CHAPTER 2
Global Marketplaces and Business Centers

AFTER STUDYING THIS CHAPTER, YOU SHOULD BE ABLE TO:

• Evaluate the impact of the political and economic characteristics of the world’s various marketplaces on businesses.
• Appreciate the uses of national income data in making business decisions.
• Discuss North America as a major marketplace and business center in the world economy.
• Describe Western Europe as a major marketplace and business center in the world economy.
• Discuss the problems facing the economies of the former communist countries of Eastern and Central Europe.
• Discuss Asia as a major marketplace and business center in the world economy.
• Assess the development challenges facing African, Middle Eastern, and South American countries.
The boom times in mining are attributable in large part to the voracious demands of China.

Mining the Boom

The mining industry is among the world's most cyclical. When times are good, they are very good. When times are bad, they are very, very bad. The mid-2000s have been very, very good to mining companies throughout the world, which are enjoying record or near-record prices and profits. The profits of Anglo American PLC, the huge London-based mining company that dominates the South African market, jumped 39 percent in 2005 to $3.7 billion, thanks to record platinum, coal, and iron prices. The revenues of Australia's BHP Billiton, the world's largest mining company, rose 32 percent, while its profits soared by 76 percent. And the good times are extending to the industry's suppliers. The profits of Caterpillar, which dominates the market for heavy earthmoving equipment (see Chapter 6's opening case, "Caterpillar: Making Money by Moving Mountains," for a richer description of the company's role in the global marketplace), leaped 40 percent in 2005, on sales growth of 20 percent.

The boom times in mining are attributable in large part to the voracious demands of China and its burgeoning manufacturing sector. China's economy has been growing at near-double-digit rates for the past decade. The country is undergoing the largest labor migration in the world's history, as rural residents leave their farms to become factory workers. Not only do these factories consume raw materials, but the newly arrived workers must be housed, fed, transported, and entertained, expanding the demand for apartments, automobiles, buses, roadways, electricity, police, restaurants, and every other product imaginable. In Shanghai, for example, the local government is planning nine new communities, each accommodating 800,000 people, to house its growing population.

China is estimated to consume 47 percent of the world's cement output, 37 percent of its cotton, 30 percent of its coal, 26 percent of its steel, and 21 percent of its aluminum. Its insatiable demand for raw materials has impacted commodity prices ranging from aluminum to zinc. The prices that China's steelmakers paid for iron ore rose over 70 percent in 2005, for example. And China is no small player in this market. It imported 275 million tons of iron ore in 2005, about 43 percent of the world's output. In 2005, copper prices reached a 16-year high, while oil prices surged to over $70 a barrel. Aluminum was at a 6-year high; nickel, a 15-year high; copper and tin, 8-year highs.

These boom times have not gone unnoticed by the world's investment bankers, who have financed a wave of mergers and acquisitions within the mining industry. In 2005, BHP Billiton purchased Australia's WMC Resources Ltd. for $7.3 billion in order to acquire its uranium and nickel reserves. Similarly, Barrick Gold Corporation bought Canada's Placer Dome Inc. to control Placer's rich gold and copper mines.
The boom has generated some predictable and some not-so-predictable consequences. Not surprisingly, the currencies of major commodity exporters such as Australia, New Zealand, and South Africa surged on foreign exchange markets, as these countries benefited from the boom in commodity prices and output. Salaries for geologists and mining engineers are skyrocketing. The lead time to purchase draglines, the large shovel cranes used in strip mining, has elongated from 18 months to 30 months. The demand for the giant dump trucks used to haul ore has grown so rapidly that mines may wait a year and a half after ordering before a new truck is delivered. Human resource managers for mining companies struggle to locate qualified workers, while purchasing managers find it increasingly difficult to acquire necessary materials ranging from explosives to tires. Indeed, the booming commodity market has caused a global shortage of industrial tires, particularly the giant tires—some the size of a house—used on dump trucks that carry ores produced by open pit mines. The lack of tires is forcing some mining companies to idle equipment, while other firms are buying used equipment simply to acquire the tires, or paying double the normal new-tire price for used tires or retreads, which, considering that some industrial tires can cost more than $30,000, is not a decision to be taken lightly. Industry experts believe the tire shortage may last through 2010, because tire manufacturers like Michelin, Goodyear, and Bridgestone have been slow to expand production. And the commodities boom has even made it harder for Australian suburbanites to get their cars repaired. The demand for mechanics is so high in Queensland’s coal mines that auto dealers can’t retain them. George Sicklinger, an area Toyota dealer, for example, now recruits for auto mechanics in India and South Africa to replace his mechanics, who are continually lured away by the high wages offered by the local coal mines.\(^1\)

The boom times enjoyed by the $200 billion a year global mining business demonstrates how changes in one national economy—in this case, China—can affect markets far and near. 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 is concentrated in a group of countries called the Triad (Japan, the European Union, and the United States) or the Quad (the Triad plus Canada). Together the 909 million residents of the Quad countries produce 73 percent of the world’s gross domestic product (GDP), as Figure 2.1 indicates. Many business gurus, such as Kenichi Ohmae, the former managing director of McKinsey & Company’s Tokyo office, believe that major corporations must be competitive throughout the Quad if they wish to keep pace with their industry rivals. Many multinational corporations (MNCs) have operationalized Ohmae’s warning and recognized the importance of competing globally to expand their customer bases. Global strategic thinking typifies industries such as airlines, banking, securities, automobiles, computers, and accounting services.

