Postscript 2001

Charles W.L. Hill

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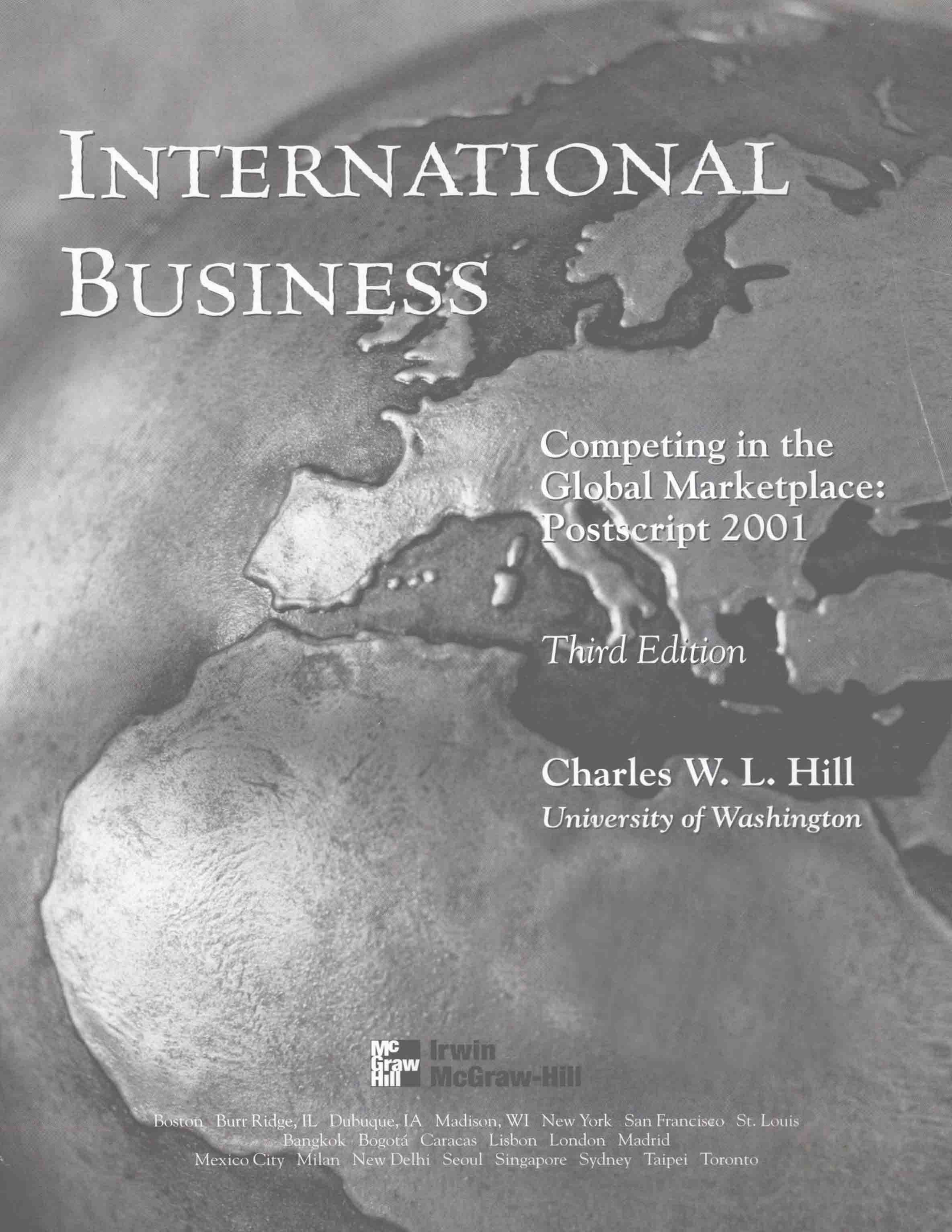

INTERNATIONAL BUSINESS

Competing in the Global Marketplace: Postscript 2001

Third Edition

Charles W. L. Hill
University of Washington

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Introduction

One key task of any author of an international business text is to keep the content as current as possible. This is a difficult job given that the world is constantly changing, often in ways that are important for the global economy and international business. In this postscript, we review some important developments that have occurred since the manuscript for this edition of the book was sent to the publisher, and we discuss the implications of these developments for international business. One development was the breakdown of the World Trade Organization meetings in Seattle, Washington, in December 1999. A second development was the January 1999 birth of the euro, the currency unit now used by 11 of the 15 nations of the European Union. A third development was the surprisingly robust rebound of Asian economies from the 1997–98 financial crisis. To mark the dawn of a new millennium, the postscript closes with a review of the economic and political achievements of the twentieth century and a discussion of the outlook for the early years of the twenty-first century.

The World Trade Organization: Recent Developments

As discussed in Chapter 5, the World Trade Organization (WTO) is the multinational institution that polices the global trading system, resolving trade disputes between member nations. The WTO also coordinates efforts to further reduce barriers to cross-border trade and investment. With 135 countries on its membership roster, the WTO is at the forefront of efforts to promote global free trade. Established in 1995, the WTO replaced the General Agreement on Tariffs and Trade (GATT), which had been overseeing world trade since 1947. The experience of the past few years suggests that the policing and enforcement mechanisms of the WTO are working well. As of late 1999, some 150 trade disputes between member countries had been brought to the WTO. About 30 were withdrawn after consultations between the countries in dispute; more than 100 are going through consultation, panel adjudication, or appeal; about 20 are in the final stage of implementing a solution; 4 have been settled and the solution implemented; 7 have been closed without any need for action to be taken.[1] This compares with a total of 196 cases that were handled by the GATT over almost half a century.

