Postscript 2003

Global Business Today

Second Edition

Charles W. L. Hill

Postscript

Global Business Today

Postscript 2003
Second Edition

Charles W. L. Hill
University of Washington

McGraw-Hill Irwin

Boston Burr Ridge, IL Dubuque, IA Madison, WI New York San Francisco St. Louis
Bangkok Bogotá Caracas Kuala Lumpur Lisbon London Madrid Mexico City
Milan Montreal New Delhi Santiago Seoul Singapore Sydney Taipei Toronto

McGraw-Hill Higher Education

A Division of The **McGraw-Hill** Companies

GLOBAL BUSINESS TODAY, POSTSCRIPT 2003

Published by McGraw-Hill/Irwin, a business unit of The McGraw-Hill Companies, Inc., 1221 Avenue of the Americas, New York, NY, 10020.
Some ancillaries, including electronic and print components, may not be available to customers outside the United States.

This book is printed on acid-free paper.

2 3 4 5 6 7 8 9 0 VNH/VNH 0 9 8 7 6 5 4 3 2

ISBN 0-07-282904-4

Publisher: *John E. Biernat*
Senior developmental editor: *Christine Scheid*
Marketing manager: *Lisa Nicks*
Producer, Media technology: *Mark Molsky*
Project manager: *Jim Labeots*
Production supervisor: *Debra R. Sylvester*
Senior designer: *Jennifer McQueen*
Cover design: *Copyright © 2000 Photo Disc, Inc. All rights reserved.*
Interior design: *Crispin Prebys*
Printer: *Von Hoffmann Press, Inc.*
Typeface: *10/12 Baskerville*
Compositor: *Techbooks*

Library of Congress Cataloging-in-Publication Data

Hill, Charles W. L.
Global business today, postscript 2003 / Charles W.L. Hill.–2nd ed.
p. cm.
Includes bibliographical references and index.
ISBN 0-07-282904-4 (alk. paper)
1. International finance. 2. Financial crises. 3. International trade. 4. Foreign exchange. 5. International business enterprises–Management. I. Title: Global business today. II. Title.
HG3881 .H488 2003
658′.049–dc21 2002023505

www.mhhe.com

Introduction

One key task of any author of any text that deals with international business is to keep the content as current as possible. This is a difficult job given that the world around us is constantly changing, often in ways that are important for the global economy and international business. In this postscript, we review important developments that have occurred since the manuscript for the second edition of this book was sent to the publishers, and we discuss the implications of these developments for international business.

One development has been the continuing globalization of the world economy. We update the statistics contained in this book on the growth of world trade and foreign direct investment. The rate of growth in cross-border trade and investment is slowing, reflecting the first coordinated slowdown in global economic activity in a generation.

A second important development has been the growing tide of protests against globalization. These first entered the public consciousness in December 1999, when violent protests in Seattle, Washington, against the perceived ills of globalization helped to shut down meetings of the World Trade Organization (WTO) aimed at launching a new round of talks to reduce barriers to international trade. Since Seattle, similar protests have become a regular feature of meetings of international bodies including the WTO, the International Monetary Fund (IMF), the World Bank, and the World Economic Forum. We review the reasons for the protests and discuss their implications.

Despite protests against globalization, the World Trade Organization has made progress on two important fronts. In November 2001, the member states of the WTO agreed to launch a new round of talks aimed at reducing barriers to international trade and investment. The talks are scheduled to last for five years and, among other things, hold out the promise of reducing barriers to trade in agricultural products, an area in which trade barriers have historically remained high. Then in December 2001, China formally joined the World Trade Organization, ending a 15-year quest. In this postscript, we shall discuss these developments in depth.

Another important development was the formal adoption of euro notes and coins by 12 nations of the European Union on January 1, 2002. This signaled the end of a two-year transition period when the euro was traded in financial markets, while notes and coins denominated in historic currencies traded in EU member states that had joined the euro zone. We shall review the progress of the euro and ask whether it is on track to becoming a rival to the U.S. dollar in international financial markets.

Finally, to mark the first year of a new millenium, the postscript closes with a review of the economic and political achievements of the 20th century and a discussion of the outlook for the early years of the 21st century.

Globalization of the World Economy

As discussed in Chapter 1, for half a century global trade has expanded much faster than global output. Between 1950 and 2000, the volume of world trade increased more than 20-fold, while the inflation-adjusted value of world gross domestic product (GDP) increased a little over sixfold. The late 1990s and 2000 were no exception to this long-term trend. In 1998 and 1999, the volume of global trade in merchandised products expanded at 5 percent annually compounded, while world GDP grew at 2 percent in 1998 and 2.5 percent in 1999.[1] In 2000, the volume of world trade grew by an extraordinarily strong 12.4 percent, well above historic norms and far in excess of the estimated 4.5 percent expansion in world GDP during 2000. However, 2001 brought a sudden slowdown in this long-term trend. Preliminary figures suggest the volume of world trade grew by less than 1 percent in 2001, the slowest rate in almost 20 years.[2]

There are three reasons for the particularly strong growth in world trade in 2000. First, robust economic growth in the world's largest economy, the United States, resulted in high demand in the United States for merchandised imports, which grew at 19 percent during 2000. By comparison, U.S. merchandised exports grew at 11.5 percent over the same period. As a result, in 2000 the U.S. trade deficit exceeded $900 billion, amounting to about 4.5 percent of U.S. GDP. Second, the continuing recovery of Asian countries from the 1997–98 financial crises fueled growth in world trade. The value of Asia's imports and exports rose 23.5 percent and 18.5 percent, respectively, during 2000. Asian exports were in part boosted by strong demand for information technology hardware in the United States, much of which was manufactured in places such as Taiwan and Korea. Third, spurred by continued rapid economic growth, the value of China's trade expanded by more than one-third in 2000. Japan, too, registered a large expansion in international trade, which increased by more than 20 percent over the same period.[3]

