

## CHAPTER 2

# Global Marketplaces and Business Centers



Jan Will/Fotolia

### AFTER STUDYING THIS CHAPTER, YOU SHOULD BE ABLE TO:

1. Evaluate the impact of the political and economic characteristics of the world's various marketplaces on the opportunities available to international businesses.
2. Appreciate the uses of national income data in making business decisions.
3. Discuss North America as a major marketplace and business center in the world economy.
4. Describe Western Europe as a major marketplace and business center in the world economy.
5. Discuss Asia as a major marketplace and business center in the world economy.
6. Assess the development challenges facing African, Middle Eastern, and South American countries.

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## THE NORTHWEST PASSAGE

Shortly after voyages to the Americas by explorers such as Christopher Columbus, Vasco da Gama, and Amerigo Vespucci, European kings and merchants eagerly sought to discover the Northwest Passage, a rumored route that would allow them to access the riches of Asia by winding their way through the Arctic seas. Despite their best efforts, adventurers like John Cabot, Juan de Fuca, Martin Frobisher, Vitus Bering, James Cook, and Jacques Cartier found no such passage—the Arctic ice cap frustrated all such attempts.

Fast forward to the twenty-first century. To the alarm of scientists and environmentally concerned citizens, the Arctic ice cap has been rapidly shrinking as a result of global climate change. But the diminishing ice cap has raised the prospect that a Northwest Passage will now become feasible. At the current rate of thaw, some scientists believe the Arctic Ocean will be nearly free of summer ice by as early as 2020.

Two such Arctic routes may prove commercially feasible. The first, the famed Northwest Passage, hugs the northwestern North American coast, wends its way through the numerous Canadian Arctic islands, and then exits south of Greenland for the remaining voyage to Europe or the eastern coasts of the Americas. The second, the Northern Sea Route, follows the coastline of eastern Siberia and enters the Arctic Ocean through the Bering Strait. The Northern Sea Route then traverses northern Siberian waters until it reaches the famed ice-free port of Murmansk, easily accessible to the Atlantic Ocean and the busy ports of Europe.

Chinese researchers believe such polar routings could develop into the world's most important trade corridors. For many cargo routings, the distance between Western European ports and East Asian ports could be cut by a third using the Northwest Passage or the Northern Sea Route. Major Asian trading nations like China, Japan, and South Korea are sinking money into ice-breaker research and ice capable vessels to take advantage of this opportunity to decrease transport times and expenses to the European market.

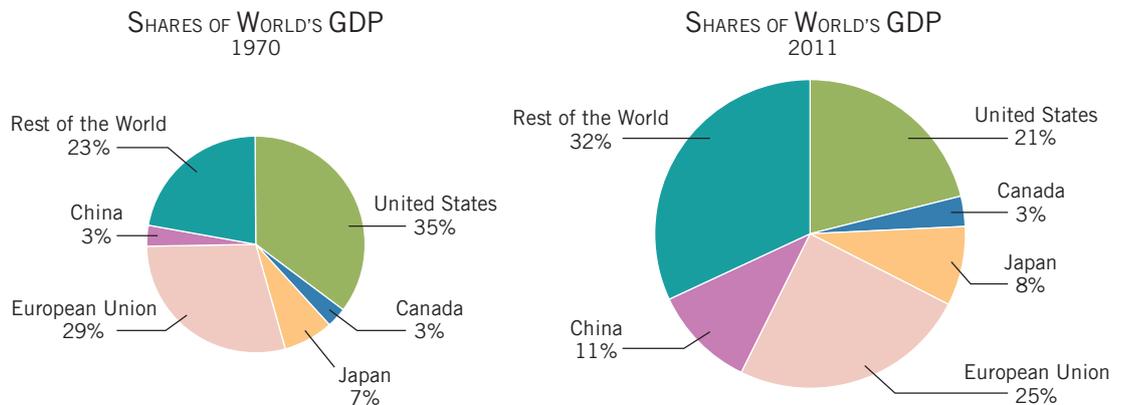
The shrinking ice cap also has raised prospects of exploring and exploiting the mineral wealth of the waters cloaked by the ice. The U.S. Geological Survey believes the Arctic could contain as much as a quarter of the world's undiscovered commercially recoverable reserves of oil and natural gas. This then heightens the importance of who owns the rights to these waters. Under the United Nations Convention on the Law of the Sea (UNCLOS), countries are given control over navigation within 12 miles of their coastline, and an exclusive economic zone (EEZ) within 200 miles of their coastline. UNCLOS contains additional codicils dealing with the presence of islands affiliated with a coastline and with the treatment of continental shelves.

Historical claims to territory further complicate the definitions of these control rights.

Not surprisingly, as the ice cap has shrunk and made commercial exploitation of the area more feasible, countries have been more aggressive in staking out their Arctic claims. The Arctic Council, composed of countries with territorial claims to the Arctic (Canada, Denmark, Finland, Iceland, Norway, Russia, Sweden, and the United States) is the primary international organization addressing the region's issues. Founded in 1996, the Arctic Council is charged with developing rules and procedures for protecting the fragile Arctic environment, promoting sustainable development, and coordinating scientific research. China, India, Italy, Japan, Singapore, and South Korea were granted permanent observer status on the council in May 2013. But these applications did generate some political controversy. China, for example, diplomatically snubbed Norway after a Norway-based committee awarded the 2010 Nobel Peace Prize to a Chinese dissident pro-democracy activist, Liu Xiaobo. In response, Norway was slow to approve China's request for permanent observer status on the Arctic Council. A hotel development project in Iceland by a Chinese entrepreneur stoked fears that it was a Trojan horse designed to further China's claims to the Arctic, despite any evidence to support the concerns. Russia, the owner of roughly half of the Arctic coastline, was also reluctant to grant China's request. And Canada blocked the EU's application for observer status, concerned that EU environmentalists would gain more clout to meddle in the annual seal hunts conducted by indigenous Canadian natives.

Although the members of the Arctic Council are in general agreement about the scope of members' territorial claims, some conflicts remain. Canada and Denmark are squabbling over ownership of some rocks claimed by Canada and by Greenland (a self-governing division of the Kingdom of Denmark). Canada also asserts that much of the Northwest Passage lies within its territorial waters, while the United States and the United Kingdom argue that they are international waters. Of greater concern is delimiting the boundaries of countries' continental shelves. In 2007, a Russian submersible planted the Russian flag 4 kilometers below the surface of the North Pole, emphasizing its claim to an underwater ridge, thought to be rich with minerals and several billion barrels of oil deposits, also claimed by Denmark and Canada. Yet experts believe the conflict will be solved peacefully. All three countries have clear title to numerous commercially feasible development projects. Russia's president, Vladimir Putin, recognizes the importance of the region to Russia's economic growth and has promoted a policy of collaboration on the Arctic Council.<sup>1</sup> ■

**FIGURE 2.1**  
**The World Economy 1970 and 2011**



Source: Based on World Bank, *World Development Indicators* database.

The growing interest in the Arctic Ocean is but one example of the myriad opportunities created by globalization. Yet businesses trying to internationalize their operations often blunder because they fail to obtain information vital to their success. Ignorance of basic geography, market characteristics, culture, and politics may lead to lost profits or, in the extreme, doom a venture to failure. Linguistic and cultural ties, past political associations, and military alliances play significant roles in the world pattern of trade and investment and in shaping the opportunities available to businesses today. For example, London's contemporary importance as a world financial center arises from the political and military power of the British Empire in the nineteenth century. Similarly, Austria serves as a bridge between Western and Eastern Europe because of transportation, educational, and cultural linkages that remain from the 600-year reign of the Hapsburg dynasty over the Austro-Hungarian Empire.

Providing an overview of the world economy is a challenge because of its vast size. Much of the world's current economic activity—about 57 percent, as Figure 2.1 indicates—is concentrated in the developed countries of North America, the EU, and Japan. This is not to suggest that international managers can ignore other markets if they wish to compete successfully. The emerging markets we discussed in Chapter 1—particularly China and India—are responsible for much of the growth in the world economy. In the twenty-first century, the growth rates of China and India, 10.8 percent and 8.1 percent, respectively, have far outpaced Japan's 0.7 percent, Germany's 1.3 percent, or the United States' 1.6 percent. Because astute international managers increasingly need a thorough and sophisticated understanding of the opportunities available in each of the six inhabited continents, we provide a brief overview of all the world's marketplaces in this chapter.

## The Marketplaces of North America

North America includes the United States, Canada, Mexico, Greenland, and the countries of Central America and the Caribbean. Home to 546 million people, these countries produce approximately 26 percent of the world's output.

