

ADM 3318 N: International Business

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Quick Review

National Accounts

- How do we measure the economic size of a country? Using GDP!
- Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.
- GDP is the market value ...” adding apples and oranges? And that is ok as market price is used.
- “... Of all ...” GDP is a comprehensive measures
- “... Final ...” intermediate inputs are taken out to avoid multiple counting
- “ ... Goods and services ...” not only tangible goods but also intangible services
- “... Produced ...” it does not include transactions involving items produced in the past (such as used car).
- “... Within a country ...” it is measured within the political boundary of a country. If a US citizens is working in Canada, her income is Canadian GDP.
- “ In a given period of time ...” GDP is measured within a specific period of time, monthly, quarterly or annually.

Defining Economic Globalization

What Is Globalization?

Globalization refers to the shift toward a more integrated and interdependent world economy.

Globalization has several different facets, including

- Globalization of Markets
- Globalization of Production
- Globalization of Consumers

Globalization of Markets

- It refers to the merging of separate national markets into one huge global marketplace.
- Low-cost transportation has made it more economical to ship products around the world, thereby helping to create global markets.
- Low-cost global communications networks such as the World Wide Web are helping to create electronic global marketplaces

A logical result of this evolution is the emergence of global markets for consumer products

Globalization of Markets

- Low-cost global communications networks such as the World Wide Web are helping to create electronic global marketplaces
- While modern communication and transportation technologies are ushering in the “global village,” very significant national differences remain in culture, consumer preferences, and business practices

Globalization of Production

- Refers to the sourcing of goods and services from locations around the world to take advantage of national differences, costs, and quality of factors of production.
- As transportation costs associated with the globalization of production declined, dispersal of production to geographically widespread locations became more economical

Globalization of Customers

Refers to the merging of separate national markets into one huge global marketplace.

Global Institutions

- As markets globalize business activities and transcend national borders, institutions need to help manage and regulate the global marketplace.

Including the following organizations:

- United Nations (1945)
- World Trade Organization (WTO)
 - Preceded by the GATT
- International Monetary Fund (IMF)
- World Bank

Dimensions of Economic Globalization

- The globalization of *trade in goods and services*
- The globalization of *corporation and industries* is led by sharp increases in foreign direct investment
- The globalization of *financial markets* has triggered sharp growth in short-term capital
- The globalization of *technology* with international networks, linking to public and private research centers
- The globalization due to new strategic consideration of enterprises
- Globalization due to labor (*skilled*) mobility

Drivers of Globalization

1. Decline in barriers to the free flow of goods, services, and capital, since the end of World War II
2. Technological change in communication, information processing, and transportation
3. Labor mobility
4. Changed notion of foreign capital

Decline in barriers

- In addition to reducing trade barriers, many countries have also been progressively removing restrictions to foreign direct investment
 - The lowering of barriers to international trade enables firms to view the world, rather than a single country, as their market.
 - The lowering of trade and investment barriers also allows firms to base production at the optimal location for that activity, serving the world market from that location.
 - A firm might design a product in one country, produce component parts in two other countries, assemble the product in yet another country, and then export the finished product around the world

Technological change

- The lowering of trade barriers made globalization of markets and production a possibility.
- Technological change has made it a tangible reality.
- Since the end of World War II, the world has seen major advances in
 - communication,
 - information processing,
 - transportation technology,
 - and the explosive emergence of the Internet and World Wide Web.

Technological change

- The Internet has changed the way people communicate.
- The Web makes it much easier for buyers and sellers to find each other, wherever they may be located and whatever their size.
- It allows businesses, both small and large, to expand their global presence at a lower cost than ever before.
- Transportation Technology
 - Before the advent of containerization, it could take several days and several hundred longshoremen to unload a ship and reload goods onto trucks and trains.

Two Phases of Globalization

- **First Golden Age of Trade**
 - The period from 1890 until World War I (1914-1918), is sometimes referred as “golden age” of international trade.
 - Those years saw dramatic improvement in transportation, such as shipment and railroad, that allowed a great increase in international trade.
 - By 1914, the share of average trade (exports and imports) in GDP for UK was already 30%. All other developed countries, including Canada, had the share at around 20%.
- In the aftermath of World War I, trade fell; it was made worse by great recession (that started in 1929) and World War II which started in 1939.

Two Phases (contd.)