This is not to suggest that international managers can ignore markets outside the Quad. 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, 8.7 percent and 6.2 percent respectively, have far outpaced Japan’s 1.3 percent, Germany’s 0.5 percent, or the United States’ 2.6 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 507 million people, these countries produce approximately 33 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 almost 30 percent of the world’s $40.9 trillion GDP in 2004. As Map 2.1 shows, the United States enjoys the highest per capita income of the North American countries. The United States occupies a unique position in the world economy because of its size and political stability, accounting for about one-eighth of world trade in 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 over $1.6 trillion in U.S. factories, equipment, and property.

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 2005 totaled $1.3 trillion but were only 10.4 percent of U.S. 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
Although Greenland is geographically in North America, it is affiliated politically with the Kingdom of Denmark.
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, MNCs heavily influence international trade and investment. In 2005 the world’s 500 largest corporations had total sales of $18.9 trillion. Given the importance of the United States in the world economy, it should come as no surprise that 170 of these corporations, or 34 percent, are headquartered in the United States, including 31 of the largest 100 (see Figure 2.2). Exxon Mobil is currently the world’s largest company, with sales of $340 billion in 2005.

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 $10,066. (Per capita income is usually measured by dividing a country’s gross domestic product (GDP) 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.) 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 30 market-oriented democracies formed to promote economic growth. The OECD includes 23 Western European countries (the 15 European Union members prior to its 2004 expansion plus the Czech Republic, Hungary, Iceland, Norway, Poland, the Slovak Republic, Switzerland, and Turkey), four Pacific Rim countries (Australia, Japan, New Zealand, and South Korea), and Canada, Mexico, and the United States. Twenty-four of the OECD’s 30 members fall in the high-income category. (The remaining members—the Czech Republic, Hungary, Mexico, Poland, the Slovak Republic, and Turkey—are classified as middle income.) The second cluster comprises oil-rich Kuwait and the United Arab Emirates. The third cluster consists of smaller industrialized countries—Hong Kong, Israel, Singapore, and Taiwan.

Middle-income countries have per capita incomes of more than $825 but less than $10,066. This category includes most of the former Soviet bloc, 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, Croatia, 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 $825 or less. This category includes some countries, such as India and Indonesia, whose economies are growing substantially because of external aid, sound domestic economic policies, foreign direct investment (FDI), and/or exploitation of valuable natural resources. Officially labeled “undeveloped” 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.

Canada

Canada has the world’s second largest land mass, although its population is only 32 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 for 37 percent of its 2004 GDP of $980 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 over three-quarters of Canada’s exports in a typical year. Two-way trade between the United States and Canada, which totaled $514 billion in 2004, forms the single largest bilateral trading relationship in the world.

Exports of natural resources are an important component of the Canadian economy. The Suncor Energy Complex near Fort McMurray, Alberta, extracts oil from the area’s thick Athabasca oil sands, which constitute one of the largest petroleum reserves in the world. Although extracting hydrocarbons from these sands is expensive, oil sand operators like Syncrude, Suncor, and Shell have benefited from high oil prices and innovative technologies.
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.

Mexico

Now the world’s largest 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 over 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 two 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 Aeroméxico and Teléfonos de México. In 1994, Canada, Mexico, and the United States initiated the North American Free Trade Agreement (NAFTA), which is reducing 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 European Union, 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.

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 77 million—more than twice the population of Canada. However, their total GDP of $250 billion is far less than Canada’s $980 billion. With a few exceptions (notably Costa Rica), the economic development of these countries 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.

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 European Union (EU) and other countries in the region (see Map 2.2).

The EU, which we discuss in greater detail in Chapter 10, comprises 25 countries that are seeking to promote European peace and prosperity by reducing mutual barriers to trade and investment. (Its membership will grow to 27 countries when Bulgaria and Romania join in 2007.) During the past two decades the EU has made tremendous strides in achieving this objective. With a 2004 GDP of $12.7 trillion and a population of 455 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 that of the United States. In 2002, 12 EU members eliminated their national currencies, replacing them with a new common currency known as the euro (€).
As the EU’s leading voice favoring free trade, the United Kingdom provides a strong counterweight to France’s protectionist tendencies.

As the political leader of the EU, France has long been a strong advocate of strengthening human and workers’ rights in the EU.

The German central bank had de facto control over the monetary policies of EU members, but its role was taken over by the European Central Bank (ECB) in 1999. The ECB now controls monetary policy for countries using the euro.
From an economic perspective, Germany is the EU’s most important member. With a 2004 GDP of $2.7 trillion it possesses the world’s third largest economy, after Japan and the United States. It is a major player in international business; in 2004 it was the world’s largest exporter of goods, some $912 billion. 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.