### The United States

The United States has only the world's third largest population and fourth largest land mass, yet it possesses the largest economy, accounting for 21 percent of the world's \$69.9 trillion GDP in 2011. As Map 2.1 shows, the United States enjoys a per capita income of over \$48,000.<sup>2</sup> The United States occupies a unique position in the world economy because of its size and political stability, accounting for about one-eleventh of world exports of goods

and services and about one-eighth of world imports of goods and services. It is the prime market for lower-income countries trying to raise their standards of living through export-oriented economic development strategies. It is also the prime market for firms from higher-income countries trying to attract business from its large, well-educated middle class. (See “Emerging Opportunities.”)

The U.S. dollar serves as the **invoicing currency**—the currency in which the sale of goods and services is denominated—for about half of all international transactions and is an important component of foreign-currency reserves worldwide. Because of its political stability and military strength, the United States also attracts **flight capital**—money sent out of a politically or economically unstable country to one perceived as a safe haven. Citizens unsure of the value of their home country’s currency often choose to keep their wealth in dollars. The United States also is an important recipient of long-term foreign investment. Foreigners have invested \$2.7 trillion in U.S. factories, equipment, and property as of 2012.

Although international trade has become increasingly more important during the past decade, it is a relatively small component of the U.S. economy. U.S. exports of goods and services in 2012 totaled \$2.2 trillion but were only 14 percent of its GDP. However, this figure is somewhat misleading. Because of the country’s large size, trade that might be counted as international in smaller countries is considered domestic in the United States. For example, the money spent for a hotel room in neighboring Belgium by a Dutch motorist trapped in a thunderstorm 50 miles from home late at night is counted in the international trade statistics of both Belgium and the Netherlands. A similar expenditure by a Connecticut motorist stuck in New Jersey after watching a football game at the Meadowlands is a purely domestic transaction.

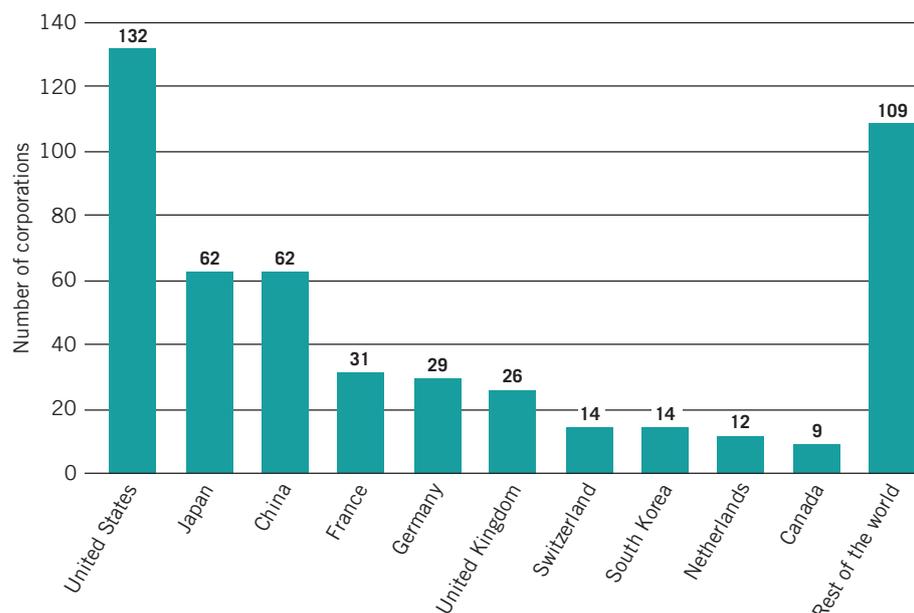
As discussed throughout this book, multinational corporations (MNCs) heavily influence international trade and investment. In 2012, the world’s 500 largest corporations had total sales of \$30.3 trillion. Given the importance of the United States in the world economy, it should come as no surprise that 132 of these corporations, or 26 percent, are headquartered in the United States, including 32 of the largest 100 (see Figure 2.2). Royal Dutch Shell is currently the world’s largest company, with sales of \$481.7 billion in 2012.

### Canada

Canada has the world’s second largest land mass, although its population is only 34 million. Eighty percent of the population is concentrated within a 100-mile band along the country’s southern border with the United States. Exports are vital to the Canadian economy, accounting

**FIGURE 2.2**  
Headquarters of  
the World’s Largest  
Corporations in 2012  
by Country

Source: Based on data from *Fortune*,  
July 22, 2013, p. F1.



for 31 percent of its 2011 GDP of \$1,736 billion. Canada's most important exports reflect its rich natural resources: forest products, petroleum, minerals, and grain. The United States is the dominant market for Canadian goods, receiving more than three-quarters of Canada's exports in a typical year. Two-way trade between the United States and Canada, which totaled \$715 billion in 2012, forms the single largest bilateral trading relationship in the world.

International investors have long been attracted to Canada because of its proximity to the huge U.S. market and the stability of its political and legal systems. Canada's excellent infrastructure and educational systems also contribute to the performance of its economy. However, a lingering threat to Canada's political stability—and to its ability to attract foreign investment—is the long-standing conflict between French-speaking Canadians (many of whom live in the province of Quebec) and English-speaking Canadians. A strong separatist movement has existed in Quebec since the 1960s, and English-speaking Canada has been pressured to adopt policies to diffuse separatism. This conflict has affected domestic and international businesses in many ways. For example, firms exporting products to Canada must be aware of the country's bilingual labeling laws. Also, the riskiness of loans to Quebec firms would increase substantially, at least in the short run, if the province were to become a separate nation, as the 40-year-old separatist movement desires. A more immediate threat to the Canadian economy—the rising value of its currency relative to the U.S. dollar—is explored in Chapter 8's opening case, "The Loonie Takes Flight."

## EMERGING OPPORTUNITIES

### CLASSIFYING COUNTRIES BY INCOME LEVELS

Often the single most important piece of information needed by international businesspeople about a country is its income level. Income levels provide clues to the purchasing power of residents, the technological sophistication of local production processes, and the status of the public infrastructure.

One important source of income statistics is the World Bank, which divides the world's countries into high-income, middle-income, and low-income categories. High-income countries are those that enjoy annual per capita incomes of at least \$12,476. (**Per capita income** is usually measured by dividing a country's **gross domestic product (GDP)** or its **gross national income (GNI)** by its population. GDP is the total market value of all goods and services produced in a country during some time period, such as a year. GNI is GDP plus net income, such as dividends and interest received from residents of other countries minus those paid to residents of other countries.) The high-income group comprises three clusters of countries. The first cluster is drawn from the **Organization for Economic Cooperation and Development (OECD)**, a group of 34 market-oriented democracies formed to promote economic growth. The OECD includes 25 Western European countries (the 15 EU members before its 2004 expansion plus the Czech Republic, Estonia, Hungary, Iceland, Norway, Poland, the Slovak Republic, Slovenia, Switzerland, and Turkey), four Pacific Rim countries (Australia, Japan, New Zealand, and South Korea), and Canada, Mexico, the United States, Israel, and Chile. Thirty-one of the OECD's 34 members fall in the high-income category. (The remaining members—Chile, Mexico, and Turkey—are classified as upper-middle income.) The second cluster comprises oil-rich countries such as Bahrain, Brunei, Kuwait, Qatar, Russia, Saudi Arabia, and the United Arab Emirates. The third cluster consists of smaller industrialized countries and island states, including Croatia,



Latvia, Hong Kong, Singapore, Taiwan, Bermuda, the Bahamas, and the Cayman Islands.

Middle-income countries have per capita incomes of more than \$1,025 but less than \$12,476. The World Bank subdivides this group into lower-middle income (per capita income between \$1,026 and \$4,035) and upper-middle income (per capita income between \$4,036 and \$12,475). This category includes many of the former Soviet republics, which generally enjoyed high levels of development in the 1930s but fell behind the Western economies economically after World War II. Other countries in this category, such as Chile, Costa Rica, and Mauritius, have been undergoing successful industrialization and economic growth and may be elevated to the high-income category by the end of this decade.

Lower-income countries, often called developing countries, have per capita incomes of \$1,025 or less. This category includes some countries, such as Cambodia and Rwanda, whose economies are growing substantially because of external aid, sound domestic economic policies, foreign direct investment (FDI), or exploitation of valuable natural resources. Officially labeled "underdeveloped" by the United Nations General Assembly in 1971, these countries have the potential for above-average economic growth. Other countries, designated "undeveloped" and "least developed" by the United Nations, have low literacy rates, per capita incomes, and economic growth. They are less attractive to international businesses because they offer less consumer demand and lack the public infrastructure necessary for reliable production and distribution of goods and services. A prime example of this latter category is Somalia, an East African country wracked by drought, civil war, and starvation.

Source: World Bank, *World Development Indicators* database.

