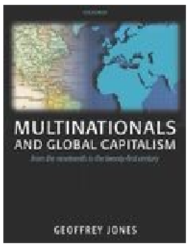

Multinationals and Global Capitalism: From the Nineteenth to the Twenty First Century

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CHAPTER

2 Multinationals and globalization

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Abstract

The history of global economy is characterised by major ebbs and flows. By 1914, an integrated global economy was in place. This was later destroyed by World War I. The global economy was rebuilt between the 1950s and 1970s. From the 1980s, the integration of global capital and commodity markets intensified.

Keywords: globalisation, global economy, multinationals

Subject: Economic History, Capitalist Systems

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2.1 Antecedents

Flows of people, trade, and capital across political borders have occurred for thousands of years. According to Moore and Lewis (1999), international trade began to develop in the Near East around 3500 BC. They identify the first 'multinationals' appearing in the Old Assyrian kingdom shortly after 2000 BC. Family-owned firms headquartered in the capital of Ashur opened branches in other political jurisdictions spread over what became the modern states of Syria and Iraq. Between 1000 and 500 BC ancient Phoenician merchants, especially those located on the island of Tyre, which is located off the coast of today's Lebanon, created firms which traded in silver from Spain, tin from Britain, ivory from Africa and textiles from all over the Mediterranean.

Over following centuries empires rose and fell, and trade routes were opened and closed. The integration of world civilization was never a continuous process, but one in which there have been numerous shocks and discontinuities, as well as periodic backlashes. Between 50 BC and AD 500 the Roman Empire controlled the Mediterranean region, which was linked by roads, harbors and a common currency. For nearly 1500 years from before the beginning of the Christian era, trade routes known as the Silk Route joined Europe, the Middle East and China. From the sixth century Islam spread outwards from Arabia into Asia, Africa and the

Iberian peninsula. This provided a political and ideological basis for the growth of trading connections and flows of knowledge. Islamic cities in Spain, such as Cordoba, flourished as clusters of knowledge at a time when much of Europe was technologically stagnant. During the fifteenth century Chinese ships reached the Arabian Gulf and east Africa, but soon afterwards political developments shifted China in a more inward direction.

The Voyages of Discovery of Spanish and Portuguese explorers to the New World and Asia in the fifteenth and sixteenth centuries saw transfers of technology—and deadly diseases—on a new scale. Entire American civilizations, including the Aztecs and the Incas, were destroyed by European armies and germs. At the end of the fifteenth century Portuguese explorers discovered the water route between Europe and Asia via the Cape of Good Hope, transforming the possibilities for trade between the two continents.

Although merchants were trading between different political sovereignties for centuries, a strong case can be made that the use of the word 'multinational' is anachronistic before the modern idea of the nation state took hold. Political scientists traditionally identify the origin of the modern system of nation states to the Peace of Westphalia, which ended the Thirty Years War in Europe in 1648. This replaced the European
 medieval ↳ structure of overlapping feudal hierarchies by the division of geographical space into exclusively defined jurisdictions within borders. The distinguishing feature of the multinational enterprise was that it operated in several of these clearly defined jurisdictions.

As the process of European colonization also got underway from the seventeenth century, state-sponsored trading companies were created to support colonial trading systems. The English, Dutch and Danish East India Companies, the Hudson's Bay Company, the Royal African Company, and similar firms were given monopoly trading rights by their respective governments. They became large-scale business organizations which some have seen as 'proto-multinationals' (see Box 2.1). In India, China, and the Middle East, they traded with local merchants who organized and financed the production of such commodities as pepper (Marshall 2002). As a result, they functioned as powerful drivers of regional integration.

Box 2.1 The English East India Company as a proto-multinational

In 1600 Queen Elizabeth I of England awarded a charter giving a body formed by a group of London merchants a monopoly over trade with the 'East Indies'. The merchants were initially concerned to secure spices such as pepper for the European market. Along with the rival Dutch East India Company formed in the Netherlands in 1602, the English East India Company came to dominate trade between Asia and Europe during the seventeenth and eighteenth centuries.

The Company was organized as a joint stock company headed by a Court of Directors. By the middle of the eighteenth century it employed 350 head office administrative staff which supervised a large managerial hierarchy which in turn supervised the trade between Europe and Asia. It functioned as a **vertically integrated** firm that undertook a full range of activities from the procurement of commodities in Asia to their wholesaling in Europe. The Company diversified into silk spinning factories in India.

In 1765 the Company obtained revenue collection rights in the province of Bengal from the ruling Mughal Empire in India. Thus began a process whereby it attained growing political power in India. In 1813 a new charter legalized the entry of private traders into the East Indian trade. Twenty years later the Company ceased trading and became concerned entirely with the colonial administration of India. The Company was liquidated in 1858 following the assumption of direct responsibility for India by the British Crown.

(*Source*: Chaudhuri 1978; Carlos and Nicholas 1988; Bowen, Lincoln, and Rigby 2002.)

European merchants were also traders in human beings. The commodities being developed in the New World such as sugar, tobacco, cotton and metals required large quantities of labor. This was found in the form of slaves from West Africa. The Royal African Company, chartered in Britain in 1672 and dissolved in 1752, exchanged European products for African commodities such as pepper and ivory and for slaves, which were transported to the West Indies. The proceeds in bullion were then sent back to Britain (Carlos and Kruse 1996). Between the sixteenth and the nineteenth centuries, at least 10 million Africans were transported to the Americas. Although slavery had been a feature of most human societies, capitalism resulted in an extraordinary expansion in its size and geographical scope.

By the eighteenth century, therefore, the 'integration of civilizations' had been in progress for millennia. Europe, Asia, Africa and the Americas were joined by strong trade links. There was a 'global' market in some products, including wine (Hancock 2002). There was a flourishing Atlantic economy. By then London had replaced Amsterdam as the world's largest international service center. However, distance remained a formidable obstacle to the closer integration of national markets. Transport costs were still very high. World trade probably grew at only a little over 1 percent per annum between 1500 and 1800. There seems to have been little or no price convergence between continents. Moreover, periodic wars between the European nations constantly disrupted integration (Findlay and O'Rourke 2003).

2.2 Creating the first global economy

During the nineteenth century the process of globalization accelerated on an unprecedented scale. From the 1820s international trade grew around 3.5 percent per annum for the rest of the century. The Industrial Revolution, which had begun in Britain and made it the world's largest manufacturing country by 1800, drove this growth. British exports of manufactured textiles poured into the markets of the world, dislocating the handicraft industries of China and India, formerly the world's largest manufacturers. The British industry was wholly dependent on imported cotton which created a huge demand for this commodity. During the first half of the nineteenth century modern industrialization was diffused to neighboring European countries and across the Atlantic to the United States. These newly industrialized regions sought markets for their products, and also raw materials for their industries, and foodstuffs for their rapidly expanding populations.

Exogenous circumstances favored the growth of trade. The end of the prolonged period of warfare between 1790 and the defeat of Napoleon in 1815 was followed by a century of relative world peace, despite major regional conflicts including the American Civil War (1861–65), during which half a million soldiers died. Transport costs fell sharply as steamships and railroads transformed the speed and cost of travel. International trade was further stimulated by a shift towards liberal economic policies, as monopolies were abandoned. By mid-century, tariffs had fallen to low levels. Subsequently the United States led a worldwide trend back towards protectionism. Nevertheless, by the late nineteenth century international trade was still growing much faster than world output. Overall, commodity price gaps between continents were cut by four-fifths between 1820 and 1914, primarily because of declining transport costs (O'Rourke and Williamson 1999).

