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0521832985 - Nations and Firms in the Global Economy: An Introduction to International Economics and Business

Steven Brakman, Harry Garretsen, Charles van Marrewijk and Arjen van Witteloostuijn

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Nations and Firms in the Global Economy

This accessible introduction to the world economy and to the theory and practice of globalization argues that key topics in international economics cannot be understood without a knowledge of international business, and vice versa. It reviews and combines insights from both literatures and applies them to real-world issues, clearly explaining the main concepts of international economics and business in a uniquely integrated approach. Written in a lively and accessible style, this innovative textbook covers all the main issues, including international trade, capital mobility, comparative advantage, foreign direct investments, multinational behaviour, financial crises and economic growth. It includes carefully selected international examples and case studies, and special interest boxes which clearly explain more challenging economic concepts. The companion website includes additional case studies, exercises and answers to exercises, data, illustrations and links to other useful websites.

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Frontmatter

[More information](#)

iii

“This book is a remarkable achievement. It covers all the pressing international economic issues of our day in an accessible yet thorough manner. The authors adroitly combine illustrative data and essential theory to explain the how’s and why’s of trade and trade liberalisation, the delocation of firms and multinational activity, capital flows, currency and financial crises, and the role of international organisations such as the IMF and WTO. It is appropriate for students without an economics specialisation both at the undergraduate and non-specialists graduate level, e.g. MBA and Masters of Public Administration. The facts and real-world feel of the book make it interesting as a supplement for specialist students as well.”

Richard Baldwin, *Professor of International Economics,
Graduate Institute of International Studies, Geneva*

“International trade and international business have hitherto existed in two separate worlds – a world of nations and a world of firms – in academic teaching and even in research. This book gives us a welcome integration of the two at the level of teaching. Students who use it will develop a unified vision that will benefit them in their future careers, whether in business, government, international institutions, or academic research.

Avinash K. Dixit, *Department of Economics, Princeton University*

“This is a fascinating book with a practical approach to international economics that enhances our understanding of the globalisation process.”

Hans-Werner Sinn, *President of the Ifo Institute for Economic Research, Munich*

“This book offers a valuable integration of the economics and business aspects of globalization. The integrated approach makes the book a unique and valuable resource for students of international economics and business studies.”

Prof. Dr. Joseph Francois, *Tinbergen Institute, Rotterdam, and CEPR, London*

“Understanding the enormous changes taking place in the world economy requires the perspectives of many different disciplines, of which international economics and international business are two of the most relevant. Yet until now these two fields have interacted very little. This new text does a superb job of combining the insights of these two complementary academic fields. The authors present a lucid overview of theories of international economics, with an emphasis on recent contributions such as imperfect competition, multinational corporations, agglomeration and financial crises. In addition they present a wealth of relevant and insightful case-studies from the international business literature which helps bridge the gap between theory and reality. Students in a range of courses will benefit from this integration of different approaches, and researchers who want an overview of recent work in fields outside their own will learn a lot too.”

J. Peter Neary, *Department of Economics, University College Dublin*

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Contents

List of figures	<i>page</i> xii
List of tables	xv
List of boxes	xviii
Preface	xxi
Glossary	xxv
Suggested course structure	xxviii

Part I Introduction

1 The global economy	1
1.1 Introduction	1
1.2 A sense of time; the universe and population	4
1.3 Income levels: GNP and GDP	10
1.4 What is the global economy?	18
1.5 Globalization and income	21
1.6 Globalization and international trade	26
1.7 Analyzing the global economy	30
1.8 Conclusions	39
2 International accounting practices	40
2.1 Exciting accounting?	40
2.2 Macro-level accounting: a country’s balance of payments	41
2.3 Micro-level accounting: a firm’s annual report	47
2.4 The importance of distinguishing between micro and macro	55
2.5 Accounting principles as a platform	56