## Mexico

Now the world's most populous Spanish-speaking nation, Mexico declared independence from its Spanish conquerors in 1810. Like the United States, Mexico is a federal system but one whose head of government, a president, is elected by popular vote every six years. For more than half a century the Mexican government implemented a program of economic nationalism under which Mexico discouraged foreign investment and erected high tariff walls to protect its domestic industries. During the past three decades, however, Mexico has abandoned these policies and opened its markets to foreign goods and investors. Mexico also reduced the government's role in its economy by selling off many publicly owned firms, such as Aeromexico and Telefonos de Mexico. In 1994, Canada, Mexico, and the United States initiated the North American Free Trade Agreement (NAFTA), which reduced barriers to trade among the three countries over a 15-year period. Thousands of foreign companies have established new factories in Mexico to take advantage of NAFTA, generating hundreds of thousands of new jobs in the process. In 1999, Mexico signed a similar agreement with the EU, hoping to create additional benefits for its citizens. In 2000, it signed free trade pacts with neighboring El Salvador, Guatemala, and Honduras, and, in 2004, with Japan and Uruguay.<sup>3</sup> The role of trade in Mexico's economy is explored further in Chapter 10's opening case, "Trade and Prosperity: The Case of Mexico."

## Central America and the Caribbean

Besides the United States, Canada, and Mexico, the North American continent is occupied by two dozen other countries that are divided geographically into two groups: Central America and the island states of the Caribbean. Collectively their population equals 85 million—more than twice the population of Canada. However, their total GDP of \$510 billion is a third of that of Canada. Several island states with vibrant offshore financing or tourism industries, such as Aruba, the Bahamas, the Cayman Islands, and Curaçao, have achieved high income status, while Costa Rica and Panama (see "Bringing the World into Focus") are classified as upper-middle income. Unfortunately, the economic development of other countries in the region has suffered from a variety of problems, including political instability, chronic U.S. military intervention, inadequate educational systems, a weak middle class, economic policies that have created large pockets of poverty, and import limitations by the United States and other developed countries on Central American and Caribbean goods, such as sugar and clothing.

## BRINGING THE WORLD INTO FOCUS

### THE CANALS OF COMMERCE

The chapter's opening case discusses the implications of opening an ice-free Arctic passage between eastern Asia and the Atlantic Ocean. For now, however, two canals play a major role in channeling ocean-borne trade between Asia and the Americas and Europe. The Suez Canal, a sea-level canal that cuts through Egypt, was constructed under the leadership of French developer Ferdinand de Lesseps. It opened for business in 1869. This canal played a major role in allowing the United Kingdom to control its Asian colonies, particularly British India. In 1956, Egyptian President Gamal Nasser seized control of and nationalized the canal. British, French, and Israeli troops formed an expedition to recapture it from the Egyptians, but diplomatic pressures from the Eisenhower administration squelched their effort. Today more than 20,000 vessels transit the Suez Canal annually, generating \$5.3 billion in tolls.

The Panama Canal is the younger of the two canals. Serving more than 14,000 vessels a year and yielding \$2.3 billion in tolls, the Panama Canal accounts for 5 percent of global commercial trade. After Spanish explorer Vasco Núñez de Balboa explored the Isthmus of Panama in 1513, entrepreneurs and dreamers for centuries sought to connect the Atlantic and Pacific Oceans at



this narrowest point of the Americas. In 1881, France, under the leadership of de Lesseps, raised millions of dollars to do this. However, the French effort was frustrated by mudslides, malaria, and yellow fever, killing 22,000 workers. It was abandoned in 1893, after burning through \$287 million. A second French company was formed, but sold its rights and equipment to a U.S. company in 1903. When the government of Colombia denied the United States rights to build the canal, the U.S. government backed the independence claim of Panama, thereby securing its building rights. Completed in 1914, the Panama Canal is one of the great engineering feats of the early twentieth century. A series of locks raise or lower ships 85 feet to accommodate the differences in the height of the two oceans. The Panama Canal is so crucial to the ocean-going trade that a standard class of ships are labeled Panamax, the maximum size vessel that can transit the canal. However, the locks of the Panama Canal are too narrow for many modern container ships; eager to expand its market share, the managers of the Panama Canal are in the process of building another set of locks to accommodate these larger ships, a project costing \$5.2 billion that is expected to be finished in 2015.

The Panama Canal, one of the premier engineering feats of the early twentieth century, is a vital commercial link between East Asia and the eastern seaboard of North and South America. The canal is transited by 14,000 vessels a year, such as this heavily-laden Panamax-class container ship.



Ricky W. Griffin

### In Practice

- The large two-way trade between the United States and Canada is a good example of the implications of the CAGE model discussed on page 29. “Distance” between the United States and Canada is small, which encourages trade.
- Beginning in the mid-1980s, Mexico altered its inward-looking economic policies and embraced free trade. Mexico’s per capita GDP is now over \$10,000.

*For further consideration:* The Panama Canal is constructing a new, wider set of locks capable of handling extremely large containerships. How vulnerable is this \$5.2 billion investment if the Arctic ice cap continues to shrink?

## The Marketplaces of Western Europe

Western European countries are among the world’s most prosperous, attracting the attention of businesses eager to market their products to the region’s wealthy consumers. These countries can be divided into two groups: members of the EU and other countries in the region (see Map 2.2).

The EU, which we discuss in greater detail in Chapter 10, comprises 28 countries that are seeking to promote European peace and prosperity by reducing mutual barriers to trade and investment. During the past two decades the EU has made tremendous strides in achieving this objective. With a 2011 GDP of \$17.6 trillion and a population of 508 million, it is one of the world’s richest markets. EU members are free-market-oriented, parliamentary democracies. However, government intervention and ownership generally play a more important role in these countries’ economies than in the economy of the United States. Seventeen EU members have eliminated their national currencies, replacing them with a new common currency known as the euro (€). Latvia is expected to adopt the euro in 2014, becoming the eighteenth EU to do so.

From an economic perspective, Germany is the EU’s most important member. With a 2011 GDP of \$3.6 trillion, it possesses the world’s fourth largest economy, after the United States,

China, and Japan. It is a major player in international business; in 2011 it was the world's third largest exporter of goods (after China and the United States), some \$1.5 trillion. "Bringing the World into Focus" provides additional insights into Germany's exporting success. Because of the strength of the German economy and the government's strict anti-inflation policies, Germany has played a major role in formulating the economic policies of the EU.

## BRINGING THE WORLD INTO FOCUS

### THE EU'S GROWTH ENGINE

During the 2008–2009 global recession, Germany's economy suffered a deeper downturn but recovered more quickly and strongly than most developed countries. The German economy's solid performance is attributable in part to the exporting prowess of the so-called *Mittelstand*, which are the backbone of Germany's manufacturing sector. A typical *Mittelstand* firm is a small-to medium-sized, family-owned enterprise, often located in a small town or city. Many of the *Mittelstand* compete on quality, innovation, reliability, and craftsmanship, not price. German labor costs are high, but the labor force is well educated and quality oriented. The *Mittelstand* account for about 52 percent of Germany's economic output and 39 percent of corporate sales.

Many *Mittelstand* firms specialize in product niches, but then aim to be the world's best in that niche. Some of them make the machines that make things. For example, Kugler-Womako is a world leader in crafting the machines that make passports; Wirtgen specializes in manufacturing machines that make new tar roads out of old ones; Koenig & Bauer fabricates printing presses. Other *Mittelstand* firms focus on more mundane products. Tente produces casters for hospital beds, while Aeroxon is a leader in manufacturing flycatchers. The emphasis is on making durable, well-engineered products. Devotion to customer service is another hallmark of the



*Mittelstand*, as is their export orientation. More than 90 percent of Koenig & Bauer's revenue is generated from exporting, for example.

Much of the *Mittelstand*'s success is attributable to the German secondary education system. Germany provides three-year long, vocationally oriented programs for high-school students who are not interested in attending college. These vocational programs blend classroom training with on-the-job experience. Graduates of these programs supply the skilled craftsmen and technicians that underlie the enviable exporting performance of the *Mittelstand*.

*Sources:* Based on "The engines of growth," *Wall Street Journal*, June 27, 2011, p. R4; "Anybody home?," *Wall Street Journal*, June 27, 2011, p. R6; "The German drive to globalise," *Financial Times*, June 1, 2011, p. 6; "China blunts Germany's edge," *Wall Street Journal*, May 12, 2011, p. B11; "Profits of inside knowledge," *Financial Times*, April 5, 2011, p. 14; "Exodus of skilled labor saps Germany," *Wall Street Journal*, March 11, 2011, p. A12; "A machine running smoothly," *The Economist*, February 5, 2011; "Reflected glory," *Financial Times*, January 19, 2011, p. 9; "Mittel-management," *The Economist*, November 27, 2010; "How Germany got it right on the economy," *Washington Post*, November 24, 2010; "Mittelstand style still limited in UK," *Financial Times*, September 26, 2010; "Much to learn," *The Economist*, March 11, 2010.



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Small- and medium-sized family-owned firms, known as the *Mittelstand*, are a critical element in Germany's exporting success. *Mittelstand* firms rely on skilled German craftsmen to produce high-quality, well-engineered products that dominate many product niches.