The sharp slowdown observed in 2001 has three interrelated causes. First, there was a sharp reduction in the volume of trade in information technology products. The slump reflected the bursting of the "bubble economy" that prevailed in the United States in the late 1990s. During the bubble economy, well-funded start-ups from Web-based retailers (or "e-tailers") to new telecommunications service providers raised over $1 trillion from the debt and equity markets. Much of this money was invested in information technology products that are traded internationally, including computer hardware, telecommunications equipment, and software. This boosted both demand for these products and the overall volume of international trade in 1999 and 2000. By 2001, however, many of these new businesses found that their business models did not work, and they started going out of business. As the bubble burst, demand for information technology products collapsed, helping to pull down both world economic growth and the volume of international trade.

Second, 2001 saw a simultaneous slowdown in the rate of economic growth across the three major economies of the world–the United States, Japan, and the European Union. In 2000, the world economy expanded by some 4 percent, but in 2001 the growth rate slowed to 1.3 percent, with major economies such as the United States entering recession in the second half of 2001. As might be expected, this pulled down the rate of global economic growth and world trade. Third, the terrorist attacks on the United States on September 11, 2001, were followed by a sharp fall in the volume of international trade. However, it is possible that much of this decline was temporary and reflected a reflexive curtailing of consumption in the United States that might reasonably be expected to reverse itself in 2002 and 2003, assuming the background level of economic activity starts to improve. However, some commentators believe it will take several years for the financial excesses of the 1990s bubble economy in the United States to be worked out of the system. Currently, both U.S. corporations and consumers are burdened with near record levels of debt. This debt may act as a brake on near- to medium-term economic expansion in the world's largest economy. Without robust growth in the United States, the volume of international trade is unlikely to recover to the levels seen in 1999–2000.

Despite this, the underlying trends point to continued expansion in the volume of international trade. Even in a slow growth environment, if barriers to cross-border trade continue to decline, global trade seems likely to grow faster than global economic output. This implies that national economies will continue to become increasingly intertwined, depending on each other for an ever-larger percentage of goods and services. As this development unfolds, globalization is accelerating with global markets and global production systems replacing national markets and national production systems. The economic theories reviewed in Chapter 4 suggest this development is beneficial, with greater trade translating into increased efficiency of the world economy, income gains in countries involved in the global trading system, and greater global economic growth.

Similar trends can be seen in the data on foreign direct investment (FDI) flows. In 1998–2000, the flow of foreign direct investment surged to record levels, but this was followed by a sharp slump in 2001.[4] During 1996–1999, the value of FDI grew at 40.8 percent a year compounded. In 2000, the growth rate slowed, but it was still a very robust 18 percent, which boosted the total value of FDI in that year to $1.3 trillion. To put this in perspective, in 1980 the value of foreign direct investment was just $60 billion, and in 1990 it was $210 billion.[5] Between 1996 and 2000, about 50 percent of FDI took the form of cross-border mergers and acquisitions, as opposed to green-field developments in the host country. The flow of FDI was focused primarily on advanced economies, as it has been since records have been kept. Of the $1.3 trillion total FDI in 2000, some $1.05 trillion occurred between developed countries, and some 70 percent of this involved flows between the world's three largest economies, the United States, Japan, and the European Union.

Reflecting the slowdown in global economic activity, in 2001 the value of FDI slumped by more than 40 percent to around $760 billion. The most notable decline was in the levels of cross-border mergers and acquisitions. In 2000, there were some 7,900 cross-border deals totaling $1.1 trillion. In 2001, the number of cross-border mergers and acquisitions fell to less than 6,000, valued at about $600 billion. The overall decline in FDI was also most pronounced in developed nations, where FDI flows fell in half in 2001. In comparison, FDI into developing nations declined from $240 billion in 2000 to $225 billion in 2001, a decline of only 6 percent.[6]

The rapid expansion of FDI during 1990–2000 suggests two things. First, individual enterprises were increasingly building global production systems, dispersing various activities to those locations in the world where they could be produced most efficiently. Second, the data imply that enterprises were entering each other's markets in an attempt to create and exploit emerging global markets for the goods and services they produce. Increasingly, cross-border mergers and acquisitions seem to be a favored mode of entry, as firms from different nations merge to form larger transnational entities that have the scale and scope to compete in global markets, instead of national or regional markets. As a result of foreign direct investment, there are now some 60,000 multinational companies in the world with about 800,000 foreign affiliates. Their growing importance in the world economy can be measured by their share of foreign direct investment stock in world GDP, which increased from 2 percent in 1980 to 14 percent at the start of 2001.[7]

The slowdown in FDI flows observed in 2001 will probably be temporary. Surveys undertaken by the United Nations and other institutions in late 2001 suggest most corporations plan to continue with their foreign investment plans over the next three to five years. Among the nations that are likely to benefit from increased FDI inflows in the 2001–2005 period, China seems likely to see the largest percentage increase. As of 2001, China was already the largest recipient of FDI among developing nations, with inflows of $46.8 billion. Many firms have plans to accelerate their investment in China following the country's entry into the WTO (which occurred in December 2001). For example, in late 2001, one-quarter of large Japanese firms stated they would increase their investment in China following WTO entry or have already done so in anticipation of WTO entry.[8]