The fact that countries are using the WTO represents an important vote of confidence in the organization's dispute-resolution procedures. Reflecting this success, in its 1999 annual report the WTO noted:

> The state of the world trading system is generally sound . . . there were no major trade policy reversals in 1998 and 1999 and . . . there is no evidence of a return to protectionist measures. On the contrary, a number of countries have undertaken concrete measures to further liberalize their economic and trade regimes.[2]

However, the tone of this report, released in November 1999, was to sound overly optimistic given the events that occurred in Seattle just a few days later.

The World Trade Organization in Seattle

At the end of November 1999, representatives from the 135 member states of the World Trade Organization met in Seattle. The goal of the meeting was to launch a new round of talks—dubbed "the millennium round"—aimed at further reducing barriers to cross-border trade and investment. This round of talks was to be the ninth since 1947, when the forerunner of the WTO, the GATT was established (see Chapter 5 for details). Since 1947, the GATT and then the WTO have substantially lowered barriers to cross-border trade. Under the auspices of the GATT and WTO, the average tariff rate on manufactured products imported into developed nations has fallen from more than 20 percent of value in 1950 to less than 4 percent. As barriers tumbled, the volume of international trade expanded dramatically, increasing by almost 2,000 percent between 1950 and 1998.[3] Many economists argued that this surge in trade was one of the engines of world economic growth in the second half of the twentieth century. As explained in Chapter 4, free trade allows countries to specialize in the production of goods and services that they can produce most efficiently, while importing those goods and services that they produce less efficiently from other nations. By increasing the efficiency of resource utilization, economic theory predicts that free trade will boost economic growth and real incomes in all countries that participate in a free trade agreement. The experience of the past 50 years seems to have borne this theory out.

When the WTO convened in Seattle, expectations were high that after the normal amount of haggling, posturing, and last-minute brinkmanship, the talks would yield agreement on major goals for the next round of talks, which were scheduled to begin soon after. Prominent on the agenda was an attempt to get the assembled countries to agree to work toward the reduction of barriers to cross-border trade for agricultural products and for trade and investment in services. These expectations were dashed on the rocks of a hard and unexpected reality. On December 3, 1999, the talks ended without any agreement. Inside the meeting rooms, the problem was an inability to reach consensus on the primary goals for the next round of talks. A major stumbling block was friction between the United States and the European Union over whether to endorse the aim of ultimately eliminating subsidies to farmer exporters. The United States wanted the elimination of such subsidies to be a priority. The EU, with its politically powerful farm lobby and long history of farm subsidies, was unwilling to take this step. Another stumbling block was related to efforts by the United States to write "basic labor rights" into the law of the world trading system. The United States wanted the WTO to allow governments to impose tariffs on goods imported from countries that did not abide by what the United States saw as fair labor practices. Representatives from developing nations reacted angrily to this proposal, suggesting that it was simply an attempt by the United States to find a legal way of restricting imports from poorer nations.

However, while the disputes inside the meeting rooms were acrimonious, it was events outside that captured the attention of the world press. Originally, the choice of Seattle as the host city for the WTO meetings seemed auspicious. After all, the Seattle region was one of the export powerhouses of the United States and was home to two of the largest multinationals in the country: Boeing and Microsoft. Also, Washington state has the highest ratio of exports per capita in the United States, with agricultural products and timber supplementing its high-tech aerospace and software exports. Surely there were few cities in the world that would be more open to the idea of free trade?

The calculation was amiss. The WTO talks proved to be a lightning rod for a diverse collection of organizations from environmentalists and human rights groups to labor unions. For various reasons, these groups are opposed to free trade. All these organizations argued that the WTO is an undemocratic institution that was usurping the national sovereignty of member states and making decisions of great importance behind closed doors. They took advantage of the Seattle meetings to voice their opposition, which the world press recorded. Environmentalists expressed concern about the impact that free trade in agricultural products might have on the rate of global deforestation. They argue that lower tariffs on imports of lumber from developing nations will stimulate demand and accelerate the rate at which virgin forests are logged, particularly in nations such as Malaysia and Indonesia. They also point to the adverse impact that some WTO rulings have had on environmental policies. For example, the WTO recently blocked a US rule that ordered fishermen to equip shrimp nets with a device that allows endangered sea turtles to escape. The WTO found the rule discriminated against foreign importers who lacked such nets.[4] Environmentalists argue that the rule was necessary to protect the turtles from extinction.

Human rights activists see WTO rules as outlawing the ability of nations to stop imports from countries where child labor is used or where working conditions are hazardous. In a similar vein, labor unions oppose trade laws that allow imports from low-wage countries and result in a loss of jobs in high-wage countries. They buttress their position by arguing that American workers are losing their jobs to imports from developing nations that do not have adequate labor standards.

Supporters of the WTO and free trade are quick to dismiss these concerns. They have repeatedly pointed out that the WTO exists to serve the interests of its member states, not subvert them. The WTO lacks the ability to force any member nation to take an action that it is opposed to. The WTO can allow member nations to impose retaliatory tariffs on countries that do not abide by WTO rules, but that is the limit of its power. Furthermore, free trade supporters argue, it is rich countries that pass strict environmental laws and laws governing labor standards, not poor ones. In their view, free trade, by raising living standards in developing nations, will be followed by the passage of such laws in these nations. Using trade regulations to try to impose such practices on developing nations, they believe, will produce a self-defeating backlash.

