spend less on higher education. Public ownership of industry has also been more common in this region, especially in Greece, though these countries have been following their European neighbours in reducing the level of state ownership in recent years. Again, there are a number of differences between individual countries. Italy is perhaps the most distinct, with its more individualistic culture, extremes of left and right in politics, large family-owned corporations, and networks of small family businesses in industries such as clothing and footwear. The Mediterranean model is also characterized by bureaucratic administrative procedures and lax standards of corporate governance.

6.6.4 The East-Asian Model

The path to economic recovery followed by Japan after World War II has been variously described as the Japanese, Asian, or East Asian model. The approach pioneered by Japan, with US political and financial support, was then adopted by other East Asian countries, notably South Korea, Singapore, and Taiwan, from the 1960s onwards. Although there is not yet a clear alternative Asian model, the term East Asian model seems more appropriate as it is mainly associated with Asia's eastern and south-eastern regions. The East Asian countries are heavily dependent on bank finance, perhaps more so than their European counterparts, and workers are normally afforded a high degree of employment protection. Many Japanese skilled workers have enjoyed lifetime employment with the same company, though this practice is now gradually being eroded. Japan's relatively collectivist culture values mutual loyalty between a company and its employees, so the idea of making workers redundant, bringing in managers from outside, or promoting young employees to senior positions is alien to traditional Japanese culture.

The close links between companies and their employees also exist between different companies and between government and industry. Many Japanese companies belong to *keiretsu*, networks of companies with inter-locking shareholdings, often headed either by a bank (a *horizontal keiretsu*) or by a major company such as Toyota exercising a paternalistic oversight of its suppliers (a *vertical keiretsu*). A particular feature of the Japanese system, also common in other East and South-East Asian countries, is the way in which government works in partnership with companies. Japanese governments successively promoted the development of the steel, shipbuilding, motor vehicle, and electronics industries, among others, during the post-war years. When Japanese companies began to internationalize in the 1970s, it was no accident of the free market. Japanese companies were encouraged to venture abroad in tandem (the *convoy system*), supported by government and low-cost loans from their keiretsu bank (see section 15.2). Governments have also been active in promoting industrial development in Taiwan, South Korea, and elsewhere, though not always in the same way as Japan. The Taiwanese government encouraged selective joint-ventures with Western companies to promote its embryonic electronics industry, whereas South Korea supported its giant conglomerates (*chaebol*), including Hyundai, Samsung, Daewoo, and LG, in the electronics, motor vehicle, and other industries.

Practical Insight: Is Japan's Corporate Culture Changing?

Even Japan's relatively collectivist, high uncertainty-avoidance culture is starting to change. In line with tradition, an employee of the Nichia company, Shuji Nakamura, was rewarded with only modest promotion, a small pay rise, and a tiny bonus of Y20,000 ($190) after he invented blue light-emitting diodes (LED), one of the major inventions of the twentieth century. As an employee of the company, Mr Nakamura was simply part of the collective whole and was not therefore allowed to benefit much from his individual efforts. However, in February 2004, the Tokyo District Court made the landmark decision to require Nichia to pay him Y20bn ($190m), equivalent to approximately half the profit the company could earn from his invention before its patents expire in 2010. Shuji Nakamura was offered a professorship at the University of California after he left Nichia, but the court decision made considerable waves in Japanese corporate circles.[36]

Question: Is it necessary for Japanese companies to reward individual achievement in order to stimulate the country's collective innovation?

This collective approach to industrial development has encouraged cooperation rather than competition in internal markets, and these markets are often highly regulated. Nevertheless, until the end of the 1980s in Japan and the Asian financial crisis (1997-8) elsewhere in the region, East Asian companies were often highly successful in international markets – and a number of them remain so. Their success was based on high productivity, advanced technology, efficient work practices, and continuous improvements in quality (*kaizen* in Japanese) rather than low costs and competitive prices. In the more difficult conditions of the 1990s, however, the 'soft' bank finance that had enabled them to expand rapidly became a liability as companies such as Nissan, Mitsubishi, and Daewoo Motors struggled to manage their vast debts, excess capacity, and poor profitability. Although the East Asian Model has a number of apparent similarities with the European Model, and especially France, the underlying cultural differences are significant and the East Asian countries rely much more on companies rather than the state to provide social protection, leaving 'public' services such as health and higher education largely to the private sector.