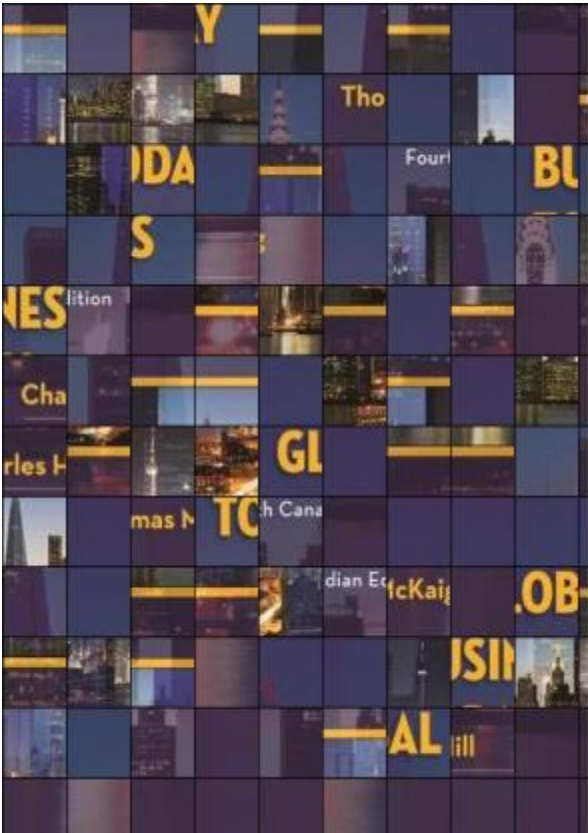
- **Second Golden Age of Trade**
 - It took many years for the world to regain the same level of global integration that existed before World War I.
 - The trade started to regain its strength in the 1950s.
- **With tariff fallings, technological improvement and other market access arrangement made expansion in trade uninterrupted until the financial crisis hit in 2008.**
- **From 2011 again we are in the rising phase of trade expansion, however, we are experiencing a plateau!**

The Interdependent Global Economy

In today's world, national economies are merging into an interdependent economic system:

- barriers to cross-border trade and investment are falling,
- distance is shrinking due to advances in transportation and telecommunications technology.
- Consumption patterns are converging world over, and
- national economies are merging into an interdependent global economic system.

The Interdependent Global Economy



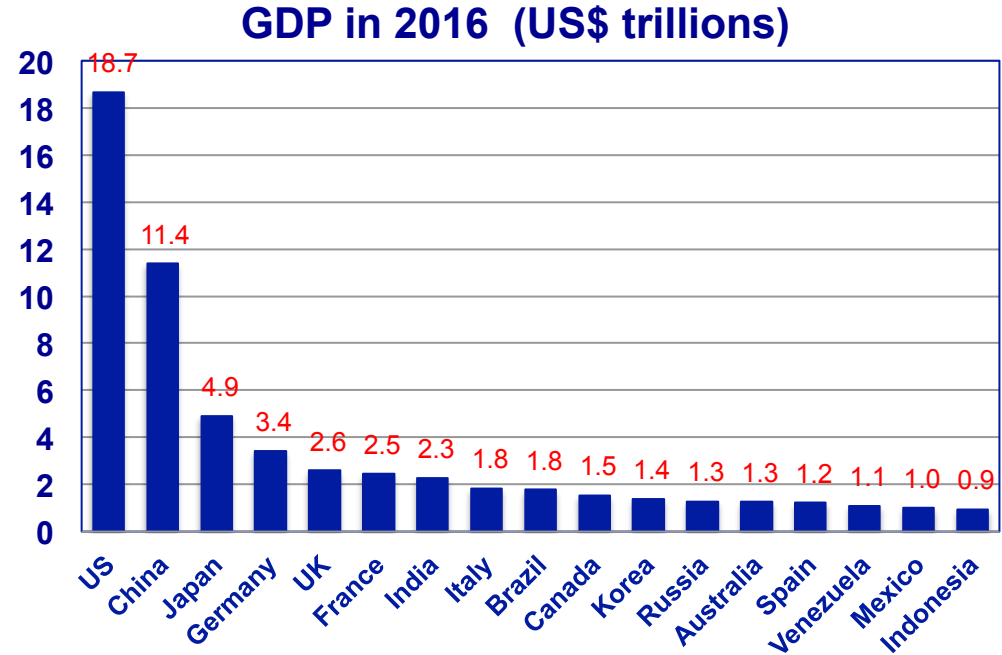
Example: A Canadian might drive a car that was:

- Designed in Germany
- Assembled in Canada by DaimlerChrysler
- Manufactured from components made in the UK and Japan
- Those components could be made from rubber from Malaysia or steel from Korea
- You may have filled your car with gas from a service centre owned by a Dutch company (Shell)

Major Players in the Globalization

World output is dominated by few countries.

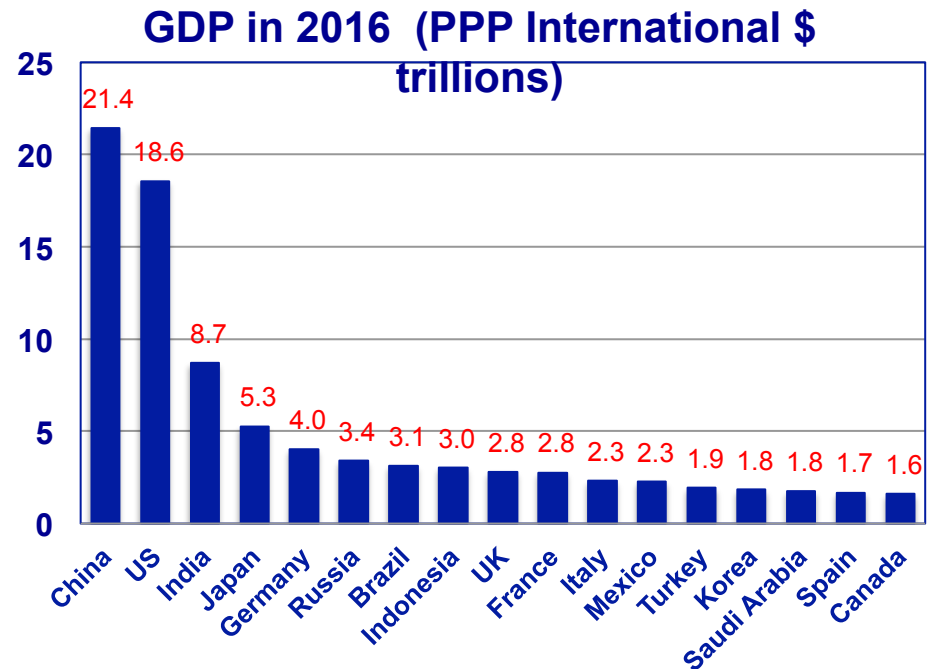
- These 17 largest economies constituted 77 percent of world GDP in 2016.
- Canada was 9th largest economy with GDP of US\$ 1.5 trillion.
- Does domestic market size matter for companies to grow large?
- Can size itself be a hindrance for faster growth, *ceteris paribus*?