Many representatives from developing nations, who make up about 100 of the WTO's 135 members, also reject the position taken by environmentalists and advocates of human and labor rights. Poor countries, which depend on exports to boost their economic growth rates and climb their way out of poverty, fear that rich countries will use environmental concerns, human rights, and labor-related issues to erect barriers to the products of the developing world. They believe that attempts to incorporate language about the environment or labor standards in future trade agreements will amount to little more than trade barriers by another name.[5] If this were to occur, they argue that the effect would be to trap developing nations in a grinding cycle of poverty and debt.

However, such pro-trade arguments fell on deaf ears. As the WTO representatives gathered in Seattle, environmentalists, human rights activists, and labor unions marched in the streets. Some of the more radical elements in these organizations, together with groups of anarchists who were philosophically opposed to "global capitalism" and "the rape of the world by multinationals," succeeded not only in shutting down the opening ceremonies of the WTO but also in sparking violence in the normally peaceful streets of Seattle. Against the wishes of the vast majority of protesters, a number of demonstrators damaged property and looted. The police responded with tear gas, rubber bullets, pepper spray, and baton charges. When it was all over, 600 demonstrators had been arrested, millions of dollars of property had been damaged in downtown Seattle, and the global news media had their headline: WTO Talks Collapse Amid Violent Demonstrations.

The question that now must be asked is whether the events in Seattle portray an end to half of a century of trade liberalization or whether they represent nothing more than a bump in the road? On the one hand, history suggests the WTO will ultimately get the next round of talks under way. After all, the last round of global trade talks—the Uruguay Round—also took several years to initiate.

On the other hand, there is a sense that Seattle may have been a watershed. Previous trade talks were pursued in relative obscurity with only interested economists, politicians, and businesspeople paying much attention. Seattle demonstrated, however, that the issues surrounding the global trend toward free trade have suddenly moved to center stage in the popular consciousness. The debate on the merits of free trade and globalization has become mainstream. Whether further liberalization occurs, therefore, may well depend on the importance that popular opinion in countries such as the United States attaches to issues such as human rights and labor standards, job security, environmental policies, and national sovereignty. It will also depend on the ability of advocates of free trade to articulate in a clear and compelling manner the argument that, in the long run, free trade is the best way of promoting adequate labor standards, of providing more jobs, and of protecting the environment. Much of the media coverage surrounding the Seattle conference made it clear that the merits of free trade are not well understood, while the perceived drawbacks are easy to identify and make for good press copy. Exactly how this debate will play out remains to be seen, but given recent trends it would not be surprising if labor rights and environmental considerations played a much larger role than hitherto in the next round of global trade talks when they finally get started (which, despite the breakdown of the Seattle meeting, seems likely to occur in 2000). The current US administration has signaled that it would like language related to labor standards and environmental protection to be included in the next round of trade talks.

China and the World Trade Organization

An early indication of the strength of opposition both to further liberalization of the global trading system and to the World Trade Organization may be seen in how China's application to join the WTO is processed. China has been trying to join the WTO, and the GATT before it, for 13 years. China sees membership in the WTO 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.[6] In 1998, the country exported $184 billion and imported over $140 billion, giving the country a healthy trade surplus. Trade has emerged as a major engine of economic growth in China.

China's leadership believes that further gains from trade will require membership in the WTO. They understand that this will not be a painless process. Joining the WTO will require China to dismantle many trade barriers that currently protect local industry from foreign competition. Chinese leaders hope that such short-term pain will 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.

One big roadblock to China's accession to the WTO has been the United States. The United States is China's largest trading partner, accounting for $70 billion of exports in 1998. With its huge population and rapid economic growth, China also holds out the promise of being a very important market for US 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 has supported greater economic engagement with China. This administration has repeatedly argued that greater economic freedom in China will be followed by greater political freedom and greater 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 several 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 has agreed to support China's application to join the WTO.

With this in hand, China now needs to convince a number of other WTO members that it is worthy of membership, including the European Union. It seems likely that the remaining holdouts will follow the US lead and agree to Chinese membership. If all goes well, China could join the WTO sometime during 2000. However, before this happens, the bilateral agreement between the United States and China has to be ratified by the US Congress, and this could be problematic. Fresh from what they perceive as a victory in Seattle, anti-WTO forces are now pressuring Congress to oppose China's entry into the WTO. As in Seattle, they are evoking arguments related to human rights, labor rights, and environmental protection (China's environmental record is very poor). Given that there are already substantial anti-China and protectionist blocs in Congress, and given that 2000 is an election year and the Clinton administration is seen as a lame duck, Congress could reject the bilateral trade treaty. This would block China's bid to join the WTO. If this occurs, it will be another significant victory for the antitrade forces that showed their hand in Seattle.

Asia Rebounds from Financial Crisis

When this edition of *International Business* went to press, many Southeast Asian countries were still struggling with the financial crisis that rocked the region in 1997 and 1998. This crisis, which is described in detail in Chapter 10, was caused by a combination of excess investment; too much industrial capacity; excessive debt, much of it denominated in dollars; and asset inflation, particularly in property. As the crisis spread throughout Asia in 1997 and 1998, several countries saw the value of their currencies fall by as much as 80 percent against the US dollar, while their stock markets registered similar declines. Following the crash, these countries were plunged into a deep recession. The worst hit were Indonesia, Thailand, Malaysia, and South Korea.

