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Key stylized facts about globalization

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References for this lecture

- Textbook:
  - BBGV chapter 1 “The global economy”
  - BBGV chapter 2 “Getting the numbers right”
    - Study: 2.1, 2.2, 2.7, 2.8
    - Read only: 2.3, 2.4, 2.5, 2.6

- Further suggested readings:
  - Maddison A (2001) *The World Economy: A Millennial Perspective*. OECD Development Centre Studies
  - *When did globalisation start?* The Economist, Sep 23rd 2013
  - O’Rourke, K. H., and Williamson, J. G. (2002) *When did globalisation begin?* European Review of Economic History, 6(1), 23-50

https://www.weforum.org/press/2017/01/president-xi-jinping-don-t-blame-economic-globalization-for-the-world-s-problems

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President Xi Jinping: Don't Blame Economic Globalization for the World's Problems

Published

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But, Xi warned, "We should recognize that economic globalization is a double-edged sword. The pitfalls of economic globalization have been laid bare and we need to take these seriously." He added: "Nothing is perfect in the world. It is true that economic globalization has created new problems. But this is no justification to write off economic globalization altogether." Xi recalled that China had at first doubted the wisdom of joining the World Trade Organization, but had bravely gone ahead with membership and determined that it was the right strategic choice. "If one is always afraid of the bracing storm, one will get drowned in the ocean sooner or later," he said.

Xi called for efforts to rebalance economic globalization so that all people share in its benefits. This will require more effective international cooperation and new models of global governance, bold action and a commitment to avoid protectionism. "We should not develop the habit of retreating to the harbour whenever encountering a storm." Referring to the threat of protectionism, he predicted that "nobody will emerge as a winner in a trade war."

http://www.washingtonpost.com/wp-dyn/content/article/2011/01/28/AR2011012801651.html

washingtonpost.com > Business > U.S. Economy

Poll: Americans increasingly view global economy as a negative for U.S.

By Jon Cohen and Peyton M. Craighill
Washington Post Staff Writers
Friday, January 28, 2011; 8:02 PM

A growing number of Americans consider the accelerating trend toward globalization a bad thing for the United States. At the same time, a majority now sees being the world's No. 1 economic power as an important national goal.

The numbers mark a turnabout over the past decade. In 2001, six in 10 Americans said tightening economic ties were a positive development. That dropped to 42 percent in 2003 and now sits as 36 percent.

What is globalisation (in your view)? Is it positive or negative?

GLOBALISATION IS:

1. Mostly positive as it helps in diffusing wealth worldwide
2. Mostly negative as it increases world inequalities
3. Do not know

The results of a poll in Italy in 2001

GLOBALISATION IS:

1. Mostly positive as it helps in diffusing wealth worldwide **27%**
2. Mostly negative as it increases world inequalities **34%**
3. Do not know **39%**

Before we start

Do you know:

- What is the GDP – Gross Domestic Product?
- What is an investment?
- What is capital?

- What is a demand function?
- What is a supply function?
- What is a monopoly or an oligopoly?

Discussion: what do we mean for globalization?

- **Cultural** globalization
- <u>**Economic** globalization</u>
- **Geographical** globalization
- **Institutional** globalization
- **Political** globalization

Cultural globalization

- Is there a ‘**global culture**’?
  - Access to similar ‘**cultural experiences**’ (e.g. Youtube ‘hits’, American movies, British and American music, etc.)
  - Access to ‘global’ **products** (e.g. Coca Cola, iPhone, etc.) that influence people’s behaviors

- **Fear** that increased cultural **homogeneity** may threaten local cultures and traditions
  - Very interesting issue to be studied (but not in an ‘Economics’ course…)

Economic globalization

- **Decline** of **national markets** and **rise** of **global** markets as the firms' focal point
  - For **production**, **sale**, **procurement** of inputs

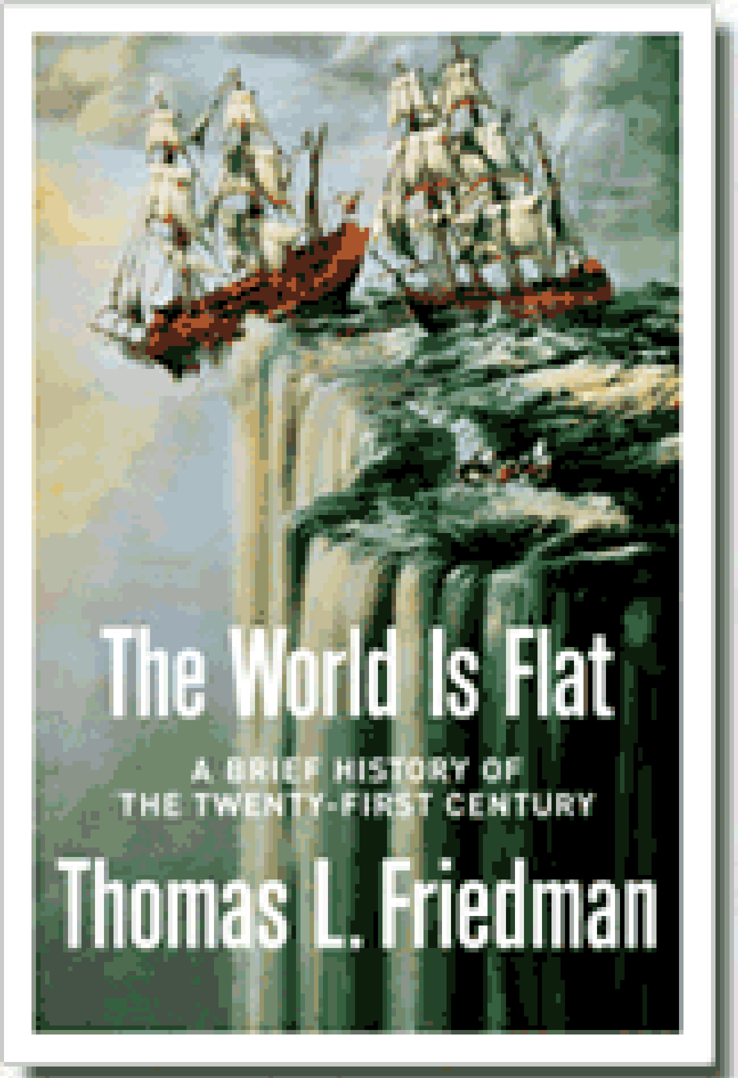
- Increased **interdependence** of national economies

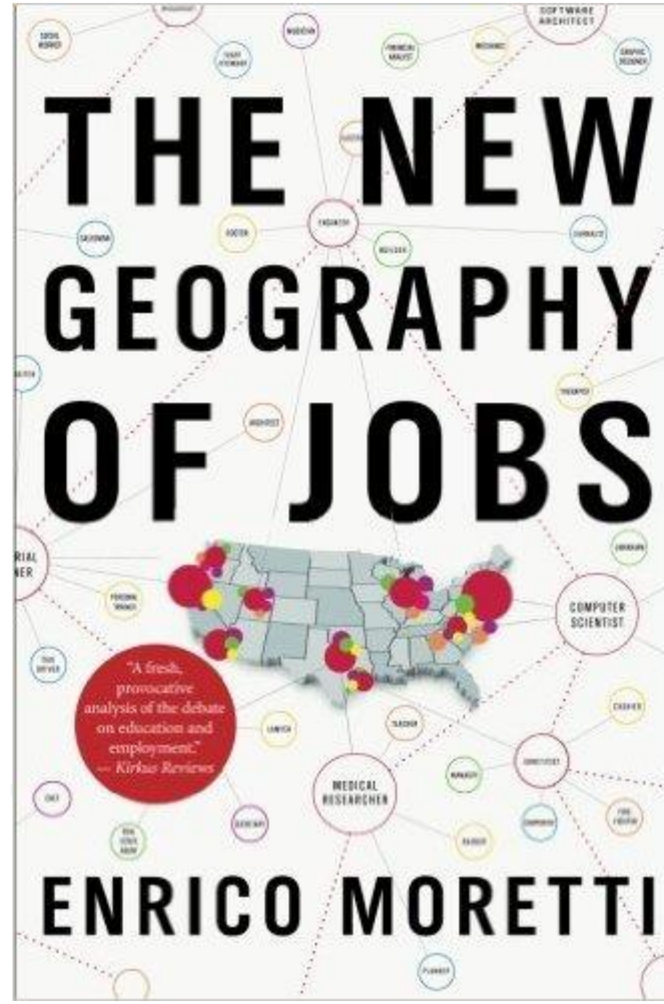
- Greater **integration** (i.e. lower barriers across countries) of goods/services, labour and capital markets

Geographical globalization

- Reduced **travel time** and **costs** for:
  - **People** (e.g. high-speed trains, low-cost regional flights)
  - **Goods** (e.g. larger and faster cargo ships)
  - **Information** (e.g. internet broadband)

- Is the world **flat**(ter)?
  - **Location** in a specific place is still **very important** (but for **different reasons** than in the past)
    - Everyone (almost…) wants to start a business in SF!!!
    - …even though real estate costs in SF are way higher than in any small town in, say, Idaho, despite the same speed of internet connection