6.6.5 Socio-Economic Models in other Regions of the World

A number of other candidates might be considered as alternative socio-economic models. Two major regions of the world have thus far been excluded from the above analysis: Africa and Latin America. Recent developments might also suggest the possibility that the experiences of China and India are sufficiently distinct to represent new variants of the Asian model. The case for Latin America, China, and India is considered below. The countries of Africa, whilst representing a variety of different traditions and experiences, have generally followed a dependent path, drawing on the legacy of their former colonial masters or Soviet communism, or the policy prescriptions of the IMF and World Bank. Many of them are also held back by climate, disease, conflict, corruption, and poor governance (see section 16.4). There are of course a few exceptions, but even the relative success enjoyed by countries such as South Africa, or in former times Zimbabwe, probably owes as much to their European heritage as to their own distinctive characteristics. For these reasons it is difficult to demonstrate the existence of a distinct African model.

- **A Latin American Model?**

The Latin American countries, extending from Mexico in the north to Chile and Argentina in the south, represent a coherent cultural group or civilization. The Spanish language and culture predominate, while Portuguese is influential mainly because of South America’s largest country, Brazil. Descendants of their former Spanish and Portuguese colonial rulers intermingle with native American Indians and descendants of Black African slaves to form a unique cultural blend. Many of the Latin American countries achieved independence during the first quarter of the nineteenth century, but Spanish and Portuguese political power was soon replaced by economic dependence on Britain and later the United States. During this ‘neo-colonial’ period their economies became increasingly dependent on exports of basic agricultural commodities to Europe and North America. Export-dependence was often accompanied by economic liberalism, enforced by British and American business and financial institutions and by local authoritarian leaders.

The Latin American economies turned inward after the Great Depression that followed the Wall Street Crash of 1929, pursuing domestic industrialization and import-substitution. High protective tariffs remained until liberal economic policies re-emerged in the latter years of the twentieth century, notably in Chile from the 1970s onwards but also more gradually in Argentina, Mexico, Brazil, and elsewhere. It is probably fair to say that each change of direction reflected the influence of external factors rather than an indigenous socio-economic model. The most recent liberalization is a response to global competition and US intervention, but the Latin American economies have struggled to maintain financial stability while opening up their economies. Given the dependent path of Latin American economic development and the difficulties these countries have experienced in harnessing economic change, it is probably unjustified to speak of a Latin American model.

- **A Chinese Model?**

The gradual opening of the Chinese economy from 1978 after Deng Xiaoping came to power has enabled China to achieve an unprecedented rate of economic growth. The question is: has this success resulted from a unique Chinese model or from economic liberalization? Three main elements are present in China: its distinctive culture, its communist political system, and its embrace with economic liberalism. If each of these elements has helped to produce the country's economic success, there may indeed be a distinctive Chinese model. However, it is not at all certain that the three elements are equally responsible. Communist state control may in fact be more of a hindrance than a help to economic development, except to the extent that gradual relaxation of state control may have helped to avoid the chaotic inflationary conditions experienced by Russia and some of the other former communist states of Central and Eastern Europe.

In cultural terms, the Chinese share the common high power-distance and collectivism of other Asian societies but have a noticeably longer-term time orientation and are surprisingly less risk-averse than their Asian neighbours. These characteristics almost certainly play a significant role in Chinese economic development. At the moment, however, the most significant factor accounting for their recent economic fortunes appears to be economic liberalism. As their economy develops and communist political control diminishes, it is possible that a specific Chinese model may emerge.