Changes in national regulations governing FDI also suggest that the slowdown in FDI observed in 2001 will be temporary. Since the late 1980s, national regulations governing FDI have been progressively relaxed, allowing firms to enter foreign markets on a scale that would not have been possible a generation ago. In recent years, the trend toward deregulation has accelerated. Between 1990 and 2000, 1,185 changes were made in national regulatory regimes, of which some 1,121 (95 percent) created a more favorable environment for FDI. The average number of regulatory changes made per year accelerated from around 90 during 1990–1995 to more than 140 per year during 1996–2000. During 2000, the last year for which there is good data, 69 countries made 150 changes in regulations governing FDI, of which 147 (98 percent) were more favorable to foreign investors, lowering the barriers to inward investment. As national markets become progressively more open to foreign investors, one would expect the flow of FDI to respond positively.[9]

Despite the positive long-term outlook for growth in international trade and FDI, the data for recent years suggest that we are witnessing not so much the globalization of the world economy as the rapid integration of the economies of a select club of developed and developing nations. The poorer nations of the world continue to be left on the sidelines in the rush toward global economic integration. Africa, for example, accounted for $9 billion, or less than 1 percent, of FDI in 2000 and around 2 percent of all international trade flows. In a recent report, the World Bank focused on this issue, noting that one-sixth of the world's people produce 78 percent of the world's goods and services and receive 78 percent of the world's income, an average of $70 a day. By way of contrast, three-fifths of the world's people in the 61 poorest countries receive 6 percent of the world's income, or less than $2 a day on average.[10]

This continuing disparity suggests that one of the biggest challenges facing global economic institutions such as the World Trade Organization, the World Bank, the International Monetary Fund, and the United Nations is to bring the poorer nations of the world into the global economic system of the 21st century. Excluding the majority of the world's population from the global economic system represents an enormous waste of resources and untold suffering implied by the continued existence of extreme poverty. If conditions for the poor do not improve, the growing division between the rich and poor nations of the world could lead to geopolitical conflicts that impinge on the economic prosperity of the developed world.

The critical question, of course, is how to engage the world's poorer nations in the global economic system. The material contained in Chapters 2, 4, 6, and 9 suggests introducing democratic political institutions, reducing corruption, protecting property rights, deregulating markets, privatizing state-owned enterprises, and liberalizing regulations governing foreign trade and foreign direct investment will all help the poorer nations of the world raise their economic growth rates and promote engagement in the world economy. However, many in the developed and developing world disagree with this assessment. Those who hold this contrary view made their presence felt in November 1999, when they derailed talks sponsored by the World Trade Organization that were aimed at initiating a new round of negotiations to reduce barriers to international trade and foreign direct investment.

Protests against Globalization

As suggested by the data on world trade and investment, the integration of the world economy, or globalization as it is often called, is proceeding rapidly. Viewed against long-term trends, the setback experienced in 2001 will probably turn out to be no more than a short-term event. The theory and evidence reviewed later in this book suggest that globalization is generally a good thing; it is part of a process that leads to greater economic growth and rising living standards for the citizens of all countries that have chosen to participate in the global trading system (see Chapters 1, 4, 5, and 6). Despite this evidence, recent years have seen a rising wave of protests against globalization.

Significant demonstrations against globalization date to December 1999, when more than 40,000 protesters blocked the streets of Seattle in an attempt to shut down a World Trade Organization meeting being held there. The demonstrators were protesting against a wide range of issues, including job losses in industries under attack from foreign competitors, downward pressure on the wage rates of unskilled workers, environmental degradation, and the cultural imperialism of global media and multinational enterprises, which was seen as being dominated by what some protesters called the "culturally impoverished" interests and values of the United States. All of these ills, the demonstrators claimed, could be laid at the feet of globalization. The World Trade Organization was meeting to try to launch a new round of talks to cut barriers to cross-border trade and investment. As such, it was seen as a promoter of globalization and a legitimate target for the antiglobalization protesters. The protests turned violent, transforming the normally placid streets of Seattle into a running battle between "anarchists" and Seattle's bemused and poorly prepared police department. Pictures of brick-throwing protesters and armored police wielding their batons were duly recorded by the global media, which then circulated the images around the world. Meanwhile, the WTO meeting failed to reach agreement, and although the protests outside the meetings halls may not have caused that failure, the impression took hold that the demonstrators had succeeded in derailing the meetings.

Emboldened by the experience in Seattle, antiglobalization protesters have turned up at almost every major meeting of a global institution since. In February 2000, they demonstrated at the World Economic Forum meetings in Davos, Switzerland, and vented their frustrations against global capitalism by trashing that hated symbol of U.S. imperialism, a McDonald's restaurant. In April 2000, demonstrators disrupted talks being held at the World Bank and International Monetary Fund, and in September 2000, 12,000 demonstrated at the annual meeting of the World Bank and IMF in Prague. In April 2001, demonstrations and police firing tear gas and water cannons overshadowed the "Summit of the Americas" meeting in Quebec City, Canada. In June 2001, 40,000 protesters marched against globalization at the European Union summit in Göteborg, Sweden. The march was peaceful until a core of masked anarchists wielding cobblestones created bloody mayhem. In July 2001, antiglobalization protests in Genoa, Italy, where the heads of the eight largest economies were meeting (the so called G8 meetings), turned violent, and in the now familiar ritual of running battles between protesters and police, a protester was killed, giving the antiglobalization movement its first martyr. In January 2002, protesters were encamped outside the World Economic Forum meetings in New York. Smaller protests have occurred in several countries. For example, in an event that was widely publicized, antiglobalization protesters in France destroyed a McDonald's restaurant in August 1999 to protest the impoverishment of French culture by American imperialism (see the accompanying box)!