Politically, France exerts strong leadership within the EU. The French government has been a leading proponent of promoting common European defense and foreign policies and strengthening human rights and workers' rights in the EU. But French leaders have drawn criticism for promoting an agenda of economic nationalism, defending French corporations from takeover efforts by other European firms, contrary to the founding principles of the EU, and protecting the large subsidies paid to French farmers under the EU's Common Agricultural Policy.

France's positions have not gone unchallenged, however. The United Kingdom has resisted many of the initiatives to broaden the EU's powers and, as a traditionally strong supporter of free trade, has provided an important counterweight to French protectionist tendencies. The United Kingdom's capital city, London, is a major international finance center, employing more than 300,000 in its financial services sector. The United Kingdom is also a major exporter and importer of goods, an important destination for and source of foreign investment, and home to the headquarters or regional divisions of numerous MNCs.

Many of the newest EU members were either part of the Soviet Union (Estonia, Latvia, and Lithuania) or allied with the Soviet Union politically and economically (Bulgaria, Czech Republic, Hungary, Poland, Slovakia, and Romania). (EU members Croatia and Slovenia declared their independence from communist Yugoslavia, but Yugoslavia was not part of the Soviet bloc.) After the Soviet bloc began dissolving in 1989 and the Soviet Union disintegrated in 1991, the regional trading system established by the Soviet Union broke down, and the former Soviet satellite states had to adjust to the loss of guaranteed export markets. They also had to restructure their economies from centrally planned communist systems to decentralized market systems and implement necessary political, legal, and institutional reforms, a process facilitated by their joining the EU. The Czech Republic, Croatia, Estonia, Hungary, Poland, Slovakia, and Slovenia are the furthest along in this process, already achieving high-income status according to the World Bank's measures.

Rich Western European countries that are not EU members include Iceland, Norway, and Switzerland, plus several small, "postage stamp" countries such as Andorra, Monaco, and Liechtenstein. Classified as high income by the World Bank, these free-market-oriented countries collectively account for 2 percent of the world's GDP. The economies of the Balkan countries of Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, and Serbia are classified as middle income by the World Bank. Their post-Cold War economic progress was slowed by the chaos that surrounded the disintegration of Yugoslavia in 1991. The economies of Serbia, Montenegro, and Bosnia were devastated by the brutal wars over control of Bosnia in the early 1990s and over Kosovo in the late 1990s. These conflicts, needless to say, discouraged most MNCs from investing there during those troubled times.

### In Practice

- Germany is the EU's largest and strongest economy, with a vibrant exporting sector led by the *Mittelstand*. Germany has taken a leadership role in formulating the EU's response to its recent economic crises.
- The economic performance of the former Soviet bloc members who have joined the EU has been impressive. Joining the EU has allowed their exporters to access the rich consumer markets of Western Europe.

*For further consideration:* Chapter 1's closing case discussed demographic change. The populations of many EU countries are expected to shrink and to get older in the coming decades. What impact will this have on the competitiveness of these countries?

## The Marketplaces of Eastern Europe and Central Asia

No area of the world has undergone as much economic change in the past two decades as the countries carved out of the former Soviet Union (see Map 2.3), many of which are still dealing with the aftermath of the painful processes of converting from communism to capitalism and from totalitarianism to democracy. Soviet leader Mikhail Gorbachev's 1986 reform initiatives of *glasnost* (openness) and *perestroika* (economic restructuring) triggered the region's political, economic, and social revolutions.

## The Marketplaces of Asia

Asia is home to more than half the world's population, yet it produces less than a third of the world's GDP (see Map 2.4). Asia's importance to international business cannot be overstated. The region is a source of both high-quality and low-quality products and of both skilled and unskilled labor. Asia is both a major destination for foreign investments by MNCs and a major supplier of capital to non-Asian countries. More important, its aggressive, efficient entrepreneurs have increasingly put competitive pressure on European and North American firms to improve their productivity and the quality of their products.

### Japan

Japan, an island country of 128 million people, rose from the ashes of World War II to become one of the world's economic superpowers, with a GDP of \$5.9 trillion in 2011. For most of the post-World War II period, Japan's GDP was second only to that of the United States. In 2010, China's GDP surpassed that of Japan, relegating Japan to the number three position. Japan's economic success during the past 60 years is in part the result of the partnership between its Ministry of International Trade and Industry (MITI) and its industrial sector. (In 2001, MITI was renamed the Ministry of Economy, Trade, and Industry.) MITI has used its formal and informal powers to guide the production and investment strategies of the country's corporate elite. For example, immediately after World War II, MITI encouraged Japanese firms to concentrate their efforts on such basic industries as steel and shipbuilding. As other countries entered these industries, MITI and Japan's MNCs shifted their focus to producing automobiles, consumer electronics, and machinery.

MITI has been aided by Japan's concentrated industrial structure. Japanese industry is controlled by large families of interrelated companies, called *keiretsu*, that are typically centered on a major Japanese bank. The bank takes primary responsibility for meeting the keiretsu's financing needs. The members often act as suppliers to each other, thus making it more difficult for outsiders to penetrate Japanese markets. Members are also protected from hostile takeovers by an elaborate system of cross-ownership of shares in which keiretsu members own shares in one another's companies. Keiretsu members often rely on a *sogo shosha*, an export trading company, to market their exports worldwide. Typically the *sogo shosha* is also a keiretsu member.

Japan's economic growth slowed in the 1990s, however. Since 2003, its GDP has grown at an annual rate of 0.7 percent, well below the 2.7 percent average growth in the world economy. Many experts are concerned that the Japanese political and economic systems have not been able to adjust quickly enough to the changes in the world economy created by the growth of e-commerce and the emerging markets. Moreover, Japan has received much international criticism because of the perception that it employs unfair trading practices to market its exports while using numerous nontariff barriers to restrict imports to its domestic market (we will discuss this further in Chapter 9). Perhaps Japan's greatest challenge, however, is dealing with its growing demographic crisis: the aging of its population (see Chapter 1's closing case, "Demography Is Destiny").