- **An Indian Model?**

India began to turn a corner in its recent economic development after the reforms introduced by prime minister Narasimha Rao and his finance minister, Dr Manmohan Singh, in 1991. Since then, India's economic growth has been accelerating but always in the shadow of China's more spectacular economic performance. A significant difference, however, has been the development of India's computer software and IT services industries as opposed to China's greater reliance on manufacturing. The early stages of India's modern industrialization occurred in the late nineteenth century under British rule when its textile industry began to challenge Britain's dominant position in world markets, though in other respects colonial rule and the traditional Hindu caste system have had more of a restraining effect on India's recent economic development. The caste system, which dates back many centuries, represented an orderly hierarchy in the labour market, where higher castes had positions of authority, middle castes conducted business, and lower castes performed more menial tasks in India's predominantly rural economy.

The British Raj (or 'rule') gave way to Indian independence in 1947, which was followed by a period of socialist-inspired economic planning or 'dirigisme'. Active government intervention helped to improve India's poor infrastructure, but industrial development was based largely on inward-looking protectionist policies and import substitution. These policies left India with burgeoning public debt, rising inflation, and exchange rate instability. They also acted as a restraint on private enterprise. The 1991 and subsequent economic reforms have helped to create a more enterprising environment, though India still suffers from a bureaucratic administrative culture that is a remnant both of the British Raj and the hierarchical caste system. In this sense, India's past probably acts more as a constraint than as a contributory factor in its recent economic success and, like China, rapid growth seems to stem mainly from liberal economic reforms. At the present time, therefore, the designation of a specific Indian socio-economic model seems unwarranted.

Suggestions for Further Reading

Most of the material in this lecture programme can be found in:
Harrison, A. (2010), Business Environment in a Global Context, Oxford University Press, chapters 2, 5, and 6

For a broad understanding of the international business environment:
Rugman, A. M. and Collinson, S. (2008), International Business, Financial Times Prentice Hall

The political context of the international business environment:
Huntington, S. P. (2002), The Clash of Civilizations: and the Remaking of World Order, The Free Press

Detailed analyses of globalization from an economic perspective:
Bhagwati, J. (2004), In Defense of Globalization, Oxford University Press
Wolf, M. (2005), Why Globalization Works, Yale University Press

On globalization and cultural differences:
Cowen, T. (2002), Creative Destruction: How Globalization is Changing the World's Cultures, Princeton: Princeton University Press

Trade, globalization, and the developing countries:
Sachs, J. D. (2009), Common Wealth: Economics for a Crowded Planet, Penguin
Stiglitz, J. E. (2007), Making Globalization Work: The Next Steps to Global Justice, Penguin

On the varieties of capitalism and socio-economic models:
Amable, B. (2003), The Diversity of Modern Capitalism, Oxford University Press
Hall, P. A. and Soskice, D. (2001), Varieties of Capitalism: The Institutional Foundations of Comparative Advantage, Oxford University Press

GROUP ACTIVITY

The 2025 Global Landscape

Relative Certainties	Implications?
A global multi-polar system is emerging with the rise of China, India, and others. The relative power of non-state actors — businesses, tribes, religious organizations, and even criminal networks — also will increase.	
The unprecedented shift in relative wealth and economic power roughly from West to East now under way will continue.	
The United States will remain the single most powerful country but will be less dominant.	
Continued economic growth — coupled with 1.2 billion more people by 2025 — will put pressure on energy, food, and water resources.	
The number of countries with youthful populations in the "arc of instability"[1] will decrease, but the populations of several youth-bulge states are projected to remain on rapid growth trajectories.	
The potential for conflict will increase owing to rapid changes in parts of the greater Middle East and the spread of lethal capabilities.	
Terrorism is unlikely to disappear by 2025, but its appeal could lessen if economic growth continues in the Middle East and youth unemployment is reduced. For those terrorists that are active the diffusion of technologies will put dangerous capabilities within their	

reach.	

[1]Countries with youthful age structures and rapidly growing populations mark a crescent or "arc of instability" stretching from the Andean region of Latin America across Sub-Saharan Africa, the Middle East and the Caucasus, and through the northern parts of South Asia.