Part II Firms, trade and location

3 Trade and comparative advantage	63
3.1 Introduction	63
3.2 Comparative advantage: David Ricardo’s fundamental insight	64
3.3 Comparative advantage versus competitiveness	69
3.4 Comparative advantage: the neo-classical answer	72
3.5 The closed economy	73

viii	Contents	
3.6	Open economy international trade: the Heckscher–Ohlin result	78
3.7	Factor endowments and competitiveness	80
3.8	Fragmentation	83
3.9	Fragmentation: an evaluation	91
3.10	Conclusions	93
	Appendix: Heckscher–Ohlin algebra	94
4	Trade and competitive advantage	96
4.1	Trade and imperfect competition	96
4.2	Understanding intra-industry trade: monopoly power	100
4.3	The trading equilibrium	103
4.4	Strategic interaction between firms: the Airbus–Boeing example	107
4.5	Monopolistic competition	110
4.6	Trade with monopolistic competition	113
4.7	Empirical support for intra-industry trade	116
4.8	Conclusions	119
	Appendix 4A: strategic interaction: reaction curves	120
	Appendix 4B: derivation of the Helpman equation	124
5	Firms, location and agglomeration	125
5.1	Introduction	125
5.2	Distance in economics	126
5.3	Geographical economics	130
5.4	The geographical economics approach: an example	133
5.5	Geographical economics: a further discussion	136
5.6	Multinational behaviour	139
5.7	The boundary of the firm: outsourcing	146
5.8	Conclusions	151
	Appendix: a more general model of multinational behaviour	152
Part III Capital, currency and crises		
6	International capital mobility	161
6.1	Introduction	161
6.2	Measuring international capital mobility	162
6.3	Issues about capital mobility	167
6.4	Determinants, benefits and costs of capital mobility	176
6.5	Summing up and looking ahead	180
6.6	Policy autonomy	182
6.7	Conclusions	188

ix

Contents

7	Gains from capital market integration	190
7.1	Introduction	190
7.2	International allocation of savings and investments	191
7.3	The degree of international capital market integration and a puzzle	196
7.4	Does capital flow in the wrong direction?	198
7.5	Capital flows and risk diversification	205
7.6	Firm investment and asymmetric information	210
8	Investors, exchange rates and currency crises	217
8.1	Introduction	217
8.2	What is a currency crisis?	218
8.3	Characteristics of currency crises	222
8.4	First generation models	226
8.5	Second generation models	229
8.6	Coordination	233
8.7	Efficiency	235
8.8	Frequency and measurement	237
8.9	Looking ahead	240
9	Financial crises, firms and the open economy	241
9.1	Introduction and terminology	241
9.2	An asymmetric information view of financial crises	242
9.3	Disruptions and asymmetric information	243
9.4	A financial crisis framework	245
9.5	Financial crises in an open economy	247
9.6	Wake-up call and perverse savings	252
9.7	Evidence about twin crises	256
9.8	Bad fundamentals or malicious investors?	259
9.9	Synthesis and conclusions: the vicious circle	261
Part IV Policy, dynamics and organization		
10	Trade and capital restrictions	267
10.1	Introduction	267
10.2	Welfare effects of trade restrictions: a tariff on imports	268
10.3	World welfare effects of trade restrictions	272
10.4	More on protectionism	273
10.5	Trade agreements	277
10.6	Evaluation of the demand for and supply of trade protection	283
10.7	Capital restrictions: the trade-off between efficiency and stability	285

x

Contents

10.8	The welfare effects of a tax on capital inflows	287
10.9	The pricing of risk and the role of policy	289
10.10	Two examples of capital restrictions: preventing crises	293
10.11	Capital restrictions as a cure for crises	296
10.12	Changing the international financial system?	298
10.13	Rounding up the restrictions	300
11	Globalization and economic growth	304
11.1	Introduction	304
11.2	Catching-up	305
11.3	Production, capital and investment	307
11.4	Empirical implications	312
11.5	Technology, knowledge, innovation and TFP growth	318
11.6	Open economies, TFP and economic growth	320
11.7	An historic example: Japan	325
11.8	A recent example: China	332
11.9	Conclusions	335
12	Nations and organizations	339
12.1	Convergence or divergence?	339
12.2	Game theory: basics and terminology	347
12.3	An experiment	350
12.4	HRM and cultural diversity	352
12.5	Corporate governance and institutional diversity	359
12.6	Recent Americanization?	365
12.7	Conclusions	369
	Appendix: the Bertrand duopoly experiment	370