Source: United Nations Conference for Trade and Development

Cost of living adjusted ranking is different

- The ranking changes if we select countries based on purchasing power parity GDP.
- PPP takes into account the cost of living in the countries.
- In other words, it adjusts a country's GDP by looking at what basket of goods one US \$ could buy in that country.
- Take for example China, in China the Chinese currency equivalent of one US\$ can buy more goods and services than what (US\$ 1 can buy in the US).
- Canada was 17th largest.

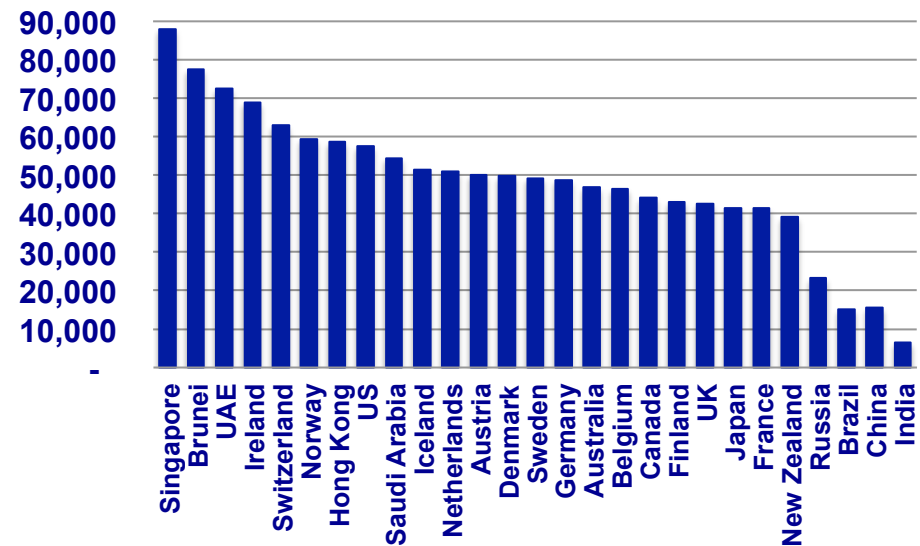


Source: World Bank, World Development Index

Largest economies differ in richness.

- The largest economies are not necessarily the richest ones (which is measured based on per capita income).
- The potential for international business rises both with size and richness matters.
- In large and richer countries there will be more demand for both goods and services.

Per capita income in PPP dollars in 2016



Source: World Bank, World Development Index

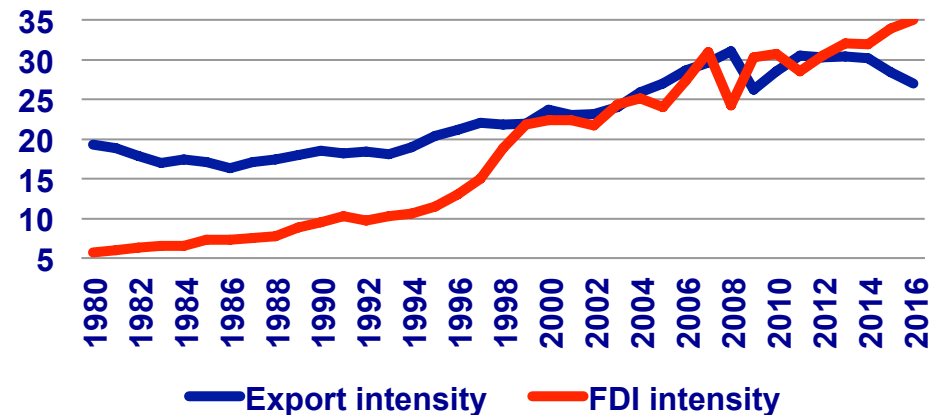
- Three countries (island) whose per capita GDP was even higher than that of Singapore are not plotted. They are: Qatar with per capita income of 128 thousand, Luxemburg with 106 thousand and Macao, China with 104 thousand.

Trade and FDI are the main drivers of globalization.

- The share of global exports in global GDP increased continuously over time reaching max of 31 percent in 2008 and again in 2011.
- But recently this export intensity has fallen to 27 percent.
- It means that exports was rising faster than GDP before now it is rising slower than GDP.
- The stock of FDI in GDP has increased to 35 percent.

– Stock and flow concepts!