The World Is Flat
A BRIEF HISTORY OF
THE TWENTY-FIRST CENTURY
Thomas L. Friedman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THE NEW
GEOGRAPHY
OF JOBS
COMPUTER SCIENTIST
"A fresh, provocative analysis of the debate on education and employment."
— Kirkus Reviews
MEDICAL RESEARCHER
ENRICO MORETTI

Institutional globalizatoin

- Spread of **universal institutional arrangements** across the globe

- Neo-liberalism diffusion throughout the world (aka **Washington Consensus**) through policies and programmes of IMF and Wolrd Bank

Political globalization

- **Fear** that large **multinational** entreprises (larger than many countries) will **substitute** nation **states** in taking decisions that affect the people
  - Multinational entreprises are **not democratic** as opposed to (some or many) nation states
  - In case of **international disputes** they have some possibility of **escaping jurisdictions**
  - **Race-to-the-bottom** in terms of corporate **taxation**, **rights** for workers and **environmental** standards

- Nation **states** maintain many **important 'functions'** that are at the core of sovereignity (e.g. defense and security, but also education, infrastructures, etc)

The four dimensions of economic globalization

- International movements of **goods and services** (import, export, subcontracting, international fragmentation of production)
- International movements of **capital** (financial exchanges, foreign direct investment, international fragmentation of production)
- International movements of **people** (migrations, international mobility of workers, students, researchers)
- International movements of **knowledge** (foreign patents, licences, agreements, R&D internationalisation, international mobility of workers, students, researchers)

Dimensions are interrelated

- International movements of people, capital, goods and knowledge have **different origins** and had different **patterns** over time but they are more and more **interrelated**

- **Capital** movements have **favoured trade** exchanges as well as movements of **people** and **knowledge**

- **People moving** across countries **bring knowledge** gathered elsewhere and activate import/export from/to countries of origin

Is economic globalization a new phenomenon?

- When we talk about globalization we often refer to the most recent **wave** of globalization (occurred in the last half century)

- Economic globalization was:
  - Very **important** already **centuries ago**
  - Did **not** increase **monotonically** since then but was rather characterized by various **waves**

TRADE

Developments of trade

- Important trade flows already in **ancient cultures** => Egypt, Greece, Roman Empire, China, India, Mesopotamia

- **Venice, 1000-1500 AD**
  - Radical **improvement** in shipbuilding and **navigation** (i.e. compass)
  - **New** long-range **routes** (including routes to China, remember the travel of Marco Polo around 1300 AD)
  - ‘**Invention**’ of accounting and **banking**
  - Trade of **valuable items** (e.g. spices, silk)
  - The power of Venice as a commercial player **declined** after the **fall** of the **Eastern Roman Empire** (1492)

Developments of trade

- After the decline of Venice, **Portugal** took the lead in world trade
  - **New routes** to Africa, China and Japan
  - Key role in **exploration** of new lands (e.g. Vasco de Gama, Magellan), together with Spain (that financed the expedition of Cristoforo Colombo, who was Italian,though ☺)

- The globalization processes discussed so far were characterized by a **stable 'price wedge'** (i.e. additional price for importing foreign goods) and expanding demand for **luxury goods**

Developments of trade

- The **Netherlands**, first, and **Britain**, afterwards, took over the Portuguese leadership in trade

- The success of **Britain** (XVIII century) was due to its **industrial leadership** and its **pro-trade** attitude
  - **Reduction** of **tariffs** on imported **agricultural** items, that allowed a **specialization** in **industrial** products

- This wave of globalization (**up to WWI**) and the one **after WWII** were driven by **reductions in the ‘price wedge’**
  - Trade liberalization, collapsed transportation costs, better communication possibilities

Table 1.5 Price convergence and declining transport cost, 1870–1913

Transport cost reductions (index)		
American export routes, deflated freight cost	1869/71–1908/10	100 to 55
American east coast routes, deflated freight cost	1869/71–1911/13	100 to 55
British tramp, deflated freight cost	1869/71–1911/13	100 to 78
Commodity price convergence at selected markets (% deviation)		
Liverpool–Chicago, wheat price gap	1870–1912	58 to 16
London–Cincinnati, bacon price gap	1870–1913	93 to 18
Philadelphia–London, pig iron price gap	1870–1913	85 to 19
London–Boston, wool price gap	1870–1913	59 to 28
London–Buenos Aires, hides price gap	1870–1913	28 to 9

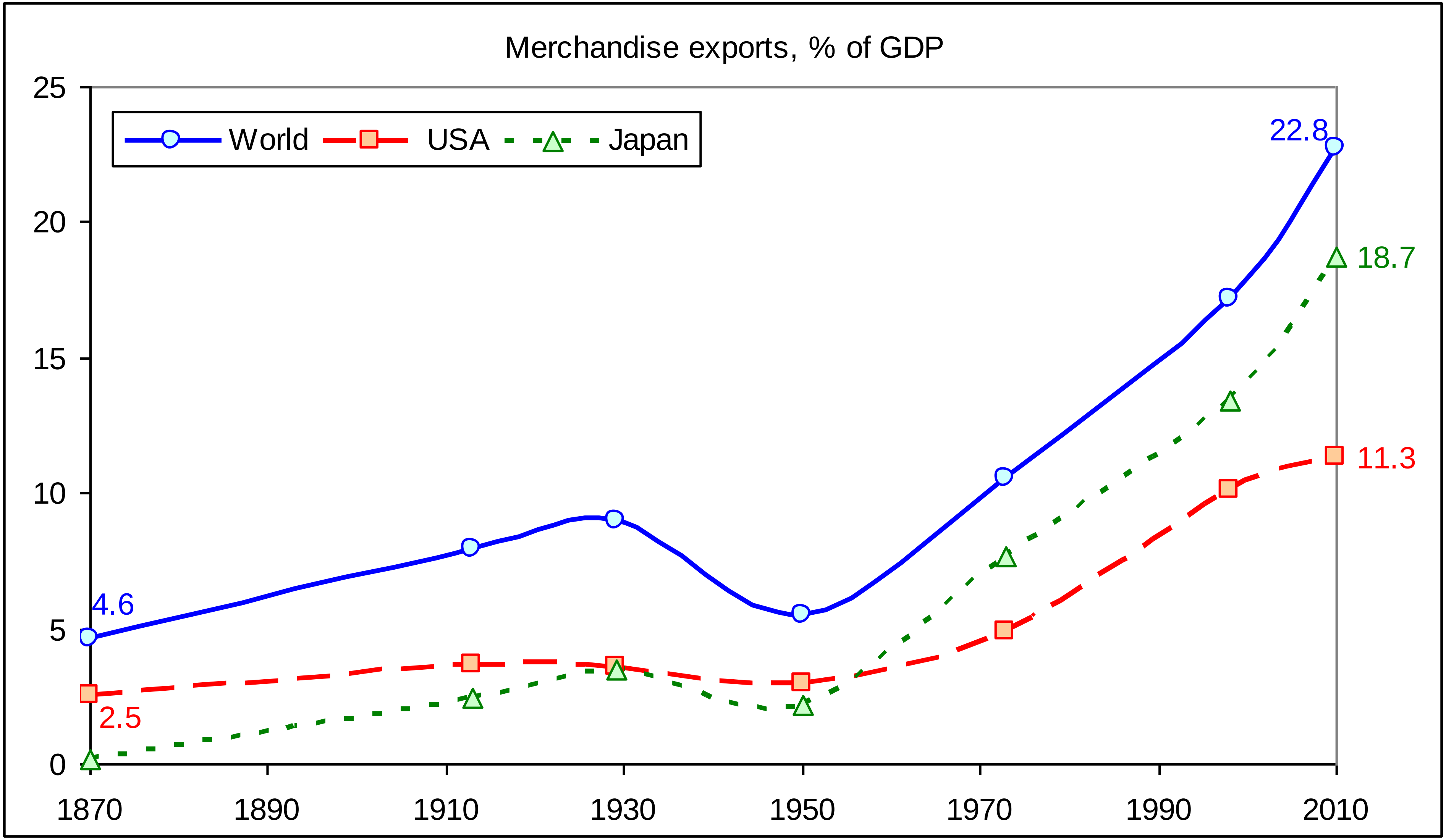
Source: O'Rourke and Williamson (2000, table 1).