Part V Conclusions

13	Globalization: is it really happening?	375
13.1	Introduction	375
13.2	Income inequality over time	377
13.3	Does globalization make the rich richer and the poor poorer?	378
13.4	Low-skilled labour, trade and within-country income inequality	381
13.5	Low-skilled labour and the irrelevance of trade	383
13.6	Outsourcing and income inequality	388
13.7	Developing countries and the ‘globalization bonus’	390
13.8	Conclusions	395

Cambridge University Press
0521832985 - Nations and Firms in the Global Economy: An Introduction to International Economics and Business
Steven Brakman, Harry Garretsen, Charles van Marrewijk and Arjen van Witteloostuijn
Frontmatter
[More information](#)

xi	Contents	
14	Towards an international economics and business?	397
14.1	Glocalization	397
14.2	More than macro or micro alone: multi-level interaction	402
	Bibliography	406
	Author index	426
	Subject index	430

Figures

1.1	‘Big Bang’ and beyond	<i>page 5</i>
1.2	Development of world population over the last 2,500 years	6
1.3	Developments in world population, 2000–2050	7
1.4	Gross domestic product (GDP) and gross national product (GNP)	12
1.5	Correction of GDP <i>per capita</i> for purchasing power, 2000	16
1.6	Development of world per capita income over the last 2,000 years	22
1.7	Advantages and disadvantages of logarithmic graphs	23
1.8	Leaders and laggards in GDP per capita: a widening perspective	25
1.9	Carrying capacity of European merchant fleets, 1470–1780	27
1.10	Two ‘waves’ of globalization	29
1.11	Trade and market integration	31
1.12	London external bond spread, 1870–1940	35
1.13	Foreign capital stocks, assets/world GDP, 1860–2000	35
1.14	Relative migration flows, Western Europe and Western Offshoots, 1870–1998	37
1.15	Traditional and globalized fragmented production processes	38
2.1	A country’s balance of payments	42
2.2	Current account balance, selected countries, 1970–2000	46
3.1	Wages per hour and GDP per hour, 1997–2001, selected countries	68
3.2	An isoquant	75
3.3	Cost minimization	76
3.4	Lerner diagram, goods prices and factor prices	77
3.5	The impact of international trade	79
3.6	Fragmentation possibility	86
3.7	Fragmentation profitability	87
3.8	Labour re-allocation between Home and Foreign	90
4.1	Manufacturing intra-industry trade: high and increasing intra-industry trade countries	99
4.2	Increasing returns to scale and perfect and imperfect competition	102
4.3	A trading equilibrium: monopoly versus duopoly	103
4.4	Intra-industry trade as a result of transportation costs	106

xiii	List of figures	
4.5	The varieties approach of monopolistic competition	110
4.6	Monopolistic competition, demand and costs	112
4.7	Monopolistic competition and foreign trade pressure	115
4A.1	Derivation of firm A's reaction curve	122
4A.2	Cournot duopoly equilibrium	123
5.1	Monopolistic competition and the re-location of a firm	137
5.2	Development of world GDP, foreign direct investment (FDI) and trade, 1970–2000	140
5.3	Profits in the Home and Foreign market: national exporting firm	142
5.4	Going multinational: the horizontal case	143
5.5	Going multinational: the vertical case	144
5.6	Summary of the firm's main decisions	145
5.7	The effects of outsourcing on production and income distribution	150
5A.1	Decision process and firm types	154
5A.2	Endowment distributions in the Edgeworth Box	155
5A.3	Characterization of market structure	156
5A.4	Stylized impact of parameter changes for market structure	157
6.1	Global net capital flows, average for fifteen countries	163
6.2	Capital outflows 1860–1910, selected countries	164
6.3	Net private capital flows to emerging markets, 1992–2000	166
6.4	Evolution of net financing through international financial markets, 1983–1998	168
6.5	Evolution of British and American share in foreign assets, 1825–2000	171
6.6	Interest rate differential, 1880–1994	175
6.7	Spider web spiral: world imports, January–December 1929–1933	178
6.8	The policy trilemma	183
7.1	Capital mobility is welfare-enhancing	192
7.2	Capital re-allocation between Home and Foreign	199
7.3	Firm investment, supply of funds and asymmetric information	211
8.1	The Asian crisis: rapid drop in the value of some currencies, 1985–2002	218
8.2	The Asian crisis: current account balance, 1980–2000	223
8.3	The Asian crisis: developments of GDP <i>per capita</i> , 1990–2002	225
8.4	Interest rates in Germany and Italy, 1992–2004	230
8.5	Crises frequency, percentage probability per year	238
9.1	Stylized balance sheets of firms and banks	244
9.2	Financial crisis in an asymmetric information framework	246
9.3	Share of \$US-denominated debt, 1996–1998, selected countries	249