Share of global exports and FDI stock in global GDP in 2016 (percent)

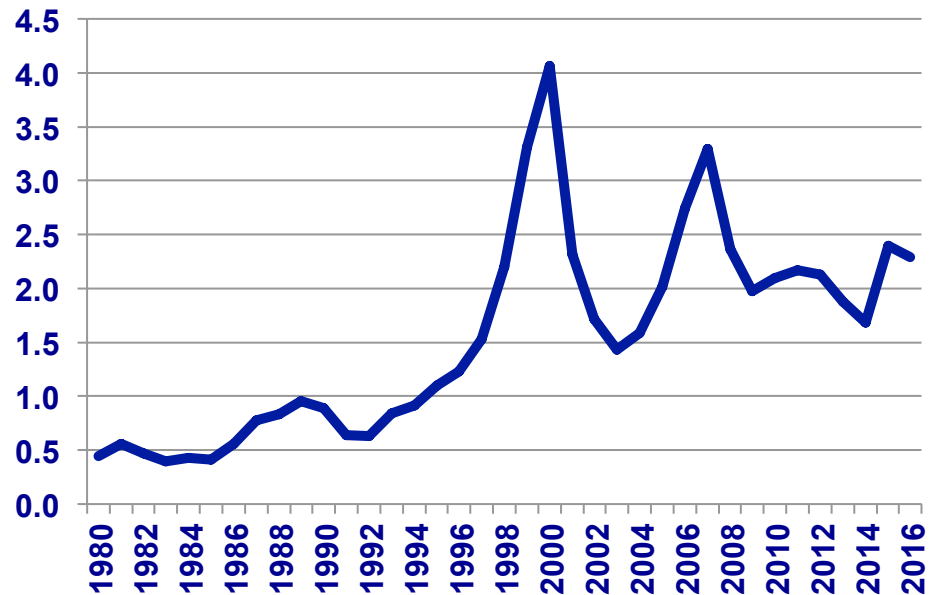


Source: UNCTAD

Multinationals are tapering their activities.

- The share of inward FDI flow in GDP has fallen somewhat in recent years, an indication again that the multinationals are putting some breaks in their foreign activities.
- This trend mimics the situation of falling exports to GDP ratio.
- Some firms exports (exporters), some firms do FDI (multinationals) and most of them may do both.
- That is, exporters are also multinationals—trade and FDI are complements rather than substitutes!

Share of global FDI inflow in global GDP (percent)

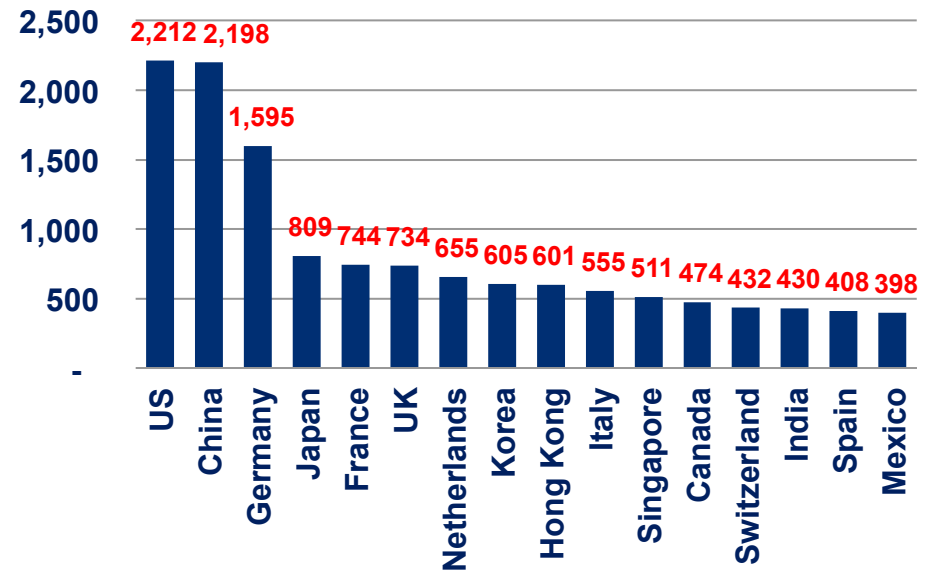


Source: UNCTAD

As GDP, exports are dominated by few countries ...

- These are the world largest exporters of goods and services in the world in 2016.
- They contributed two-thirds of world exports in that year.
- Canada was the 12th largest exporter.
- Only three developing countries made the cut: China, India and Mexico.
- In 2015, China's exports were slightly higher than that of the US and 2016 US took back its historical role of largest global exporter.

