Globalisation

Q. Explain what is meant by globalisation.

Ans. Economic "globalisation" is a historical process, the result of human innovation and technological progress. It refers to the increasing integration of economies around the world, particularly through trade and financial flows. The term sometimes also refers to the movement of people (labour) and knowledge (technology) across international borders. There are also broader cultural, political and environmental dimensions of globalisation that are not covered here.

At its most basic, there is nothing mysterious about globalisation. The term has come into common usage since the 1980s, reflecting technological advances that have made it easier and quicker to complete international transactions—both trade and financial flows. It refers to an extension beyond national borders of the same market forces that have operated for centuries at all levels of human economic activity—village markets, urban industries, or financial centres.

There are many forms of globalisation.

Capital markets

These are now more integrated. Capital is more mobile and currency controls have been relaxed in most countries. The movement of capital to those investment opportunities and countries where it generates the highest return can be destabilising - witness the controls recently placed on capital in Malaysia.

This is due in part to the mobility of financial capital. Physical capital, represented by physical plant, is not mobile; once built a factory is hard to move. As currency controls have been relaxed, investment opportunities for individuals have been increased and they can now buy shares in the US, or any number of other countries.

Goods and services markets

There has been rapid growth in the value of world trade, much faster than the growth in the total world economy. This reflects increasing specialisation by countries, illustrating the principle of comparative advantage.

Sometimes this advantage is based on physical resources. For example, Australia has coal and can trade this. In other cases the comparative advantage has been developed over time. For example, there is no reason why Japan should have an advantage in consumer electronics, or Germany in chemicals, but they have developed such an advantage.

So comparative advantage can be created or generated. It may not be based on 'natural' resources. These created advantages are of significant value to the country since they are renewable. Switzerland is strong in ethical pharmaceuticals and these are not finite or non-renewable resources as is coal or iron ore.

Labour markets

Labour markets are probably the least developed markets and in fact may have become less global over time. In the period 1850-1900 it has been estimated that some 60 million people left Europe for the US, Canada and Australia. Now there is a smaller flow of people between countries, due generally to political restrictions. In addition, there are cultural, language and family barriers to movement. There may be fairly free movement within a country, and within the European Union, but not between countries. Movements between countries are likely to be restricted to highly skilled individuals.

Q. Discuss the causes and consequences of globalisation.

Answer. The term "globalisation" has acquired considerable emotive force. Some view it as a process that is beneficial—a key to future world economic development—and also inevitable and irreversible. Others regard it with hostility, even fear, believing that it increases inequality within and between nations, threatens employment and living standards and thwarts social progress. This brief offers an overview of some aspects of globalisation and aims to identify ways in which countries can tap the gains of this process, while remaining realistic about its potential and its risks.

What explains this globalisation? It is certainly not attributable to conquest, the source of most previous historical episodes where a single economic system has held sway over a vast geographical terrain. The source lies instead in the development of technology. The costs of transport, of travel and above all the costs of communicating information have fallen dramatically in the post-war period, almost entirely because of the progress of technology. A 3-minute telephone call from the USA to Britain cost $12 in 1946, whereas today it can cost as little as 48 cents, despite the fact that consumer prices have multiplied by over eight times in the intervening period. The first computers were lumbering away with piles of punched cards in the early post-war years, and telegrams provided the only rapid means of written communication. There was no fax or Internet or e-mail or world wide web, no PCs or satellites or cell-phones. Today we witness phenomena that no futurist dreamed of half a century ago, such as Indians with medical degrees residing in Bangalore who earn a living by acting as secretaries to American doctors by transcribing their tapes overnight.

One of the driving forces behind globalisation is the existence of national comparative advantage. For example Australia has natural advantages in the growing of wool, in terms of land, sunshine, weather and so on. Other countries may have advantages in the processing of that wool, possibly because they are close to the market and can respond quickly to changing consumer tastes. So Australia specialises in the production of wool and a country like Italy specialises in the manufacture of woollen goods, and some of their customers will be in Australia. In this way, consumers in both countries may be better off than if Italy tried to grow wool and Australia tried to process the wool.

