Declining trade and investment barriers economics essay

The environment in which international business operates has become subject to the forces of globalisation and increasing world integration. One might even say that globalisation is the buzzword of economics today. There are many varying definitions of globalisation, some including cultural and political aspects but for the purpose of this manual, it is best to focus on the economic aspects of it. Globalisation, it is argued, is a shift towards a more integrated and interdependent world economy.

Furthermore, at a very simple level, one may distinguish between two broad aspects of globalisation.

1. 2. 1 Globalisation of Markets

It could have been argued that in the past, one could distinguish between many different national markets. However, globalisation of markets has caused moves towards a single homogeneous global market whereby consumer preferences are converging towards a global norm. One of the strong proponents of such an argument was Levitt (1983) who argued that companies needed to view the world as a single homogeneous, global market for products and services. A global firm should therefore view the world as a single unit and must strive to produce and market standardized product worldwide. Nevertheless, the firm is also expected to adjust its product offerings for local differentiation. The benefits from global standardization have enormous potential since firms are able to achieve economies of scale in many value-chain activities including production, distribution and management[1].

However, whilst there are indeed many common market needs, demands and acceptance of certain global products, there are also many deep divisions, cultural and other national differences between countries and markets. At the simplest level, these differences relate to differences in product use. For example, in some countries like for instance in Continental Europe, people drive on the right hand side whilst in South Africa or Mauritius for example, people drive on the left hand side. Hence, vehicle specifications to that end will be different[2].

1. 2. 2 Globalisation of Production

This refers to the sources of goods and services from locations around the world to take advantage of national differences in the cost and quality of factors of production. Globalisation of production is characterized by increased dispersion of value chain activities to different world locations. Instead of all business activities being singly concentrated, firms may choose to disperse some of their business activities to other locations.

For example, production may be undertaken in certain developing countries where labour is cheap; research and development in another location where high-level specialized skills are in abundance; and assembly may be performed at yet another location for ease of transport to world markets. As such, firms may exploit national differences in factor conditions such as land, labour, capital and skills, as well as demand conditions, infrastructure and government regulations.

1. 3 DRIVERS OF GLOBALISATION

Hill (2005) identifies the following factors that underlie the trend towards greater globalisation:

1. Declining Trade and Investment Barriers

After the Great Depression and the Second World War, developed countries have opted to remove barriers to international trade and foreign direct investment. This resulted in the GATT (General Agreement on Tariffs and Trade). There were a number of rounds of negotiations between countries which ensued and these led to further reductions and also extended GATT to cover services, intellectual property rights and eventually to the establishment of the World Trade Organisation (WTO) following the Uruguay Round in 1994. The WTO is a permanent body that is responsible for establishing and further entrenching rule based trade and for managing the rule based world-trading system (Hill, 2003).

These developments have contributed to the reduction of trade and investment barriers and lower restrictions on capital flow. These have in turn facilitated the globalisation of markets and production. In addition to reducing trade barriers, many countries have also been progressively removing restrictions to foreign direct investment that has further boosted world trade growth.

However, whether the removal of those barriers to trade is a good thing is a debatable issue. Many developing countries would argue that given their intrinsically different economic underpinnings, it will be almost impossible for them to compete on a level playing field as is propounded by globalisation.

They have further advanced that these barriers or protectionist measures are extremely important in that they provide in most cases a market for the developing countries' exports.

2. Technology

Over the last decades there has been significant technological advancement. The microprocessor revolution is perhaps the one that has had the most significant impact. Microprocessors are the underlying components that have fuelled the advancement in global communications. These include satellite, optic fibre and wireless communications as well as the computing revolution that has borne the Internet, the worldwide web and provided the possibilities of e-commerce. These technological developments have contributed to the globalisation of markets and production, through better communication, and integration of worldwide activities. It has also facilitated the speedy global transfer of funds and capital, which further fuels globalisation.

Other technological advancements that have contributed to globalisation include that of jet travel and containerization. Jet travel has enabled the rapid and widespread movement of people and goods across national borders (Hill, 2003). This has facilitated the setting up of new businesses, partnerships and negotiations across borders and has also helped in the co-ordination and integration of worldwide business activities.

3. Changing World Order

The fall of communism in the late 1980s has led to moves away towards democratization of countries in Eastern Europe and the former Central Asian Republics. Many of the former Iron Curtain Countries are more amenable to free market policies which are in turn conducive to globalisation. Thus, it can be argued that a shift in political ideology towards capitalism has been an important determinant of globalisation.

4. Convergence of Industrialisation Strategy Towards An Export Oriented Platform

To the classical economists, trade was seen as an engine of growth as it facilitated the exploitation of comparative advantage. But, by the 1950's, it was obvious trade was not having the expected propulsive effects because of imperfections in international trading systems, such as oligopolistic competition, discriminatory pricing, product differentiation and high tariff barriers. As a result, many nations adopted an import-substitution[3]strategy in a bid to reduce their import dependency.

Import-substitution strategy entailed a high level of protection, via tariffs, import restriction measures and quotas, which discriminated against exports via explicit and implicit tax of export activities and an overvalued foreign exchange rate. Also, the government used investment license, differential taxes, tax holidays, exemptions and remissions to influence resource allocation between industries and sectors.