xiv **List of figures**

9.4	Profitability of non-financial firms, emerging markets, 1992–2004	251
9.5	Perverse savings and the backward-bending savings curve	255
9.6	The unfolding of a financial crisis	257
9.7	The vicious circle of financial crises	262
10.1	Domestic welfare effects of imposing a tariff	269
10.2	The world welfare effects of a tariff	273
10.3	‘Predicted’ duration of the Doha round	278
10.4	Customs union: trade creation	281
10.5	Customs union: trade creation and diversion	282
10.6	The net supply of and demand for funds	287
11.1	France, share of income invested, 1950–2000	310
11.2	Income levels and capital accumulation (Solow)	311
11.3	Education and total factor productivity (TFP) in developing countries	313
11.4	USA: GDP <i>per capita</i>	314
11.5	Japan and Indonesia: GDP <i>per capita</i>	315
11.6	Machinery imports and TFP in developing countries	318
11.7	Intertemporal adjustments in Singapore, 1972–2001	322
11.8	Foreign research and development (R&D) capital stock and TFP in developing countries	324
11.9	A Dutch ship in Nagasaki, 1859	327
11.10	The Japanese economy, 1500–1998	328
11.11	Rapid growth in Europe–Asia trade, 1500–1800	329
11.12	Multinational trade composition, Portugal, the Netherlands and England	331
11.13	Developments in Chinese income and trade flows, 1960–2001	333
11.14	China: geographic export market composition, 1997	334
12.1	Results from three experiments: A, B and C	351
12.2	Correlation in cultural characteristics	356
12.3	Correlation between corruption and social economic conditions	364
13.1	Inequality among world citizens, 1820–1992	378
13.2	Growth rates in open and closed economies, 1970–89	379
13.3	Income levels, growth rates and population, 1980–2002	380
14.1	China’s FDI and trade connections	404

Tables

1.1	The twenty countries with the highest population and population density, 2000	<i>page</i> 8
1.2	Population projections, 2000–2050, the world and continents	8
1.3	The twenty most powerful economies, 2000	13
1.4	Assumed labour productivity, Australia and Botswana	14
1.5	Price convergence and declining transport cost, 1870–1913	33
1.6	Tariffs on manufactures for selected countries, 1820–1950	34
2.1	Analytic presentation: balance of payments, 2002	43
2.2	A firm’s statement of income	49
2.3	A firm’s balance sheet	50
2.4	Abstracts from the annual report of DaimlerChrysler, 2003	51
2.5	Abstracts from the annual report of Royal Dutch Shell, 2002 and 2003	52
2.6	Top 100 based on a sales–GDP ranking, 2002	57
2.7	Top 100 based on a value added–GDP ranking, 2000	58
2.8	The size ranking of firms in terms of sales <i>vis-à-vis</i> value added, 2000	59
3.1	Hypothetical labour productivity: production per hour	65
3.2	Production of cloth and wine in the EU and the USA	66
3.3	Sign tests of factor abundance	82
3.4	Multinationals, investment, trade and income	85
4.1	Manufacturing intra-industry trade, 1988–2000	98
4.2	Airbus–Boeing strategic interaction pay-off matrix	109
4.3	Strategic interaction pay-off matrix after Airbus subsidy	109
4.4	Country similarity and intra-industry trade	118
5.1	CIF/FOB ratios, 1965–1990	127
5.2	Regional trade pattern of Europe, 1860–1996	128
5.3	Geography of sales	134
5.4	Transport costs	135
5.5	FDI inflows and outflows, share in total flows	141
6.1	Size of net capital flows since 1870, selected countries	163
6.2	Net capital flows to emerging market economies, 1992–2000	166