There was a rapid increase in cross-border flows of capital, which accelerated from the late nineteenth century. There were few restrictions on capital movements, while the widespread adoption of the **Gold Standard**—which fixed the value of national currencies to the price of gold—sharply reduced foreign exchange risks. By 1880 quite a few countries were on the Gold Standard, and by 1900 there were a large number. Between 1820 and 1913 there was an estimated 60 percent progress from complete segmentation
p. 19 towards market integration in global capital markets (Obstfeld and Taylor 2003). Britain ↳ stood at the center of this monetary system. The country was by far the largest capital exporter. London functioned as the global international financial center. Sterling, fully convertible into gold, was the world's hardest currency. The Bank of England, Britain's quasi-central bank, oversaw the functioning of the Gold Standard. By participating in the international monetary system based on fixed exchange rates and balanced budgets, national governments accepted severe constraints on their domestic policies. In this respect, political ‘distance’ shrank remarkably in the first global economy.

There was unprecedented mobility of labor. Over the course of the nineteenth century 60 million Europeans emigrated to the Americas. There was also mass emigration of Russians to the empty lands of Siberia, and Chinese to Southeast Asia and California. By 1900, 14 percent of the population of the United States, which had grown from around five million in 1800 to reach 76 million, were foreign-born. There were few restrictions on immigration. Passports were unnecessary for international travel. Work visas did not exist. Falling steerage costs made emigration feasible for an unprecedented share of the world's population. Overall, in the Atlantic economy, the income gaps between rich and poor countries converged. Real wage dispersion declined by over a quarter between 1870 and 1910 (Hatton and Williamson 1998).

The forced movement of people as slaves finally ended. However, slavery as an institution continued in the United States until the 1860s and in Brazil till 1888. There was also the growth of cross-border movements of ‘indentured’ labor from regions of Asia to work as laborers in plantations in the Caribbean, Africa, and elsewhere, and on the many infrastructure projects undertaken at this time. Between the 1830s and World

War I around four million Indians, Malays, Chinese, and others were sent around the world in this capacity. In many cases, they were so restricted as to become virtual slaves, and few returned to their home countries (Bayley 2004).

The incorporation of outlying regions into the emergent global economy was driven by imperialism (Cain and Hopkins 2002). Although the British Empire lost its North American colonies following the Declaration of Independence in 1776 and the formation of the United States, the borders of the British Empire spread over large parts of Asia and Africa during the nineteenth century. By 1913 Britain, whose population was 45 million, had a worldwide empire of 400 million inhabitants. France, Belgium, Portugal, and Germany also occupied substantial parts of Africa, while France's Asian colonies included the modern states of Vietnam, Laos, and Cambodia. In southeast Asia, the Dutch East Indies (Indonesia) was a colonial possession of the Netherlands. The United States occupied Cuba and the Philippine Islands following a war with Spain, their former colonial ruler, at the end of the nineteenth century. Japan, which had closed its borders to foreigners in the sixteenth century, was forced to open them following the arrival of an American naval force in 1853. By 1914 Japan, which had undergone rapid modernization and economic growth, had occupied neighboring Korea and Taiwan. Imperialism involved the forcible removal of barriers to cross-border flows of capital, trade, and knowledge.

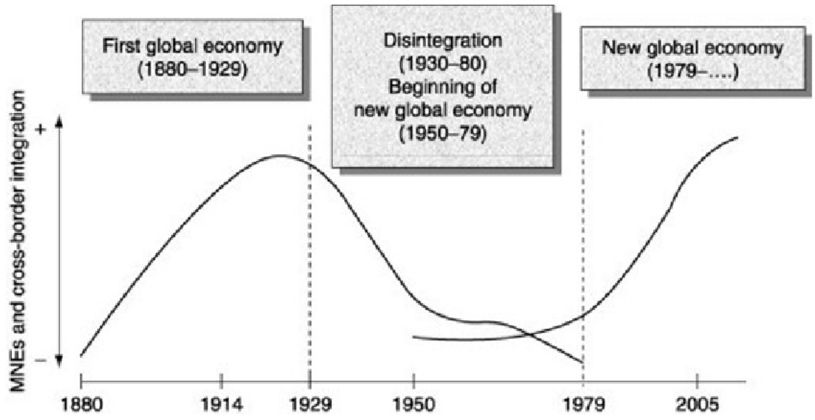
2.2.1 The growth of multinationals

The webs of the first global economy were built by firms and entrepreneurs. As shown earlier, this was not new, but there was a new scale and durability to the business p. 20 ↳ structures which began to be created in the nineteenth century. For millennia, when merchants and bankers despatched representatives across borders they employed family members, as the concept of 'professional managers' did not exist, while the problem of distance ruled out close monitoring of representatives abroad. The only option was to use people who could be 'trusted' not to act opportunistically. This greatly constrained the size of any organization. Typically such family members would in time become assimilated in their new countries, or else return home. The exceptional case of business enterprises which sustained cross-border businesses over long periods, such as the chartered trading companies, were typically supported by governments.

From the 1820s business enterprises began to make cross-border investments which were sustained without the benefit of monopoly rights. These were sometimes in a mine in a neighboring European country. They were often in colonies. During the 1830s British merchants and bankers began forming specialist 'overseas' banks to introduce banking into the Australian, Canadian, and West Indies colonies. Later entrepreneurs began to erect factories across borders. These were not large investments, but their real significance was that they were sustained. They continued to be managed from their home economies. Firms such as the German-owned electrical company Siemens and US-owned Singer Sewing Machines, which established their first overseas plants in the 1850s and 1860s respectively, were among the first manufacturing multinationals in history (see Chapter 4).

From the 1880s the numbers and scale of multinationals grew rapidly. They drove the rapid increase in international trade as they discovered and exploited natural resources and food supplies over much of the world. By 1914 multinational manufacturing was also undertaken in a wide range of manufactured products, including chemicals, pharmaceuticals, electricals, machinery, motor cars, tires, branded food products, and cigarettes. While entrepreneurs had made one-off cross-border transfers of knowledge in the past, the more sustained investments meant that there was a continuous flow of knowledge and other resources across borders within the boundaries of firms. Figure 2.1 portrays in an illustrative fashion the role of business enterprises in cross-border integration.

Fig. 2.1



Waves of globalization.
Source: the author.

p. 21 It is not easy to quantify the amount of FDI between the late nineteenth century and 1914. There was an enormous amount of foreign investment in the world, but there remains great uncertainty about its composition. The total world stock of foreign investment by 1914 has usually been estimated at between $40 billion and $45 billion, but even the size of the capital exports from the world's largest creditor nation—the United Kingdom—remains uncertain (Platt 1980; 1986; Feinstein 1990). It was long believed that almost 90 percent of total capital flows were portfolio. J.H. Dunning's historical estimates of world FDI stock—which, although made over two decades ago, remain the only estimates of the global figure—suggest that by 1913 around one-third of total world foreign investment, or some $14 582 million, took the form of FDI (Dunning 1983; 1988a; 1992). Table 2.1 compares this sum to world output, suggesting that multinationals might have already reached an importance in the global economy, which was only achieved again in the 1990s.

Table 2.1 World FDI as a percentage of world output, 1913–97 (%).
Source: World Investment Reports 1994, 1997, 1999.

1913	1960>	1980	1990	1997
9.0	4.4	4.8	8.5	11.8

In 1914 Western Europe as a region, and Britain as a single country, were the dominant sources of world FDI. The United States accounted for most of the remainder. FDI was widely dispersed around the globe. Latin America and Asia were especially important as host economies, even though the largest individual host countries seem to have been the United States and Canada. Possibly one-half of world FDI was invested in natural resources, and a further one-third in services, especially financing, insuring, transporting commodities, and foodstuffs. Multinational manufacturing was overwhelmingly located in the industrial economies of Western Europe and North America.

A central challenge in understanding the scope of multinational business at this time is posed by the diversity of organizational forms employed by entrepreneurs as they sought to take advantage of the opportunities of the rapidly globalizing world economy. Firms such as Siemens and Singer began by undertaking value-added activities in their home market, and then expanded abroad. The managerial and technological competences developed at home helped these firms sustain their investments abroad. This was the kind of firm and growth trajectory which economic theorists in the 1960s considered as the standard model of multinationals (see Chapter 1).