The International Monetary Fund stepped in to help many of these countries, committing more than $110 billion in short-term loans to South Korea, Thailand, and Indonesia. To access this money, these countries had to agree to implement tight macroeconomic policies, deregulate their economies, and reform their domestic banking systems. The IMF came in for substantial criticism at the time. Some critics claimed the conditions applied to its loans were too tough and would make the situation worse. Others argued that the IMF should not bail out Asia's troubled economies and by extension the banks that had engaged in excessive lending (see Chapter 10 for details). Despite mounting criticism, the IMF stuck to its course. A year later, the early signs are that doing so was the correct decision.

The apparent strength and speed of the recovery in Asia has surprised most observers. Thailand's gross domestic product (GDP), which fell 10.4 percent in 1998, rebounded by 4.1 percent in 1999. For Indonesia, the corresponding figures are down 13.7 percent in 1998 and down 0.2 percent in 1999; for Malaysia, down 7.5 percent and up 4.3 percent; and for South Korea, down 5.8 percent and up a stunning 9.3 percent. The region's stock markets staged an even more impressive rebound, led by the South Korean stock market, which surged over 80 percent during 1999.[7]

There are a number of reasons for this strong recovery. Perhaps the most important factor was that while Asia slumped, the American economy continued to boom. A strong American economy consumed exports from Asia, which following the 1997–98 collapse of Asian currencies were far less expensive than they had been a year earlier. Also helping to lift demand in the beleaguered Asian economies was the beginning of a recovery in Japan, which had been mired in a recession for much of the 1990s. Continued economic growth throughout much of Western Europe also helped to create demand for Asian exports. Thus, export-led growth helped to pull Asia's economies off the floor. Across the region, exports in 1999 were 15 percent ahead of those in 1998 by value.[8]

A second reason for the strong recovery was that after some initial belt-tightening at the insistence of the IMF, the region's countries relaxed their restrictive fiscal policies, boosting government spending on infrastructure projects and reducing taxes.[9] This fiscal stimulus helped to pump demand into the region's economies. However, there has been a price to pay for this stimulus. South Korea, Indonesia, Malaysia, and Thailand are now all running budget deficits that are equivalent to about 5 to 6 percent of their GDP. This will not matter much if tax revenues start to grow in line with the recovery in domestic demand, but it is important for governments in the region to limit their fiscal spending. Otherwise, the recovery might be choked by too much government debt and higher domestic interest rates.

As the combination of strong export demand and fiscal stimulus raised economic growth, companies across the region begin to rebuild their stocks of inventory. These had been run down to very low levels during the height of the 1997–98 financial crisis. In turn, inventory buildups have played a leading role in the economic rebound, particularly in heavily industrialized South Korea. Also important has been growth in intraregional trade, which accounts for half of all trade in the region.

Despite the impressive rebound, problems still remain in the region's economies. Following the crisis there were calls for substantial structural reforms, including a removal of barriers to foreign investment, a reduction in government spending, a halt to government direction of corporate investment, widespread reform of the national banking systems, and the breakup of indebted companies, particularly the South Korean *chaebol* (see Chapter 10 for details). Although progress has been made on all these fronts, the pace of structural reform has been slower than many economists and the IMF would like to see.

For example, while there have been clear moves to reform the region's troubled banking systems, there are still far too many weak banks and nonperforming loans (nonperforming loans are loans where the debtor has defaulted on the repayment of debt). The high level of nonperforming loans means that credit is still tight, making it difficult for enterprises in the region to borrow money to fund new investments. Although this has had little effect so far given the excess industrial capacity in the region, as demand continues to expand, companies will need to borrow money to fund investments in new capacity. If they cannot do so, the recovery may stall.

On the other hand, some banks have been sold to foreign companies, troubled banks have been forced to merge, barriers to foreign investment have been lowered, and there has been less government involvement in corporate investment decisions. In South Korea, the government has also pushed with some success for the breakup or restructuring of the nation's industrial groups (the *chaebol*). Its case was helped by financial troubles at Daewoo, one of the largest *chaebol*, which is bankrupt and is selling many of its assets.

For Asia to continue to rebound, analysts argue that governments must continue to push forward with these structural reforms. They also point out that although the region's economic recovery in 1999 looked impressive, this recovery was from the depths of a severe slump. For the most part, output still remains below preslump levels and it is far too early to declare victory. The region's recovery may stall if economic growth in the United States slows or if Japan fails to sustain its tentative economic recovery and slumps back into a recession. A slowdown in the United States would halt Asia's export-led recovery and reexpose the structural weaknesses in the region. Also of concern would be a financial crisis in China, the region's largest economy. China escaped the 1997–98 crisis, but concerns remain that China's economy is vulnerable to the kind of currency debacle that hit other Asian states in 1997.