Antiglobalization Protests in France

One night in August 1999, 10 men under the leadership of a local sheep farmer and rural activist, Jose Bove, crept into the town of Millau in central France and vandalized a McDonald's restaurant under construction, causing an estimated $150,000 worth of damage. These were no ordinary vandals, however, at least according to their supporters, for the "symbolic dismantling" of the McDonald's outlet had noble aims, or so it was claimed. The attack was initially presented as a protest against unfair American trade policies. The European Union had banned imports of hormone-treated beef from the United States, primarily because of fears that hormone-treated beef might lead to health problems (although EU scientists had concluded there was no evidence to support this). After a careful review, the World Trade Organization stated the EU ban was not allowed under trading rules that the EU and United States were party to, and that the EU would have to lift it or face retaliation. The EU refused to comply, so the U.S. government imposed 100 percent tariffs on imports of certain EU products, including French staples such as foie gras, mustard, and Roquefort cheese. On farms near Millau, Bove and others raised sheep whose milk was used to make Roquefort. They were incensed by the American tariff and decided to vent their frustrations on McDonald's.

Bove and his compatriots were arrested and charged. They quickly became a focus of the emerging antiglobalization movement in France that was protesting everything from a loss of national sovereignty and "unfair" trade policies that were trying to force hormone-treated beef on French consumers, to the invasion of French culture by alien American values, so aptly symbolized by McDonald's. Lionel Jospin, France's prime minister, called the cause of Jose Bove "just." Allowed to remain free pending his trial, Bove traveled to Seattle in December to protest against the World Trade Organization, where he was feted as a hero of the antiglobalization movement.

Back in France, Bove's July 2000 trial drew some 40,000 supporters to the small town of Millau, where they camped outside the courthouse and waited for the verdict. Bove was found guilty, and sentenced to three months in jail, far less than the five-year maximum possible sentence. Outside his supporters wore T-shirts claiming, "The world is not merchandise, and neither am I."

About the same time in the Languedoc region of France, California winemaker Robert Mondavi had reached agreement with the mayor and council of the village of Aniane, and regional authorities, to turn 125 acres of virgin wooded hillside belonging to the village into a vineyard. Mondavi planned to invest some $7 million in the project and hoped to produce top-quality wine that would sell in Europe and the United States for $60 a bottle. However, local environmentalists objected to the plan, which they claimed would destroy the area's unique ecological heritage. Jose Bove, basking in sudden fame, offered his support to the opponents, and the protests started. In May 2001, the Socialist mayor who had approved the project was defeated in local elections in which the Mondavi project had become the major issue. He was replaced by a Communist, Manuel Diaz, who denounced the project as a capitalist plot designed to enrich wealthy U.S. shareholders at the cost of his villagers and the environment. Following Diaz's victory, Robert Mondavi announced his company would abandon the project. A spokesman noted, "It's a huge waste, but there are clearly personal and political interests at play here that go way beyond us."

So are the French opposed to foreign investment? The experience of McDonald's and Mondavi seems to suggest so, as does the associated news coverage, but look closer and a different reality seems to emerge. McDonald's has more than 800 restaurants in France and continues to do well there. Foreign investment in France reached record levels in the late 1990s and 2000. In 2000, France recorded 563 major inward investment deals, a record, and American companies accounted for the largest number, some 178. Moreover, French enterprises are also investing across borders at record levels. Given all of the talk about American cultural imperialism, it is perhaps striking that a French company, Vivendi, now owns two of the propagators of American cultural values, Universal Pictures and publisher Houghton Mifflin. And for all of their bluster, French politicians seem set on removing domestic barriers that make it difficult for French companies to compete effectively in the global economy.[11]

While violent protests may give antiglobalization a bad name, it is clear from the scale of the demonstrations that the support for the cause goes beyond a hard core of anarchists. Large sections of the population in many countries fear that globalization has detrimental effects on living standards and the environment. As we shall see in this book, both theory and evidence suggest these fears are exaggerated, but this may not have been communicated clearly enough, and both politicians and businesspeople need to do more on this count. Also, many protests against globalization are tapping into anti-American sentiments, for the United States and its corporations appear to some to be the driving forces behind globalization. Rightly or wrongly, the values of the emerging global business and social culture are often perceived as American values. More generally, the antiglobalization movement is drawing on a general sense of loss at the passing of a world in which barriers of time and distance, and vast differences in economic institutions, political institutions, and the level of development of different nations, produced a world rich in the diversity of human cultures. It is true that this world is now passing into history. However, while the rich citizens of the developed world may have the luxury of mourning the fact that they can now see McDonald's restaurants and Starbucks coffeehouses on their vacations to exotic locations such as Thailand, far fewer complaints are heard from the citizens of those countries, who welcome the higher living standards that progress brings. The homogenization of material culture is often only a veneer that hides deep differences in values and norms. Just because the Japanese now drink Starbuck's coffee, it does not follow that they ascribe to American values of individualism. Whatever one's view of the merits and demerits of globalization, one thing is clear—post-Seattle, the debate of globalization has moved increasingly from the periphery toward the center of popular consciousness. As such, we can expect to hear much more about it in the future.