In fact, firms employed diverse organizational forms when they crossed borders. Many ventures were formed to undertake business activities exclusively or mainly abroad without prior domestic business. These have been termed **free-standing companies** (see Box 2.3).

Box 2.3 Free-standing companies and the first global economy

During the nineteenth century thousands of British, and hundreds of Dutch and other European, companies were formed exclusively to operate internationally with no prior domestic business. The period between 1870 and 1914 saw particularly rapid levels of firm creation. They were international venture capitalists, exploiting the numerous opportunities of the booming world economy and of expanding imperial frontiers.

Typically, free-standing companies were legally incorporated in their home economy. They would have a small head office where a part-time board of directors met, supported by a handful of other clerical staff. They usually specialized on a single commodity, product or service, often in a single overseas country. They were predominantly located in the natural resource and service sectors, and occasionally in processing. Most free-standing companies invested in developing, including colonial, countries, although many British free-standing firms were formed to conduct business in the United States. Three-fourths of the 200 Dutch free-standing companies active in 1914 operated in the Dutch colony of Indonesia, then known as the Dutch East Indies.

This type of firm was long considered as a vehicle for portfolio capital flows. Yet insofar as management control was exercised from head offices at home, they are more appropriately regarded as a form of multinational. The reclassification of free-standing firms engaged in FDI prompted the large upward revision of the amount of FDI in the world economy before 1914. In fact, there remain many uncertainties about the management structures of these firms. In some cases, most managerial decision-making was located in host economies. Some firms were engaged in a form of property development. Once the short-lived need for their specialized project management skills dried up, management control shifted to locals, and the investment ceased to be FDI.

Nominally independent free-standing companies were often part of wider business networks. There were 'clusters' linking different firms around original promoters, financial intermediaries, solicitors, accountants, mining engineers, merchant banks, trading companies, and influential individuals. Common to all clusters was the provision of services. The small head offices of the free-standing companies typically outsourced many managerial functions. Insofar as firms formed parts of networks, the description 'free standing' might be misleading.

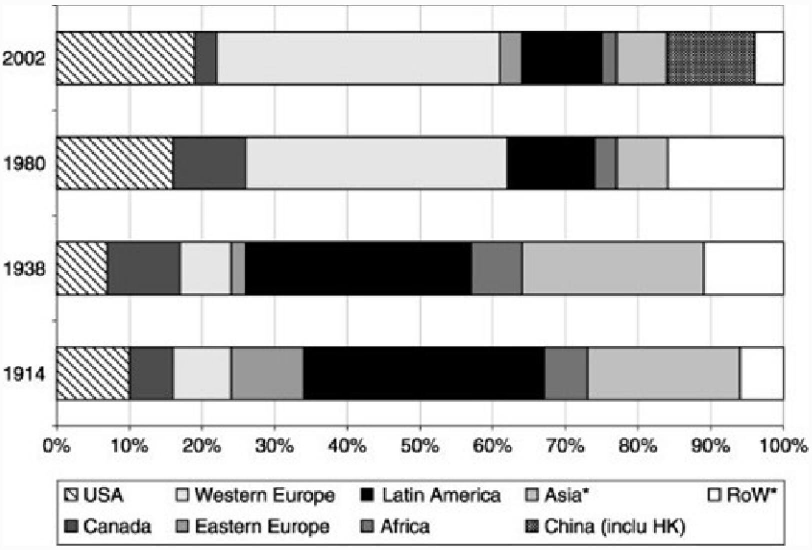
(*Source*: Wilkins 1988a; Corley 1994; Sluyterman 1994; Casson 1994a; Hennart 1994a; Jones 1998a; Wilkins and Schroter 1998.)

The 'clustering' of free-standing companies was characteristic of the network forms of organization widely employed in the first global economy. British trading companies and merchant houses in Asia, Latin America, and Africa formed **business groups** linking nominally independent free-standing firms using both equity and nonequity modes. Many other European companies collaborated when they crossed borders, either in business groups or other types of network or alliance (see later chapters, especially Chapter 7).

p. 22 There are further complexities in interpreting the significance of FDI in the world economy because of the large percentage of investment located in colonial empires. In so far that the essence of multinational enterprise is crossing political borders, it is not evident that colonial investment is a form of FDI. The counter-argument is that metropolitan enterprises investing in colonial territories still faced different cultural, labor, and geographical conditions than in their home countries. Doing business in Saigon or Jakarta remained different from Paris or Amsterdam, whatever the borders of empire. Nor were colonial administrations necessarily supportive of expatriate firms. In the British Empire, there was often a distant relationship between individual administrators and expatriate business (see Chapter 8).

Parallel definitional issues arise when firms invested literally just over national borders. This was a common occurrence before 1914. Swiss chemical firms established factories in Germany within walking distance of the Swiss border. Early US investments in Canada were sometimes just over the border (Schröter 1993b; Wilkins 1988a). These investments might be more accurately described as 'multiregional' than 'multinational'. If both colonial and multiregional investments were excluded from current estimates of FDI in 1914, its overall importance in the world economy would decline sharply.

p. 23



Box Fig. 2.2 Stock of inward FDI by host economy and region 1914–2002 (% total world inward FDI).

* Rest of the world, includes China and Hong Kong for 1914, 1938, and 1980.

(*Source*: Dunning 1983, 1988a, 1992; Stopford and Dunning 1983; United Nations 1993, 2003.)

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2.2.2 The drivers of multinational growth

The growth of multinationals over the course of the nineteenth century was driven by a number of factors.

Firstly, the diffusion of modern economic growth created an accelerating search for raw materials and foodstuffs and for markets for manufactured products. The process which had begun with the Industrial Revolution in Britain intensified over time. The new capital-intensive industries such as chemicals, machinery, and packaged food products which grew towards the end of the nineteenth century were large consumers of raw materials. Chemicals and electricals production consumed large amounts of minerals such as copper, aluminum, and zinc. The automobile industry which appeared in the early twentieth century needed tin for solder and for the alloys used in bearings. In the late nineteenth century petroleum, initially used as kerosene for lighting and heating, began to be used as an alternative to coal to drive trains and steamships, while it was the only fuel that could be used in automobiles. While the United States had a rapidly increasing market and was rich in resources and land for growing food, European countries, including Britain, had to seek markets and resources across borders.

The policy environment was critical in the emergence of the modern multinationals also. While the absence of major international wars reduced the risks of cross-border business, the spread of international property law guaranteed property rights virtually worldwide. Seventeenth-century European governments had started the process of reducing the risks of trade by signing bilateral commercial treaties that protected alien property, but it was only in the nineteenth century that these treaty standards hardened into international law, the core principle of which was that the property of foreigners could not be taken without prompt, full compensation. Uncompensated seizure was considered robbery, and the use of unilateral force was considered a legal and legitimate response. The principles of this law were strongly supported by
p. 25 European governments, and enforced on ↳ much of the rest of the world by the British and, later, the United States. Western concepts of property rights were imposed through treaties, the securing of extraterritorial rights (especially at Far Eastern ports) and by the spread of colonial rule. Down to 1914, there were no large-scale **sequestrations** of foreign property (Lipson 1985).

As the nineteenth century progressed, liberal economic policies took hold in many countries as governments withdrew from economic activities. Government intervention was, by later standards, minimal. Most governments treated foreign-owned firms more or less like domestic firms. The growth of trade protectionism from mid-century represented a partial departure from liberalism. The McKinley Act of 1890 raised US tariffs to an average level on protected commodities of 50 percent. However, as governments sought to restrict foreign goods but not foreign companies—or people—this served to stimulate multinational manufacturing, as firms were able to respond to restrictions on their exports by opening factories in international markets instead.

Geographical distances were dramatically reduced by improvements in transport and communications. In 1800 land transport was based on dirt roads and water transportation. Both were slow and dependent on the weather. The international spread of railroads from the 1830s brought a new speed and reliability. The earliest railroads were built in Britain and the eastern United States in the 1830s, but their subsequent spread was rapid. During the first half of the century improvements in sailing-ship technology produced a sharp fall in ocean freight rates. From the mid-century the use of steamships also expanded. The opening of the Suez Canal in 1869 provided a shorter route between Europe and Asia. Sea journey times and costs continued to fall with the opening of the Panama Canal in 1915. By then, travel by ship across the Atlantic took only six days (Wilkins 2004). The result was a revolution in the speed and reliability that people and goods could be transported across distances, and a fall in the cost of such transportation.