xvi	List of tables	
6.3	Net financing at international financial markets, 1983–1999, seventeen countries	169
6.4	Gross financial stocks, 1825–1938	171
6.5	Looking for the trilemma: estimates of β	185
6.6	Effective corporate income tax rates across the EU, 1990–1999	188
7.1	Correlation between national savings and investment, 1960–1999	197
7.2	The Feldstein–Horioka test	198
7.3	Institutions and financial development	201
8.1	Real income growth and capital account crises	225
8.2	Median changes in private capital flows and current account	226
8.3	Coordination of a speculative attack	234
8.4	The incidence of global contagion, 1970–1998	239
9.1	Cost of crises in lost output (relative to trend output)	242
9.2	Developing countries: external debt and equity financing, 1997–2003	248
9.3	Profitability of non-financial firms in emerging markets, 1992–2001	250
9.4	Possible relationships between signals and crises	258
9.5	Percentage of crises accurately called	258
9.6	Ratio of short-term debt to total debt and to reserves, June 1997	260
10.1	GATT and WTO rounds, 1947–	278
10.2	Gross capital inflow to Chile, 1988–1997	295
10.3	Annual growth rate, 1970–1989	302
11.1	GDP per capita, 1990–2000 growth projections	305
11.2	GDP per capita growth rates per decade, 1960–2000	306
11.3	GDP per capita 1960–2000 growth projections	307
11.4	European output and TFP growth, 1870–2001	316
12.1	Overview of multinational organizations’ typologies	344
12.2	Top ten non-financial multinationals, 2003, ranked according to TNI	346
12.3	Firm I–Firm II interaction pay-off matrix	347
12.4	Reciprocal dumping game	349
12.5	Information, culture and trustworthiness	352
12.6	International cultural diversity in four dimensions, index scores, 1994	355
12.7	Corporate governance around the world	362
12.8	Political risk diversity, 2003	365
12.9	Effectiveness of downsizing	368
12.10	Stock exchange reactions to downsizing announcements	368
12A.1	Firm I–Firm II interaction pay-off matrix	371

Cambridge University Press
0521832985 - Nations and Firms in the Global Economy: An Introduction to International Economics and Business
Steven Brakman, Harry Garretsen, Charles van Marrewijk and Arjen van Witteloostuijn
Frontmatter
[More information](#)

xvii	List of tables	
13.1	Price changes, manufacturing industries	384
13.2	Wage differentials, by education	385
13.3	Unemployment and labour skills	386
13.4	Changes in labour productivity, Europe and USA, 1979–2001	388
13.5	Imported intermediate deliveries, industry, 1974–1993	389
13.6	Institutions and economic performance	393

Boxes

1.1	Purchasing power parity (PPP) corrections	<i>page</i> 14
1.2	Logarithmic graphs	22
2.1	The balance of payments for Germany and the USA	42
2.2	Annual reports for DaimlerChrysler and Royal Dutch Shell	50
2.3	Why accounting is useful and why accounting is not explaining	59
3.1	Wages and productivity	68
3.2	Isoquants	75
3.3	Empirical tests of factor abundance: Ricardo revisited?	81
3.4	Multinationals, fragmentation and investment	85
3.5	The economic effects of international migration	89
3.6	The extent of the firm	92
4.1	Intra-industry trade	97
4.2	Alternative explanations for intra-industry trade	106
4.3	Imperfect competition in international business: Fuji versus Kodak	108
4.4	Models compared	114
4.5	Competitive advantage and MNEs	120
5.1	The relevance of transportation costs	126
5.2	The location decision of MNEs in international business	139
5.3	Another look at multinationals	140
5.4	The regional bias of FDI	147
5.5	<i>Maquiladoras</i>	149
5.6	Competitive advantage and the location decision	151
6.1	The spider web spiral	177
6.2	EU countries and the effective income tax rate	187
7.1	How to test for UIP	194
7.2	The importance of institutions for financial development and growth	203
7.3	Insurance against shocks through portfolio diversification	207
7.4	Ethnic bias in FDI	209
7.5	The financing of firm investment and the external finance premium	214