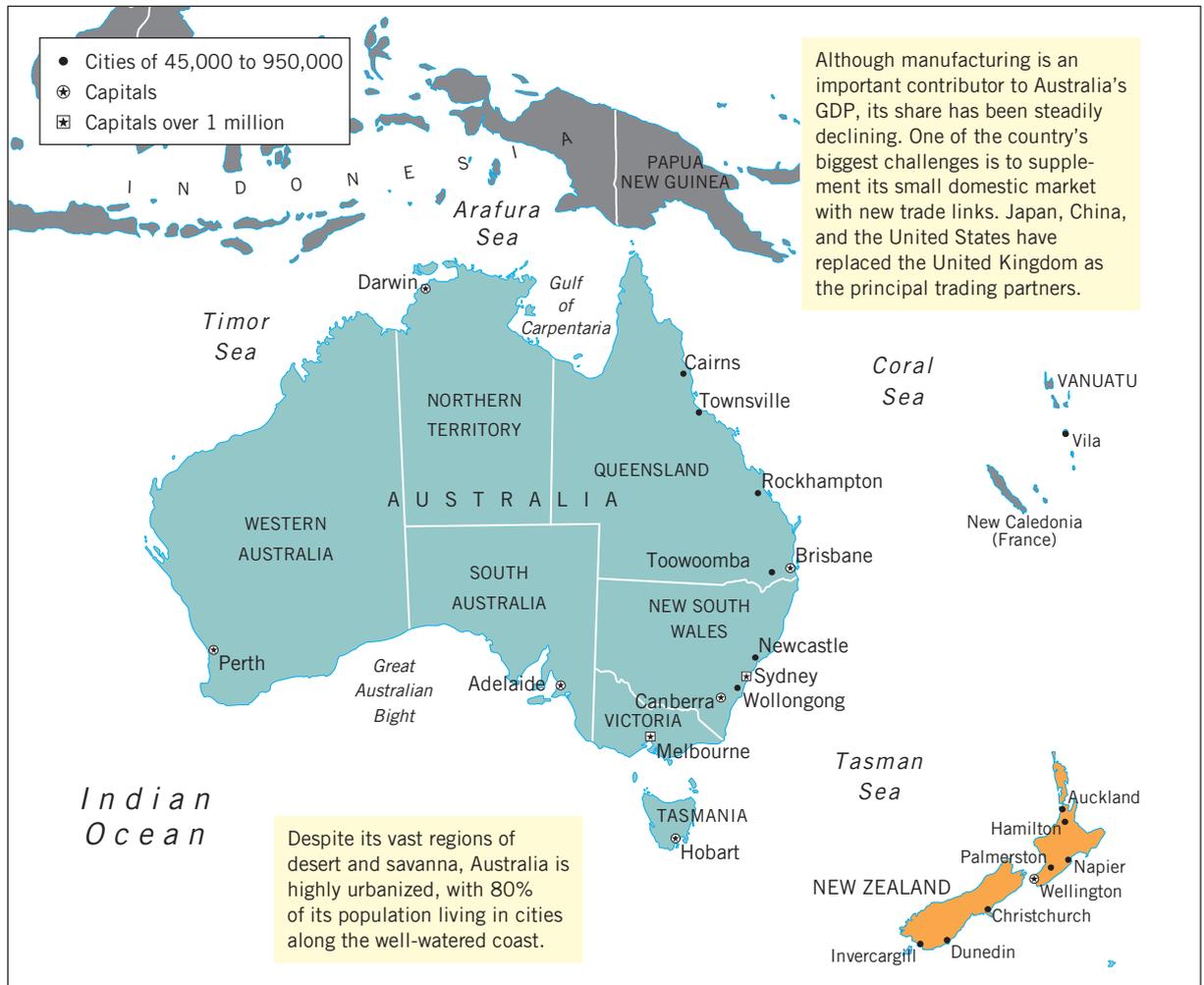
### Australia and New Zealand

Australia and New Zealand are the other traditional economic powers in Pacific Asia. Although they share a common cultural heritage, significant differences exist between the two countries, which are separated by 1,200 miles of ocean (see Map 2.5). Australia's 23 million people live in an area of 2.97 million square miles. Because much of the continent is arid, most of the population is concentrated in the wetter coastal regions, with approximately 40 percent living in either Sydney or Melbourne. Australia is rich in natural resources but has a relatively small workforce. As a result, its merchandise exports, which in 2011 accounted for 20 percent of its \$1,379 billion GDP, are concentrated in natural resource industries (such as gold, iron ore, and coal) and in land-intensive agricultural goods (such as wool, beef, and wheat).

New Zealand's 4.4 million people live on two main islands—the more populous North Island and the more scenic but less temperate South Island. After systematically deregulating and privatizing its economy in the 1980s, New Zealand gained an international reputation

## MAP 2.5

## Australia and New Zealand



as being in the forefront of the worldwide shift toward greater reliance on market-based policies. Merchandise trade is extremely important to the country; in 2011 exports constituted 24 percent of its \$160 billion GDP. More than a third of New Zealand's exports are attributable to its extensive pasture lands. These exports include dairy products, meat, and wool. Australia, China, Japan, and the United States purchase approximately half of New Zealand's exports and imports.

### The Four Tigers

Pacific Asia is one of the world's most rapidly industrializing regions. South Korea, Taiwan, Singapore, and Hong Kong in particular have made such rapid strides since 1945 that they are collectively known as the "Four Tigers," a reference to the Chinese heritage that three of the four countries share. They are also referred to as the newly industrialized countries (NICs) or the newly industrialized economies (NIEs). Although many publications still classify the Four Tigers as "emerging markets," they have in fact already emerged, as indicated by their having achieved high-income classification by the World Bank for more than a decade.

**SOUTH KOREA** The Republic of Korea, more commonly known as South Korea, was born of the Cold War, which left the Korean peninsula divided into communist North Korea and capitalist South Korea. Since the end of the Korean War in 1953, South Korea has been one of the world's

communications and financial services for firms in Pacific Asia and is well on its way to becoming the region's high-technology center.

**HONG KONG** Hong Kong was born of the “opium war” (1839–1842) fought between the United Kingdom and China. As a consequence of this war, Hong Kong was ceded to the British. In 1860 the British obtained possession of Kowloon on the Chinese mainland, and in 1898 they were granted a 99-year lease on an area of the mainland known as the New Territories. The lease expired on July 1, 1997. On that date China again assumed political control of Hong Kong and designated it a special administrative region (SAR). As an SAR, Hong Kong enjoys a fair degree of autonomy. It has its own legislature, economic freedom, free-port status, and a separate taxation system. Hong Kong will enjoy these privileges until 2047. However, China has made it clear that it will impose its own political will on Hong Kong.

Hong Kong's attractiveness to international businesses lies in its deep, sheltered harbor and its role as an entry point to mainland China. Seven million people are packed into Hong Kong's small land area. It offers highly educated, highly productive labor for industries such as textiles and electronics and provides banking and financial services for much of East Asia. As a result of common culture and geography, Hong Kong entrepreneurs often act as intermediaries for companies around the world that want to do business with China. Hong Kong has also traditionally served as a bridge between Taiwan and its political enemy, China. Accordingly, Hong Kong has thrived as an entrepôt for China, receiving goods from it and preparing the goods for shipment to the rest of the world, and vice versa. Export statistics for Hong Kong reflect its role as a reexporter. It exported \$456 billion worth of goods in 2011, or 183 percent of its \$249 billion GDP.

## China

With 1.3 billion people, China is the world's most populous country. It also is one of the world's oldest, ruled by a series of emperors from 2000 B.C.E. until the early 1900s, when a republic was founded. A chaotic civil war facilitated a Japanese invasion in 1931. After the Japanese were expelled at the end of World War II, the civil war resumed. Finally, in 1949 the communist forces of Mao Tse-tung defeated the nationalist army led by General Chiang Kai-shek.

Communism in China under Mao went through several stages. The Great Leap Forward was a program undertaken from 1958 to 1960 to force industrialization through the growth of small, labor-intensive factories. The program's failure led eventually to the Cultural Revolution in 1966, during which youthful communist cadres indiscriminately purged Communist Party members suspected of deviating from Mao's doctrines. The political chaos that followed set back the

Hong Kong's deep, sheltered harbor and its dedication to free markets have made it a regional center for international trade and banking. Once a British Crown Colony, it is now a Special Administrative Region of the People's Republic of China.



## India

India is the world's second most populous country, having reached the 1 billion mark in 2000. It also is one of the poorest countries, with a per capita GDP of only \$1,488. India was part of the British Empire until 1947, when the Indian subcontinent was partitioned along religious lines into India, where Hindus were in the majority, and Pakistan, where Muslims were dominant. The eastern part of Pakistan became the independent nation of Bangladesh in 1971. The new country of India adopted many aspects of British government, including the parliamentary system, a strong independent judiciary, and a professional bureaucracy. For most of its post–World War II history, the country relied on state ownership of key industries—including power, transportation, and heavy industry—as a critical element of its economic development efforts.

India's bureaucracy can be cumbersome and slow to provide documents necessary to do business in the country. Until 1991, India discouraged foreign investment, limiting foreign owners to minority positions in Indian enterprises and imposing other onerous requirements. For example, as a condition for remaining in the country, the Coca-Cola Company was retroactively required in the 1970s to divulge its secret soft drink formula. Coca-Cola refused and chose to leave the market. Coca-Cola subsequently reentered the Indian market as a result of Prime Minister Rao's 1991 market-opening reforms, which reduced trade barriers, opened the doors to increased FDI, and modernized the country's financial sector.

These reforms have begun to pay off. (See Chapter 12's closing case, "The House of Tata," for a discussion of one company that has thrived as a result of these reforms.) India has attracted much FDI from MNCs based in developed countries, and its GDP growth has averaged 8.1 percent annually since 2003. However, problems remain. Corruption is widespread. The country's infrastructure is overburdened. A lack of clarity in government policy has created enormous confusion for some foreign investors. The World Bank has warned that failure to trim red tape may threaten the flow of foreign capital into sectors that are crucial to India's economic growth.

## Southeast Asian Countries

Asia is home to numerous other countries with promising records of economic development. Of particular note are Thailand, Malaysia, and Indonesia, countries with low labor costs that have been recipients of significant FDI in the last three decades. As labor costs have risen in their homeland, many Japanese MNCs have built satellite plants in these three countries to supply low-cost parts to parent factories in Japan. U.S. and European MNCs have used these countries as production platforms as well. The Thai, Malaysian, and Indonesian economies have boomed as a result of exports generated by FDI, although their growth temporarily slowed as a result of the 1997 Asian currency crisis, which is discussed in Chapter 7. Vietnam, too, is becoming important to MNCs: Intel, for instance, built a billion-dollar chip testing and assembly factory in Ho Chi Minh City, which commenced operations in 2010.<sup>6</sup>

### In Practice

- Because of their size and rapid economic growth rates, China and India have served as growth engines for the world economy in the past decade. Their usage of natural resources such as oil, iron ore, and copper are carefully monitored by stock market and commodity analysts for clues about growth prospects for the world economy.
- Although Japan and South Korea have thrived since the end of the Second World War, they face severe demographic problems. Both countries' populations are forecasted to become older and smaller, threatening their future global competitiveness.

*For further consideration:* China's economy has grown at double-digit rates for several decades. How likely is it that China can continue this level of economic growth?

## The Marketplaces of Africa and the Middle East

Africa covers approximately 22 percent of the world's total land area and is rich in natural resources. Egypt occupies the northeastern tip of the African continent and represents the western boundary of what is commonly known as the Middle East.