There were major improvements in communications also. The telegraph was the most important nineteenth-century innovation. In 1852 London and Paris were joined by electric telegraph. The first successful trans-Atlantic cable connection was in 1866. In 1870 Bombay and London were linked by cable. The cable from Europe reached Australia in 1872. Information could now cross continents in minutes.

These transport and communication improvements opened new markets, and made the exploitation of natural resources in distant lands more feasible. Ores and metals could be shipped economically from Bolivia, central Africa, and Malaysia to the major markets in Europe and North America (Schmitz 1979). Before the nineteenth century the best chance of sustaining direct investments was if a government awarded a monopoly or special privileges. Improvements in transport and communications made it feasible, if still difficult, to manage cross-border operations.

Finally, the expansion of multinationals was facilitated by the appearance of new types of firms. In the eighteenth century most firms everywhere were small and family-owned. Owners were usually responsible for paying all of a firm's debts. There were high levels of volatility. The largest private enterprises of the eighteenth century were the European chartered trading companies. During the nineteenth century legal reforms permitted new forms of corporate governance. During the first half of the century many states in the United States permitted limited liability. Limited liability became fully available in Britain in 1861. p. 26 Earlier forms of corporate governance, such as partnerships, persisted, ↳ but limited liability facilitated capital raising, and opened the way for the growth of larger firms.

The subsequent emergence of the modern industrial enterprise was also important (see Box 2.4). The modern industrial enterprise came to play a central role in creating the most technologically advanced fast-growing manufacturing industry of each generation. Large corporations already accounted for most US multinational investment before 1914. However, much multinational business did not take this form (see Chapter 7).

Box 2.4 The rise of managerial capitalism

Chandler (1962, 1977, 1990) has described the emergence of the modern industrial enterprise in the nineteenth century. At the beginning of the century, production and distribution of goods all over the world was carried on by small enterprises whose managers were also the owners. Business enterprises in the nineteenth century normally operated a single unit of production or of distribution. The flow of goods between these enterprises was coordinated by the 'invisible hand' of the market. From the middle of the nineteenth century there was the development of large corporations administered by a hierarchy of salaried professional managers. Ownership was separated from control.

Chandler identified changes in technology and in markets as two crucial variables in explaining the shift from these personally managed enterprises to the modern corporation. The coming of modern transportation and communication in the nineteenth century—especially railroads, telegraphs, steamships and cables—made possible **mass production** and mass marketing for the first time. The first corporations with managerial hierarchies appeared in the United States in the 1850s and 1860s to coordinate the movement of trains and the flow of goods on the new railroad networks and messages over the new telegraph system.

Transportation improvements coincided with the development of new technologies in certain industries which permitted much greater reduction in cost per unit of output as volume increased. The first industries to secure these economies of scale included oil refining, metallurgy and food processing, where continuous flow techniques were applied. Mass production in turn required assured mass markets, with the result that manufacturing enterprises in these industries typically built their own extensive marketing organizations. In those industries that integrated mass production and mass distribution, managerial hierarchies emerged to provide a 'visible hand' to coordinate the flows of goods within the enterprise.

The large managerial enterprise which emerged in the capital-intensive manufacturing industries of the late nineteenth and early twentieth century achieved economies of scale from their size and integration and **economies of scope** from diversifying into new products and, eventually, countries. The success of individual firms depended on their organizational capability, which in turn rested on their willingness to make three interrelated investments in production facilities, marketing, and in management. Firstmover firms had considerable advantages over subsequent challengers. In many cases their industry quickly became and remained oligopolistic.

Chandler regarded the United States as the seedbed of **managerial capitalism**. It was the United States that took the lead in the creation of large corporations. The United States had many more and many larger managerial hierarchies than those of other nations. In Germany there was also a growth of large corporations in the capital-intensive industries, though family ownership and management was stronger. German firms also tended to collaborate in cartels. Chandler described this system as cooperative managerial capitalism. In Britain manufacturing firms remained smaller, and continued to be dominated by their founding families. Chandler argued that British **personal capitalism** caused a lag in that country's competitive abilities in the capital-intensive industries of chemicals, machinery and electric equipment. However, many historians dispute the view that family business was inherently less successful than managerial capitalism. Wardley (1991) also showed that large-scale companies did emerge in Britain particularly in the service sector.

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2.3 Globalization challenged and reversed, 1914–50

The outbreak of World War I in 1914 began a process which saw the beginning of the end of the first global economy. There had already been signs of a backlash against globalization in the previous decades. The most visible sign was the shift towards trade protectionism. By 1914 Britain, the Netherlands, and Denmark were the only free-trading countries left. There was also the beginning of a backlash against immigration. The United States began to attempt to control Asian immigration from the 1880s. In 1901 Australia implemented its 'White Australia' policy which virtually blocked immigration from Asia or the Pacific Islands.

The world economy became progressively unstable. There was a severe recession soon after the end of World War I in 1918, although countries such as the United States, Australia, Canada, Brazil, and India saw a rapid growth in manufacturing as a result of import substitution. The onset of the Great Depression in 1929 resulted in a worldwide economic shock. US real GDP fell by almost a third between 1929 and 1933. While much of the industrialized world in the 1930s experienced high levels of unemployment, declining primary commodity prices caused sharp falls in real incomes for the producer countries in Latin America, Asia, Africa, and Australia.

The backlash against the global economy was evident in multiple areas. The nationality of firms was identified as an issue during World War I, as governments sequestrated affiliates of enemy-owned companies in their countries (see Chapter 10). The Russian Revolution in 1917 was followed by the sequestration of foreign property. Russia had been a leading host economy for multinationals before World War I. Perhaps two-thirds of French and Belgium foreign investment had been located in that country. Singer Sewing Machines had built one of the largest modern industrial enterprises in Russia. All was now lost. The Soviets acknowledged a legal obligation to compensate foreign property owners, but only if Western countries paid for the damage their armies had caused after they intervened in the civil war which followed the Communist Revolution. Throughout the 1920s, the League of Nations (the predecessor to the United Nations) held conferences designed to clarify the obligations of host states to foreign capital, but the European states were unable to secure their aims in the face of resistance from Latin American and other 'peripheral' countries (Lipson 1985).

p. 28 Elsewhere, during the 1920s there was an increase in the growth of restrictions on foreign companies. By the following decade political nationalism was rampant. Xenophobic dictatorships ruled Germany, Italy, and Japan. Many governments of developing countries began to question foreign control over their natural resources. The Mexican **nationalization** of foreign oil companies in 1938 was a landmark event which asserted national sovereignty over natural resources.

During World War I the international monetary system was severely disrupted by inflation and the suspension of the Gold Standard. Though many countries returned to the Gold Standard in the mid-1920s, world finance and economic conditions had changed greatly. Countries both overvalued and undervalued their currencies in relation to gold, providing a further source of instability. Capital flows often assumed a speculative and short-term form. The war transformed Germany from a major creditor country to a debtor, whereas the United States emerged as the world's largest creditor. US foreign investment rose from $7 billion to $17 billion between 1919 and 1929, but—exceptionally for the United States—portfolio lending grew faster than FDI (Lewis 1938).

The Great Depression was followed by the collapse of the international financial system. The repatriation of the large amounts of American portfolio lending from Europe provoked a major financial crisis in central Europe and Germany in 1931. The Gold Standard was fatally undermined when Britain abandoned it in September of that year, followed by the United States two years later. Regional currency blocs developed, each supported by extensive exchange controls. A US Dollar area included Latin America; a Sterling bloc included most of the British Empire and some northern European countries; a German bloc extended over parts of central Europe; a Yen bloc included parts of Asia; and a residual 'gold bloc' included France and some other Western European countries. In this environment, cross-border capital flows fell sharply, and were largely confined within currency blocs (Kenwood and Lougheed 1992).