Table 1.6 Tariffs on manufactures for selected countries, 1820–2010, per cent

	1820[a]	1875[a, b]	1913[a, b]	1931[c]	1950[c]	2010[c]
Denmark	30	15–20	14	–	3	1.9 (EU)
France	Prohibition	12–15	20	30	18	1.9 (EU)
Germany	–	4–6	13	21	26	1.9 (EU)
Italy	–	8–10	18	46	25	1.9 (EU)
Russia	Prohibition	15	84	Prohibition	Prohibition	6.0
Spain	Prohibition	15–20	41	63	–	1.9 (EU)
Sweden	Prohibition	3–5	20	21	9	1.9 (EU)
Netherlands	7	3–5	4	–	11	1.9 (EU)
UK	50	0	0	–	23	1.9 (EU)
USA	45	40	44	48	14	3.0

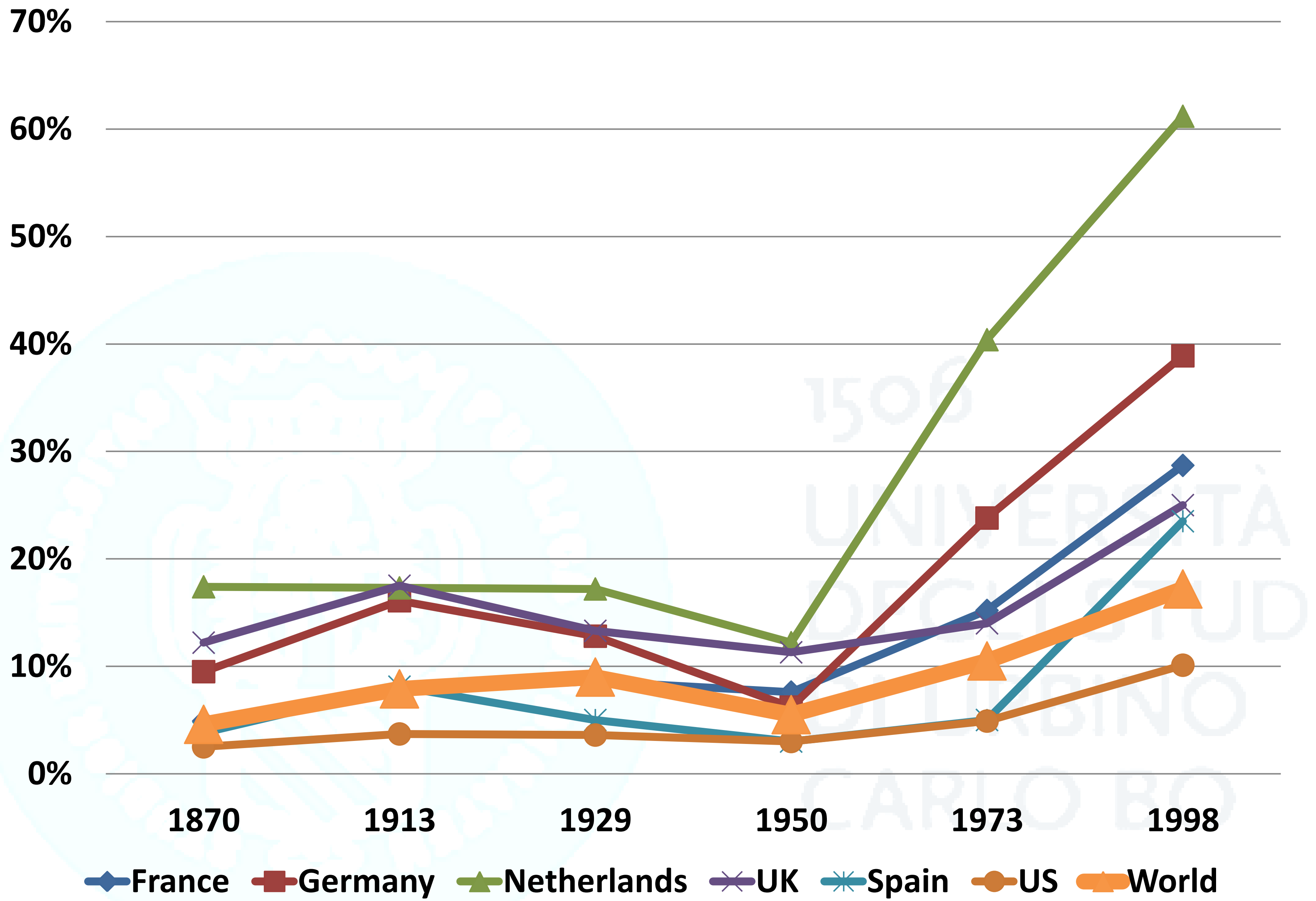
Sources: [a] Baldwin and Martin (1999, table 8); [b] O'Rourke and Williamson (1999, table 6.1); [c] World Development Indicators Online; – = data unavailable.

Figure 1.10 Two 'waves' of globalization, merchandise exports, per cent of GDP

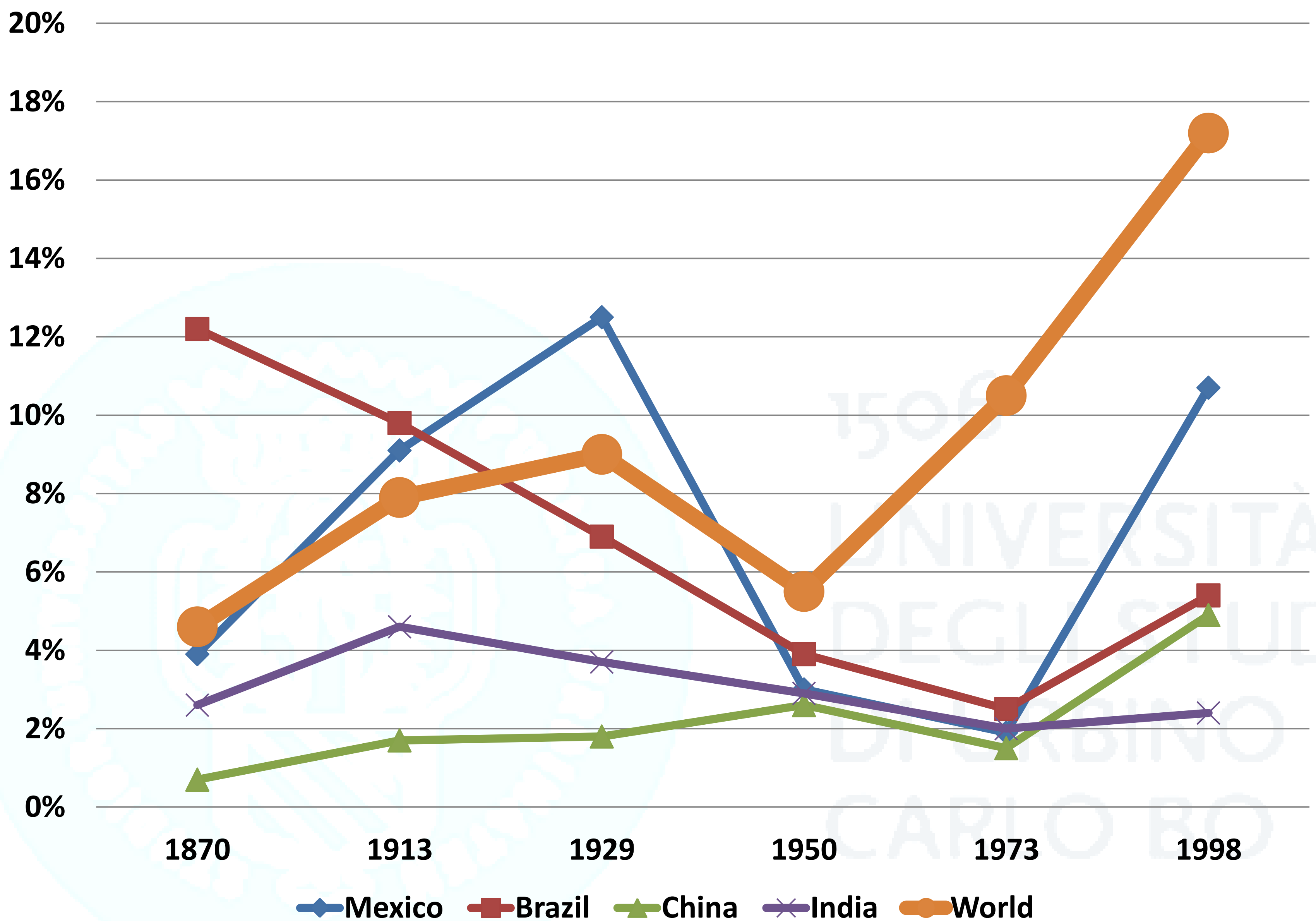


Data sources: Maddison (2001, table F-5) in constant 1990 prices, extended to 2010 using WTO International Trade Statistics and World Development Indicators Online.

Merchandise Export as Per Cent of GDP, 11 Countries and World, 1870-1998. Source: Maddison (2001)



Merchandise Export as Per Cent of GDP, 11 Countries and World, 1870-1998. Source: Maddison (2001)



Modern history of trade

- Rapid **rise** of trade **barriers** after **WWI** and the **Great Depression** (1929) up to the end of **WWII** (1945)

- **Negative** impact on economic **growth**

- **After WWII trade** has been seen as a tool to **promote pacific relationships** between countries
  - Creation of **GATT** (General Agreement on Tariffs and Trade, then transformed into WTO), **OECD** (Organisationi for Economic Co-operation and Development) and the **World Bank**
  - Remarkable increase of **trade** and **income** worldwide
  - Sometimes, the sudden **'forced' opening to trade** mandated by international organizations generated the collapse of the industries of the country ➔ e.g. USSR post-1991; Asian Tigers 1997-1998