Another aspect is the reduction in the cost of transportation. Sometimes it is easy to forget how fast and significant this has been. How many of us realise that in 1945 the cost of the airfare between Melbourne and London was about twice the annual salary in Australia? By 1998, the cost had plummeted to about three to four weeks salary.

Similarly in shipping, the introduction of containerisation and other innovations has seen major reductions in shipping costs.

Another cause is the increasing similarity of customers around the world. There are significant numbers of consumers in Russia and Brazil who want a particular brand of sunglasses or jeans. It is also true that the steel mill in China requires about the same iron ore as the steel mill in Poland, or Germany.

Another explanation for globalisation is economies of scale - the fact that for many goods the unit cost of manufacture is lower in large factories than in small ones. Another explanation is the reduction of obstacles to trade. Governments have reduced both tariff and non-tariff barriers. Trade liberalisation under the auspices of the World Trade Organisation (WTO) has opened up additional opportunities for trade and financial flows. In addition, there have been major government programs of deregulation, of opening up markets formerly closed to overseas firms. In other countries, many sectors of the economy have been protected from international competition by government regulation. Such areas as finance, transport, Government has protected utilities from international competition, but in many countries this is changing. Market based reforms, removing government barriers to new firms, are occurring in many countries of the world.

The major benefit of globalisation is improved living standards derived from a better division of labour, or better specialisation of labour. Low wage countries specialise in labour intensive tasks, high wage countries have to use employees in more productive ways, or produce more technologically sophisticated products, products which need a high tech infrastructure.

Most low wage countries do not have the scientific and educational infrastructure to support, say, the manufacture of high-tech drugs, or bio- technology products. High wage countries must move to higher technology products. Hong Kong no longer produces toys - these have all moved to China. But Hong Kong has developed other products, particularly financial services, and has a comparative advantage over China in this.

Another benefit of globalisation is that it encourages the most efficient use of capital. Global capital markets permit capital to flow to the economy which provides the best return, and away from economies which provide low return.

With globalisation, firms can exploit economies of scale and thus produce goods at a lower cost, which it is assumed will be passed on to consumer in the form of lower prices. So if the company can serve a large global market it can build large cost efficient plants.

In some products the level of integration around the world is high. If we look inside a personal computer we will find components from maybe 20 countries, and this is one explanation for their low prices.

There are serious implications of globalisation on the society and the government and the firms in operation in the world.

There may be a lack of control over economic policy by government. If overseas investors find a particular country unattractive, or fear for the future of that economy, they may decide to remove their capital from that country by selling the currency. That government may then have to act to maintain the value of the currency by buying it, or they may have to raise interest rates to make the economy more attractive to international investors. But these higher interest rates (let us say home mortgage rates), may cause a slow down in the domestic economy. So there may be a lack of autonomy on the part of government.

Another concern is that countries will compete at the lowest cost. Countries may reduce their tax levels (and associated services) to make that country more attractive to international firms. Or they may reduce environmental standards or health and safety provisions for the same reason.

On the negative side, it may be that the benefits of globalisation are not shared equally. There is a concern that competition from low wage countries will force down wages for unskilled workers in developed countries and destroy jobs in developed countries. So the losers will be the unskilled workers in developed countries. This may cause developed countries to reduce wages, to reduce welfare benefits, to loosen environmental controls so as to reduce costs to make their products competit ive with those from low wage cost countries.

Organisations have to decide whether to be part of the globalisation process or not. As markets move from national to global there is a period of transition a period of instability. Some firms make the transition, some will not, so there will be winners and losers. For example, the UK car industry was a major producer of cars in Europe in the 1950s. But as the market became global, customers in US, South America, Asia and other regions were served by suppliers from other countries, particularly Japan, the US and Europe and now the UK auto industry is very small and almost all foreign owned.

There is likely to be increased competition for Australian firms as well as increased opportunities. Some firms have gone global in banking, wine and building materials. Other small firms in software and computer systems have experienced high growth internationally.

Firms will have to make difficult choices. They must either specialise and become world class and world scale in their chosen industry, or focus on the national market and hope that they can survive international competition. Otherwise, they will fail.