After World War I, trade protectionism spread. By the early 1920s, US tariffs had been raised to their highest-ever levels by the Fordney-McCumber tariff. Australia, India, and some Latin American countries were among those that used tariffs, import quotas and other trade barriers to help infant industries and foster their manufacturing sectors by import substitution. International trade recovered from the wartime nadir during the 1920s: by the end of that decade the ratio of world trade to world product had probably returned to its 1913 level (Kenwood and Lougheed 1992). But the Great Depression led to the collapse of the international trading system. The Smoot-Hawley Act of June 1930 substantially increased the US tariff level, and other countries followed in the classic 'beggar my neighbor' pattern. By the end of the 1930s almost half of the world's trade was restricted by tariffs.

It was physically easier for human beings to travel and communicate. Automobiles became an item of mass consumption, at least in the United States. Telephone systems spread. Air travel became faster, safer, and more regular. However, the backlash against the global economy was particularly strong in the area of migration. During World War I many countries, including the United States, made the use of passports for entering and leaving countries compulsory for the first time. Work restrictions dated from the same period. In 1917 the United States required foreign nationals to have visas issued by US census offices. In 1921 an
p. 29 Immigration Act reduced the annual number of immigrants ↳ from over one million to a maximum of 357 803. The maximum number of immigrants from any nationality was set at 3 percent of the foreign-born of that nationality residing in the United States in 1910. In 1924 a further act set a quota of 2 percent and took the base year back to 1890. This was before the large southern and eastern European immigration of the 1890s and 1900s. All Asians had been excluded in 1917 (James 2001).

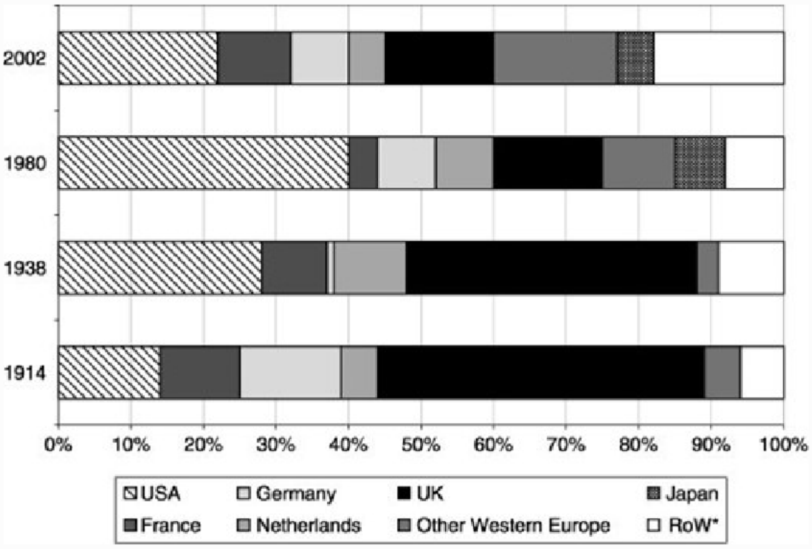
During the interwar years the first global economy disintegrated. Between 1914 and 1950 the commodity price gaps between continents reverted to their 1870 levels. Capital markets reverted to market segmentation (Obstfeld and Taylor 2003; Lindert and Williamson 2003). Mass migration fell sharply. The annual migration rate to the United States fell from 11.6 immigrants per thousand population in the first decade of the twentieth century to 0.4 immigrants per thousand population in the 1940s (Chiswick and Hatton 2003).

2.3.1 Multinationals during the Great Depression and world wars

Multinationals continued to operate, and even to expand, as the first global economy disintegrated. However, there were some major shifts in response to the stocks of the era. The United States emerged from World War I as the most dynamic direct investor in the world economy, though its stock remained well below European levels. US FDI almost doubled in the 1920s. In contrast German FDI all but disappeared following its sequestration during and after World War I by the victorious Allies. The sequestration of foreign capital in Russia in 1917 not only eliminated a large share of total French and Belgian FDI, but dampened new multinational investment from those countries. In 1938 the estimated total world stock of FDI was around $26 350 million. The United States, Britain and the Netherlands together may have accounted for over three-quarters of the total amount (see Box 2.2).

Box 2.2 The geographical distribution of world FDI, 1914–2002

Box Fig. 2.1



Stock of outward FDI by home economy 1914–2002 (% total world outward FDI).

* Rest of the world, includes Japan for 1914 and 1938

(*Source*: Dunning 1983, 1988a, 1992; Stopford and Dunning 1983; United Nations 1993; UNCTAD 2003.)

The Great Depression and its aftermath finally halted the overall growth of world FDI. **Exchange controls** were a major disincentive to engage in new FDI, as dividends and profits could not be repatriated, though they could give rise to 'enforced investment' as funds that could not be repatriated were ploughed back into business. This helps to explain the almost 50 percent increase in the level of US FDI in Germany between 1929 and 1940 (Wilkins 1974a). A picture of stagnation emerges for the only economy for which FDI estimates exist, the United States. The stock of **outward** US FDI fell, though **inward** FDI into the US between 1935 and 1940 may have risen from $1.6 billion to $2.9 billion (Lipsey 1988). The ratio of FDI to total US output tumbled from 4.7 percent to 1.4 percent between 1914 and 1929, but may have climbed back to 3.2 percent by 1939 (Wilkins 2004).

Even during the 1930s there were exceptions to stagnation. There remained opportunities for multinational growth in markets protected by high tariff barriers. Falling world food and raw material prices caused cheaper imports and higher real incomes in some countries, at least for the proportion of the working population which remained in employment, and this created growing markets for new consumer products like vacuum cleaners and refrigerators, and processed food products. Although international trade slumped in the 1930s, some multinational trading companies found rich opportunities. Japan's large trading companies grew alongside Japanese exports, opening up new ↳ markets in Latin America, the Middle East and the **Soviet Union**, and creating 'global sales networks' (Kawabe 1987).

World War II and the immediate aftermath saw—not surprisingly—little new multinational investment. Both sides in the conflict sequestrated the assets of the other. The entire stock of German and Japanese FDI was lost. The spread of Communism to eastern Europe in the late 1940s, and to China in 1949, resulted in further falls in the stock of FDI as those countries progressively nationalized privately owned firms, foreign and domestic. The United States was the only country to significantly increase its actual FDI during the war, yet this was dwarfed by the dramatic growth of the domestic economy. The ratio of inward FDI to total US output was around 1.3 percent by 1945 (Wilkins 2004).

The numbers of multinationals which were large hierarchical corporations continued to grow in the interwar years. Their operations became more complex, involving more countries and more products. New US industries became involved in multinational expansion on a substantial scale for the first time, notably automobiles, food, and consumer chemicals (Wilkins 1974a). There were further developments in corporate organization. In the United States, a number of large corporations including Du Pont, General Motors (GM), and Standard Oil of New Jersey responded to the managerial problems caused by scale and diversification by moving from centralized or wholly decentralized organizations towards semi-autonomous product divisions. This **multidivisional structure (M-form)**, which was spread rapidly through US industry, combined coordinated control, implemented through financial reporting and capital allocation, with sufficient decentralization to make further product and geographical growth possible. The M-form had the capacity to manage scale and complexity by separating strategy from operations (Chandler 1962). Both GM and Standard Oil of New Jersey were major US multinational investors in the interwar years.

There was no clear-cut correlation between the spread of the M-form and the further growth of multinationals. Most US corporations had still to adopt the M-form in the interwar years. Ford, which had extensive multinational operations, remained personally managed by its owner, Henry Ford. Some scholars have now questioned whether, even at GM, the M-form worked in practice as it was described in theory (Freeland 2001). Nor can it now be seen as a uniquely American phenomenon. It is evident that German companies, including the steel firm Thyssen, had developed a similar organizational form before World War I (Fear 2004).