xix	List of boxes	
8.1	Foreign exchange risk, hedging and multinational firms	220
8.2	The second-generation model of currency crises	231
9.1	Moral hazard and over-investment: an example	253
10.1	The costs of protection	270
10.2	The EU–USA steel conflict	275
10.3	World Trade Organization (WTO) and General Agreement on Tariffs and Trade (GATT) trade rounds	277
10.4	The politics of free trade zones: how many trade blocs?	283
10.5	Asset/price inflation	290
10.6	Policy options and moral hazard behaviour	291
10.7	Political risk and the multinational firm’s investment strategy	296
10.8	Trade, financial liberalization and economic growth	302
11.1	Growth accounting and growth modelling	308
11.2	TFP and school enrolment in developing countries	312
11.3	TFP and imports of machinery and equipment in developing countries	317
11.4	Foreign R&D and TFP in developing countries	324
11.5	VOC: the world’s first multinational	329
11.6	The Prebisch–Singer hypothesis	336
11.7	A multinational’s experience and performance in transition economies	337
12.1	Cross-national culture clashes in the business world	341
12.2	International outsourcing	343
12.3	The case for dominant transnationality	346
12.4	‘Hard’ institutions and ‘soft’ cultures: competition or cooperation?	353
12.5	Culture distance and foreign entry mode	358
12.6	Delegation games and managerial compensation	360
12.7	Institutional diversity	364
12.8	Shareholder value, ‘Americanization’ and downsizing	367
13.1	Globalization and international labour migration	375
13.2	A closer look at wage differentials and labour market differences	385
13.3	Philips Electronics	387
13.4	Let’s dance to the New (International) Order (NIO)	392
14.1	Glocalization	400
14.2	Ceremonial adoption	401
14.3	FDI and trade in China	404

Cambridge University Press

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Frontmatter

[More information](#)

Preface

The title *Nations and Firms in the Global Economy: An Introduction to International Economics and Business* reflects our main motivations for writing this book. It contains the six core elements we address (i) introduction, (ii) the global economy, (iii) nations, (iv) firms, (v) international economics and (vi) international business. We briefly review these components and their interaction in this preface.

Introduction Our book is an introduction to the subject, indicating that our target audience consists of students interested in (international) economics and (international) business for whom this is the first structured encounter with the issues discussed, who wish to get acquainted with the facts and forces of the hotly debated globalization process. Depending on the background of the student and the type of programme (s)he is enrolled in, this first encounter could be in different parts of the curriculum, although it will usually be in the first or second year of an undergraduate programme. For other interested readers, this book offers an up-to-date introduction to what we know about globalization, its drivers and its consequences, particularly from an economics and business perspective. The preliminary requirements for a proper understanding of our book are limited. We assume that the reader has taken an introductory (micro and macro) economics course, and that (s)he has some grasp of elementary mathematics allowing him or her to understand simple graphs and equations. We also provide some technical material in boxes, as quick reminders of essential concepts.

The global economy We analyse the global economy—or, as it is more popularly known: the globalization process. As this is an introduction to the global economy, we define in chapter 1 what we mean by ‘globalization’ and what we will and will not analyze in the sequel. Throughout the book, we provide ample empirical information on the globalization process so that we may distinguish between fact and myth. In presenting the facts, we show longer time series than most textbooks or popular introductions. This enables readers to place current developments into their proper perspective, providing a better understanding of the developments giving rise to today’s complex structure of the international economy. We address all the major economic components of the globalization process, both real and monetary. We discuss international trade and capital flows, foreign direct investments (FDI), multinational firms, exchange rates, financial crises, outsourcing, economic development, location and much more. In doing so, the emphasis will be more on

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Frontmatter

[More information](#)

international trade and capital mobility, and less on international labour mobility, which reflects the fact that in economic terms international trade and capital flows are much more important than international labour migration, as we shall show.

Nations A proper understanding of the globalization process necessarily looks at the role of nations, governments and international organizations.