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 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 French 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 over 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.

Western European countries that are not EU members include Iceland, Norway, and Switzerland, plus several “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 Marketplaces of Eastern Europe and Central Europe

No regions of the world have undergone as much economic change in the past decade and a half as Eastern Europe and Central Europe, which are in the midst of the painful processes of converting from communism to capitalism and 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. Eastern Europe includes many of the 15 separate countries that resulted from the disintegration of the Soviet Union in 1991 (see Map 2.3). Central Europe is composed of Albania, Austria, and the former Soviet satellite states of Bulgaria, Czechoslovakia (now divided into the Czech Republic and the Slovak Republic), Hungary, Poland, and Romania. Central Europe also includes Bosnia-Herzegovina, Croatia, Macedonia, Slovenia, Serbia, and Montenegro, which were carved out of Yugoslavia (see Map 2.4).

The Former Soviet Union

The Union of Soviet Socialist Republics (Soviet Union or U.S.S.R.) emerged from the disintegration of the Russian Empire that followed its defeat in World War I. In the chaos that ensued from the 1917 abdication of Czar Nicholas II, the Communist Party seized control of the Russian government and established the Soviet Union in the name of the workers and peasants. The communists outlawed the market system, abolished private property, and collectivized the country’s vast rich farmlands. By doing so, they succeeded in reducing the enormous income inequalities that had existed under czarist rule. Despite this success, the population’s standard of living increasingly fell behind that of the Western democracies.

Gorbachev’s economic and political reforms led to the Soviet Union’s collapse in 1991 and subsequent declarations of independence by the 15 Soviet republics, which are now often referred to as the Newly Independent States, or NIS. In 1992, 12 of the NIS (all but the Baltic countries of Estonia, Latvia, and Lithuania) formed the Commonwealth of Independent States (CIS) as a forum to discuss issues of mutual concern. The most important of these new countries is the Russian Federation (Russia), which was the dominant republic within the former Soviet Union. As an independent state, Russia is the world’s largest country in land mass (6.5 million square miles) and the sixth largest in population (143 million people). The country is well endowed with natural resources, including gold, oil, natural gas, minerals, diamonds, and fertile farmland.
The three Baltic republics were conquered by Soviet troops in 1940. They were among the first of the republics to claim their independence and are the only ones that did not join the Commonwealth of Independent States.

The Caucasus republics have suffered much political instability. Armenia and Azerbaijan have fought over their regional boundary, and rebels have tried to topple the government of Georgia. That portion of Russia lying in the Caucasus (the land between the Black and the Caspian Seas) has had similar problems, most notably in Chechnya.

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The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, and Slovakia joined the EU in 2004. Bulgaria and Romania are scheduled to join the EU in 2007.

Albania is Europe’s poorest country, the result of its former reliance on a Stalinist-style economy. Albania split from the Soviet bloc in 1961, believing the bloc’s policies were insufficiently Marxist. Today, one-quarter of its labor force works abroad, sending home funds vital to Albania’s survival.

Six new countries were created when Yugoslavia dissolved in the 1990s. Several hundred thousand lives were lost in Bosnia-Herzegovina and Kosovo’s quest for independence.
The transformation of the economies of Russia and many of the other NIS from communism to a free-market system has not been easy, to say the least. Boris Yeltsin, Russia’s first democratically elected president, tried to privatize many of Russia’s state-owned firms. Although some newly privatized firms improved their productivity, many fell into the hands of individuals who were more concerned with looting corporate assets than restoring the companies’ economic health and performance. Under Yeltsin’s administration, Russia’s central government staggered from one financial crisis to another, burdened by an inability to collect taxes and a political need to subsidize the inefficient state-owned enterprises that it was unable to sell to private interests. Russia’s second president, Vladimir Putin, quickly overhauled the country’s taxation system, instituting a flat income tax of 13 percent. This initiative appeared to work, as government revenues increased. Russia, which is the world’s second largest oil producer and exporter, has also benefited from the increased prices of oil and other raw materials, which were discussed in the chapter’s opening case. However, Russia has attracted relatively little FDI for a country its size—a total of $98 billion by the end of 2004—because foreign businesses have grown concerned by worsening levels of corruption, governmental favoritism towards state-owned or politically connected firms, and a perception that Putin has been trying to weaken democratic institutions. According to Transparency International, a leading corruption watchdog, in 2005 Russia ranked 126th out of 159 countries in its annual corruption analysis.

Central Europe

Central European countries that were aligned with the former Soviet Union also faced serious challenges (see Map 2.4). With the collapse of the region’s communist governments, 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. The Central European countries also had to restructure their economies from centrally planned communist systems to decentralized market systems.

The Czech Republic, Hungary, Poland, and Slovakia—all of which are now classified as upper-middle-income countries by the World Bank—are further along in restructuring their economies than other Central European countries. They have attracted more FDI than their neighbors and have become members of the OECD, NATO, and the EU.