The biodiversity seen in the organization of multinationals persisted. It does seem that the creation of new free-standing firms fell greatly. Many European free-standing firms active in the United States disappeared or passed into local ownership during and after World War I. In Latin America, a swathe of British free-standing firms were acquired by US companies. Yet in some sectors (such as banking and utilities) and some regions (such as Southeast Asia and Africa) the free-standing type structure survived. Some networks of loosely coordinated firms evolved tighter organizational structures over time (Greenhill 1995). Even a new generation of free-standing firms appeared on the New York stock market as US investors floated companies that owned sugar plantations and mines in Latin America (Wilkins 1993a; Hennart 1994b).

The macroeconomic conditions of the interwar years, and the heightened risks of investment, also
p. 31 encouraged entrepreneurs to pursue collaborative strategies as an ↳ alternative to FDI. Numerous international cartel agreements were formed in both manufacturing and natural resources, as firms sought to maintain prices in conditions of overcapacity. In many developed countries merger waves had led to the creation of larger firms. Collusive behavior on an international scale was made much easier by the existence of oligopolistic and cartelized domestic markets, as it was far easier to organize industries when there were only a handful of major corporations than in a situation of hundreds or thousands of competing firms.

After 1930, multinationals were less drivers of global integration, than part of the process of disintegration. International cartels restricted flows of international trade, although there is some evidence that they continued to provide a channel for flows of knowledge (see Chapter 4). Although extensive multinational operations remained in place, they functioned in more 'national' ways. Trade barriers and exchange controls led to the increased autonomy of national affiliates, which increasingly became responsible for most of the value-added chain of their products. Nationalism encouraged firms to strengthen their 'local' identities in their host economies. In Europe, US companies such as IBM, Ford, and GM responded to European competition by developing new products for major markets which were distinct from those produced for their domestic American market.

2.4 Restoring a global economy, 1950–80

The 1950s onwards saw the beginning of the reconstruction of a new global economy. Between 1950 and 1973 the annual real GDP growth of developed market economies averaged around 5 percent. This growth was smooth, with none of the major recessions seen in the interwar years. World War II left the United States in a uniquely powerful position. While Europe and Asia had experienced extensive destruction and loss of life, no battles had been fought on the soil of the United States. The US dollar became the world's major reserve currency. US corporations assumed leading positions in many industries. Europe and Japan had to spend the immediate postwar decade undergoing extensive reconstruction, heavily dependent on official aid from the United States, yet over time Europe and Japan closed the technological and productivity gap with the United States. The emergence of a US deficit on its balance of trade in the 1960s, and the devaluation of the US dollar, and the end of its convertibility into gold in 1971, provided symbolic signs of the ending of an era.

There remained many restrictions on the flow of capital, trade, and people across borders. Foreign companies were entirely excluded from the Communist world. In the twenty years after 1945 the European colonial empires were dismantled. In some cases, decolonization was followed by an aggressive reaction against the businesses of the former colonial power, and sometimes all foreign investment. The relatively small number of expropriations without compensation until the late 1960s—when a period of large-scale expropriation began—reflected the power and determination of the United States to protect foreign investments, but Western countries were unable to re-establish an international legal regime which p. 32 guaranteed the property rights of international ↳ investors. Even in the developed countries, receptivity towards multinationals fell. In Europe and the United States, whole sectors were closed to foreign companies. The Japanese economy grew so fast that it had become the world's second largest capitalist economy by the 1970s, but its governments systematically discouraged wholly owned FDI, and restricted it to a low level (see Chapter 8).

During the 1940s and early 1950s only the US dollar was available as a major convertible currency. Elsewhere exchange controls regulated capital movements. They were often the instruments used by governments to screen or monitor FDI flows. The worldwide controls over capital movements were related to balance of payments concerns and the system of fixed exchange rates established at Bretton Woods. It was not until 1958 that most European countries adopted nonresident convertibility, which permitted foreigners to move funds for current account purposes freely from one country to another. This was the key development in the establishment of a liberal and open international economy. It had an immediate impact on FDI flows, with an increase of US FDI into Europe (Wilkins 1974a). However, most developing countries continued to exercise tight controls over capital movements. Even most developed countries retained some exchange controls.

It was only after the collapse of the Bretton Woods system of fixed exchange rates in the early 1970s that controls over capital movements began to be slowly dismantled. The advent of floating exchange rates permitted a huge explosion in international financial markets from the 1970s, but these capital flows were different than before 1914, for they largely occurred between rich countries. In 1900 Asia, Latin America, and Africa had accounted for 33 percent of global liabilities. In the 1990s, they accounted for 11 percent (Obstfeld and Taylor 2003).

World trade barriers were reduced under the auspices of the General Agreement on Tariffs and Trade (GATT) signed in 1947. This process peaked in the 1960s, when the Kennedy Administration in the United States made major efforts to secure radical reductions in tariff rates. During the middle of this decade there was a comprehensive reduction of barriers to trade in manufactured goods. By the end of the 1960s, however, the US-inspired drive for trade liberalization showed a loss of momentum, as US balance of payments deficits began to cause concern about the scale of foreign imports. Nontariff barriers spread in the following decade. Most developing countries in Latin America, Asia, and Africa became progressively closed to international trade from the 1950s to the 1980s. Even the richest and most developed countries maintained very high levels of protection for agricultural products, far higher than before 1913 (Findlay and O'Rourke 2003).

The formation of regional trading blocs was both a part of the process of reducing trade barriers and a limitation on it. The European Economic Community (later known as the EC, and, from 1993, the **European Union**) was formed in 1957, and initially consisted of six Western European countries. It developed common tariffs against external imports. An extreme case was the Common Agricultural Policy, adopted in 1966, which severely restricted US agricultural exports to Europe. However, within Europe, free trade was established between the member countries, even though nontariff barriers persisted. The creation of such a large 'Common Market' attracted many US companies to Western Europe.

p. 33 Technology made it easier than ever before for companies to move people, knowledge, and goods around the world. There were new waves of innovations in transport and communications. In 1958 the first commercial jet made an Atlantic crossing. This was followed by a phenomenal increase in air traffic. The development of telex was a considerable advance over telephones in facilitating international communications and coordinating of multinational business. In 1965 the first satellite for commercial telecommunications was launched. During the 1970s the use of the facsimile machine took off. The movement of goods across the world was facilitated by the development of larger ocean-going ships or super-freighters, and the growth of containerization.

The flow of migrants across borders remained constrained by immigration policies. Although the number of migrants were considerable—there were 3.2 million immigrants to the United States in the 1960s—they were much smaller relative to the host population than in the early twentieth century. The proportion of foreign-born in the US population was less than 5 percent in 1970. There was also a major shift in the geographical source of emigrants. Europeans were much less important, although they moved within their home region. The proportion of Europeans and Canadian to total immigrants in the United States fell from 78 percent in the 1940s to 13 percent in the 1980s. Over the same decades the proportion of Latin Americans rose from 18 percent to 47 percent, and the proportion of Asians from 4 percent to 37 percent (Chiswick and Hatton 2003).

By 1980, the integration of worldwide capital, commodity and labor markets remained limited compared to the late nineteenth century.

2.4.1 The resumption of multinational growth

The expansion of the world economy prompted a recovery in the growth rate of world FDI. The system of international cartels was dismantled. By 1960 the world stock of FDI had reached $60 billion. By 1980 it was over $500 billion. These were the decades when the term 'multinational' was invented, and when economic theorists turned their attention to explaining their existence.

Between 1945 and the mid-1960s the United States may have accounted for 85 percent of all new FDI flows. By 1980 it held 40 percent of total stock. In the twenty years after the end of World War II both German and Japanese FDI remained low, but growth during the 1970s gave the two countries an overall share of world FDI of 8 percent and 7 percent respectively. The German share finally surpassed that of the Netherlands by that date. By 1980 almost two-thirds of world FDI was located in Western Europe and North America. Latin America and Asia had declined very sharply in their relative importance as host economies. By 1980 there was no multinational investment in China, and almost none in India. Even Japan in that year accounted for less than 1 percent of world inward FDI stock.