- Why do nations specialize in the export of certain types of goods and services, and import others?
- Is specialization always beneficial, or are there winners and losers from the globalization process?
- If so, who are these winners and losers?
- Why do governments adhere to particular policies regarding exchange rates, trade flows and capital mobility?

And so on and so forth. We address these and other issues from both a theoretical and a practical point of view by giving many empirical examples and discussing numerous case studies.

Firms In many respects, the decisions by individual (multinational) firms produce the most important driving forces behind the globalization process, ultimately determining international trade, capital flows and FDI. Naturally, these firms react to the conditions of the economic environment in which they operate, which is determined to a considerable extent by governments and international organizations. Firms therefore both shape the global environment and are shaped by it. Throughout the book, we discuss the forces with which firms are confronted, the competitive forces they unleash and how the interaction of these powers influences the firm's organizational structure, human resource management (HRM), corporate governance and other issues internal to the firm. Here, our focus is on the multinational enterprise (MNE).

International economics To some extent, it could be argued that the international economics literature tends to emphasize the role of nations (and comparative advantage) rather than the role of firms in the globalization process. This is, of course, not entirely accurate as the role of the industrial organization and international business literatures, and thus the factors influencing the organizational structure of individual firms, is becoming increasingly important in the international economics curriculum. We argue, therefore, that it is becoming increasingly clear that the latter type of analysis complements the former. Compared to other introductory textbooks on international economics, the primary goal of our book is not to cover the whole field, but to focus on those theories and insights that help us to understand the economic causes and consequences of globalization, as well as the role played by both nations and (multinational) firms. To give just one example, monetary policy is discussed in our analysis of international capital mobility, but we do not dwell on issues such as the conduct of monetary policy or the theory of monetary

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0521832985 - Nations and Firms in the Global Economy: An Introduction to International Economics and Business

Steven Brakman, Harry Garretsen, Charles van Marrewijk and Arjen van Witteloostuijn

Frontmatter

[More information](#)

integration as such. We discuss such issues only if they are relevant within the context of the main theme of our book. This also means that when it comes to understanding the global economy, we cover a lot more ground than other introductory textbooks.

International business It could be argued that the international business literature tends to emphasize the role of firms (and competitive advantage) rather than the role of nations in the globalization process. This, too, is not entirely accurate as the international economic environment in which the (multinational) firm operates is an increasingly important part of the international business curriculum. Once again, the latter type of analysis complements the former, which is the reason we combine these perspectives throughout the book. After all, MNEs do not operate in a vacuum – on the contrary, they must take account of all kinds of issues related to international economics, from exchange rate fluctuations and capital market restrictions to fiscal policies and labour market conditions.

To complement the material presented in this textbook, there is a website available providing additional information and supporting material. Its location is: www.charlesvanmarrewijk.nl.

The website provides: (i) background information on the structure of the book; (ii) background information on the authors; (iii) additional illustrations and data material, such as all the figures and tables used in the book; (iv) different types of exercises for self-study, as well as answers to (a subset of) these exercises; (v) other self-study material; and (vi) updates, and links to useful other sources of information. The choice of posting questions on a website rather than including them in the book itself is motivated by the important advantage that it allows us to integrate and respond to recent developments in the global economics and business environment in the questions posed.

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0521832985 - Nations and Firms in the Global Economy: An Introduction to International Economics and Business
Steven Brakman, Harry Garretsen, Charles van Marrewijk and Arjen van Witteloostuijn
Frontmatter
[More information](#)

xxiv Preface

Ees, Hans Groeneveld and Ralph de Haas for the opportunity to make use of previous mutual work.