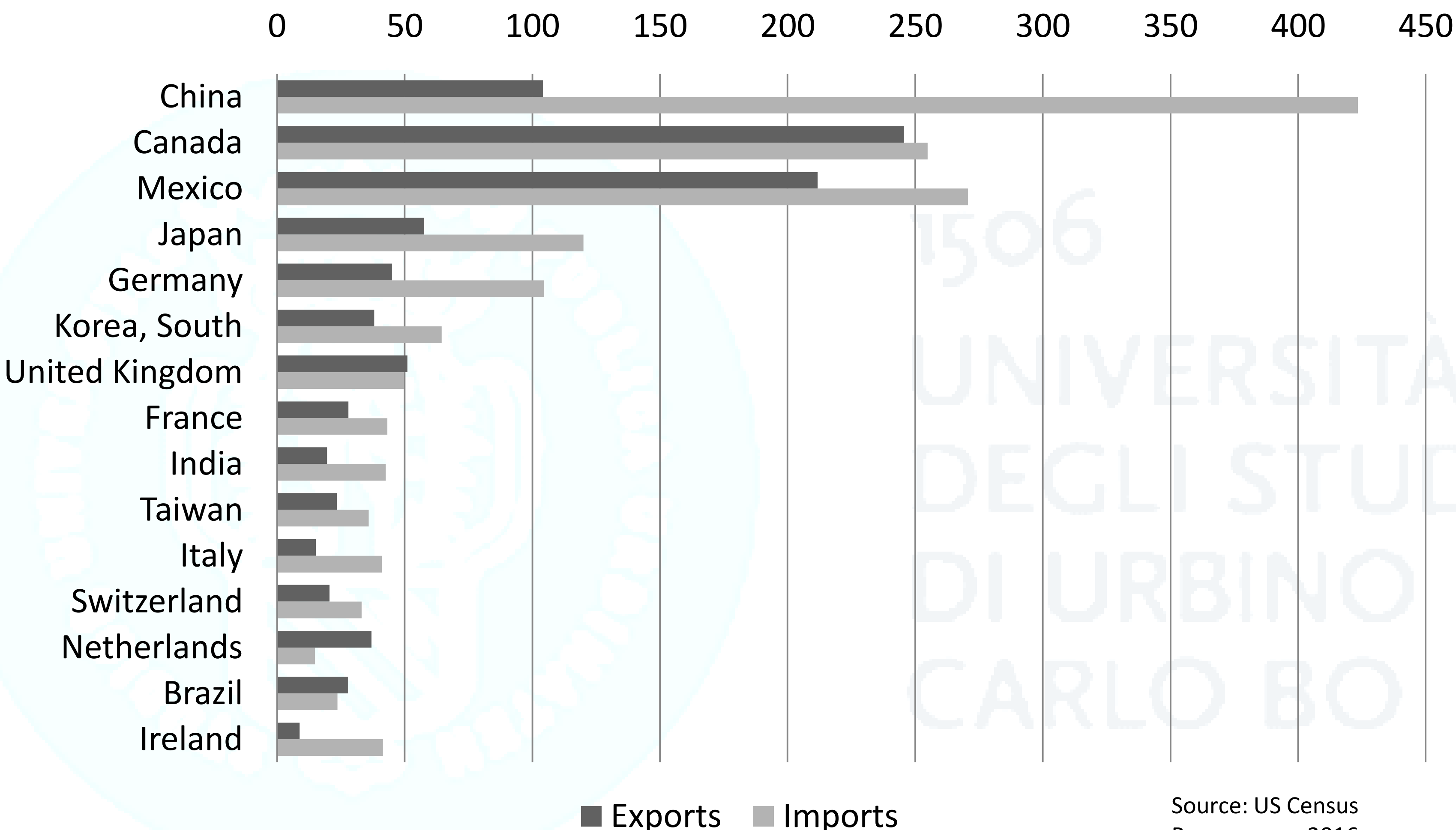
What kind of trade?

- **Before** the **industrial revolution** the bulk of long-distance **trade** consisted of **noncompeting products**
  - Products that were **not produced** in the **importing** regions (e.g., spices, silk)

- In the early **nineteenth century**, it also covered significant amounts of **basic goods**, such as wheat, and **simple manufactures**, such as textiles

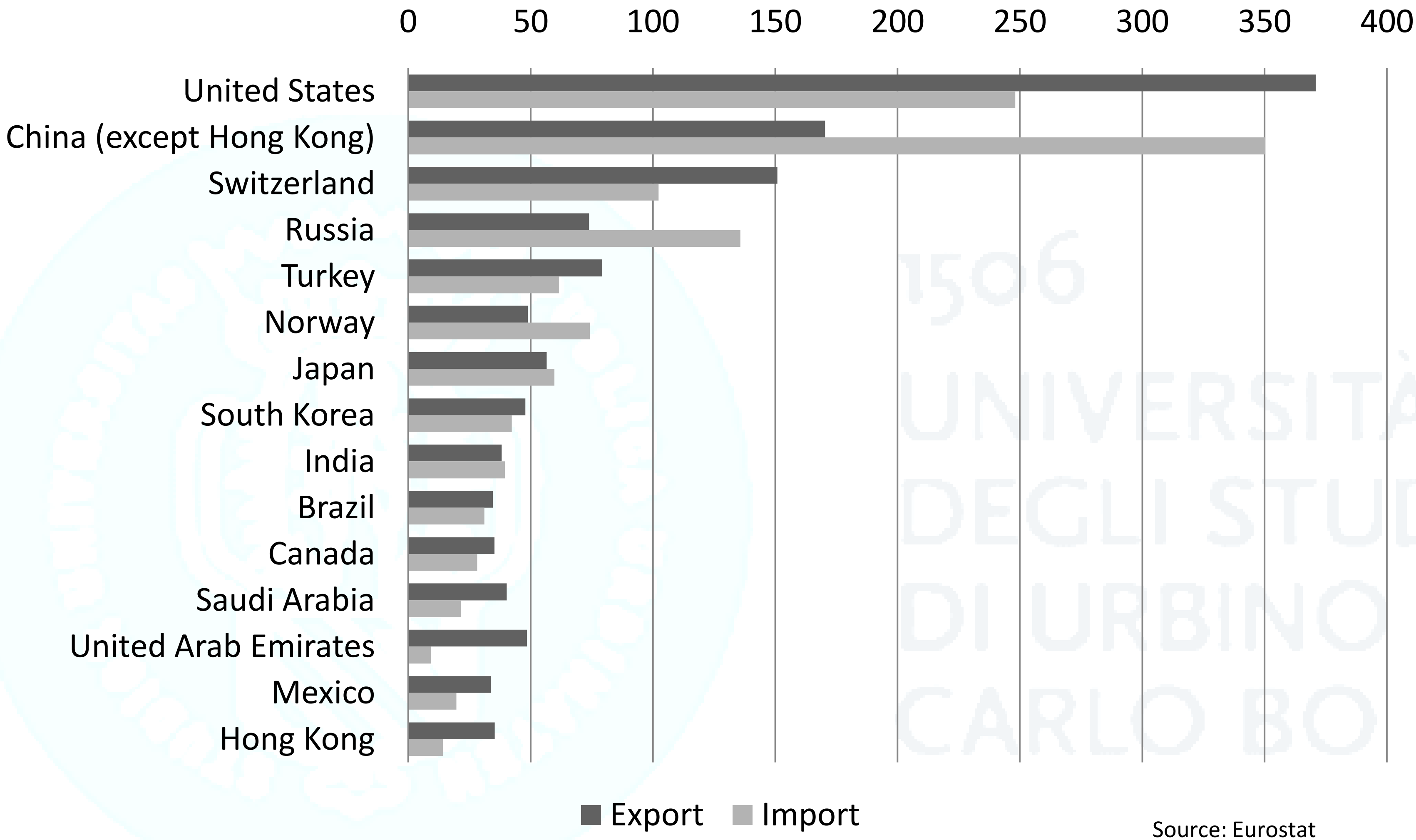
- During the nineteenth century, **trade expanded** rapidly, partly because of an incredible **decline** in **transport costs** and partly because of the **rise of manufacturing**

Who trades with the U.S.?



Source: US Census Bureau, year 2016

Who trades with the EU?



Source: Eurostat

INVESTMENTS

Trade vs investments

- To serve a **foreign market**, firms may:
  - Produce at home and **export ➔ trade**
  - Produce (and thus **invest**) **abroad ➔ Foreign Direct Investment** (FDI)

- The **value chain** of production may also be **fragmented** and **located** in a **variety of countries**