Economic reforms are less advanced in Albania, Bulgaria, and Romania because these countries were slower to develop a political consensus about the direction they wanted their economies to take. The situation is far worse in parts of what was Yugoslavia. Slovenia avoided almost all the chaos that surrounded the disintegration of Yugoslavia. This was true to a lesser extent in Croatia and Macedonia. However, 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.

The Marketplaces of Asia

Asia is home to over half the world’s population, yet it produces less than a quarter of the world’s GDP (see Map 2.5). 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 the world’s second largest economy (with a GDP of $4.6 trillion in 2004) and an important member of the Quad (see “Bringing the World into Focus”). Japan’s rapid growth during the past 50 years is due in part to the partnership between its Ministry of International Trade and Investment (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
China, India, and Indonesia are the first, second, and fourth most populous countries in the world, and China alone is home to more than one-fifth of the human race.

The Ural Mountains divide Russia into its European and Asian regions.

Of the top 20 trading nations—based on the sum of imports and exports of goods—7 are countries in East Asia.

China, India, and Indonesia are the first, second, and fourth most populous countries in the world, and China alone is home to more than one-fifth of the human race.
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.

**BRINGING THE WORLD INTO FOCUS**

**Who’s Number Two?**

By all measures, the economy of the United States is the world’s largest. Who’s number two depends on how you measure size. Most sources of such data compare sizes by taking a country’s gross domestic product (GDP) measured in its home currency and converting that figure to a standard currency (for example, the U.S. dollar) using existing exchange rates. However, some experts believe that to make meaningful comparisons one must adjust the original GDP figures for purchasing power parity—that is, differences in purchasing power among the local currencies. Figure 2.3(a) shows the world’s seven largest economies when adjustments for purchasing power are not made; Figure 2.3(b) shows the seven largest economies when purchasing power adjustments are made. Note that China jumps from the seventh- to the second-largest economy, and India leaps from the eleventh to the fourth when adjustments for purchasing power are made.

**FIGURE 2.3**

*Source: Based on data provided by The World Bank Group, World Development Report 2006.*
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. Toyota Motors, for example, owns 19 percent of the common stock of Koito Manufacturing, and other members of Toyota’s keiretsu own 40 percent of Koito’s stock. Koito in turn is the primary supplier for Toyota’s automotive lighting needs. 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 1990, its GDP has grown at an annual rate of 1.3 percent, well below the 2.5 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. 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). Fortunately, in 2005 the Japanese economy showed signs of sustained recovery, attributable in part to reforms instituted by Prime Minister Junichiro Koizumi.

**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 2.6). Australia’s 20 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 2004 accounted for 14 percent of its $631 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 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 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 2004 exports constituted 20 percent of its $100 billion GDP. Over half of New Zealand’s exports are attributable to its extensive pasture lands. These exports include dairy products, meat, and wool. Australia, 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). The Four Tigers are the only countries once categorized as less developed by the World Bank that have subsequently achieved high-income status.

**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 fastest-growing economies. Merchandise exports accounted for 37 percent of its 2004 GDP of $680 billion. To promote economic development, Korea relied on tight cooperation between the government and 30 or so large, privately owned, and family-centered conglomerates that dominate the Korean economy. The most important of these
Although manufacturing is an important contributor to Australia's GDP, its share has been steadily declining. One of the country's biggest challenges is to supplement its small domestic market with new trade links. Japan, China, and the United States have replaced the U.K. as the principal trading partners.

Despite its vast regions of desert and savanna, Australia is highly urbanized, with 80% of its population living in cities along the well-watered coast.

MAP 2.6
Australia and New Zealand

conglomerates, or chaebol, are Samsung, Hyundai, Daewoo Group, and LG (formerly Lucky-Goldstar). In many ways the Korean government tried to follow the economic path established by the Japanese: discouragement of imports, governmental leadership of the economy, and reliance on large economic combines for industrialization.

Unfortunately, Korea’s growth came to a screeching halt as a result of the 1997–1998 Asian currency crisis, and many of the chaebol were plunged into financial difficulties. (The Asian currency crisis is analyzed in Chapter 8’s closing case, “A Bad Case of Bahtulism.”) Many observers argued that their problems were due to overexpansion and the poor lending practices of Korean banks. Many of the chaebol seemed to be more interested in size than profitability and borrowed money to enter industries already burdened by overcapacity, such as automobiles.

Some of the chaebol learned their lesson and emerged from the crisis as stronger and leaner competitors. Samsung, for example, narrowed its corporate focus. Its senior managers chose to concentrate the company’s resources in electronics. Samsung is now a market leader in memory chips, flat-panel displays, DVD players, and cell phones. The process was painful, however, for Samsung was forced to lay off almost half its workforce and sell off noncore operations. Other chaebol struggle to regain their former glory, such as Hyundai and Daewoo. Part of their empires have been sold off to foreigners or allowed to die in bankruptcy courts.5
Taiwan. Taiwan, as the Republic of China is commonly known, is a small island country off the coast of mainland China that is home to 23 million people. It was born in the aftermath of the civil war between the nationalist forces led by General Chiang Kai-shek and the Chinese communists led by Mao Tse-tung. After their defeat on the mainland in 1949, Chiang’s army and government fled to Taiwan. Declaring the island “the Republic of China” and himself the rightful governor of the mainland, Chiang set about developing the Taiwanese economy to support a promised invasion of the mainland. Redistribution of land from large estate holders to peasants increased agricultural productivity. Reliance on family-owned private businesses and export-oriented trade policies has made Taiwan one of the world’s fastest-growing economies during the past three decades, with a real growth rate averaging more than 8 percent annually over that time span. Exports were $189 billion in 2004, or 31 percent of the country’s GDP of $611 billion.