Key Uncertainties	**Implications?**
Whether an energy transition away from oil and gas — supported by improved energy storage, biofuels, and clean coal — is completed during the 2025 time frame.	
How quickly climate change occurs and the locations where its impact is most pronounced.	
Whether mercantilism stages a comeback and global markets recede.	
Whether advances toward democracy occur in China and Russia.	
Whether regional fears about a nuclear-armed Iran trigger an arms race and greater militarization.	
Whether the greater Middle East becomes more stable, especially whether Iraq stabilizes, and whether the Arab-Israeli conflict is resolved peacefully.	
Whether Europe and Japan overcome economic and social challenges caused or compounded by demography.	
Whether global powers work with multilateral institutions to adapt their structure and performance to the transformed geopolitical landscape.	

Source: Global Trends 2025: A Transformed World, US National Intelligence Council, published November 2008
www.dni.gov/nic/PDF_2025/2025_Global_Trends_Final_Report.pdf

Scenario Planning

Scenario planning is a method increasingly being used to provide insights into a possible future course of events. It involves the development of plausible alternative scenarios, drawing on information, analysis, and understanding of a particular issue, which can be used as a basis for risk management strategies. Through the process of scenario planning, an organization is able to identify alternative ways of planning its operations in order to minimize the consequences of risk or even to influence the likelihood of a particular event occurring. Each alternative scenario is intended to envision a possible course of events and its consequences. This process makes use of warning signs, triggers, signposts and other indicators, but above all it requires insight and imagination. For this reason, it is often preferable to involve teams of people in developing scenarios in order to generate a wide range of ideas. The alternative scenarios represent a number of possible ways in which a particular issue may develop. Some scenarios may, of course, involve greater risks than others, but it is important for an organization to understand these risks and to put strategies in place to manage the risks effectively. It is also possible to include a few 'wild cards' when developing scenarios of the global environment: low-probability but high-impact events such as a terrorist attack or global epidemic that may disrupt the expected course of events.

In general terms, it is important to look for *warning signs*, *triggers*, and *signposts* when considering changes in the external environment. Warning signs are events that provide an indication of a potential risk; in the context of the world oil market, evidence of falling oil stocks or the rapid expansion of China's economy might provide a warning sign of tight supply conditions and rising demand, leading to rising oil prices over a period of time. A trigger is an event that sets off an immediate reaction, such as a flare up of military conflict in the Middle East; even if oil supplies are not actually disrupted, this news may cause panic buying and a sharp increase in oil prices. A signpost is something that provides an indication of a trend or future course of events, such as the decision of a major motor manufacturer to develop vehicles using alternative fuels – signalling a possible move away from oil-dependent technology. Whilst this is unlikely to have a short-term effect on oil prices, it may influence future research and investment priorities. Each of these factors creates either short-term or long-term risks for business.

Developing Alternative Scenarios

Task 1: The Changing Balance of Economic Power

Using the information from the Goldman Sachs Report below, suggest the most likely scenario for the world economy in 2050, covering each of the following points:

- The world's ten largest economies
- The implications for international trade and investment
- Patterns of demand for different goods and services

- The role of regional economic groupings
- Risk factors that could change the course of the above scenario

A Goldman Sachs Report, 'Dreaming with BRICs: The Path to 2050', published in 2003, argued that the balance of economic power could change significantly during the first half of the 21st century as a result of the rapid development of the BRIC economies (Brazil, Russia, India and China). One of two other countries could perhaps be added to this list, including Mexico, South Africa and one or two south-east Asian economies (e.g. Malaysia or Indonesia). The Goldman Sachs study is based on projections of demographic change, capital accumulation and productivity growth for the countries in question. Of course, any such projections may be subject to significant variation and will depend on the policies pursued by each country. However, even if the projections are only partly correct, the balance of international economic activity could change significantly in the coming years. The following is a brief summary of the main conclusions reached in the 2003 Goldman Sachs Report:

- Brazil, Russia, India and China—the BRICs economies—could become a much larger force in the world economy by 2050.
- If things go right, in less than 40 years, the BRICs economies together could be larger than the G6 in US dollar terms. By 2025 they could account for over half the size of the G6. Currently they are worth less than 15%.
- About two-thirds of the increase in US dollar GDP from the BRICs should come from higher real growth, with the balance through currency appreciation. The BRICs' real exchange rates could appreciate by up to 300% over the next 50 years (an average of 2.5% a year).
- The shift in GDP relative to the G6 takes place steadily over the period, but is most dramatic in the first 30 years. Growth for the BRICs is likely to slow significantly toward the end of the period, with only India seeing growth rates significantly above 3% by 2050. And individuals in the BRICs are still likely to be poorer on average than individuals in the G6 economies, with the exception of Russia.
- As early as 2009, the annual increase in US dollar spending from the BRICs could be greater than that from the G6 and more than twice as much in dollar terms as it is now. By 2025 the annual increase in US dollar spending from the BRICs could be twice that of the G6, and four times higher by 2050.
- The key assumption underlying our projections is that the BRICs maintain policies and develop institutions that are supportive of growth. There is a good chance that these projections will not be met, either through bad policy or bad luck.
- The relative importance of the BRICs as an engine of new demand growth and spending power may shift more dramatically and quickly than expected. Higher growth in these economies could offset the impact of ageing populations and slower growth in the advanced economies. Higher growth may lead to higher returns and increased demand for capital.
- Rising incomes may also see these economies demand different kinds of products, as local spending patterns change.
- As today's advanced economies become a shrinking part of the world economy, the accompanying shifts in spending could provide significant opportunities for global companies. Being invested in and involved in the right markets—

particularly the right emerging markets—may become an increasingly important strategic choice.

- The list of the world's ten largest economies may look quite different in 2050. The largest economies in the world (by GDP) may no longer be the richest (by income per capita), making strategic choices for firms more complex.

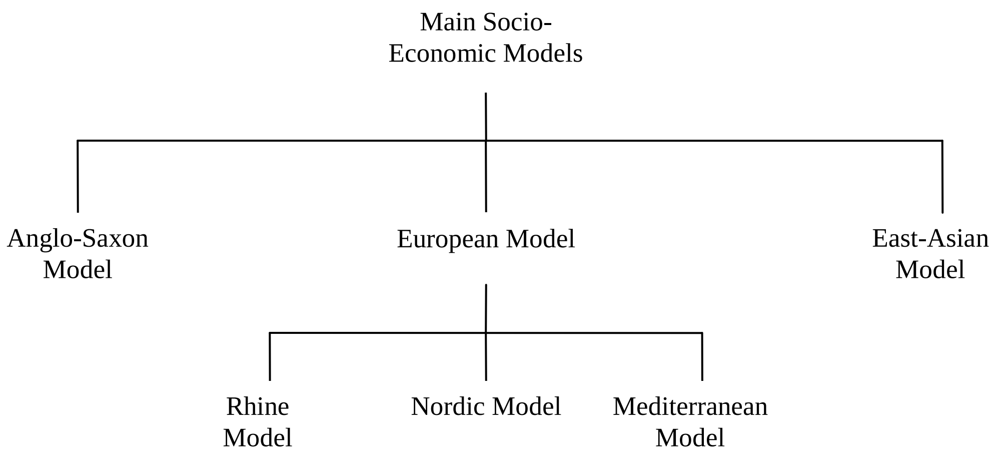
Task 2: The Changing World Order

Consider the following basic alternative scenarios representing visions of the world in 2020. Try to flesh out each of the scenarios in more detail, drawing out their implications for a business, public sector, or third sector organization.

- Scenario 1: The Bipolar World - a world dominated by the United States and China, two superpowers jostling for position in political, economic, and military affairs.
- Scenario 2: The Multipolar World – a world dominated by powerful groups of countries in North America, Europe, and Asia, characterized by a changing balance of economic and political power.
- Scenario 3: The Fragmented World - a world with no overall political leadership where there is little consensus on trade, environmental, or social issues.
- Scenario 4: The Closed World – a world characterized by nationalism and security problems where countries develop a siege mentality and protect their economic and political borders.
- Scenario 5: The Open World – a world characterized by free trade, increasing globalization, and open borders.

Task 3: Varieties of Capitalism

Redraw the diagram below to represent what you think the main socio-economic models may look like in 2025 and provide a justification for your diagram



Assessment

There will be a written examination based on this lecture programme. It will last **ONE HOUR** only and the examination will include three questions, one on each of the three tasks above. You will be required to answer **TWO** questions only. Further information will be given during the lecture programme.