- **Foreign production** (of any kind) requires an **investment abroad**

Figure 2.1
Home firm decision tree

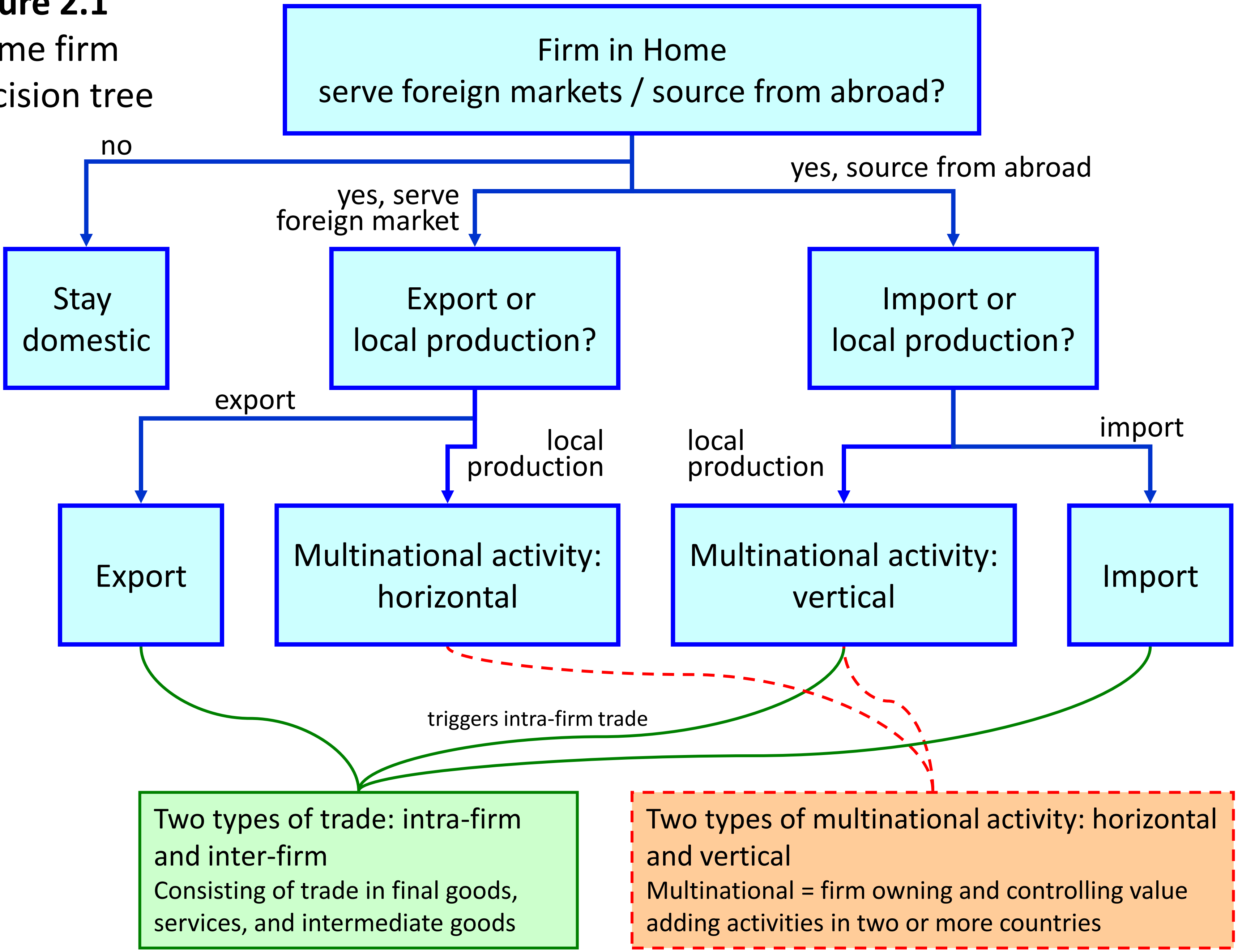
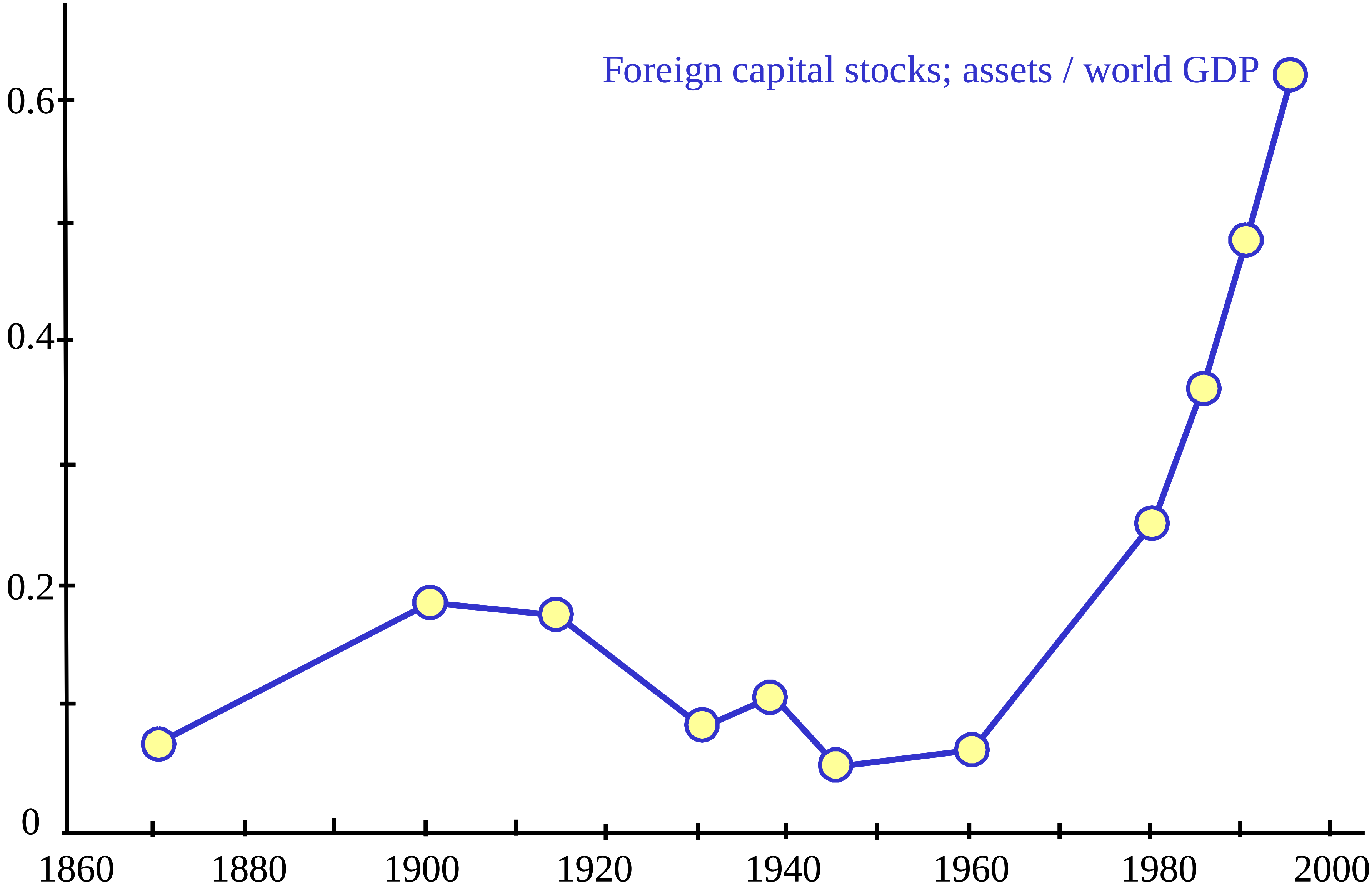


Figure 1.13 Foreign capital stocks; assets/world GDP, 1860–2000



Source: Based on Obstfeld and Taylor (2003).

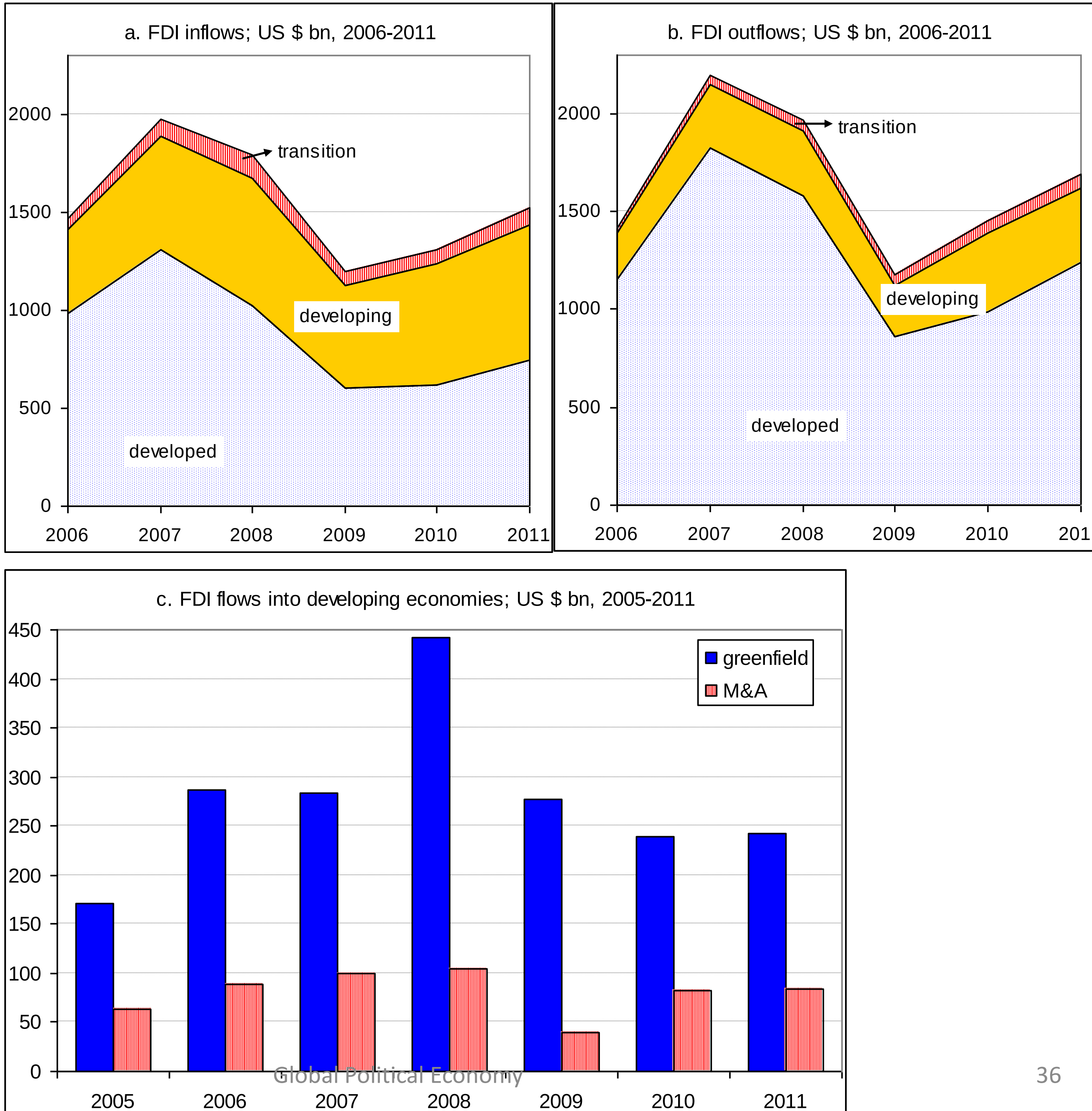
Foreign Direct Investment

Definition (UNCTAD, 2006):