The Birth of the Euro

The euro was born January 1, 1999. The euro is the common currency unit now used by 11 of the 15 nations of the European Union (EU). The 11 states are members of what is often referred to as the euro zone. For now, three EU countries—Britain, Denmark, and Sweden—are still sitting on the sidelines, although there are indications that Britain and Sweden may join before 2002. The establishment of the euro was an amazing political feat. There are few historic precedents for what the Europeans are doing. Establishing the euro required the participating national governments not only to give up their own currencies, but also to give up control over monetary policy. Governments are not in the habit of giving up control over important economic policy instruments—of sacrificing national sovereignty for the greater good—so this demonstrates the importance the Europeans attach to the euro. By adopting the euro, the EU has created the second-largest currency zone in the world after that of the US dollar.

Euro notes and coins will not actually be issued until January 1, 2002. In the interim, national currencies will continue to circulate in each of the 11 countries. However, in each participating state the national currency will stand for a defined amount of euros. Notes that now look like French francs or German Deutsche marks or Italian lira are mere denominations of the euro. In each participating state, banks and businesses now keep two sets of accounts, one in the local currency and one in euros. Many prices are now posted in both euros and the local currency. Increasingly, many business transactions will be conducted in euros.

After January 1, 2002, euro notes and coins will be issued and the national currencies will start to be taken out of circulation. After about six months, only euros will be in circulation—and all prices and routine economic transactions within the euro zone will be in euros. In effect, after January 1, 2002, the euro will move from being a virtual currency to a real currency.

Benefits of the Euro

There are several reasons the Europeans decided to establish a single currency in the EU. First, they believe that business and individuals will realize significant savings from having to handle one currency, rather than many. The savings come from lower foreign exchange costs and lower hedging costs. For example, an individual going from Germany to France will no longer have to pay a commission to a bank to change Deutsche marks into francs. Instead, they will be able to use euros. According to the European Commission, such savings could amount to 0.5 percent of the European Union's GDP, or about $40 billion per year.

Second, and perhaps more important, the adoption of a common currency will make it easier to compare prices across Europe. This should increase competition because it will be much easier for consumers to shop around. For example, it will be easy for German consumers to compare the price of cars in Germany with those in neighboring France or Holland and to buy from the least expensive source. The resulting increase in competitive pressures should lead to lower prices within the euro zone, resulting in substantial gains for European consumers. Third, faced with increased competition and lower prices, European producers will be forced to look for ways to reduce their production costs in order to maintain their profit margins. To the extent that this occurs, so the argument goes, the introduction of a common currency, by increasing competition, should ultimately produce long-run gains in the economic efficiency of European companies.

Fourth, the introduction of a common currency should give a strong boost to the development of a highly liquid pan-European capital market. The development of such a capital market should lower the cost of capital and lead to an increase in both the level of investment and the efficiency with which investment funds are allocated. This could be especially helpful to smaller companies that have historically had difficulty borrowing money from backward domestic banks. For example, the capital market of Portugal is very small and illiquid, which makes it difficult for bright Portuguese entrepreneurs with a good idea to borrow money at a reasonable price. However, in theory, entrepreneurs and such companies in general should soon be able to tap a much more liquid pan-European capital market. Right now Europe has no continent-wide capital market, such as the NASDAQ market in the United States, that funnels investment capital to dynamic young growth companies. The introduction of the euro could greatly facilitate the establishment of such a market.

Finally, the development of a pan-European euro-denominated capital market will increase the range of investment options open to both individuals and institutions. For example, it will now be much easier for individuals and institutions based in, let's say, Holland, to invest in Italian or French companies. This will enable European investors to better diversify their risk, which again lowers the cost of capital and should also increase the efficiency with which capital resources are allocated.[10]

Drawbacks of the Euro

The main drawback of a single currency is that national authorities within the euro zone have lost control over monetary policy. The European Central Bank (ECB) now manages monetary policy within the euro zone. Its prime objective is to ensure price stability. The major tool at its disposal is its ability to set interest rates for the euro. The implied loss of national sovereignty to the ECB underlay the decision by Britain, Denmark, and Sweden to stay out of the euro zone, at least initially. In these countries, many people are highly suspicious of the ability of the ECB to remain free from political pressure and to keep price inflation under tight control.

In theory, at least, the design of the ECB should ensure that it remains free of political pressure. The ECB is modeled on the German Bundesbank, which historically has been the most independent and successful central bank in Europe. The language contained in the Maastricht treaty prohibits the ECB from taking orders from politicians. The executive board of the bank, which consists of a president, vice president, and four other members, carries out policy by issuing instructions to national central banks. The policy is determined by the governing council, which consists of the executive board plus the central bank governors from the 11 euro zone countries. The governing council votes on interest rate changes. Members of the executive board are appointed for eight-year nonrenewable terms, insulating them from political pressures in order to get reappointed. Nevertheless, the jury is still out on the issue of the ECB's independence, and it will take some time for the bank to establish its inflation-fighting credentials.

According to critics, another drawback of the euro is that the EU is not what economists would call an optimal currency area. An optimal currency area is an area where similarities in the underlying structure of economic activity make it feasible to adopt a single currency and use a single exchange rate as an instrument of macroeconomic policy. Many of the European economies in the euro zone, however, are very dissimilar. For example, Finland and Portugal are dissimilar economies. They have different wage rates, tax regimes, and different business cycles, and they may react very differently to external economic shocks. A change in the euro exchange rate that helps Finland may actually hurt Portugal. Obviously, these differences complicate macroeconomic policy. For example, when euro economies are not growing in unison, a common monetary policy may mean that interest rates are too high in depressed regions and too low in booming regions. It will be interesting to see how the EU copes with the strains caused by such divergent economic performance.