The World Trade Organization: Recent Developments

The World Trade Organization (WTO) is the multinational institution that polices the global trading system, resolving trade disputes between member nations (see Chapter 5 for details). The WTO also coordinates efforts to further reduce barriers to cross-border trade and investment. Established in 1995, the WTO replaced the General Agreement on Tariffs and Trade (GATT), which had been overseeing world trade since 1947. With 144 countries in its membership roster as of January 2002, and 20 others negotiating to join, the WTO is at the forefront of efforts to promote global free trade. WTO members now account for more than 90 percent of the value of global merchandized trade.

The experience of the past few years suggests that the policing and enforcement mechanisms of the WTO are working well. Between 1995 and 2001, some 213 trade disputes between member countries were brought to the WTO.[12] This record compares with a total of 196 cases that were handled by the GATT over almost half a century. Of the cases brought to the WTO, some three-quarters had been resolved by 2001 following informal consultations between the countries in dispute. Resolving the remainder has involved more formal dispute resolution procedures, but these have been largely successful. In general, the countries involved have adopted the WTO's recommendations. Only a handful of cases so far have yet to be resolved by the WTO.

Antidumping: A Rising Trend?

A number of issues confront the WTO. One has been the proliferation of antidumping actions in recent years. If a company exports a product at a price lower than the price it normally charges in its home market, it is said to be "dumping" the product. WTO rules allow countries to impose antidumping duties on foreign goods that are being sold cheaper than at home, or below their cost of production, when domestic producers can show that they are being harmed. Unfortunately, the rather vague definition of what constitutes "dumping" has proved to be a loophole, which many countries are exploiting to pursue protectionism. In the United States, for example, 26 antidumping cases were launched in 1998, up from 16 cases the previous year. In 1999, the United States launched 47 cases, as it did in 2000. The first six months of 2001 saw another 39 antidumping actions from the United States, suggesting a sharp increase is likely for the entire year. There has also been a rise in cases filed by the European Union.[13]

Between 1995 and June 2001, WTO members had reported implementation of some 1,640 antidumping actions to the WTO. The EU had initiated the largest number, some 230, followed by the United States with 220. Antidumping actions seem to be concentrated on certain sectors of the economy. Basic metal industries (e.g., aluminum and steel) accounted for 527 of the total, followed by chemicals (263), plastics (179), and machinery and electrical equipment (167).[14] In sum, four sectors account for some 69 percent of all antidumping actions reported to the WTO. Since 1995, these four sectors have been characterized by periods of intense competition and excess productive capacity, which have led to low prices and profits (or losses) for firms in those industries. It is not unreasonable, therefore, to hypothesize that the high level of antidumping actions in these industries represents an attempt by beleaguered manufacturers to use the political process in their nations to seek protection from foreign competitors, who they claim are engaging in unfair competition. While there may be merit to some of these claims, the process can become very politicized as representatives of businesses and their employees lobby government officials to "protect domestic jobs from unfair foreign competition," and government officials, mindful of the need to get votes in future elections, oblige by pushing for antidumping actions. The WTO is clearly worried by this trend, going as far as to suggest that it reflects persistent protectionist tendencies, and it is pushing members to strengthen the regulations governing the imposition of antidumping duties.

Protectionism in Agriculture

Another recent focus of the WTO has been the high level of tariffs and subsidies in the agricultural sector of many economies. Tariff rates on agricultural products are generally much higher than tariff rates on manufactured products or services. In 2000, for example, the average tariff rates on nonagricultural products was 4.4 percent for Canada, 4.5 percent for the European Union, 4.0 percent for Japan, and 4.7 percent for the United States. On agricultural products, however, the average tariffs rates were 22.9 percent for Canada, 17.3 percent for the European Union, 18.2 percent for Japan, and 11 percent for the United States.[15] The implication is that consumers in these countries are paying significantly higher prices than necessary for agricultural products imported from abroad, which leaves them with less money to spend on other goods and services.

The historically high tariff rates on agricultural products reflect a desire to protect domestic agriculture and traditional farming communities from foreign competition. In addition to high tariffs, agricultural producers also benefit from substantial subsidies. According to estimates from the Organization for Economic Cooperation and Development (OECD), on average government subsidies account for some 20 percent of the cost of agricultural production in Canada, 24 percent in the United States, 49 percent in the European Union, and 64 percent in Japan.[16]

In total, OECD countries spend more than $300 billion a year in subsidies to agricultural producers.

Not surprisingly, the combination of high tariff barriers and significant subsidies introduces significant distortions into the production of agricultural products and international trade of those products. The net effect is to raise prices to consumers, reduce the volume of agricultural trade, and encourage the overproduction of products that are heavily subsidized (with the government typically buying the surplus). Because global trade in agriculture currently amounts to around 10.5 percent of total merchandized trade, or about $700 billion a year, the WTO argues that removing tariff barriers and subsidies could significantly boost the overall level of trade, lower prices to consumers, and raise global economic growth by freeing consumption and investment resources for more productive uses. The biggest defenders of the existing system have been the advanced nations of the world, which want to protect their agricultural sectors from competition by low-cost producers in developing nations. In contrast, developing nations have been pushing hard for reforms that would allow their producers greater access to the protected markets of the developed nations.

Protecting Intellectual Property

Another issue that has become increasingly important to the WTO has been protecting intellectual property. The 1995 Uruguay agreement that established the WTO also contained an agreement to protect intellectual property. The basis for this agreement was a strong belief among signatory nations that the protection of intellectual property through patents, trademarks, and copyrights must be an essential element of the international trading system. Inadequate protection for intellectual property reduces the incentive for innovation. Since innovation is a central engine of economic growth and rising living standards, the argument has been that a multilateral agreement is needed to protect intellectual property.