*"A <u>Foreign Direct Investment</u> (FDI) is an investment involving a **long-term relationship** and reflecting a **lasting interest and control** by a resident entity in one economy (parent enterprise) in an enterprise resident in an economy other than that of the parent entrerprise (affiliate enterprise or foreign affiliate).*

*FDI implies that the investor exerts a **significant degree of influence on the management** of the enterprise resident in the other economy. Such investment involves **both** the **initial transaction** between the two entities and **all subsequent transactions** between them and among foreign affiliates."*

Figure 2.6
FDI flows, 2005-2011



Source: based on data from UNCTAD, World Investment Report 2012; developed = developed economies; developing = developing economies; transition = transition economies.

Table 2.4 Inward FDI stock; US $ bn, 2009

a. USA inward FDI stock			b. Germany inward FDI stock		
Total	2,253	%	Total	909	%
United Kingdom	454	20.1	Netherlands	230	25.3
Japan	264	11.7	Luxembourg	127	14.0
Netherlands	238	10.6	United States	98	10.7
Canada	226	10.0	France	96	10.5
Germany	218	9.7	Switzerland	75	8.2
Switzerland	189	8.4	United Kingdom	73	8.1
France	189	8.4	Italy	47	5.1
Luxembourg	128	5.7	Austria	25	2.8
Australia	46	2.0	Japan	20	2.2
Spain	44	1.9	Sweden	18	2.0

c. Japan inward FDI stock			d. Australia inward FDI stock		
Total	189	%	Total	224	%
United States	75	39.7	United States	66	29.5
Netherlands	36	19.1	United Kingdom	42	18.6
Cayman Islands	17	9.0	Japan	25	11.1
France	15	8.0	Netherlands	17	7.7
Singapore	11	5.6	Switzerland	14	6.0
United Kingdom	7	3.9	Germany	10	4.2
Germany	7	3.8	France	9	4.1
Switzerland	5	2.6	Canada	7	3.1
Luxembourg	4	2.3	Singapore	7	3.1
Hong Kong	3	1.4	Hong Kong	7	2.9

Source: OECD Foreign Direct Investment Position database; German and Australian data for 2008.

Table 2.7 FDI inflows and outflows, as % of total flows

	Developed economies		Developing economies		Transition economies	
Period	In	Out	In	Out	In	Out
1980-89	74.7	94.0	25.3	6.0	0.0	0.0
1990-99	68.1	88.0	30.8	11.7	1.0	0.4
2000-09	65.1	85.0	31.3	13.2	3.9	1.8

Source: UNCTAD

Multinational enterprises (MNEs) are key actors in the globalisation process

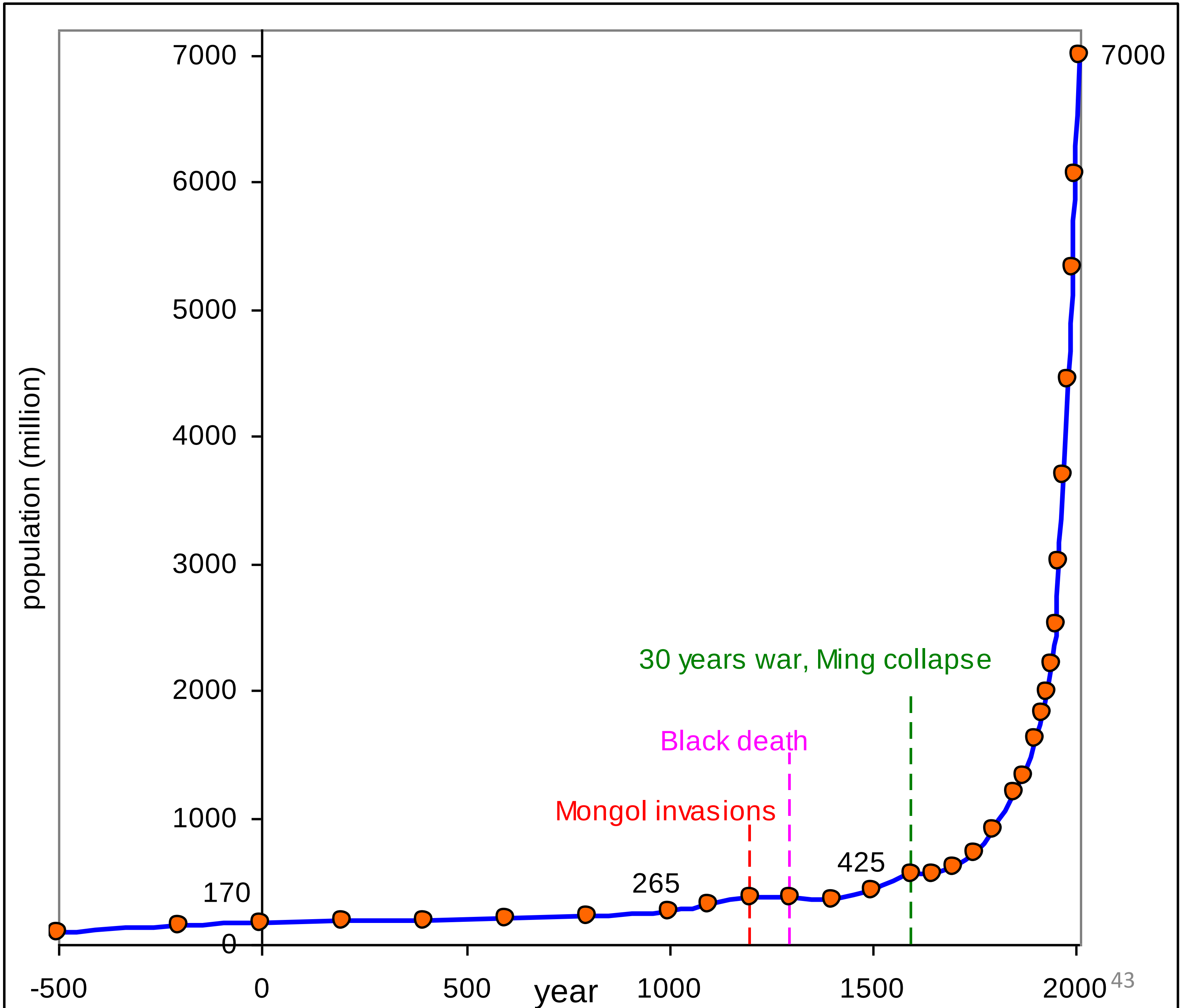
- MNEs are the only responsible for **FDI**
- MNEs are key actors in **import/export**
- MNEs' **subsidiaries** abroad play a significant **role** in **foreign economies**
- MNEs' activities have (positive and negative) **indirect effects**
- MNEs are key players in **R&D** and **innovations**

- Imagine you are the **CEO** of **Ford** and you want to **enter a new market** (either through export or FDI) for the new **Ford Ka**
- You should **choose** among these countries:

Country	Population (in million)	GDP (in bn$)	GDP per capita (in $)
India	1,293	8,700	6,600
China	1,376	20,853	15,095
Japan	127	4,901	38,731