Exports of goods and services in 2016 (in US\$ billions)

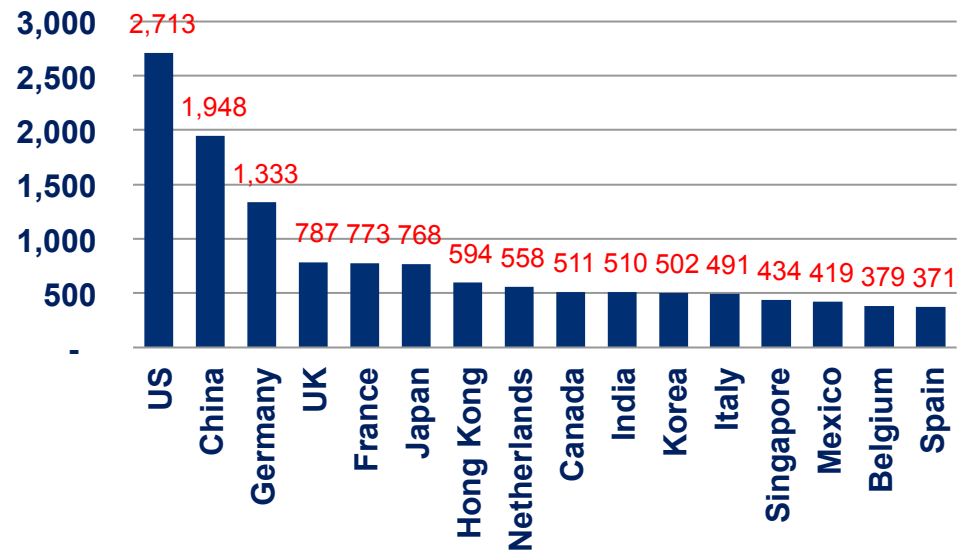


Source: UNCTAD

... so are imports

- These are the 16 largest importers in 2016, contributing two-thirds of global imports of goods and services.
- Canada was the 9th largest importer.
- In the pack of 16 largest exporters and 16 largest importers only one country differed, 15 countries were in the both packs.
 - Switzerland was not in the importer list whereas Belgium was not in the exporter list.
- Why, generally, large exporter is also a large importer?

Imports of goods and services in 2016 (US\$ billions)

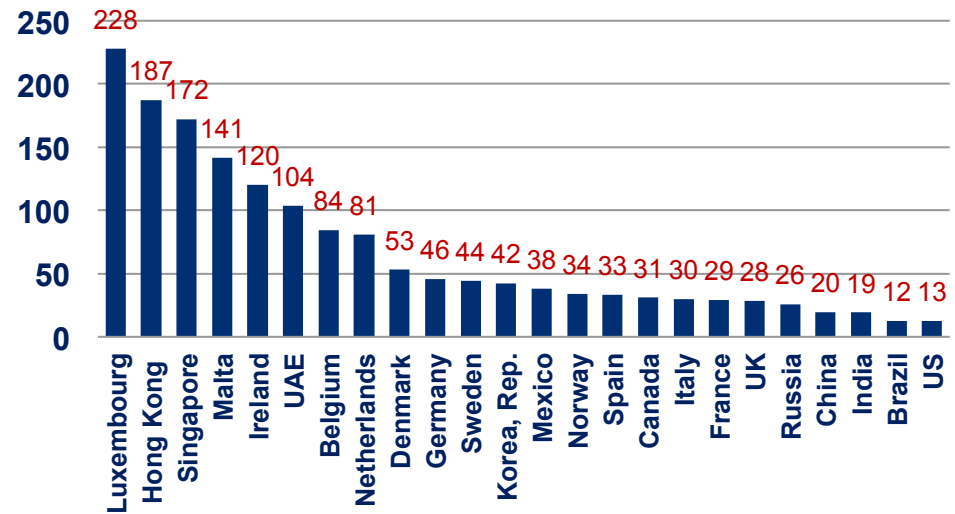


Source: UNCTAD

Smaller countries have higher export-intensity.

- The larger countries are not necessarily the most trade oriented ones (share of trade in GDP).
- The relationship between trade orientation and size of the economy, if anything, is negative. (Why?)
 - The largest traders, US and China, have two-way trade origination at 28 and 41%, whereas HK and Singapore have very high trade orientations.

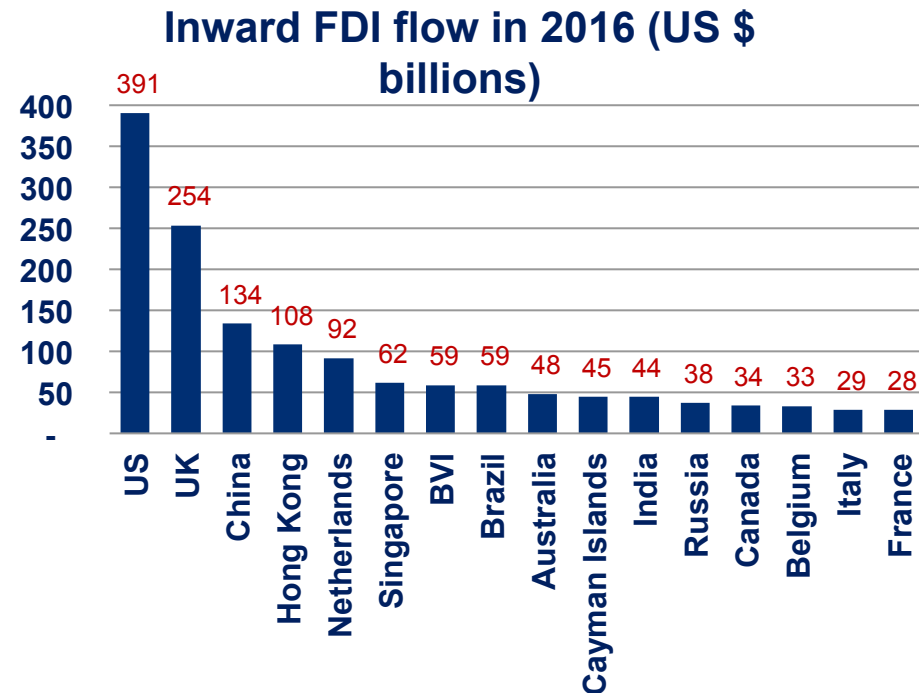
Share of exports in GDP
(percent)