Taiwan’s economic development has been so fast-paced that it can no longer compete as a low-wage manufacturing center. Consequently, Taiwanese businesses more recently have focused on high-value-added industries such as electronics and automotive products. However, the businesses still need low-wage workers. Despite the lack of diplomatic relations between Taiwan and China, Taiwanese businesses increasingly are investing in factories and assembly plants in China to access the low-wage workers they need.

Singapore. The Republic of Singapore is a former British colony and a small island country off the southern tip of the Malay Peninsula. To combat the chronic unemployment that plagued the country when it became independent in 1965, Singapore’s government initially emphasized development of labor-intensive industries such as textiles. This economic policy proved so successful that Singapore shifted to higher-value-added activities, such as oil refining and chemical processing, and high-tech industries, such as computers and biotechnology. With a population of only 4.3 million, Singapore now suffers from a labor shortage. It can no longer compete with such countries as Honduras and Indonesia in the production of price-sensitive, labor-intensive manufactured goods.

In 2004, Singapore’s per capita income was $24,220 and its exports totaled $180 billion, or 168 percent of its GDP of $107 billion. That figure is not a misprint. Singapore thrives on reexporting. Singapore’s firms take advantage of the country’s excellent port facilities to import foreign goods and then reexport them to other countries (particularly neighboring Malaysia). Besides being an important port and center for oil refining, Singapore provides sophisticated 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. Almost 7 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 $266 billion worth of goods in 2004, or 163 percent of its $163 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. 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 Tse-tung 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 country’s economic progress, as many of its most productive and educated members were exiled to the countryside to repent their ideological sins.

After Mao’s death in 1976 the government adopted limited free-market policies. Agriculture was returned to the private sector, and entrepreneurs were allowed to start small businesses such as restaurants and light manufacturing. Foreign companies were permitted to establish joint ventures with Chinese firms. As a result, FDI and economic growth soared, as did hopes for increased political freedom. However, Communist Party leaders were unwilling to relinquish their powers. The massacre of several thousand pro-democracy demonstrators in Beijing’s Tiananmen Square in June 1989 chilled economic and political relations between China and the Quad countries for several years.

Nonetheless, China is following a unique path. It continues to adopt market-oriented economic policies under the Communist Party’s watchful eye, while seemingly abandoning the ideological principles of the party. State-owned enterprises, known for their low productivity and shoddy products, struggle to survive. China’s vibrant private sector, however, has attracted the attention of firms worldwide. FDI in China has exploded since 1992, as Figure 2.4 indicates. Of particular note are the increased investments by overseas Chinese investors living in Taiwan, Hong Kong, and Singapore, who see China as a source of hard-working, low-cost labor, an increasingly scarce commodity in their own communities. While China’s cities have boomed economically, such is not the case for the country’s
estimated 800 million rural residents. A major challenge facing China’s leaders is closing the growing income gap between its urban and rural residents.

**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 $620. 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 has 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. India has attracted much FDI from MNCs based in the Quad countries, and its real GDP growth has averaged 6 percent annually since the reforms began. (See Chapter 1’s closing case, “A Boom in Bangalore,” for a discussion of one industry that has thrived as a result of these reforms.) However, problems remain. 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.

**Afghanistan and the Central Asian Republics**

Afghanistan and the five Central Asian republics—Kazakhstan, Uzbekistan, Tajikistan, Turkmenistan, and Kyrgyzstan—have much in common. The Muslim faith is the dominant religion in all six countries. Their languages share Turkic or Persian roots. All suffer from a scarcity of arable land; mountains and deserts dominate their landscapes. Their peoples are poor, with per capita incomes ranging from $280 in Tajikistan to $2,260 in Kazakhstan. However, extensive fossil fuel reserves can be found throughout Central Asia, particularly in Kazakhstan and Turkmenistan.
Another common feature is the importance of Russia in their recent political history. The five Central Asian republics were part of czarist Russia. Each became a Socialist Republic of the Soviet Union after the communists deposed the czars. When the Soviet Union dissolved in 1991, the five declared their independence.

Russia has also played a major role in the modern history of Afghanistan. In 1979, Soviet troops invaded the country, but withdrew a decade later after suffering military losses at the hands of the mujahedin guerrillas. After several years of civil war, an Islamic fundamentalist group, the Talibran, took control of most of the country. However, the Talibran’s public support eroded as it imposed its strict religious views, such as forbidding girls to be educated. The Talibran also allowed al Qaeda, a terrorist organization headed by Osama bin Laden, to set up training camps throughout Afghanistan. After al Qaeda’s role in the September 11 attacks on the World Trade Center and the Pentagon was established, U.S. troops and air power aided the rebel Northern Alliance in the defeat of the Talibran government. The new Afghan government faces many challenges in bringing peace and prosperity to its people.