Without such an agreement, there has been a fear that producers in a country, let's say India, might produce imitations of patented innovations pioneered in a different country, let's say the United States. This affects international trade in two ways. First, it reduces the export opportunities in India for the original U.S. innovator. Second, to the extent that the Indian producer exports its pirated imitation to third countries, it also reduces the export opportunities for the U.S. inventor in those countries. Also, one can argue that since the size of the total world market for the innovator is reduced, its incentive to pursue risky and expensive innovations is also reduced. The net effect would be less innovation in the world economy and less economic growth.

This is not simply a hypothetical example; something like this has been occurring in the pharmaceutical industry with Indian drug companies making copies of patented drugs discovered elsewhere. In 1970, the Indian government stopped recognizing product patents on drugs, but elected to continue respecting process patents. This permitted Indian companies to reverse-engineer Western pharmaceuticals without paying licensing fees. As a result, foreigners' share of the Indian drug market fell from 75 percent in 1970 to 30 percent in 2000. In a typical example, an Indian company sells its version of Bayer's patented antibiotic Cipro for $0.12 a pill, versus the $5.50 it costs in the United States. Under a WTO agreement, India has agreed to adopt and enforce the international drug patent regime by 2005.[17] The issue surrounding the violation of intellectual property rights in pharmaceuticals has been complicated by the AIDS crisis in Africa and the need to get cheap drugs to poor African countries. This issue is profiled in more depth in the accompanying box.

Drug Patents and the AIDS Epidemic in South Africa

In December 1997, the government of South Africa enacted a law that authorized two controversial practices. One, called parallel importing, allowed importers in South Africa to purchase drugs from the cheapest source available, such as India, regardless of whether the patent holders had given their approval or not. The other practice, called compulsory licensing, permitted the South African government to license local companies to produce cheaper versions of drugs whose patents are held by foreign companies. The law seems to violate international agreements to protect property rights, including World Trade Organization agreements. South Africa, however, insisted that the law was necessary given its own health crisis and the high cost of patented medicines. South Africa is wrestling with an AIDS crisis of enormous proportions. Nearly 4.2 million of South Africa's 45 million people are infected with the HIV virus, more than in any other country.

Foreign drug manufacturers saw the law as an unbridled attempt to expropriate their intellectual property rights, and 39 foreign companies quickly filed a lawsuit in the country to try to block implementation of the law. Foreign pharmaceutical companies fear that South Africa is the thin end of the wedge, and if the law is allowed to stand, other countries will follow suit. Also, many U.S. companies fear that if poor countries such as South Africa are allowed to buy low-priced drugs in violation of intellectual property laws, American and European consumers will soon demand the same. Drug companies argue that since drug development is a very expensive, time-consuming, and risky process, they need the protection of intellectual property laws to maintain the incentive to innovate. It can take $500 million and 12 years to develop a drug and bring it to market. Only one in five compounds that enter clinical trials actually become marketed drugs—the rest fail in trials due to poor efficacy or unfavorable side effects—and of those that make it to market, only 3 out of 10 earn profits that exceed their costs of capital. If drug companies could not count on high prices for their few successful products, the drug development process would dry up.

However, the drug companies do recognize that countries such as South Africa face special health challenges and lack the money to pay developed world prices. Accordingly, there is a long history in the industry of pricing drugs low in the developing world, or in some cases giving them away. AIDS drugs, for example, are sold to developing nations at an 80 to 90 percent discount over their prices in the United States. The South African government apparently thought this was not good enough. Various human rights and AIDS organizations have cast the case as an attempt by the prosperous multinational drug companies of the West to maintain their intellectual property rights in the face of desperate attempts by an impoverished government to try to stem a deadly crisis. The drug companies have stated that the case has little to do with AIDS and is really about the right of South Africa to break international law.

While the drug companies may have international law on their side, the tie-in with the AIDS epidemic has put them on the public relations defensive. It has also limited the amount of public support the U.S. government has been willing to give to U.S. drug companies involved in the case. The U.S. government initially took the side of the drug companies and lobbied South Africa to repeal the law (to little effect). However, after protests from AIDS activists in the United States, the government switched its position and stated that it would consider supporting extension of the South African policy to all poor countries. The drug companies hoped that the Bush administration, which took office in 2001, would be more supportive of their position. But this administration issued a statement in March 2001 saying it was not contemplating a change in the current flexible policy stance. Roughly translated, that meant that the Bush administration had no desire to become involved in a politically volatile issue, leaving the drug companies to fight it out in South African courts. The case began in 2001, although with appeals likely whatever the outcome, in may be several years before it is resolved.[18]

Computer software is another area battling piracy of intellectual property rights. According to the Business Software Alliance, in 2000 some 37 percent of all software in use worldwide was pirated. This represented $11.75 billion in lost revenues to software manufacturers. The piracy rate ranged from 94 percent in China to 24 percent in the United States. As a region, Asia had the highest piracy rate at 51 percent and North America had the lowest piracy rate at 25 percent. The piracy rate in Western Europe was 34 percent.[19] The problem of piracy is also endemic in the music industry. The International Federation of the Phonographic Industry estimates that in 2000 some 36 percent of all CDs and cassettes around the globe were illegally produced and sold, costing the music recording industry some $4.1 billion in lost revenues.[20]

In sum, reducing piracy rates in areas such as drugs, software, and music recordings would have a significant impact on the volume of world trade and increase the incentive for producers to invest in the creation of intellectual property. In a world without piracy, more new drugs, computer software, and music recording would be produced every year. This would boost economic and social welfare and global economic growth rates. It is thus in the interests of the member states of the WTO to make sure that intellectual property rights are respected and enforced among its member states. The 1995 Uruguay agreement that created the WTO did make some headway here, tightening requirements for WTO members to enforce internationally accepted agreements on the protection of intellectual property. However, there is a general feeling that these requirements do not go far enough and further commitments are necessary.