One way of dealing with such divergent effects within the euro zone might be for the EU to engage in fiscal transfers, taking money from prosperous regions and pumping it into depressed regions. Such a move, however, would open a political can of worms. It is difficult, for example, to imagine the citizens of Germany forgoing their "fair share" of EU funds to create jobs for underemployed Portuguese workers.

Reflecting on these issues, several critics believe that the euro puts the economic cart before the political horse. In their view, a single currency should follow, not precede, political union. They argue that the euro will unleash enormous pressures for tax harmonization and fiscal transfers from the center, both policies that cannot be pursued without the appropriate political structure. The most apocalyptic vision that flows from these negative views is that far from stimulating economic growth, as its advocates claim, the euro will lead to lower economic growth and higher inflation within Europe.

The Early Experience

In the first year of its existence, the euro did not live up to the expectations of all its supporters. In January 1999, the euro was trading at 1 euro = $1.17. By late November of that year, the value of the euro had slumped to 1 euro = $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 US dollar and was also down significantly against the Japanese yen.

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.[11] 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. Rather, the decline in the value of the euro probably reflects the fact that the largest national economy in the euro zone, Germany, had a difficult year characterized by slow growth and relatively high unemployment. Germany accounts for about one-third of the output of the euro zone. Thus, as goes Germany, so goes the euro. With the weakness in Germany, global investors have been hesitant to hold euro-denominated assets, preferring instead to hold US dollars or yen. Accordingly, the euro has sunk in value against the dollar and yen.

Germany's troubles have several sources.[12] For much of the 1990s, interest rates were kept high in Germany as the country tried to cope with the costs of reunification with the former East Germany. The high interest rates depressed economic output and help explain the country's current economic malaise. The 1998 financial crisis that rocked the emerging markets of Eastern Europe did not help either. Germany exported a higher proportion of its total output to those markets than any other developed nation, so Germany bore the brunt of the resulting decline in demand. In addition, Germany has been slow to reform its extensive social welfare programs and inflexible labor markets. Consequently, German companies have been saddled with relatively high labor costs, which have made them less competitive than they might otherwise have been in the global economy.

In other words, the fall in the value of the euro can be attributed to weakness in the German economy. The German economy has been weak due to a combination of external shocks and deep structural problems. However, there are signs that German politicians and companies are responding by engaging in corporate restructuring and political reforms.[13] As these begin to work through the German economy, its performance should improve, which in the long run should help to strengthen the euro. Although the German economy has been relatively weak, other economies in the euro zone had a good year, including France, Ireland, and Spain. The decline in the value of the euro helped these countries to boost their exports and to attract foreign investment. Germany is also starting to reap the benefits of a weak euro and its exports are expanding. Indeed, the euro zone is running a trade surplus. In sum, one should not be too quick to read too much into the fall of the euro. It is still very early.

International Business in the New Millennium

With the dawn of a new millennium, it seems worthwhile to reflect 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 for international business.

A Hundred Years of Progress

The last 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 the telephone. The automobile had only recently been invented and was still the plaything of the rich. Aircraft, radio, penicillin, television, computers, and the Internet all lay in the future. Average life expectancy was 47.3 years. Many people were infirm by the age of 40. There were 75 million people in the country and 1.65 billion people on the planet, up from 980 million in 1800. Annual income per capita was under $400. The United States was a continental economy in which international business and international trade played a limited role in economic activity, but that role was starting to expand.

A person born at the beginning of 2000 in the United States entered a dramatically different world. Life expectancy had risen to 77 years, the consequence of a revolution in health care. Annual income per capita was $30,000. Automobiles, aircraft, antibiotics, computers, television, cell phones, and Internet connections were common. There were now over 6 billion people in the world and 270 million in the United States. There had been a dramatic expansion in both industrial output and international trade. World trade had expanded 20-fold and world output sixfold since 1950.[14] The world was a much more democratic place. Some 88 of the world's 191 countries were classified as "free" by Freedom House, which noted that 55 percent of the world's people were living in democratic states, a greater proportion than at any other time in history.[15] Market-based economic systems were also at a high-water mark around the globe. During the twentieth century, rival philosophies of political economy, including fascism and communism, had fallen by the wayside. The "free world" had won a hot war against fascism (World War II) and a cold war against communism. Liberal democracy with its emphasis on market-based economic systems was the ascendant ideology. Even the last great Communist state, China, had embraced market-based systems, making its claim to be a "Communist" country ring hollow. Clearly, this was a world in which international business could thrive, as it was.

However, the twentieth century was not one of smooth progress. There were two world wars and hundreds of minor ones that claimed some 37 million lives. Worse still, several Communist governments exhibited an appalling proclivity to murder their own people. Some 62 million civilians were killed in the Soviet Union between 1917 and 1991, 35 million in China between 1949 and 1990, and 1.5 million in a spasm of brutality in Cambodia. There was mass genocide in Turkey, Nazi Germany, Rwanda, and Bosnia. The Japanese killed some 6 million civilians in occupied territories during World War II. In total, some 170 million civilians were killed by governments during the twentieth century.[16] Atomic bombs were dropped on Hiroshima and Nagasaki. The influenza pandemic of 1918 left 20 million people dead around the world (in contrast, 8.5 million soldiers lost their lives during World War I). The still unfolding AIDS pandemic had claimed 12 million lives by 1997 and left 30 million infected with HIV. In the Great Depression of the 1930s, the average American saw his income fall by more than half. For much of the twentieth century most of the world lived under totalitarian dictatorships. Only in the last decade, since the 1989 collapse of communism in Eastern Europe, has the balance of the world's population lived in democratic states. For all of the progress of the twentieth century, much of the world's population still lives in conditions that have more in common with the United States of 1900 than that of 2000. The GNP per capita of India with its 1 billion people, for example, is only about $400 a year. China's 1.2 billion people have a GNP per capita of less than $900 a year.