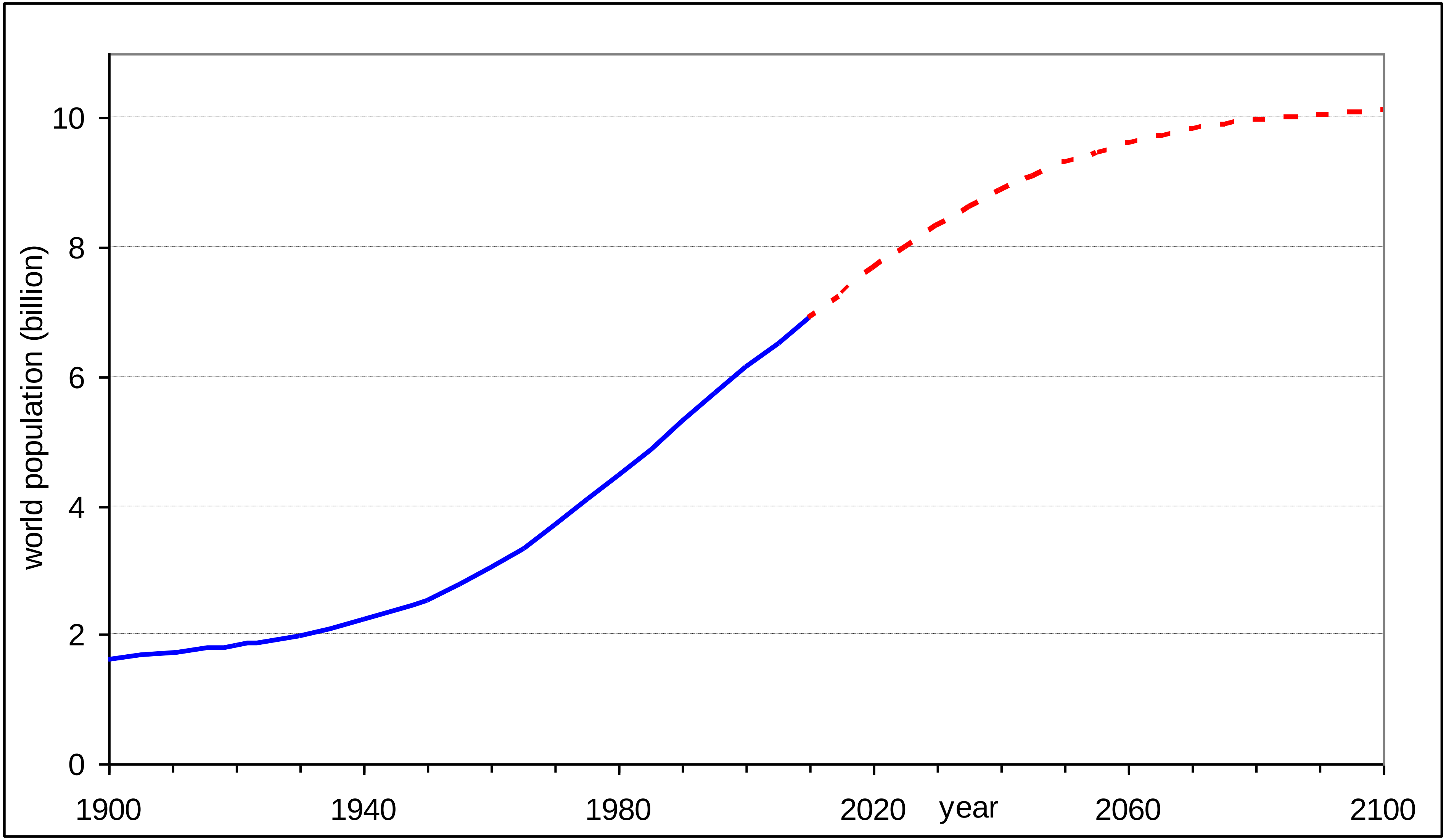
POPULATION

Figure 1.2 Development of world population over the last 2,500 years



Data sources: Kremer (1993, table 1) and UN Population Division World Population Prospects: The 2010 Revision.

Figure 1.3 Development in world population, UN projection to 2100



Data source: UN Population Division World Population Prospects: The 2010 Revision, medium variant

What is behind these trends?

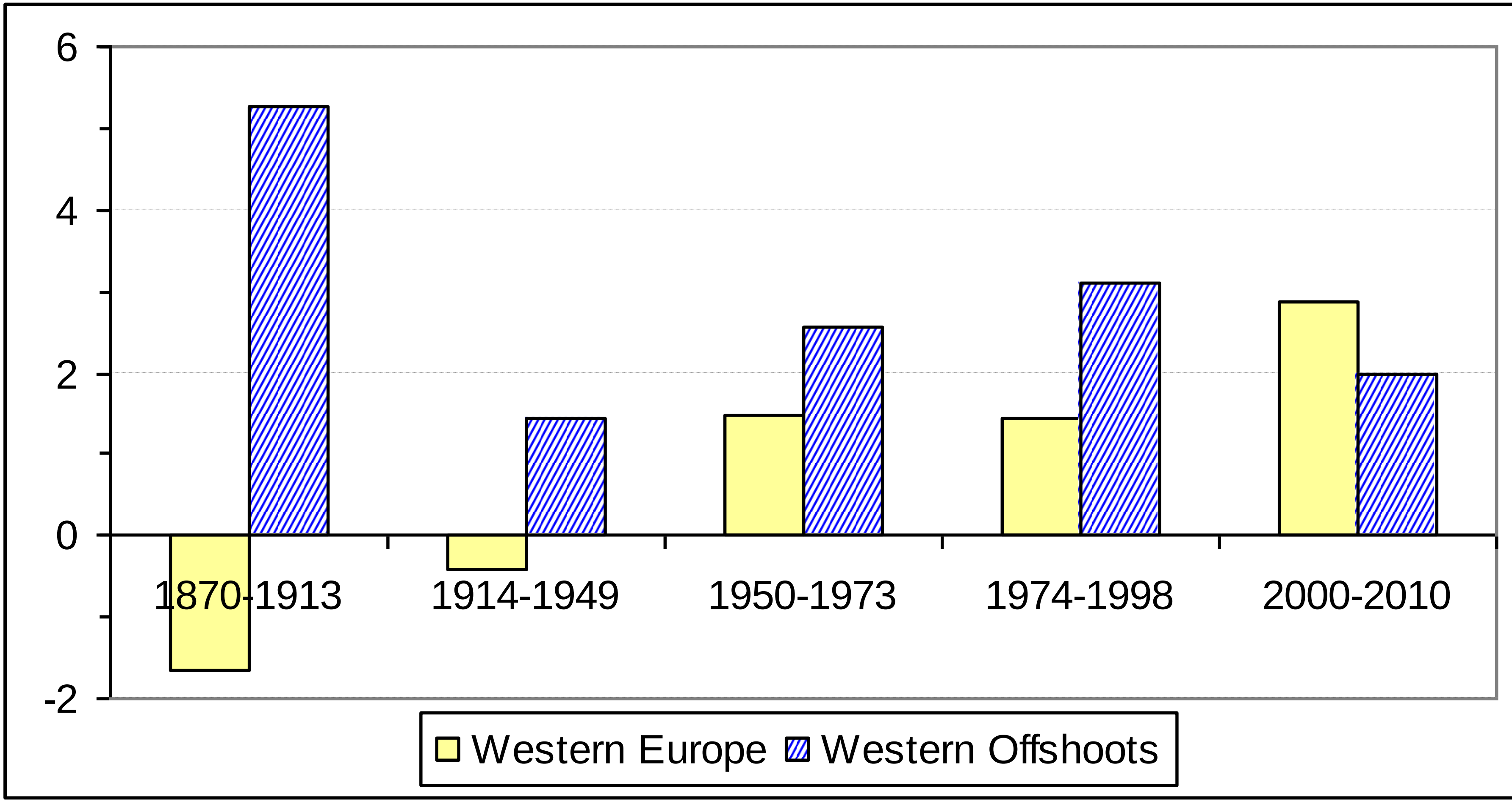
- Incredible improvements in **living conditions** lead to **reduced mortality** and increased **life expectancy**

- The **demographic transition** (i.e. stabilisation of global population) is almost completed, on average, with decreasing fertility in most countries

Capital vs labour

- International **integration** of **capital markets** lead to very large movements of capital
- Is this **true** for **labour**? ➔ **migration**

Figure 1.14 Relative migration flows, Western Europe and Western Offshoots, 1870–2010, per 1,000 inhabitants



Data sources: Net migration in the period (Maddison, 2001, table 3-4) is divided by the (simple) average population and length of the period, normalized per 1,000 inhabitants; updated for the period 2000-2010 with data from UN Population Division, Migration Section; Western Europe consists of Belgium, France, Germany, Italy, Netherlands, Norway, Sweden, Switzerland, and UK.