## Africa

The African continent, shown in Map 2.6, is home to 1.1 billion people and 55 countries. Most of Africa was colonized in the late nineteenth century by the major European powers (Belgium, France, Germany, Italy, Portugal, Spain, and the United Kingdom) for strategic military purposes or to meet domestic political demands. The tide of colonialism began to reverse in the mid-1950s, as one by one the European powers surrendered control of their colonies. Vestiges of colonialism remain in today's Africa, however, affecting opportunities available to international businesses. For example, Chad, Niger, and the Côte d'Ivoire (Ivory Coast) retain close economic and cultural ties to France. They link their currencies to that of France and follow French legal, educational, and governmental procedures. Because of these ties, French manufacturers, financial institutions, and service-sector firms often dominate international commerce with these countries. Similarly, the public institutions of Kenya, Zimbabwe, and the Republic of South Africa are modeled along British lines, giving British firms a competitive advantage in these countries.

The commodity boom of the 2000s, triggered by the growth of China's economy and the need to house the hundreds of millions of rural Chinese who have migrated to work in China's coastal cities, has boosted the economies of many African countries. Algeria, Angola, Gabon, Libya, and Nigeria are major exporters of oil, while Zambia's economy has been bolstered by the rising demand for copper and that of Botswana because of its rich diamond fields. The governments of these countries face the challenge, however, of leveraging the growth in their commodities sector to create broad-based economies capable of benefiting their entire populations. Agriculture also is important to many African countries. It accounts for more than 40 percent of the GDPs of the Central African Republic, Sierra Leone, Tanzania, and Rwanda, for example. Unfortunately, the population in many African countries is largely employed in subsistence farming; these countries include Burkina Faso, Gambia, Mozambique, Sierra Leone, Tanzania, and Zambia.

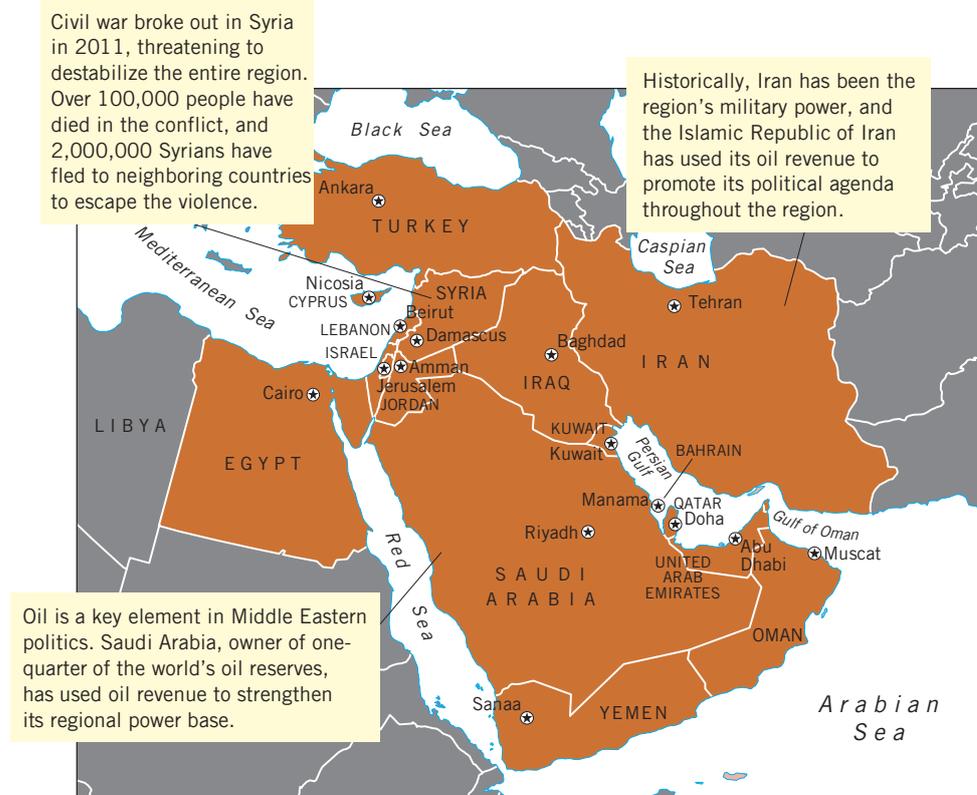
Many experts believe South Africa will be the dominant economic power and the continent's growth engine during the twenty-first century. South Africa possesses fertile farmland and rich deposits of gold, diamonds, chromium, and platinum. Many MNCs used South Africa as the base for their African operations until the 1970s, when the United Nations imposed trade sanctions against the country because of the government's apartheid policies, which called for the separation of blacks, whites, and Asians. As a result of these external pressures, the government extended voting rights to all its citizens in 1994. Nobel Peace Prize winner Nelson Mandela was elected president in May 1994 in the country's first multiracial elections. In 2011 South Africa's exports—primarily minerals—accounted for 24 percent of its \$408 billion GDP.

## Middle East

The Middle East includes the region between southwestern Asia and northeastern Africa (see Map 2.7). This area is called the "cradle of civilization" because the world's earliest farms, cities, governments, legal codes, and alphabets originated there. The region was also the birthplace of several of the world's major religions, including Judaism, Christianity, and Islam. The Middle East has had a history of conflict and political unrest; in the last half-century it has suffered through several Arab-Israeli wars, the Iran-Iraq war, and two Persian Gulf wars, all of which raised the risk of doing business in the region. In 2011, political unrest swept the area. Protests against the lack of democracy, poor employment opportunities, and high levels of income inequality led to the resignation of the long-time rulers of Egypt and Tunisia and to civil wars in Libya and Syria.

In 2011, Saudi Arabia, with a GDP of \$577 billion, had the largest economy in the Middle East, but Israel enjoyed the highest per capita income at \$31,282 per annum. The region is home to many oil-rich countries. In Saudi Arabia, for example, oil accounts for 45 percent of GDP and 90 percent of total export earnings. Some of the oil-rich nations of the Middle East are attempting to diversify their economies for "life after oil." Dubai, which is one of the seven United Arab Emirates, offers foreign investors all the benefits of a foreign trade zone (discussed in Chapter 9), an excellent infrastructure, and an entry point for exports to the region.

### MAP 2.7 The Middle East



#### In Practice

- Although many African countries have benefitted from rising commodity prices in the past decade, many Africans still engage in subsistence farming. A major task confronting African governments is wisely using the cash generated by commodity sales to improve the lives of their ordinary citizens.
- Many of the so-called petro-states, as well as some of the major Asian trading nations, such as China and Singapore, have constructed impressive state-controlled portfolios of foreign investments known as **sovereign wealth funds**. These sovereign wealth funds have grown so large that they have created significant political concerns.

*For further consideration:* This chapter's closing case discusses the impact of hydraulic fracking on the world energy market. If you were the advisor to the government of an oil-rich country in Africa or the Middle East, what recommendations would you make as to how to respond to this technological change?

### The Marketplaces of South America

South America's 13 countries, shown in Map 2.8, share a common political history as well as many economic and social problems. A 1494 papal decree divided colonization privileges between Portugal, which was allocated Brazil, and Spain, which received the rest of the continent. Spanish and Portuguese explorers subjugated the native populations, exploited their gold and silver mines, and converted their fields to sugar cane, tobacco, and cacao plantations. By the end of the eighteenth century, the hold of the two European powers on their South American colonies had weakened. Led by such patriots as Simon Bolivar, one colony after another won its

independence. By 1825 the Spanish flag was flying over Cuba and Puerto Rico only. However, independence did not cure the continent's problems. Many South American countries suffer from huge income disparities and widespread poverty among their peoples, leading to political instability and continual cries for reform.

For much of the post–World War II period, the majority of South American countries followed what international economists call **import substitution policies** as a means of promoting economic development. With this approach, a country attempts to stimulate the development of local industry by discouraging imports via high tariffs and nontariff barriers. (The opposite of import substitution is **export promotion**, whereby a country pursues economic growth by expanding its exports. This is the developmental approach successfully adopted by Taiwan, Hong Kong, and Singapore, as discussed previously in this chapter.) For most South American industries, however, the domestic market is too small to enable domestic producers to gain economies of scale through mass-production techniques or to permit much competition among local producers. Thus, prices of domestically produced goods tend to rise above prices in other markets. These policies benefit domestic firms that face import competition. However, they cripple the ability of a country's exporters to compete in world markets because the companies must pay higher prices for domestically produced inputs than do their foreign competitors. Inevitably, the government must subsidize these firms and often nationalize them to preserve urban jobs. The high costs of doing this are passed on to taxpayers and to consumers through higher prices, but over time the government runs a budget deficit. The result is inflation and destruction of middle-class savings.