Reasons for Optimism

Looking forward, there are plenty of reasons for optimism, but the history of the twentieth century also teaches us to expect reversals and uneven progress. Although predicting the future with certainty is impossible, one can argue that if current trends hold, living standards around the world will continue to improve. There are several reasons for expecting this. First, the prevailing economic ideology of the globe, with its emphasis on market-based systems, is likely to be supportive of the capitalist mode of production. In turn, as explained in Chapter 2, market-based systems beget innovations in products and processes, and innovations are the fuel of economic progress.

Second, the prevailing economic ideology is also supportive of removing barriers to cross-border trade and investment. Even without any further reductions, the relatively low level of such barriers today seems likely to ensure that the trend toward the globalization of product and capital markets will continue. In turn, the efficiency gains that flow from global markets will constitute a rising tide that lifts all economic boats.

Third, as noted above, for the first time in history the majority of the world's population now lives in democratic states. The trend toward greater democracy seems to be firmly in place. Over the past 15 years new democracies have sprung up throughout Latin America and Eastern Europe. There are signs that democracy may be gaining a foothold in parts of Africa, and several Asian countries, such as South Korea, have become far more democratic in recent decades. History teaches us that democracies rarely start wars, a fact that bodes well for the future.

Fourth, current advances in computing and communications technology, if maintained for two more decades, promise to vastly improve the efficiency of global markets and global business. Communications technology has always been a major driver of economic progress. The Gutenberg press, postal services, the telegraph, the telephone, and most recently the Internet have all lowered the costs of bringing together buyers and sellers—of making markets work—realizing substantial efficiency gains in the process. The Internet, because of its global reach, rapid growth, and potential for transmitting huge bundles of information at almost zero cost, will have a particularly dramatic impact in the near future. In 1990, fewer than 1 million users were connected to the Internet. By late 1999, the Internet had about 150 million users. By the year 2003 there may be well over 350 million users.[17] In July 1993, some 1.8 million host computers were connected to the Internet (host computers host the Web pages of local users). By July 1999, the number of host computers had increased to 56.3 million, and the number is still growing rapidly.[18] The Internet and World Wide Web (WWW) promise to develop into the information backbone of tomorrow's global economy. From virtually nothing in 1994, the value of transactions occurring on the WWW has increased at an exponential rate, hitting $98.4 billion in 1999. According to a recent report issued by the US Department of Commerce, this figure could reach $300 billion in the United States alone by 2003.[19] Other estimates suggest it could reach as much as $1.3 trillion by the same year.[20] Already, companies such as Dell Computer are booking over $5 million a day in Web-based sales, while Internet equipment giant Cisco Systems books more than 80 percent of its total sales on-line. It seems highly likely, therefore, that Internet-based commercial transactions will become an integral part of the global economy in the near future. The resulting gains in efficiency could provide a huge boost to global economic growth. Any international business that does not incorporate the Internet into its business processes will probably lose market share to those that do.

Future Challenges

Having laid out the reasons for being optimistic about the near future, it would be naïve not to highlight some potential problems that might stall global economic growth in the coming decades, or at least present international businesses with significant challenges. One possibility is that a combination of continued population growth, poverty in some less developed nations, and environmental degradation might lead to an ideological backlash against the global move toward free markets and the capitalist mode of production. One might argue that the protest against the World Trade Organization in Seattle, which was discussed earlier in this postscript, might portend the leading edge of such a backlash.

Current estimates suggest that global population will continue to expand from 6 billion today to between 9 billion and 11 billion by 2100. Much of this growth is predicted to take place in the poorer nations of the world, many of which have yet to share in the economic benefits of global capitalism.[21] Environmentalists argue that population pressure puts stress on the environment, ranging from deforestation and soil erosion to air pollution and global warming.[22] As we saw at the recent WTO meetings, some people maintain that the adoption of free market economics and free trade causes such problems.

One could counter that the relationship is not this simple. By creating wealth and incentives for enterprises to produce technological innovations, the free market system and free trade could make it easier for the world to cope with pollution and population growth. While pollution levels are rising in the world's poorer countries, they have been falling in developed nations. In the United States, for example, the concentration of carbon monoxide and sulphur dioxide pollutants in the atmosphere decreased by 60 percent between 1978 and 1997, while lead concentrations decreased by 98 percent—and these reductions have occurred against a background of sustained economic expansion.[23] These figures are a testament to the ability of rich countries to limit the adverse environmental impact of economic development. However, this somewhat subtle argument is not an easy one for many to accept and often falls on deaf ears. It seems possible that a backlash of sorts could occur. The collapse of communism has created an ideological vacuum into which a political movement opposed to unfettered free markets might step; and a movement advocating greater regulation of markets and trade in order to protect the environment could fit the bill.