The relative shift of world FDI to Western Europe and North America reflected the many barriers to foreign multinationals elsewhere. In agriculture and mining, and later in petroleum, foreign firms lost the ownership of production facilities in many countries, even if they remained very powerful in the transportation, processing, and marketing of commodities. By 1980 manufacturing FDI was larger than the natural resource and service sectors combined. In services, while transport and utility investments were no p. 34 ↳ longer important, from the 1960s multinational banks, trading companies, and international commodity dealers began rapid international expansion.

As suggested in Figure 2.1, there were two different trends evident in this era. On the one hand, much of the multinational investment dating from the first global economy in resources and utilities was swept away. The high levels of integration seen in many commodities was broken by nationalizations and other forms of government intervention. Formerly large host economies including Russia, China, and even India—which retained a quasi-capitalist economy—were isolated from the world economy. On the other hand, new types of firms expanded abroad. These included management consultants which transferred knowledge across borders, and fast food restaurants and hotels, which transferred lifestyles. They were particularly important in diffusing US management and marketing techniques to other economies, although they were typically adapted in their new hosts. In Europe, firms also began to respond to European integration by building European-wide organizations, and integrating previously autonomous national subsidiaries (see Chapters 4 and 5).

By 1979 the overall size of multinational investment was still smaller in relation to the world economy as a whole than in 1914. This reflected the barriers to foreign ownership erected in many countries, and in many sectors, such as utilities, and the disappearance of the hugely capital-intensive investments in mining and petroleum. During the first global economy, much of the growth had been driven by the exchange of manufactured goods made in the developed world for the resources found elsewhere. The emergent new global economy was driven by trade, investment, and knowledge flows between Europe, North America, and Japan.

2.5 The new global economy: borderless, regional, or semiglobal?

During the 1980s the pace of globalization intensified. By then the overwhelming influence of the United States on the world economy had given away to a situation whereby wealth was distributed more equally between the Triad of North America, Western Europe, and Japan, which accounted for around three-fourths of world manufacturing production. Paradoxically, the United States became the single 'superpower' following the end of the Cold War. Although the importance of the Triad in the global economy persisted or even grew after 1980, there were significant shifts. Japan's share of world manufacturing increased from 5 percent in the early 1960s to 20 percent thirty years later, but thereafter the Japanese economy stagnated for a decade in the wake of the collapse of its speculative 'bubble economy'. In contrast, during the 1990s the United States experienced a surge of growth, apparently driven by the productivity gains of a 'New Economy' associated with a boom in Internet and other high technology companies. This growth also ground to a halt at the end of the decade. The twenty-first century began with a major recession, scandals over auditing irregularities in large firms, major acts of international terrorism, and war.

National restrictions over cross-border capital flows were largely swept away as financial deregulation spread. The most striking changes were in emerging markets. Countries p. 35 ↳ abandoned state planning and import substitution and sought export-led growth. Multinationals were increasingly seen as a means to develop new technologies, products and skills. China's adoption of market-oriented policies in 1979 is the appropriate chronological starting point for the new, or second global economy. The collapse of Communism in Russia and eastern Europe a decade later reopened further huge parts of the globe to foreign firms. Deregulation and privatization opened further opportunities, including in services such as air transport, tourism, and telecommunications which had long been closed to foreign companies. Multinationals now faced few risks of expropriation, but the international property rules of the nineteenth century were not restored. In China, eastern Europe, and elsewhere, multinationals faced enormous uncertainties regarding their legal rights and the enforcement of contracts.

However, governments did not withdraw from the market for capital flows in the way they had before 1914. Practically every government on the planet offered incentives for multinationals to invest. There also continued to be barriers to multinational investment in many resource and service industries (see Chapter 8). Although only some developing countries had exchange controls, world exchange markets continued to see continual and sometimes massive intervention in efforts to influence exchange rates.

A worldwide trend towards tariff reduction made possible further growth in trade, and deeper levels of economic integration. By the end of the century, tariffs on manufactured goods were lower than in 1913, although this was not true for a number of populous developing countries, including India and China. Nontariff barriers also fell from the late 1980s. However, there was no return to nineteenth-century free-trade. International trade in many commodities was distorted by tariffs and subsidies. Both the United States and the EU gave their farmers huge subsidies to grow cotton, oils, and many other commodities rather than import the much cheaper products of developing countries. The rich countries were also quite prepared to erect tariffs if domestic vested interests seemed threatened. The United States heavily protected its domestic textile industry, and in 2003 imposed 'emergency' tariffs to protect its steel industry.

In part, falling tariffs reflected the further growth of regional trading blocs. The EU was enlarged in 1973, 1981, 1986, 1995, and 2004. Barriers to the movement of goods and services within Europe declined sharply, and over time, barriers to the movement of capital and people were also removed. EU law took precedence over that of member states. In 2002, twelve members of the EU even abolished their national currencies and adopted the new Euro currency. The United States, Canada, and Mexico formed the North American Free Trade Agreement (NAFTA) in 1994, although this remained primarily a free trade area. In the following year the Mercosur customs union was launched by Brazil, Paraguay, Uruguay, and Argentina.

The real costs and risks of managing at a distance were sharply reduced by changes in communications and transport technologies. Developments in information technology revolutionized communications. The use of 'geo-stationary' satellites, which orbited the earth at heights of between 12 000 and 25 000 miles, permitted simultaneous cheap voice, data, and video links worldwide. Optical fiber cables provided an alternative means of transmitting very large volumes of information at very high speeds. The 1980s saw the appearance of the personal computer (PC).

 The Internet began to be created after 1969 through the interlinking of computer networks in the United States, but it remained exotic for several decades. In 1990 the World Wide Web was born when a researcher at CERN, the high-energy physics laboratory in Geneva, Switzerland, developed hypertext markup language (HTML). Four years later the Internet was formally separated from the US government's auspices and became open to commercial activity. The number of Internet users in the United States increased from 6 million to 159 million between 1993 and 2002. There was a rapid worldwide diffusion. The number of Internet users in China increased from 2000 to 59 million over the same period, although in sub-Saharan Africa there were only 6.2 million by 2002 (http://devdata.worldbank.org).

Although information could cross borders almost instantaneously, people could not. There remained tight restrictions on migrant flows. The majority of immigrants to developed countries during the 1980s and 1990s were admitted through family reunification schemes or as refugees (Chiswick and Hatton 2003). Although both Europe and Japan had ageing populations combined with birth rates falling below replacement rates, there were few pressures on governments to relax controls, and xenophobic reactions to ethnic minorities became more rather than less frequent. However, diaspora formed a dynamic component of the global economy (see Box 2.5). There was also considerable illegal migration, especially from eastern Europe and Latin America. Emigrant remittances grew as important components of global capital flows. In 2003 estimated emigrant remittances to Latin America and the Caribbean reached $38 billion. This was more than the total of inward FDI and official aid (*Financial Times*, 26 March 2004).

Box 2.5 Diaspora and globalization

Originally the term diaspora referred specifically to the Jewish population exiled from Judea in 586 BC by the Babylonians, and in AD 235 by the Romans. The Jewish diaspora became one of the oldest, although following the Holocaust in Nazi Germany and the creation of the state of Israel in 1947, the Jewish population became more concentrated. In 2000 there were around 13 million Jews worldwide; 4.6 million lived in Israel, and 6 million in the United States. In recent decades diaspora has been used more widely to refer to any people or ethnic population which left their traditional and ethnic homelands and became dispersed throughout other parts of the world. The largest diaspora include Africans, Armenians, Chinese, Greeks, Lebanese, and Indians.

The networks established by diaspora communities have been important drivers of international business. During the late nineteenth century the Greek diaspora spread over the Mediterranean and Russia was active in wide-ranging international commercial and shipping business. About 600 000 Greeks lived in southern Russia in the first decade of the twentieth century. This community engaged in a wide range of commercial activities, creating a cosmopolitan business network based on kinship ties extending over central Europe and reaching even France and Britain.