Southeast Asian Countries

Asia is home to numerous other countries at various stages of economic development. Of particular note are Thailand, Malaysia, and Indonesia, countries with low labor costs that have been recipients of significant FDI during the 1980s and 1990s. 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 Chapters 7 and 8. Vietnam, too, is becoming important to MNCs, attracting $5 billion of FDI in 2005. Intel, for instance, announced in 2006 that it would build its sixth Asian chip assembly factory in Ho Chi Minh City, an investment that could reach $600 million.  

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 2.7, is home to 867 million people and 54 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, 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.

Much of Africa’s economy is tied to its natural resources. Crude oil production accounts for one-half the GDPS of Angola and Gabon, and one-quarter of Algeria’s and Libya’s GDPS. Agriculture also is important to many African countries. For some, agricultural products are their major exports. For example, coffee, cocoa, and palm oil account for 80 percent of Côte d’Ivoire’s exports, and coffee and tea comprised 80 percent of Rwanda’s exports prior to the eruption of tribal conflict in that country. Unfortunately, the population in many African countries is largely employed in subsistence farming; these countries include Gambia, Mozambique, Sierra Leone, Tanzania, and Zambia. “Point Counterpoint” explores the best means to promote the economic development of these countries.
The Sahara Desert divides Africa into two economic areas: the richer northern region and the poorer sub-Saharan region. Over the past 25 years, the desert has advanced southward because of overgrazing, overcultivation, and deforestation. Sub-Saharan economic development has been hindered by political instability, tribal rivalries, and unsuccessful reliance on socialist economic principles.
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 farm-land 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 2004 South Africa’s exports—primarily minerals—accounted for 22 percent of its $213 billion GDP.
Trade is preferable to aid.
An old Chinese proverb notes: “Give a man a fish and you feed him for a day. Teach a man to fish and you feed him for a lifetime.” In line with this ancient wisdom many development experts believe that it is better to base economic development on trade than on aid. Trade provides jobs for residents of less developed countries. The wages provided by these jobs get spent in the local economy, generating demand for local businesses and employment opportunities for local residents.

More important, as domestic firms expand their exports, their managers and employees learn new skills and techniques for producing and marketing these goods. They make contacts with foreign distributors, earn goodwill with foreign customers, develop credible reputations with foreign lenders, and learn the ins-and-outs of dealing with the customs services of foreign countries. This improvement in a country’s stock of human capital inevitably gets transferred to other firms and industries as employees leave to start their own companies or get lured away by domestic competitors. The aggregate effect is to raise the competitiveness, productivity, and efficiency of the economy as a whole. The postwar economic successes of countries such as Singapore, Hong Kong, and Taiwan are based on this pattern of export-driven economic development. Other experts support trade-based economic development because of the failures of aid programs. Long-term food aid, for example, often depresses local crop prices so that farmers cannot make a living, forcing them to abandon their fields and seek work in urban areas. When U.S. and UN troops entered Somalia in 1992, for instance, they brought so much food to feed the local population that Somali farmers were unable to raise crops profitably. In the next growing season fields remained unplanted, thereby making the country more dependent on outsiders. Far too often aid takes the form of large, ill-planned projects that do little to improve a country’s living standard. For example, much of the $16 billion donated to Tanzania between 1961 and 1987 was used to finance nationalization of the country’s industries and relocation of 14 million peasants and their families to newly collectivized farms. Because of inefficiencies of the state-owned industrial sector and reductions in agricultural productivity at the collective farms, the net result of the aid was a halving of Tanzania’s per capita income between 1980 and 1993. And in far too many countries, this pattern has been repeated: Decades of aid have done little to alleviate poverty.7

Wrap-Up
1. In your judgment, which is better, trade or aid?
2. What alternatives, other than aid, are available to improve the infrastructures of developing countries?
3. Which should determine how foreign aid is spent, the donor countries or the recipient countries?

Middle East

The Middle East includes the region between southwestern Asia and northeastern Africa (see Map 2.8). 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; during the latter half of the twentieth century it saw the Arab-Israeli wars, the Iran-Iraq war, and two Persian Gulf wars, all of which raised the risk of doing business in the region.
Historically, Iran has been the region’s military power, and the Islamic Republic of Iran has used its oil revenue to promote Muslim fundamentalism throughout the region.

The ouster of Iraqi dictator Saddam Hussein in 2003 by a coalition of forces led by the United States and United Kingdom has heightened concerns about the region’s stability. Iraq possesses the world’s second-largest proven oil reserves.

Oil is a key element in Middle Eastern politics. Saudi Arabia, owner of one-quarter of the world’s oil reserves, has used oil revenue to strengthen its regional power base.

MAP 2.8

The Middle East

In 2004, Saudi Arabia, with a GDP of $251 billion, had the largest economy in the Middle East, but Israel enjoyed the highest per capita income at $17,380 per annum. The region is home to many oil-rich countries. In Saudi Arabia, for example, oil accounts for 40 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.” Kuwait has used its oil revenues to develop an impressive portfolio of investments; 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.