Source: UNCTAD

Global capital is confined to a few large and developed countries

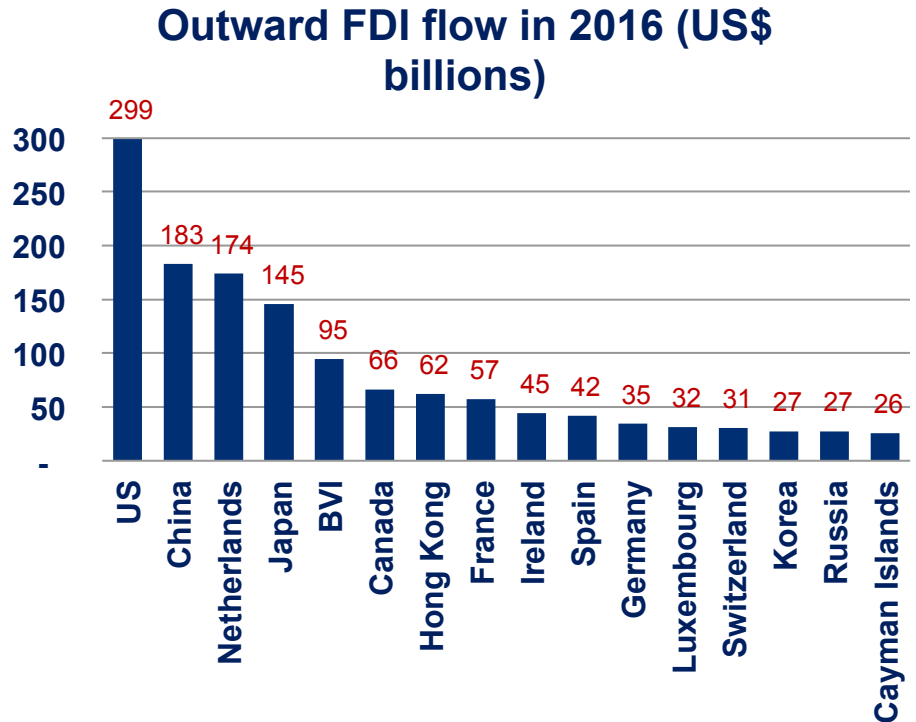
- These 16 largest FDI recipients of 2016 received 84% of the global FDI.
- Note the record FDI received by British Virgin Island (BVI), a small island, and Cayman Island, where multinationals shelter their profits to pay low taxes.
- All four BRIC (Brazil, Russia, India and China) countries are in the pack.
- It is the US trade deficits that allow other countries to invest in the US. Why?



Source: UNCTAD

... both inward and outward.

- As was the case in inward FDI flow, in outward FDI flow also US lead the world as the biggest capital supplier.
- BVI appears again; money is reported there (inward) and taken from there to somewhere where real production takes place.
- Canada was the 9th largest supplier of investment fund in 2009, ahead of UK, France and Italy among G7 countries.

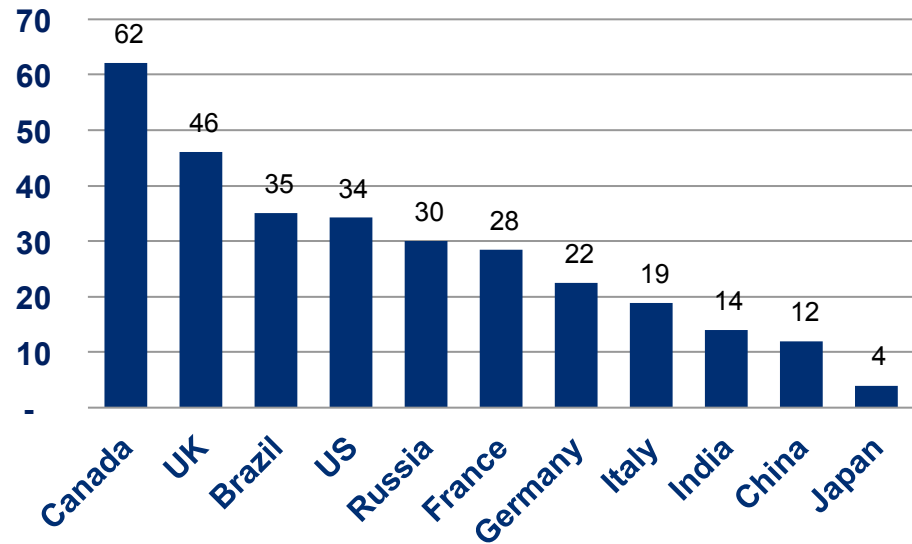


Source: UNCTAD

Capital generally flows in large and trade oriented countries.

