Mercantile projection

The examiner for foundation level Economics for Business

Has the extent of economic globalisation – the increasing interdependence of major economic entities – been overstated? Perhaps it's more a case of regional integration

"The global village", "multinational companies" and "world products" are familiar phrases. They reflect a phenomenon in which national entities have been replaced by worldwide ones. It's called globalisation, and we all know what that means. Or do we? Globalisation is more complex than at first it seems, and the role of multinational enterprises (MNEs) in that process is more complex still. To understand globalisation we need to know the main features of the process, the causes and the role that MNEs play in it.

The EC describes globalisation as "the process by which markets and production in different countries are becoming increasingly interdependent [owing] to the dynamics of trade in goods and services and the flow of capital and technology. It is... the continuation of developments that have been in train for some considerable time."

So globalisation is seen largely as the increasing interdependence of economies. But does this simply mean that they are becoming more dependent on international trade and flows of factors of production? The main point seems to be that globalisation is different from the mere internationalisation of those processes. Supporters of the globalisation thesis argue that the most important economic entities are becoming global. But what are these entities?

- **Product markets**. In a globalised world there are world markets for oil, cars, computers etc, rather than national markets.
- **Factor markets**. In a globalised world there is a world capital market, rather than national capital markets.
- **Companies**. Multinational businesses that retain national characteristics of their country of origin are replaced by genuinely transnational companies that have no real affiliation to any one country.
- **Processes**. National competition is replaced by global competition, so organisations must develop global, rather than national, business strategies.

  What is the evidence for this?

- **Increasing trade flows**. The degree to which a country is integrated into the world economy by virtue of its international trade is measured by its trade ratio, the ratio of exports and imports to national income. For example, in 1995 the UK's ratio of merchandise trade (imports plus exports of goods) to its gross domestic product was 42.6 per cent. For the Netherlands it was 83.4 per cent.
- **Increasing international capital flows**. International capital flows as a percentage of GDP for the G7 countries reached 3 per cent by the late 1990s. This was a large proportion of total savings and investment in these countries.
- **Market integration**. If there are genuine world markets, then national markets for products and factors would be integrated and there would be only small differences in prices between countries. This can be seen in some product markets, especially energy and raw materials, and in some factor markets.

This evidence needs to be considered carefully in order to assess the extent of globalisation. Two factors suggest that it may have been overstated. First, some measures of the integration of economies were higher in the past than they are now. For instance, in the UK the ratio of merchandise trade to GDP was 44.7 per cent in 1913 compared with 42.6 per cent in 1995. Also, international capital flows before 1914 were much higher in relation to GDP than they are now. Globalisation may not be such a new phenomenon as some would believe.

Second, much of the trade of many countries is conducted with a relatively small number of trading partners. EU member states have very high trade ratios of 35 per cent and above, but most of their trade is with other EU nations. For the EU as a whole, merchandise trade with the rest of world is equivalent to only about 9 per cent of its total GDP. So we may be seeing a high degree of integration within groups of countries, but much lower integration between these groups. Perhaps the world is seeing regionalisation rather than globalisation?

Globalisation has economic, cultural, social and political facets. Our concern is with economic globalisation and the forces promoting it, but we should remember that these different aspects are not entirely separate. Cultural globalisation may also promote economic globalisation, for example.

Three main forces appear to be behind economic globalisation:

- **Technological change**. The increasing importance of economies of scale and standardisation as a means of cutting costs and retaining competitiveness has encouraged firms to rationalise their production processes, placing different stages of production in different locations depending on where costs are lowest. Moreover, costs can be cut by reducing product ranges – hence the concept of "world cars" such as the Ford Mondeo. Second, greatly improved information and communications technology has made the management and control of such integrated enterprises possible.
- **Deregulation**. The liberalisation of economies has become a significant trend. Trade barriers have been dismantled under the aegis of the general agreement on tariffs and trade (Gatt) and the World Trade Organisation. Markets have been

deregulated in many countries as part of the new approach to economic management adopted since the 1980s. Goods and services can be traded much more easily and factors of production, especially capital, are now internationally mobile. This enables the integration of markets – eg, for capital – and makes internationally integrated production viable.

- **The role of multinationals**. There is no doubt that the growth and development of MNEs has been one the major drivers of globalisation. Much of the economic activity referred to above is conducted by them. A great deal of international trade is now intra-company trade – ie, the movement of goods between countries but within different parts of one MNE.

This raises the obvious question: what is the role of MNEs in globalisation? They have existed for years and there is a long history of attempts to explain why firms go multinational and the consequences of this. But what the globalisation thesis claims is that the impact of MNEs in recent years has changed, which is crucial to the process.

The number of MNEs has increased dramatically in recent years, and both technological change and market forces have encouraged many smaller enterprises to go multinational too. In 2002 the United Nations estimated that there were 65,000 multinational enterprises and that these controlled more than 800,000 subsidiary companies. Clearly, commercial activity on this scale will have a major impact on the world economy. The United Nations also calculated that MNEs accounted for a third of international trade, and that the total sales of these companies were equal to over half of the world's GDP.

But it is the behaviour of MNEs, rather than the number of them, that is central to the globalisation process. They are one of the main mechanisms for international capital flows. In effect, foreign direct investment is conducted by MNEs. These capital flows also lead to flows of technology and management style – for instance, the "Japanisation" of UK management.

MNEs are central to the "new international division of labour" by which companies break production up into different stages and then locate each one in the country where it can be performed most efficiently. Car producers therefore change from making different cars in different nations to making world cars, with each part manufactured in the country where costs are lowest and economies of scale can be achieved. International integration of production within companies leads to greater economic integration and interdependence between countries.

It would therefore appear that global processes such as trade liberalisation and the actions of MNEs are promoting the integration of national economies – ie, the process we call globalisation. But most trade flows are still within particular groups of countries, and the same goes for most capital flows. Also, most MNEs still retain national features – Microsoft is clearly a US business, for instance – and they still depend heavily on their country of origin for output and sales.

The success of the world economy in raising living standards over the past 50 years may be as much the result of a process of regional integration as it is the result of globalisation. Perhaps our focus should be on these regional groupings, such as the EU, rather than on the globalisation process, but that is another story. ■