The Marketplaces of South America

South America’s 13 countries, shown in Map 2.9, share a common political history as well as many economic and social problems. A 1494 papal decree divided colonization privileges between Portugal, which got 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
During the late 1980s, many South American governments stimulated economic growth by adopting policies promoting free trade and private enterprise, thereby increasing the continent’s appeal to U.S., European, and Asian MNCs. Unfortunately, economic and political crises have plagued many South American countries in the first decade of the new millennium.

International business in South America is affected by its physical geography. The Andes Mountains make it difficult to transport goods between Pacific Coast countries and their inland neighbors. Other mountain ranges, as well as the dense forests of the Amazon River Basin, similarly limit transport of goods.

- Cities of 350,000 to 1 million
- Cities over 1 million
- Capitals
- Capitals over 1 million
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 earlier 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-intended 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. Unfortunately, while the continent’s economies boomed during the 1990s as a result of these policies, many South American countries have faltered in the new millennium. Among the countries facing significant economic and political challenges in the 2000s are Argentina, Bolivia, Brazil, Colombia, Peru, and Venezuela. Of particular concern is their 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.8

The Quad countries—Japan, members of the EU, the United States, and Canada—are of particular importance to MNCs. Some experts believe that firms cannot succeed in the global economy unless they have a significant presence throughout the Quad. However, emerging markets like China and India cannot be ignored by international businesses, given their rapid 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 25-member EU, which will expand to 27 members in 2007. The EU members are free-market-oriented, parliamentary democracies. With the 1989 collapse of European communism, Eastern European and Central European countries are undergoing a 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. Because of the economic successes of Japan and the Four Tigers, other countries such as India and China have begun to reverse their inward-looking economic policies. 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.
The 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 and reduced governmental regulation have prompted renewed interest in the continent by international businesses. Unfortunately, several South American economies have faltered in the new millennium.

Questions for Discussion

1. 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. Many American and European businesspeople argue that the keiretsu system in Japan acts as a barrier to foreign companies entering the Japanese market. Why do you think they believe this?
3. 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?
4. What can African countries do to encourage more foreign investment in their economies?

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 compiles data about small, obscure, and politically controversial areas. For example, if you were an executive for Crestone Energy Corporation, which was hired by China’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 Crestone’s explorations would be extremely sensitive and possibly the target of political conflict.

Background Notes, a U.S. State Department series, provides 10- to 14-page profiles of individual countries. Each profile is intended to give a quick overview of a country’s geography, culture, living conditions, political orientation, economic policies, and trading patterns. Background Notes is particularly useful for briefing employees who are given temporary assignments in a foreign country.

World Development Report, published annually by the World Bank, presents 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.

Commodity Trade Statistics is an annual United Nations report that provides detailed data on each country’s exports and imports, which are classified by commodity and by country of destination or origin. The report is an excellent source of minutiae—for example, the value of pork exports from Denmark to Portugal in 2007. However, it is rather clumsy to use when time-series information is required—for example, Denmark’s total annual exports from 1986 to 2007.

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.

**National Trade Data Bank (NTDB)** is distributed monthly by the U.S. Department of Commerce. The NTDB is available at many college libraries and at all federal depositories. It is packed with information assembled from other data sources, including some of those listed here. The NTDB also contains databases not readily available elsewhere. Suppose, for example, that your company produces mountain bikes and is looking for a German distributor. The NTDB provides information on whether any German distributors are interested in distributing foreign-made mountain bikes. The NTDB also contains *A Basic Guide to Exporting*, a step-by-step guidebook developed by the U.S. Department of Commerce to assist first-time exporters. This guide contains an extensive list of sources of information often used by international businesses.

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

1. What was the total value of U.S. imports from Belgium last year? Of U.S. exports to Belgium?
2. What is the total level of U.S. investments in Belgium? Of Belgian investments in the United States?
3. 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?
4. 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?

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**Closing Case**

**Demography Is Destiny**

In the beginning of 2006 newspaper headlines trumpeted news of massive protests in Paris by students and workers denouncing pending labor market reforms; of General Motors and its former subsidiary, Delphi, offering buyouts to 131,000 workers; of marches by civil servants in London denouncing proposed cutbacks in their pensions. Meanwhile, the Central Committee of the Communist Party announced new initiatives to promote economic development in China’s rural areas. Underlying each of these actions are dramatic demographic changes occurring in these countries.

Demography is the study of the structure of human populations—their size, age composition, gender mix, growth, and so on. Demographers often assert that demography is destiny. By that they mean that a country’s demography constrains and shapes the opportunities available to it. If so, then changes in the population, age structure, and gender mix of the world’s major economies suggest that significant changes are in store for the world economy.