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Harry Garretsen
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Arjen van Witteloostuijn

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Glossary

ASEAN	Association of Southeast Asian Nations
BCG	Boston Consulting Group
BIS	Bank of International Settlements
boe	barrels of oil equivalent
BPR	business process re-engineering
CEE	Central and Eastern European
CEO	chief executive officer
CFO	chief financial officer
CIF	cost, insurance, freight
CIS	Confederation of Independent States
COMESA	Common Market of Eastern and Southern Africa
CPE	centrally planned economy
FDI	foreign direct investment
EADS	European Aeronautic Defence and Space Company
EFTA	European Free Trade Association
EIC	East India Company
EITF	Emerging Issues Task Force
EMS	European Monetary System
EMU	European Monetary Union
EMBI	Emerging Market Bond Index
ERM	Exchange Rate Mechanism (EU)
EU	European Union
EVA	economic value added
FOB	free on board
FSU	former Soviet Union
FTA	free trade area
GAAP	Generally Accepted Accounting Principles (US)
GATT	General Agreement on Tariffs and Trade
GCI	gross capital income
GDP	gross domestic product
GGDP	Groningen Growth and Development Centre
GNP	gross national product
HGB	German Commercial Code

xxvi **Glossary**

HRM	human resource management
IB	international business
ICP	International Comparison Project (UN)
ICRG	International Country Risk Guide
ICT	information and communication technology
IE	International economics
IFI	international financial institution
IFS	<i>International Financial Statistics</i> (IMF)
IMF	International Monetary Fund
IO	industrial organization
IPO	initial public offering
IT	information technology
ITC	International Trade Commission (US)
JIT	just-in-time
JV	joint venture
M&As	mergers and acquisitions
MC	marginal costs
MERCOSUR	Southern Common Market
MFN	most-favoured-nation
MITI	Ministry of International Trade and Industry (Japan)
MNC	multinational corporation
MNE	multinational enterprise
MPC	marginal productivity of capital
MR	marginal revenue
NAFTA	North American Free Trade Agreement
NIC	newly industrializing country
NIO	New International Order
NTB	non-tariff barrier
NW	Net worth
NYSE	New York Stock Exchange
OECD	Organization for Economic Cooperation and Development
OLI	Ownership, Location and Internalization (Dunning)
PPC	production possibility curve
PPP	purchasing power parity
PTA	preferential trade agreement
PWT	Penn World Tables
R&D	Research and Development
SAR	special administrative region (Hong Kong)
SDR	Special Drawing Rights (IMF)
SDRM	sovereign debt restructuring mechanism

xxvii Glossary

SEC	Securities and Exchange Commission (US)
S–I	savings–investment (model)
SITC	Standard International Trade Classification
SOE	state-owned enterprise
SSA	Sub-Saharan Africa
TFP	total factor productivity
TNE	transnational enterprise
TNI	TransNationality Index
UDROP	universal debt rollover option with a penalty
UIP	uncovered interest parity
UN	United Nations
UNHCR	United Nations High Commissioner for Refugees
USTR	United States Trade Representative
VMPL	value marginal product of labour
VOC	Verenigde Oostindische Compagnie
WB	World Bank
WTO	World Trade Organization

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Steven Brakman, Harry Garretsen, Charles van Marrewijk and Arjen van Witteloostuijn

Frontmatter

[More information](#)

Suggested course structure

Our book consists of five parts – *Introduction* (part I), *Firms, trade and location* (part II), *Capital, currency and crises* (part III), *Policy, dynamics and organization* (part IV) and *Conclusion* (part V). As the name suggests, part I provides an introduction into the world economy. We recommend that any course based on this book should always start with studying chapters 1 and 2. Part II concentrates on the *real* aspects of the global economy and analyzes, for example, production structure, trade flows, multinational firms and migration. Part III concentrates on the *monetary* aspects of the global economy and analyzes, for example, exchange rates, capital flows, investments, risk and uncertainty and financial crises. Depending on the focus of the course and the available time, either part II or part III can be skipped. We recommend that any course focusing on the real aspects of the global economy should study chapters 3–5 in sequence. Similarly, we recommend that any course focusing on the monetary aspects of the global economy should study chapters 6–9 in sequence. The first two chapters of part IV present important topics with a real–monetary combination. Both could be dealt with in a course skipping either part II or part III of the book, although a more complete comprehension is obtained when both parts are studied before turning to these chapters. Independently of the details of the course structure, we always recommend that any course should conclude by studying chapter 12 (on the organizational implications for the firm of operating in a global environment) and the two chapters of the concluding part V (an evaluation of globalization, from both a macro and micro perspective).