The proponents of IS strategy firmly believed that they would be able to meet the domestic demand for manufacturing products; provide employment opportunities for skilled labour; ease pressure on the balance of payment and strengthen the long term productive capacity of the economy by importing the production technology via foreign firms[4]and by using the " infant" industry argument.

However, the overwhelming consensus is that IS was a failure[5]. IS strategy has turned out to be self-defeating since it has resulted in huge increases in imports of equipment and inputs while transfer pricing constituted a severe drain on foreign exchange. Also, IS granted excessive protection to industries producing inefficiently non-essential goods for high-income elite. Furthermore, fiscal credit and exchange rate policies, coupled with subsidies on imports of capital goods, made it possible and advantageous to entrepreneurs to rely on high capital intensive equipment produced abroad and technology unsuited to the factor proportions prevailing in less developed countries.

As a result, a new orthodoxy emerged in the late 60's and early 70's which stressed the role of exports of labour intensive manufactures as an engine of growth. This represented a return to the static theory of comparative advantage with trade based upon different factor proportions prevailing in various countries which meant that the pendulum turned full swing for development policy in LDCs from import substitution to manufactured exports.

Export oriented strategy not only encourages free trade[6], but also the free movement of capital, labour, enterprises and an open system of communication. It also entailed more efficient allocation of resources with firms competing internationally[7]based on their relative comparative advantages. These considerations, coupled with the emergence of trade blocks, were factors motivating changes in the strategic orientation of MNEs.

MNEs underwent a complete restructuring of their global and regional supply profiles. This entailed locating[8]manufacturing operations in only a few countries but exporting for a wider market. Each subsidiary were opened to a fully competitive market situation which permitted the realisation of economies of scale and the attainment of optimal efficiency in production (Pearce, 1999). The “ where” to produce clearly gained in prominence during such an era which led to MNEs redistributing their unchanged ownership advantages in order to create an international network of subsidiaries[9]which optimised their supply of established range of products. Thus, investments undertaken by MNEs were mainly of an efficiency-seeking nature.

5. Emergence of Regional Trade Blocks

Members to a regional initiative have to work towards a reduction or complete harmonization of their tariffs. Such a step taken by these members (most of which are signatories to the WTO) is seen as a partial liberalization initiative and is the first step towards complete liberalization which is propounded by the WTO.

1. 4 ADVANTAGES OF GLOBALISATION

Faster Growth – Economies that have in the past been open to foreign direct investment have developed at a much quicker pace than those economies closed to such investment. E. g. China as opposed to Russia.

Cheaper Imports – This is simply because the reduction of barriers to entry such as tariffs on imports will lead to a fall in price.

New Technologies – Developing countries, more receptive to FDI, have a greater chance of acquiring new and better technologies through diffusion and spillover effects.

Spur of Foreign Competition – Foreign competition will encourage domestic producers to increase efficiency.

Increased Investment Opportunities – Companies can move capital to countries that offer the most attractive investment opportunities. This prevents capital being trapped in domestic economies and earning poor returns.

1. 5 DISADVANTAGES OF GLOBALISATION

Culture – The protection of its own culture through subsidies and grants may be a major hold back of globalisation.

Local focus or Localisation – Douthwaite (1996) believes that globalisation can and should be reversed. He argues that localization is the way to do this. He calls for a balance between local, regional, national and international markets since this would curb the control given to multinationals. He also argues that governments should work together to reduce the power of multinationals by negotiating new trade and treaties that would remove the subsidies powering globalisation and give local production a chance.

Loss of jobs in developed economies – Because of increased competition as a result of globalisation, firms are increasingly shifting their production plants to cheaper locations to reduce costs. This has led to an increase in the level of unskilled unemployment.

Loss of Sovereignty – Many anti-globalisation campaigners argue that countries are increasingly losing their sovereignty and powers to implement local decisions because of the powers provided to the WTO.

Technology – Although it is one of the most important drivers of globalisation, technology has nevertheless widened the poverty gap. Developing and less developing countries' inability to adopt new technologies entails that they are unable to compete against their developed countries' counterparts.

EXERCISE

Please insert case study entitled Globalisation: Boon or Bane

1. 7 SUMMARY

Globalisation of markets has caused moves towards a single homogeneous global market whereby consumer preferences are converging towards a global norm. One of the strong proponents of such an argument was Levitt (1983) who argued that companies needed to view the world as a single homogeneous, global market for products and services.

It could be argued that the following factors could be considered as the main drivers of globalisation: technology, changing world order and the dismantling of barriers to trade, convergence of industrialization strategy and the emergence of RTAs.

Some of the main advantages of globalisation are namely faster growth, cheaper imports, new technologies, spur of foreign competition and increased investment opportunities.

Some of the negative consequences of globalisation are loss of sovereignty, loss of jobs in developed countries and a widening poverty gap.

SUGGESTED READINGS

Hill, C. W. L. (2005) ‘ International Business. Competing in the Global Marketplace’, 5th Edition, New York, NY: Irwin-McGraw-Hill Inc.

Hill, C. W. L. (2003) ‘ International Business. Competing in the Global Marketplace’, 4th Edition, New York, NY: Irwin-McGraw-Hill Inc.