A traditional way of examining a country’s demography is through the use of population pyramids (see Figure 2.5). In olden days, the normal structure of a country’s age distribution was a pyramid. Each layer of the pyramid consisted of the number of individuals in an age bracket. The pyramid shape resulted from the fact that the number of people aged 0–4 was
slightly larger than the number aged 5–9, 5–9-year-olds slightly outnumbered 10–14-year-olds, and so forth. The declining size was due to the cruel reality of death from disease, famine, and childbirth in a world without modern medicine. Fortunately, better health care, education, and hygiene have freed many societies from this cruel reality, and some population pyramids more closely resemble diamonds or rectangles. But these societies now face the challenge of dealing with graying populations. (The U.S. Census Bureau’s Web site depicts the population pyramids for many of the world’s countries: see http://www.census.gov/ipc/www/idbpyr.html.)

These dramatic demographic changes portend major shifts in economic power and competitiveness. The populations of many major economic powers—including France, Italy, Germany, South Korea, and the United Kingdom—are predicted to get older and smaller over the next two decades. According to the OECD, the old-age dependency ratio will rise dramatically over the next several decades (see Figure 2.6).

The old-age dependency ratio is the ratio of the number of people 65 and older to the number of people between the ages of 20 and 64. A rising old-age dependency ratio indicates that the burden imposed on current workers to support retirees will increase. This burden can take the form of familial transfers or increased taxes. In either case, the monies available to support the consumption of current workers will decline.

The implications of these demographic changes for companies and countries alike are profound. For many companies, when retirees leave work on their last day, a lifetime of experience and knowledge walks out the door as well. Some companies recognize that they will have to change their ways of doing business. For countries, graying of the workforce suggests pressures on the public treasury to support older citizens. Japan is the first major economy to face an aging, shrinking population. In 2005, the number of Japanese males decreased. Demographers expect that Japan’s overall population will start declining in 2007. In contemporary Japan,
almost 20 percent of the population is over 65; one-quarter will be over 65 in 2015, thanks in part to the 82.5-year life expectancy that its citizens enjoy. It is not surprising, then, that Japanese companies are at the forefront of adapting to these changes. Toyota has begun to adapt its workstations to make them more comfortable for a workforce that is growing older. Although such changes will help, the reality is that companies operating in countries with shrinking populations are likely to face higher wage and salary costs as the supply of labor contracts. In countries with aging populations, firms are likely to face higher taxes as governments struggle to find revenues to support and care for older citizens. Moreover, an increasing portion of the labor force will be employed caring for retirees, shrinking the availability of labor for other sectors of the economy.

The structure of consumption will also change, because the bundle of goods consumed by retirees differs dramatically from that of younger workers. Retirees demand more medical services, for example, while younger workers buy homes, furniture, household goods, and educational services. Japanese companies appear to be at the forefront of adapting new technologies to meet these demographic challenges. Synclayer, a Nagoya-based supplier of cable television and local area network technology, has been developed a system to allow the elderly to self-administer basic medical measurements, which can then be transmitted over the local area network to their doctors. Zojirushi, a leading manufacturer of rice cookers and tea kettles, is equipping its wares with wireless transmitters that send a message to family or friends that the kitchen equipment has been used. Other manufacturers are busily developing service robots to help the elderly lift heavy objects or monitor their health. A government study predicts that the service robot market could reach $8.4 billion in a decade, thanks to the aging of the Japanese population.

The likely paths of the world’s two most populous nations, China and India, diverge. Currently the Chinese labor force is expanding as a result of dramatic declines in infant mortality that occurred in the 1960s and 1970s, providing a ready source of cheap labor for China’s manufacturing sector. However, China’s working age population will begin shrinking in 2015. Already the number of women between 18 and 35 is declining, as is the population between 15 and 24. These declines suggest that aggregate family formation will decrease within a decade, as will births. Some demographers predict that by 2050 the median age in China will be 45, as compared to 43 in the United Kingdom and 41 in the United States. India’s population, which is much younger than China’s, will continue to grow. Some demographers predict that by 2050, India’s population will be 1.6 billion (up from 1.1 billion today), while China’s population, currently 1.3 billion strong, will peak in 2030 at 1.461 billion and then gradually decline to 1.424 by 2050. India will face the task of providing employment for these young workers, while China will face the same challenges of a graying population that today confront Japan and most of Western Europe, with two added problems. Because of its “one-child” policy that discouraged families from having more than one child, as that one child enters the labor force and its parents subsequently retire, the child may need to provide financial support for its two parents, and, given the improvements in longevity in China, in...
some cases its four grandparents. Although saving rates in China are quite high, few companies provide pension benefits to their employees. Moreover, because of Chinese cultural values that favor male children, the one-child policy has created a dramatic imbalance in the gender ratio between males and females, with unknown but likely significant impacts on the marriage market, family formation, and elder care. In a decade or two, consumption patterns in young, growing India are likely to dramatically diverge from those in a graying China. Suppliers of video games, big-screen TVs, and child car seats may flock to India, while purveyors of hypertension and anticholesterol medicines, bifocals, and retirement financial services will find China an attractive market.

Case Questions
1. What challenges do graying populations create for companies?
2. What opportunities do graying populations create for firms?
3. How will demographic changes affect the competitiveness of countries in the international marketplace?
4. What has been the impact of the one-child policy on China’s economic fortunes?