If such a movement arises, it may create many difficult challenges for international businesses, including limits to cross-border trade and investment, government regulation of business activities, consumer revolts, and the imposition of "pollution taxes." For a foretaste of what might come, one only has to look at the recent unhappy experience of Monsanto. Using recombinant DNA technology, Monsanto has genetically engineered certain types of seed corn so they produce proteins that function as natural insecticides or so they resist Roundup, a popular herbicide sold by Monsanto. Seeds engineered in this manner reduce the need to use insecticides and herbicides, thereby lowering farmers' costs and boosting crop yields. Monsanto thought the world would welcome its innovations, which it believed were environmentally beneficial. Its genetically altered seeds, such as soybeans, have become extremely popular among farmers not only in the United States but also in many other countries, including Brazil, India, and China.

In Europe, however, environmentalists have mounted a vigorous and largely successful campaign against Monsanto's products, arguing that genetically altered crops might lead to "genetic pollution." According to environmentalists, insects might become resistant to the "natural insecticides" produced by Monsanto's genetically modified seed corn. Thus, in the long run, Monsanto's products might create "superbugs" that damage crop yields, not improve them. There is also a vague fear that genetic engineering, because it "upsets the natural order of things," might lead to serious problems that have yet to be identified, such as cancer. While these arguments lack scientific support, consumers and politicians across Europe have been receptive to them. Responding to pressure from consumers, many European supermarkets will no longer stock genetically modified foods. The European Union has banned the importation of some genetically modified crops, even though this probably violates World Trade Organization rules. This backlash has effectively reduced Monsanto's ability to sell its products in a market of more than 350 million people, costing the company significant potential revenues.[24]

Another challenge to globalization and international business might arise from the fear that rapid globalization will drive down the wage rates of workers in developed nations, who will see their jobs "exported" to low-wage locations in the developing world. This fear has long underlay the opposition of labor unions to free trade. The argument is also frequently articulated by populist politicians on both the left and right, who call for "fair trade" (meaning tariff barriers on imports from low-wage countries) as opposed to "free trade." If the argument gains wider support, it could lead to a partial retreat from free market ideology and an increase in trade barriers. To buttress their case, those who make this argument point to the evidence on growing wage inequality in developed nations. For example, a Federal Reserve study found that in the seven years up until 1996, the earnings of the best-paid 10 percent of US workers rose in real terms by 0.6 percent annually while the earnings of the 10 percent at the bottom of the heap fell by 8 percent. In some areas the fall was much greater: In New York City, the real wages of the worst-paid 10 percent dropped by 27 percent over this time period.[25] However, it seems unlikely that this growing inequality is due to globalization. In the United States, for example, only 13 percent of GNP can be attributed to international trade, and only one-fifth of that, or some 2.6 percent of GNP, is trade with developing nations. Most of America's trade is with high-wage countries such as Japan, Canada, and the nations of Europe. Given this, it is difficult to argue that international trade is the cause of growing income inequality.

Recent research also suggests that the evidence of growing income inequality may be suspect. Robert Lerman of the Urban Institute has taken a close look at the data. He believes that the finding of inequality is based on inappropriate calculations of wage rates. Reviewing the data using a different methodology, Lerman has found that far from increasing income inequality, an index of wage rate inequality for all workers actually fell by 5.5 percent between 1987 and 1994.[26] If future research supports this finding, the argument that globalization leads to growing income inequality may lose much of its punch. During the last few years of the 1990s, the income of the worst-paid 10 percent of the population actually rose twice as fast as that of the average worker, suggesting that the high employment levels of these years have triggered a rise in the income of the lowest paid.[27]

A final challenge to globalization and international business might arise if the economic gap between the wealthy nations of the world and the poorest nations continues to widen. Despite all the benefits associated with globalization, over the past hundred years or so the gap between the rich and poor nations of the world has become wider. In 1870 the average income per capita in the world's 17 richest nations was 2.4 times that of all other countries. In 1990 the same group was 4.5 times as rich as the rest.[28] While recent history has shown that some of the world's poorer nations are capable of rapid periods of economic growth—witness the transformation that has occurred in some Southeast Asian nations such as South Korea, Thailand, and Malaysia—there also appear to be strong forces for stagnation among the world's poorest nations. A quarter of the countries with a GDP per capita of less than $1,000 in 1960 had negative growth rates of less than zero from 1960 to 1995, and a third had growth rates of less than 0.05 percent.[29]

Although the reasons for economic stagnation are varied, several factors stand out. Many of the world's poorest countries have suffered from totalitarian governments, economic policies that destroyed wealth rather than facilitated its creation, scant protection for property rights, and war. Such factors help explain why countries such as Afghanistan, Cambodia, Cuba, Haiti, Iraq, Libya, Nigeria, Sudan, Vietnam, and Zaire have failed to improve the economic lot of their citizens during recent decades. A complicating factor is that many of these countries have rapidly expanding populations. Without a major change in government, population growth may exacerbate their problems.

It is an open question as to whether such states will prove to be a destabilizing influence in the economy of the twenty-first century. They may lash out at their neighbors, as Iraq did in the 1991 Gulf War; export their people to other nations, as Haiti and Vietnam have done; or sponsor extensive terrorist activities, as Libya has done. If such geopolitical events do come to pass, there may be significant fallout for the global economy and international businesses. The task for the world community is to find ways to bring these countries into the global trading system so that they can share in the prosperity that has been and will be created.

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