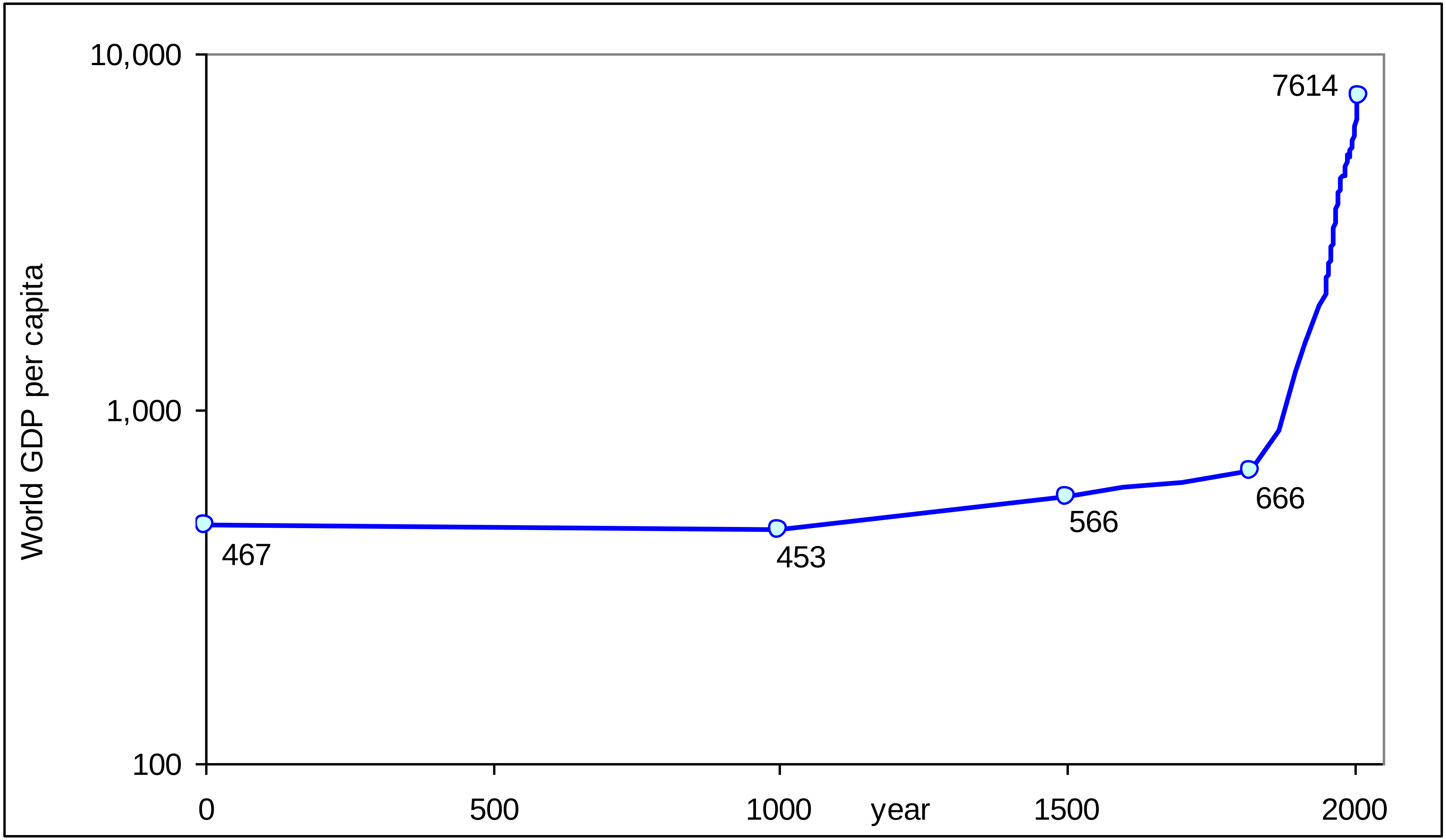
Globalization and migration

- **Heterogeneity** in **real wages** should **induce** substantive **migration** of workers
  - Wages are high where the **supply** of **workers** is **low** for a given demand for labour

- This massive migration **does not happen** for many reasons:
  - High **adjustment costs** (monetary and non-monetary) of moving from one country to another
    - **Language** barriers
    - **Cultural** barriers
    - Strong **ties** with home country/town
  - Regulatory **barriers** to migration (e.g. quotas, bans, etc)
  - **Excess demand** is not for workers ‘in general’ but for **specific** profiles (i.e. **skills**)
  - …

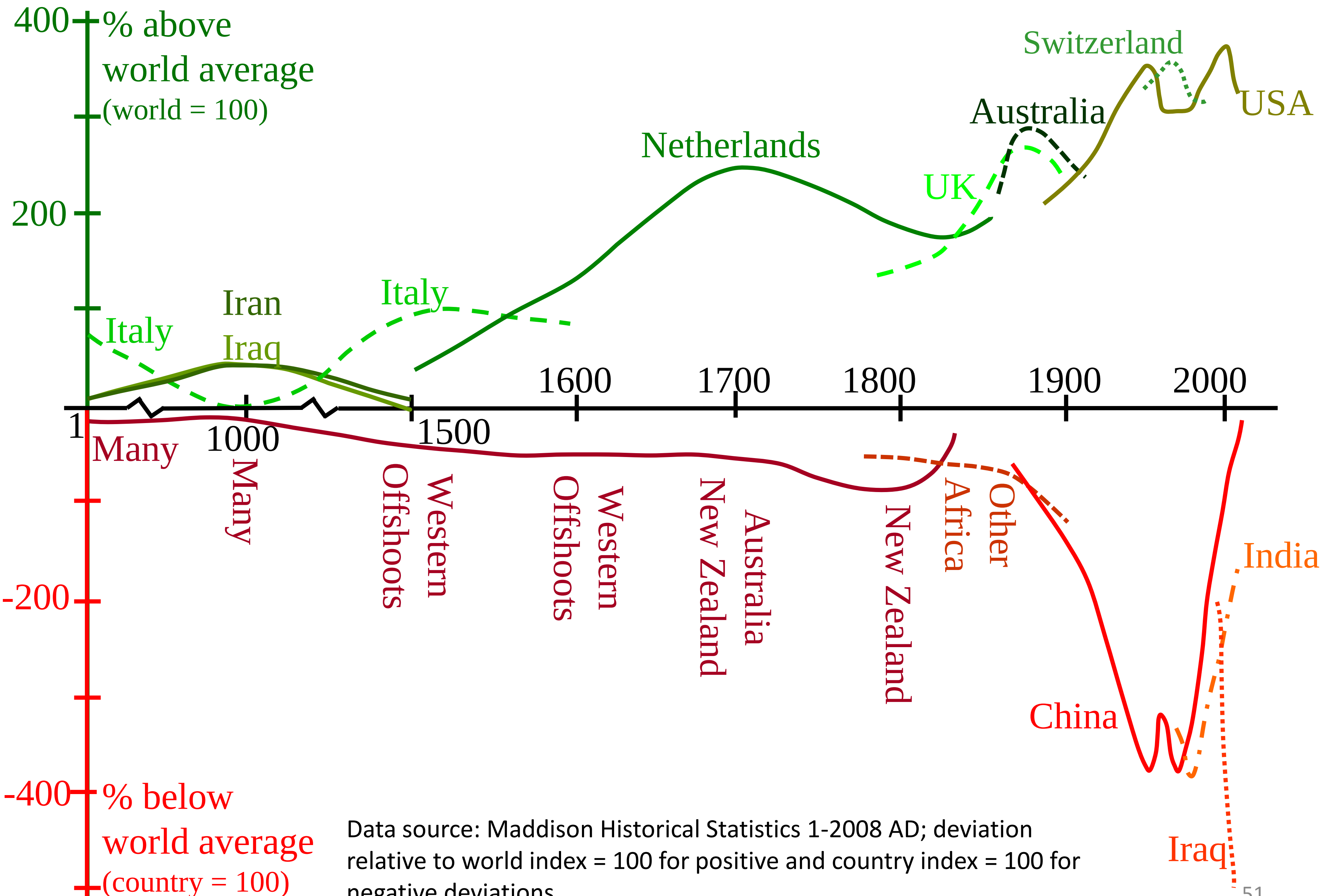
GDP

Figure 1.6 Development of world *per capita* income over the last 2,000 years, logarithmic graph



Data source: Maddison Historical Statistics 1-2008 AD; 1990 international Geary-Khamis dollars

Figure 1.8 Leaders and laggards in GDP *per capita*: a widening perspective



Data source: Maddison Historical Statistics 1-2008 AD; deviation relative to world index = 100 for positive and country index = 100 for negative deviations.

Take home messages (I)

- Economic globalization is **not new** and **not monotonic**
- It is a **multi-dimensional** process (trade, investments, migration, knowledge)
- **Two waves** of globalization driven by both reduced **transportation costs** and reduced **trade barriers**
- **MNEs** are at the **core** of globalization

Take home messages (II)

- **FDI** generally flow **from 'North' to 'North'**
- **Labour** is **not** as **mobile** as capital (i.e. migration, or absence thereof, is not explained by wage differentials)
- **Population** and **GDP** play an important role in **determining** internationalization **choices**
- Strict **connection** between **internationalziation** and economic **growth**

KOF-ETH (Zurich) index of economic globalization

i) Actual Flows	(50%)
Trade (percent of GDP)	(22%)
Foreign Direct Investment, stocks (percent of GDP)	(27%)
Portfolio Investment (percent of GDP)	(24%)
Income Payments to Foreign Nationals (percent of GDP)	(27%)
ii) Restrictions	(50%)
Hidden Import Barriers	(23%)
Mean Tariff Rate	(28%)
Taxes on International Trade (percent of current revenue)	(26%)
Capital Account Restrictions	(23%)

KOF index of economic globalization

1970			2016		
Rank	Country	Index	Rank	Country	Index
1	Luxembourg	91.96	1	Singapore	96.06
2	Singapore	85.39	2	Ireland	93.08
3	Ireland	77.88	3	Luxembourg	91.80
4	Belgium	74.83	4	Netherlands	90.89
5	Switzerland	69.58	5	Malta	90.28
6	Seychelles	66.13	6	United Arab Emirates	88.39
7	Panama	65.68	7	Hungary	86.85
8	Botswana	64.92	8	Estonia	86.11
9	Netherlands	63.33	9	Belgium	85.95
10	Canada	62.97	10	Bahrain	85.51
	…			…	
32	United States	47.20	62	Italy	67.02
59	Italy	40.54	89	United States	59.40