- FDI has both flow and stock concepts, as is the case with any investment and resulting capital stock over time.
- Canada has the largest share of foreign capital stock in terms of GDP (FDI inward orientation).
- The exchange rate fluctuations matters a lot for FDI valuation. Why?
- BRIC countries have high inward FDI intensity.

Share of inward FDI stock in GDP for G7 and BRIC countries in 2016

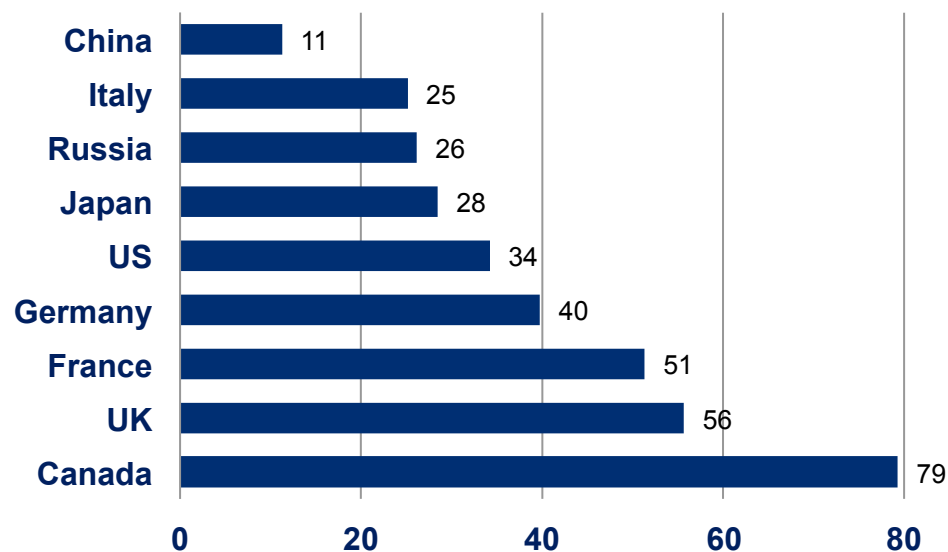


Source: UNCTAD

G7 countries are generally FDI exporters

- Again, Canada has the largest outward FDI orientation at 79%.
- Comparing this chart with that of inward orientation, it is clear that Canada is a capital exporting country, at least in terms of FDI.
- However, when we look at the overall balance of payment situation, Canada is a net debtor not a lender? How, What counts?

Share of outward FDI stock in GDP in 2016 (percent)



Source: UNCTAD

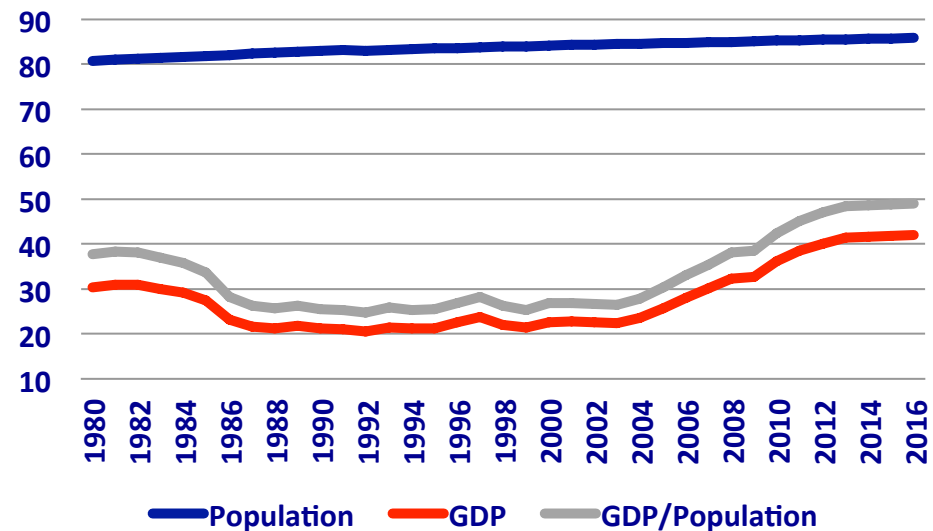
The Changing World Order

- The world order is changing in many ways and most important one from business perspective is the way the developing countries are growing.
- While the developing countries that were opposed to globalization in the past are appreciative of it, whereas countries that led for open trade are becoming more inward looking.
- In particular, China's unprecedented economic growth in the last three decades has alter the world economic order, making Asia a powerful economic center.
- Overall, the economies, are moving toward freer trade and FDI regimes.

Developing countries

- The shares of developing economies in both world output and population are rising.
- As the output share is rising faster than the population share, GDP to population ratio has increased from about one-third to now about half.
- In other words, developing countries have become relatively less poorer, but still their share of output is half the share of their global population.