Many major South American countries—including Argentina, Brazil, and Chile—adopted these well-intentioned but ultimately destructive import substitution policies. In the late 1980s, however, the countries began to reverse their policies. They lowered tariff barriers, sought free trade agreements with their neighbors, privatized their industries, and positioned their economies to compete internationally. Chile, for example, is now one of the most free-market-oriented economies in the world. The continent's economies boomed during the 1990s as a result of these policies. More recently, the increased demand for raw materials and foodstuffs triggered by China's economic growth has benefited many South American firms, including purveyors of Argentine wheat, Bolivian tin, Brazilian iron ore and soy beans, and Chilean copper. The continent is still plagued, however, by an inability to create policies that bridge the chasm between the rich and the poor. The lack of economic and social mobility has trapped generations of South Americans in poverty and despair and created political instability in many of their countries. "Bringing the World into Focus" discusses how Brazil is attempting to address its poverty problem.<sup>7</sup>

## BRINGING THE WORLD INTO FOCUS

### BRAZIL BOLSTERS ITS FAMILIES

For most of its history, Latin America has been characterized by huge income inequalities. The rich have done well; the prospects for children borne into poverty have been grim. The failure of Latin American politicians to address this problem has contributed to the region's political instability, social unrest, and lost productivity.

One innovative and successful program is Brazil's Bolsa Família, instituted by Brazil's popular former President Luiz Inacio Lula da Silva in 2003. Bolsa Família built on similar programs instituted by Lula's predecessor and by several Brazilian states. They, in turn, were patterned after Mexico's *Oportunidades* program. These poverty-reduction programs involve conditional cash transfers (CCTs). CCT programs provide cash subsidies to poor families, but the cash comes with strings attached. Families receive payments from Bolsa Família only if their children attend school on a regular basis and participate in public health programs, such as keeping their vaccinations up to date. If the children's school attendance falls below 85 percent, the family's cash stipend is eliminated.

Families whose per capita income falls below the poverty line (140 reais a month) are eligible to receive a stipend of 22 reais a



month per child, up to a maximum of three children. Families suffering from extreme poverty qualify for an additional allowance. Normally the monthly stipends are deposited on a special debit card that is mailed monthly to the female head of household. (Mothers are perceived to be more likely to spend the monies in the interests of their children.) The debit card allows the recipient to withdraw cash from the Caixa Economica Federal, a government-owned savings bank with 14,000 locations throughout the country. Some 12 million Brazilian families participate in the program. Bolsa Família costs about 0.4 percent of Brazil's GDP and accounts for about 2.5 percent of the federal government's budget.

By targeting these payments to the poorest families and incentivizing them to educate their children, Bolsa Família addresses both the short-term and long-term problems associated with poverty. In the short-run, it provides cash income to the family to improve the nutrition and health of their children. In the longer-run, with its focus on motivating parents to promote their children's education, it improves

(Continued)

the skills, training, and human capital of poor children, enhancing their future career and job prospects.

The program is not without its critics. Bolsa Família has been more successful in rural Brazil than in urban areas. In 2006, 41 percent of eligible rural families participated in the program, whereas only 17 percent in urban areas did. Fears that recipients would misuse or misspend the monies seem to have been overblown. Studies indicate that most recipients use the monies to buy food, school supplies, and clothing, as the Brazilian government had hoped.

Although poverty has not disappeared from Brazil's rural areas or its urban favelas, the Bolsa Família has had significant impact in

addressing poverty and income inequality. School attendance and educational performance among poor children has increased, and the incidence of child labor has declined. The cash subsidies have also improved the diets and health of the targeted children.

*Sources:* Based on “Favelous,” *The Economist*, March 19, 2011, p. 11; “How to get children out of jobs and into school,” *The Economist*, July 31, 2010; “Paying parents to do what is right for their children is all the rage,” *New York Times*, March 13, 2008 (online); “Happy families: An anti-poverty scheme invented in Latin America is winning converts worldwide,” *The Economist*, February 9, 2008.

### In Practice

- Brazil is by far the largest and most important economy in South America, accounting for nearly half of the continent's GDP. Brazil has assumed a regional leadership role in such organizations as the World Trade Organization and the World Bank.
- Political elections in South America often revolve around the issue of addressing income inequality. In the past decade, Venezuela's Hugo Chavez, Ecuador's Rafael Correa, and Bolivia's Evo Morales won the presidencies of their countries by promising a fairer deal for their countries' poorer citizens.

*For further consideration:* Would Brazil's Bolsa Família program work in your home country? Why or why not?

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## CHAPTER REVIEW

### Summary

To compete successfully in the international marketplace, managers need a basic understanding of the world's markets and their interrelationships. Managers also need to assess opportunities available in these markets. A key indicator of a country's desirability to international businesses is its per capita income, which provides information about its consumers and its value as a production site.

The rich developed countries of Japan, the EU, the United States, and Canada account for about 57 percent of the world's economy. However, emerging markets such as China and India are equally attractive to international businesses, given their rapid economic growth rates.

The North American market—Canada, Mexico, the United States, Central America, and the island countries of the Caribbean—is one of the world's largest and richest markets. The United States and Canada have the largest bilateral trading relationship in the world. Mexico's economic reforms,

initiated in 1982, have made it a more important force in the world economy.

Another large, rich market for international businesses is Western Europe, particularly the 28-member EU. The EU members are free-market-oriented, parliamentary democracies. With the 1989 collapse of European communism, Eastern European and Central European countries have undergone a sometimes painful transition from communism to capitalism. Most have adopted market-oriented policies to stimulate economic growth. Their growth prospects and unmet consumer demand are attractive to many Asian, North American, and European MNCs.

Asia is home to several of the fastest-growing economies of the post-World War II period. Japan and the Four Tigers—South Korea, Hong Kong, Singapore, and Taiwan—have grown dramatically because of economic policies that focus on export promotion. But the emerging markets of China and India have

enjoyed even higher rates of growth during the past decade. Australia and New Zealand are also important economies in this region.

Many African countries regained their independence during the 1950s and 1960s. Their economies primarily rely on natural resources and agriculture. Middle Eastern countries have played an important role in the world economy thanks to their oil wealth, although their stability has been threatened by civil unrest and armed conflicts.

South American countries have been independent since the early nineteenth century. Although many of them are rich in natural resources and farmlands, the continent's economic development since World War II has been hindered by chronic political unrest and import substitution policies. During the 1980s, however, key South American nations—including Argentina, Brazil, and Chile—shifted toward more market-oriented, export promotion growth strategies. Privatization, reduced governmental regulation, and booming commodity

prices have intensified interest in the continent by international businesses.

## Review Questions

- 2-1. Describe the U.S. role in the world economy.
- 2-2. How do differences in income levels and income distribution among countries affect international businesses?
- 2-3. What role did MITI serve in the Japanese economy?
- 2-4. What is a *keiretsu*?
- 2-5. What role has reexporting played in the economies of Singapore and Hong Kong?
- 2-6. Define the terms *glasnost* and *perestroika*?
- 2-7. Discuss the role of 'The Canals of Commerce' in international trade.
- 2-8. How did import substitution policies affect the economies of Brazil and Argentina?

## Questions for Discussion

- ★ 2-9. Regional trading blocs, such as the EU and NAFTA, are growing in importance. What are the implications of these trading blocs for international businesses? Are they helpful or harmful? How may they affect a firm's investment decisions?
- 2-10. Discuss how heavy reliance on oil export combined with political unrest in the Middle East might impact major economies of the world. How can an economic policy dedicated towards "life after oil" shape the future?
- ★ 2-11. Ethnic ties, old colonial alliances, and shared languages appear to affect international trade. Why might this be so? If true, how does this affect international businesses' strategies regarding which markets to enter?
- ★ 2-12. South Korea is prominently featured in many lists of "emerging markets." (For example, see Table 1.2 on page 40.) Is South Korea an emerging market? Or has it already "emerged"? Defend your answer. How would you define an "emerging market"?
- 2-13. South Korea, much like Japan, relied on a positive balance of trade, government leadership and chaebols for its economic development. How did overexpansion and poor lending practices impact Korean economy after the Asian currency crisis?

## Building Global Skills

Success in international business often depends on a firm obtaining information about foreign markets so that it can make exporting, importing, and investment decisions. Among the most useful sources are the following:

*Survey of Current Business*, published monthly by the U.S. Department of Commerce, is a basic source of statistical data on the U.S. economy. It provides detailed analyses of international trade and investment activities affecting the United States.

*The World Factbook* provides basic geographic, ethnic, religious, political, and economic information on all countries. It is put out by the U.S. Central Intelligence Agency and is particularly useful because it includes data about small, obscure, and politically controversial areas. For example, if you were an executive for Forum Energy PLC, a British company that was granted rights by the Philippine's government to hunt for oil and gas around the Spratly Islands, *The World Factbook* is one of the few sources in which you could learn that the islands, many of which are under water at high tide, have no permanent population yet are claimed and garrisoned by five different countries—China,

Malaysia, the Philippines, Taiwan, and Vietnam. Armed with this information, you would realize that Forum's explorations would be extremely sensitive and possibly the target of political conflict.