Launching a New Round of Talks: Doha

Antidumping actions, trade in agricultural products, and better enforcement of intellectual property laws were three of the issues that the WTO wanted to tackle at the 1999 meetings in Seattle. In late 2001, the WTO tried again to launch a new round of talks between member states aimed at further liberalizing the global trade and investment framework. For this meeting, it picked the remote location of Doha in the Gulf state of Qatar, no doubt with an eye on the difficulties that antiglobalization protesters would have getting there. At Doha, the member states of the WTO agreed to launch a new round of talks and staked out an agenda. The talks are scheduled to last three years, although if history is any guide, they could last much longer. They are the ninth round of talks in a series that dates to 1947 when GATT, the WTO's predecessor, was established.

The agenda agreed on at Doha should be seen as a game plan for negotiations over the next few years. The agenda includes cutting tariffs on industrial goods and services, phasing out subsidies to agricultural producers, reducing barriers to cross-border investment, and limiting the use of antidumping laws. Some difficult compromises were made to reach agreement on this agenda. The EU and Japan had to give significant ground on the issue of agricultural subsidies, which are used extensively in both areas to support politically powerful farmers. The United States bowed to pressure from virtually every other nation to negotiate revisions of antidumping rules, which the United States has used extensively to protect its steel producers from foreign competition. (For example, in early 2002 the Bush administration placed a 30 percent tariff on imports of foreign steel.) Europe had to scale back its efforts to include environmental policy in the trade talks, primarily because of pressure from developing nations that see environmental protection policies as trade barriers by another name. Excluded from the agenda was any language pertaining to attempts to tie trade to labor standards in a country.

Countries with big pharmaceutical sectors acquiesced to demands from Africa, Asia, and Latin America on the issue of drug patents. Specifically, the language in the agreement declares that WTO regulation on intellectual property "does not and should not prevent members from taking measures to protect public health." This language was meant to assure the world's poorer nations, which are hard-pressed to afford patented drugs, that they can make or buy generic equivalents to fight such killers as AIDS and malaria.

Clearly, it is one thing to agree to an agenda and quite another to reach a consensus on a new treaty. Nevertheless, there are some potential winners in this agreement. These include low-cost agricultural producers in the developing world and developed nations such as Australia and the United States. If the talks are successful, agricultural producers in these nations will ultimately see the global markets for their goods expand. Developing nations also gain from the lack of language on labor standards, which many saw as simply an attempt by rich nations to erect trade barriers. The sick and poor of the world also benefit from guaranteed access to cheaper medicines. There are also clear losers in this agreement, including EU and Japanese farmers, U.S. steelmakers, environmental activists, and pharmaceutical firms in the developed world. These losers can be expected to lobby their government hard during the ensuing year to make sure the final agreement is more in their favor.[21]

Expanding the WTO: China Enters

China has been trying to join the WTO, and the GATT before it, for 15 years. Within China, membership of the WTO is seen as a necessary component of the country's long march toward a fully functioning market economy. Over the past 20 years, the value of China's exports to the rest of the world have climbed by 15 percent per year on average, while imports have grown at an annual rate of 13 percent.[22] The growth in international trade has helped China to expand its economy at 8 percent annually for the past decade. China is now the world's seventh-largest economy and with the addition of Hong Kong, its fourth-largest exporter. If current trends continue, China could become the world's largest economy within a generation, so the entry of China into the WTO is clearly a significant event.

China's leaders believe that further gains from trade required WTO membership. They understand that this will not be a painless process. Joining the WTO requires China to dismantle many trade barriers that currently protect local industry from foreign competition. Such short-term pain is expected to be quickly outweighed by long-term gains as foreign competition forces China's producers to become more efficient and as trade with other nations expands.

Historically, one of the biggest roadblocks standing in the way of China's accession to the WTO has been the United States. The United States is China's largest trading partner, accounting for $75 billion of exports in 2000. With its large population and rapid economic growth, China also holds the promise of being a very important market for U.S. producers. For years, however, influential political forces in the United States have opposed China's entry into the WTO on the grounds that the country has scant respect for human rights, labor standards, and intellectual property rights (China is one of the largest consumers of pirated computer software).

Despite domestic opposition, the Clinton administration in the United States supported greater economic engagement with China. This administration repeatedly argued that greater economic freedom in China would be followed by greater political freedom and respect for human rights. Accordingly, in November 1999, after a difficult series of negotiations, the Clinton administration and China signed a bilateral trade agreement. The agreement resolved a series of outstanding trade issues between the two countries and set down schedules for phasing out tariff and nontariff barriers. In return for Chinese cooperation, the United States agreed to support China's application to join the WTO. China's bid to enter the WTO was further strengthened in mid-2000 when the European Union negotiated a bilateral trade agreement with China, effectively removing EU objections to China's entry into the WTO. A further signal of U.S. support was given in September 2000, when the U.S. Senate voted to normalize trade relations with China. By doing so, the United States signaled its intention to stop linking trade deals with China to human rights issues.