Share of developing economies in the world (percent)



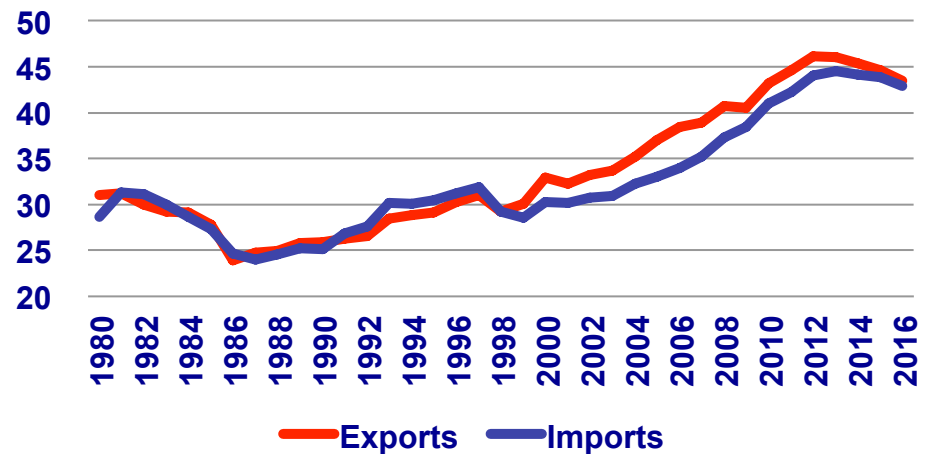
Source: UNCTAD

Developing countries are countries other than Austria, Australia, Belgium, Bermuda, Bulgaria, Canada, Croatia, Cyprus, Czechia, Denmark, Estonia, , Finland, France, Germany, Greece, Hong Kong, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxemburg, Malta, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Singapore, Slovakia, Slovenia, Sweden, Switzerland, UK, US,

It is more vivid in trade ...

- Developing countries' share of global trade (both in exports and imports) has been rising steadily.
- Their share of global exports increased from about 30 percent in the 90s and 2000s to 43 percent in 2016.
- The mirror image of this is that the share of developed countries in global export fell from about 70 percent to 57 percent during the same time period.

Share of developing countries in global trade of goods and services (percent)

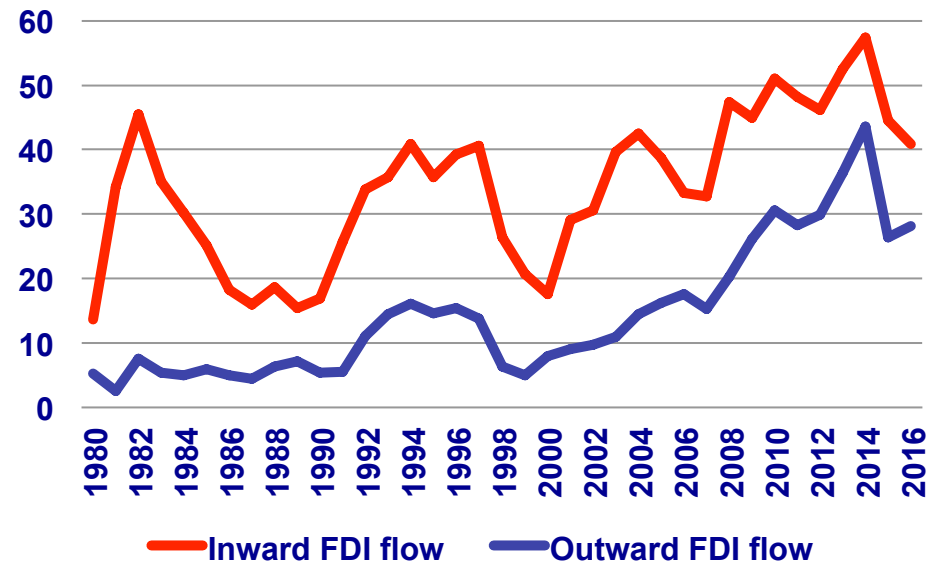


Source: UNCTAD

... And to some extent in FDI also

- More capital is flowing to developing countries.
- Their share of inward FDI flow increased from about 35 percent in the late 1990s to about 45 percent in more recent years.
- The companies of developing countries are also increasingly investing in foreign countries.
- Their share is increased to as high as 44 percent in 2014.

Share of developing countries in global FDI flows (percent)



Source: UNCTAD

Debating the issue

- **Globalization is political, technological and cultural, as well as economic: impact on all dimensions.**
- **Opposition to globalization has moved from protectionists, trade unionists, and idealistic youth to more diverse groups.**
- **The notion that globalization is the best remedy against poverty and stagnating economic growth has replaced by doubts, questions, and skepticism.**
 - Critics of globalization are not only relatively marginalized groups but the elites themselves, who were very enthusiastic about globalization.
 - What changed?

Debating the issue (contd.)

Anti-globalization arguments:

- Harmful effects on jobs and income
- Labor policies
- Environmental impact
- National sovereignty
- World's poor



Debate contd.

- Since the end of the WW II, a broad consensus was that global economic integration is a pillar for expanding global peace and prosperity.
- Yet a revolt against global integration is under way in the west.
- The revolt comes from the feeling that globalization is a project carried out by elites for elites with little consideration for the interests of ordinary people.
- Most often, the concerns are genuine.
- Moving forward, it is essential to design policies in such a way that the ordinary people are also the beneficiaries.

Coverage of the course

- **We will be covering various issues related to these few graphs.**
- **For example (just to invoke some questions that we will cover):**
 - What drives trade and FDI?
 - What is the importance of environment for business success?
 - What are the firm's strategies that help attain its core objectives?
 - What would be the best way for a firm to enter foreign market?
 - What is the role of international financial market in international business?
 - What is the role of strategy and economic institutions in international business?