*World Development Report* and *World Development Indicators*, published annually by the World Bank, present numerous tables detailing information about World Bank members, including population, income and income distribution, infrastructure, government expenditures, trade, production, living standards, health, education, and urbanization.

*International Trade Statistics Yearbook* is an annual United Nations report that provides detailed data on exports and imports, classified by country and by commodity. The report is an excellent source of minutiae—for example, the leading exporters and importers of propane and butane in 2009, 2010, and 2011. However, it is rather clumsy to use when time-series information is required—for example, Denmark's total annual exports from 1986 to 2012.

*Balance of Payments Statistics*, *International Financial Statistics*, and *Direction of Trade Statistics* are reports

published by the International Monetary Fund (IMF). *Balance of Payments Statistics*, issued annually, contains data about balance of payments performances of IMF members. The monthly *International Financial Statistics* offers international and domestic financial data on members' domestic interest rates, money and banking indicators, prices, exports, and exchange rates. *Direction of Trade Statistics* details the exports and imports of each IMF member on a quarterly basis.

*World Investment Report* is produced annually by the United Nations Conference for Trade and Development. It is a primary source of statistics regarding FDI flows and stocks into and from countries. It also provides detailed information about the role of transnational corporations (the United Nations' preferred term for MNCs) in FDI.

Go to your library or surf the Internet to examine each of these standard references. Then answer the following questions:

- 2-14. What was the total value of U.S. imports from Belgium last year? Of U.S. exports to Belgium?
- 2-15. What is the total level of U.S. investments in Belgium? Of Belgian investments in the United States?
- 2-16. Profile the economy of Belgium: What is its GDP? What is its per capita income? How fast is its economy growing? What are its major exports and imports? Who are its major trading partners?
- 2-17. Profile the people of Belgium: What languages do they speak? What is their average educational level? What is their life expectancy? How fast is the population growing?

## CLOSING CASE

### Fracturing the Energy Market

Joseph Schumpeter, an Austrian-born economist who emigrated to the United States in 1932, championed entrepreneurship and free markets. Schumpeter is perhaps best known for popularizing the phrase “creative destruction,” the concept that innovation—new technologies, new products, new ways of doing business—inevitably disrupts, supplants, and devalues the economic structure that preceded it. One such new technology—the hydraulic fracturing of shale and other rocks containing oil and natural gas deposits, popularly known as *fracking*—provides a perfect example of Schumpeter's concept. Fracking holds the potential to turn world energy and industrial markets upside down, and to scramble geopolitical relations and alliances that have dominated the past half-century.

Fracking involves the injection of fluids at high pressure into rock formations containing hydrocarbon deposits such as oil and natural gas. The fracturing fluid cracks open new channels in the rock, creating pathways for oil and gas to flow and be captured by the driller. Although the technology was developed in 1947, it was little used until combined with modern horizontal drilling. Fracking became commercially significant in 1998, when it was applied to exploit the so-called “tight” gas formations in Texas's huge Barnett Shale field. The potential reserves in such tight formations are enormous: China is estimated to have 1,275 trillion cubic feet of reserves; the United States, 862 trillion; Argentina, 774 trillion; and Mexico, 681 trillion. Even South Africa's Karoo region, a semi-desert lying between Cape Town and Johannesburg, may contain shale-gas reserves as large as 485 trillion cubic feet, the fifth largest in the world.

Fracking is important—and disruptive, in the Schumpeterian framework—for at least four reasons. First, it promises new supplies of energy, lowering its cost. Second, it substantially shifts geopolitical power among the world's nations. Third, it implies major changes in the

competitiveness of nations and in the location of the production of energy-intensive goods. Finally, fracking has the potential to have major impacts on the environment and on the global quest to control the emission of greenhouse gases.

U.S.-based oil companies have been the most aggressive users of fracking technology, creating drilling booms in numerous areas, including North Dakota's Bakken formation, Pennsylvania's Marcellus shale, and Texas's Barnett and Eagle Ford fields. The impact on the U.S. natural gas market, which accounts for 30 percent of U.S. electricity generation and heats half of U.S. homes, has been enormous. In 2008, natural gas was selling for \$12 per million British Thermal Units (mBTU) at the Henry Hub, a Louisiana crossroad for gas pipelines that serves as the basis for pricing natural gas in the United States. The boom in exploration and production of shale-based gas drove the price below \$2 per million BTU in 2012; the price has now risen above \$3.60. U.S. production of shale-based oil has also increased, thereby reducing U.S. imports of crude oil by a third since 2008.

The current low price of natural gas in the U.S. market impacts the location decisions of firms producing energy-intensive products or who use natural gas as a feedstock for their petrochemical products, allowing them to underprice their foreign petrochemical rivals. Companies like Dow and Chevron Phillips Chemical Company are planning new multibillion-dollar chemical plant projects in Texas and Louisiana. Not surprisingly, some European and Asian chemical and petrochemical companies, such as BASF and Royal Dutch Shell, are considering building new facilities in the United States to take advantage of the cheap U.S. natural gas. Other energy-intensive factories also benefit. Nucor Corp., for instance, is constructing a \$750 million facility in Louisiana to fabricate high-purity iron ore pellets, which are used as inputs in manufacturing steel, because of low natural gas prices. When completed the plant will produce 2.5 million tons of pellets a year, making it the world's second

- 2-20. Will the stability of the world's economy increase or decrease as a result of the fracking revolution? What about the stability of the world from a political perspective?
- 2-21. What environmental concerns does widespread use of fracking create? What is the appropriate tradeoff between environmental concerns and economic growth?

Sources: Based on "European Industry Flocks to U.S. to take advantage of cheaper natural gas," *Washington Post*, April 1, 2013; "Germany Takes a New Look at Fracking as Energy Bills Soar," *Wall Street Journal*, March 2,

2013, p. A11; "Better out than in," *The Economist*, March 2, 2013; "Bonanza or Bane," *The Economist*, March 2, 2013; "Now in Poland, Fracking vs. the Environment," *Bloomberg Businessweek*, February 14, 2013; "Cheaper Natural Gas Lets Nucor Factory Rise Again on Bayou," *Wall Street Journal*, February 1, 2013, p. B1; "The Shale Revolution's Shifting Geopolitics," *The New York Times*, December 25, 2012; "Beans mean high profits for guar farmers of Rajasthan," *The Guardian*, December 18, 2012; "For Guar Gum, a Bubble Goes Pop," *Wall Street Journal*, December 5, 2012; "The economics of global climate leadership," *The Economist*, November 12, 2012; "Poland has fracking tensions, too," *Washington Post*, October 30, 2012; "Fracking the Karoo," *The Economist*, October 18, 2012; "U.S. gas exports could limit Putin's influence," *Washington Post*, September 25, 2012; "Fracking heaven," *The Economist*, June 23, 2011; KPMG Global Energy Institute, *Shale Gas—A Global Perspective*.

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- 2-22. Discuss the changing role of China in the world economy. Does China's rise help or hurt people in developed countries? What about people in other emerging markets?
- 2-23. Has globalization and increased international trade and investment helped or hurt the world's poorest peoples and countries?
- 2-24. Mymanagementlab Only—comprehensive writing assignment for this chapter.

## Endnotes

1. "Oil deal fuels Beijing's Arctic Drive," *Financial Times*, June 10, 2013, p. 1; "Arctic Council Adds 6 Nations as Observer States, Including China," *New York Times*, May 15, 2013; "Arctic Body Comes In From the Cold," *Wall Street Journal*, May 14, 2013, p. A16; "Now you don't," *The Economist*, September 22, 2012; "The melting north," *The Economist*, June 16, 2012; "Too much to fight over," *The Economist*, June 16, 2012; "Cosy amid the thaw," *The Economist*, March 24, 2012; "Norway could shut China out of Arctic Council after diplomatic snubs," *The Guardian*, January 25, 2012; "Hands off our wilderness," *The Economist*, September 24, 2011.
2. This chapter reports population, GDP, and per capita GDP data for the world's countries. Most of the data are taken from the World Bank's data base, accessible at [www.worldbank.org](http://www.worldbank.org).
3. "Mexico, 3 neighbors sign free trade pacts," *Houston Chronicle*, May 12, 2000, p. 2C.
4. "Return of the overlord," *The Economist*, April 3, 2010, p. 71; "Back from the brink, Korea Inc. wants a little respect," *Wall Street Journal*, June 13, 2002, p. A1; "The glory of Hyundai sits firmly in past," *Financial Times*, January 29, 2002, p. 22.
5. "Hon Hai reaches out," *Wall Street Journal*, June 9, 2011, p. B4.
6. "Intel to build Vietnam chip plant, raising nation's high-tech profile," *Wall Street Journal*, February 24, 2006, p. A6.
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