With these endorsements in hand, China spent the next 14 months negotiating the fine details of its entry into the WTO. These negotiations were completed in late 2001, and China officially joined the WTO on December 11, 2001. Under the terms of the entry agreement, China will phase in tariff reductions and deregulation over the next decade. Key commitments by China include capping farm subsidies at 8.5 percent of the value of farm production. Tariffs on imports of agricultural products will be reduced from 22 percent to 17 percent. Tariffs on automobiles will fall to 25 percent by mid-2006, down from 80 to 100 percent in 2001. Tariffs on imports of information technology products will be eliminated by 2005. Foreign companies will be allowed to sell group and health insurance to Chinese by 2004. Foreign banks will be allowed to conduct local currency transactions for Chinese firms by 2003 and for Chinese residents by 2006. By 2007, foreign companies will be allowed to hold up to 49 percent of the equity in telecommunications providers operating in China. Collectively, these agreements will make it easier for foreign firms to invest in China and for exporters to sell their goods and services in China. In agriculture, for example, estimates suggest that imports of foodstuffs may rise by $1.5 billion a year for the next decade as a result of this agreement. Chinese enterprises will also benefit from easier access to foreign markets.[23]

The Trials and Tribulations of the Euro

The euro, the common currency unit now used by 12 of the 15 nations of the European Union (EU), was born January 1, 1999. The 12 states are members of what is often referred to as the euro zone. Britain, Denmark, and Sweden are still sitting on the sidelines, although there are indications that Britain and Sweden may join. Until January 1, 2002, the euro traded in financial markets, but domestic notes and coins continued to circulate in the EU nations that had joined the euro zone (although these domestic currencies stood for a defined amount of euros). On January 1, 2002, euro notes and coins were introduced into circulation and the euro-zone countries began a two-month process of taking old notes and coins out of circulation.

The euro's supporters claimed its introduction would facilitate the development of EU-wide markets and force European enterprises to become more efficient. They also believed that ultimately the euro would vie with the U.S. dollar in importance as a reserve currency for many of the world's major nations. Detractors argued that adopting the euro meant that member nations would have to give up control over monetary policy to an untested European Central Bank (ECB). They claimed that the ECB would be vulnerable to political pressures and might adopt monetary policy in the euro zone that would lead to price inflation (see Chapter 7 for details of these arguments).

In the first two years of its existence, the euro did not live up to the expectations of all its supporters. In January 1999, the euro (E) was trading at E1 = $1.17. By late November of that year, the value of the euro had slumped to E1 = $1. Although it recovered slightly in December, by the end of the year the euro had still lost 15 percent of its value against the U.S. dollar and was also down significantly against the Japanese yen. The slide continued in 2000, and by fall 2000, the euro was trading at E0.88 = \$1, representing a decline against the dollar of more than 20 percent. It has remained in a trading range around this level since, and as of February 14, 2002, stood at E0.874 = \$1.

Critics were quick to claim that the fall in the euro demonstrated the lack of confidence that the foreign exchange market has in the ability of the ECB to effectively manage monetary policy. However, there are no signs that the ECB is mismanaging monetary policy in the euro zone.[24] Inflationary pressures seem to be under control, the ECB seems to have managed interest rates with some skill, and there is no sign that the ECB is bowing to political pressure.

A number of other explanations have been offered to explain the fall of the euro. One was that America's GDP was growing faster than GDP in the euro area, and so a fall in the euro against the dollar was both inevitable and desirable. However, while this was true for 1999–2000, since March 2001, the United States has been in a recession. The euro area enjoyed faster economic growth than the United States in 2001 and is forecasted to again in 2002. Yet despite the change in relative growth rates, the euro has remained weak against the dollar, suggesting this explanation is not the whole story.

A second theory is that productivity growth, and hence the profitability of investment, is higher in the United States than in the euro area, and that this produces a preference for dollars relative to euros, hence the decline in the value of the euro. Alan Greenspan, chairman of the Federal Reserve, has stated that the weak euro reflected investors' expectation that America's productivity growth would outpace that in the euro area in the years ahead. He argued that rigid labor markets in Europe make it harder to dismiss workers. Much of the return from investment in information technology, he said, comes from cutting labor costs. A recent European Commission report on competitiveness appeared to confirm that U.S. productivity growth has been faster over the past decade, so there may be something to this explanation.

A third theory is that the dollar has become a safe haven; when investors become more risk-averse, they pile into dollars. Should the United States suffer a deep recession, this hurts the world economy as much, if not more. So, it is argued, more risk-averse investors will buy dollars. Should the United States have a strong recovery, they will buy dollars too. The dollar, in other words, is strong because investors expect it to be. A final explanation now favored by some economists is that the euro started life overvalued, and then overshot in the opposite direction.[25] This suggests that the recent weakness of the euro seems to owe more to short-term capital flows than it does to long-term problems in the euro zone or to any mismanagement by the ECB. Whatever the explanation for the persistent weakness in the euro, there is a silver lining to this economic cloud; the low value of the euro has helped to increase the competitiveness of European products in the global marketplace.[26]

International Business in the New Millenium

With the dawn of a new millenium, it seems worthwhile reflecting on how far the world has come over the past hundred years and what the next few years might hold for the global economy and, by extension, for international business.

A Hundred Years of Progress

The past hundred years have in many ways seen remarkable progress. A person born at the beginning of the 1900s in the United States, then the world's richest country, entered a world in which few had access to running water, electricity, or