Between the sixteenth and nineteenth centuries a Chinese diaspora developed through emigration to southeast Asia. Their ancestors form significant minority populations in the modern states of Malaysia, Indonesia, Thailand, and elsewhere, and a majority of the population of Singapore. More recently Chinese emigration has been directed primarily to the United States and Canada. There are currently an estimated 35 million ethnic Chinese living abroad.

The Chinese diaspora has never been homogeneous. It is divided into different language groups, such as Hokkien and Cantonese. In Southeast Asia (especially Thailand), ethnic Chinese adopted local names and speak the local language. Ethnic Chinese became prominent in commerce and finance, often dominating the business sectors of their host Southeast Asian countries. Family and dialect links enabled ethnic Chinese merchants to operate across borders throughout Asia. After 1980, ethnic Chinese firms based in Hong Kong and Taiwan, and later elsewhere, became the leading foreign investors as China liberalized its economy. They enjoyed connections (*guanxi*) in China, which reduced the transactions costs of investment by offering contacts with public authorities and inside information, and were welcomed by the Chinese government.

The modern Indian diaspora was a product of nineteenth-century British imperialism. Beginning in the 1840s, indentured laborers were transported from India to the British Caribbean, where they filled a gap left by the abolition of slavery. Subsequently they settled in South Africa, as workers in the sugar cane fields of Natal. Indian merchants became prominent in British colonies in Southeast Asia and East Africa. Sindhi, Gujarati and Punjabi merchants had extensive businesses throughout Southeast Asia in the interwar years. After Indian Independence in 1947, there was significant migration to Britain. Around one million ethnic Indians lived in Britain by the end of the century. During the 1990s there was an annual influx of 30 000–45 000 primarily professional Indian emigrants into the United States, which became prominent in the IT, professional, commercial, and academic sectors. Overall, there are currently an estimated 20 million ethnic Indians living outside India.

Overseas Indians were much less prominent as investors in India than their Chinese counterparts. They were less numerous, more of a professional group, and often lacked the family network connections and financial resources to invest in India. In 2003 the Indian government announced it would grant dual nationality to some overseas Indian residents abroad in order to encourage greater investment from this source.

(*Source*: Minoglou and Louri 1997; Brown 1994, 2000; Rauch 2001; McCabe, Harlaftis, and Minoglou, 2005.)

p. 37 The pressure on rich countries to permit higher immigration was relaxed because technological change permitted companies to export jobs to locations with lower labor costs rather than import workers from such countries. From the 1990s there was a growth in offshoring, involving the relocation of labor-intensive service industry functions from rich countries to remote locations with skilled workforces but much lower wages. Among the functions to be offshored first were back-end processing, call centers, accounting, and software maintenance and development. The geographical flows of offshoring were heavily influenced by language. US businesses dominated the global share of offshoring, and British companies accounted for much of the remainder. It was located mainly in countries where English was the main business language, especially India, but also the Philippines and Israel.

The benefits of global capitalism were not spread evenly between nations and within nations. For many citizens in North America, Europe, and Japan, human indicators such as life expectancy continued to
p. 38 improve. Rapid income gains were also experienced by ↳ some East and Southeast Asian economies. The lead was taken by the 'four tigers'—Hong Kong, Singapore, South Korea, and Taiwan—which from the 1960s achieved high rates of economic growth and structural transformation. Between 1966 and 1990 Singapore grew by an average 8.5 percent per annum, or three times as fast as the United States. The 'four tigers' were followed by a second wave of Asian economies, including Malaysia and Thailand, although a major currency crisis in 1997, which began in Thailand, provided a major shock. Subsequent currency crises in Russia in 1998 and Argentina in 2001 demonstrated the vulnerability of the global system to such shocks.

The sustained growth of the Chinese economy marked the most important shift of economic power in the new global economy. China's real GDP between 1979 and 2003 grew at 9 percent per annum. China's re-entry into the global economy had profound implications for the rest of the world. By 2004 China's steel production was larger than the United States and Japan combined, and the country had become the world's second largest importer of oil after the United States. Foreign trade growth averaged almost 15 percent between 1979 and 2003. In 2001, by which time China's GDP was larger than that of Italy and approaching the size of France and Britain, the country joined the WTO. China was by then the largest manufacturer in the world of many products, including DVD players, cellular phones, desktop PCs, cameras, and refrigerators. However, China's GDP per head, at purchasing power parity, was only one-sixth that of the United States in 2004. After 1991, policy liberalization in India was also followed by a more gradual but significant improvement in that country's economic performance (Bhalla 2002).

There were also visible losers. While globalization was good for Asia, most of Africa experienced declining incomes. In the 1990s half of Africa's population lived in absolute poverty. While some Latin American countries including Chile appeared to benefit, others such as Argentina were rewarded for their participation in the global economy by economic crisis and the threat of social meltdown. At the end of the twentieth century most of the world's population beyond Western Europe and East Asia lived in countries where income levels were a lower percentage of the US level than in 1950 (Crafts and Venables 2003). Some scholars ascribed this situation to poorly functioning institutions which were hard to change because of embedded customs and traditions (North 1990). Others pointed to the downsides of globalization. Economic restructuring, liberalization and competition led to increased insecurity and impoverishment for some. Even in developed countries workers with few skills, and even skilled industrial and white-collar workers, faced uncertain futures (Streeten 2001).

Unlike the first global economy, a substantial part of the world was left out of the globalization process. Most economic activity was concentrated in North America, Europe, and East Asia. Rugman (2000) talked of 'regionalization' of production rather than globalization. Ruigrok and Tulder (1995) preferred the term

‘Triadization’. Ghemawat (2003), stressing the incomplete nature of cross-border integration, opted for ‘semiglobalization’.

2.5.1 Multinationals and the new global economy

Multinationals became the leading driver of the integration of the global economy. During the 1980s the p. 39 average annual growth rate for FDI outflows reached 14 percent. ↳ Between 1996 and 2000 it reached 40 percent per annum. This was far faster than both the annual growth of world exports (4.2 percent) and of world output (1.2 percent). The huge sums of multinational investment were the result of cross-border mergers and acquisitions which had become the principal vehicle for FDI. These were driven by the new opportunities for globalization, Internet-related technological change, and the very high levels of stock valuation seen in global equity markets. The total stock of world FDI reached $6.8 trillion by 2001, before stagnating over the following two years as world share prices fell.

In 2004 the United States remained, by a considerable margin, the largest home economy. Yet the once-dominant trio of the United States, Britain, and the Netherlands only accounted for two-fifths of world FDI stock. German, French, and other European firms also held large shares of FDI. The surge in Japanese FDI, which had begun in the 1970s, increased rapidly following a sharp appreciation of the yen in 1985. Japan held almost 13 percent of world FDI in the early 1990s, but a decade later this share had fallen to 5 percent. There was also a relatively small amount of FDI from emerging markets, including South Korea (see Chapter 9).

The stock of multinational investment remained largely located in North America and Western Europe, but there was a striking rise of flows into China. For much of the 1990s China was the second largest recipient of FDI worldwide after the United States. This sum did not include Hong Kong, which reverted from being a British colony to part of the People's Republic of China in 1997, albeit administratively distinct for fifty years. From 1979 until 2000 China absorbed, on a cumulative basis, over $346 billion of FDI (Huang 2003). Although inward FDI only represented around 5 percent of Chinese GDP during the second half of the 1990s, and amounted to less than one-seventh of total investment, foreign multinationals accounted for one half of gross exports. In India, the amount of FDI was so small even after 1991 that it had little impact on overall growth. However, Indian diaspora may have been significantly directing **outsourcing** opportunities to their country of origin. The fast development of the IT industry in Bangalore has been attributed to business linkages with Indians working in Silicon Valley (Carana Corporation 2004).

While services represented around a quarter of the total world stock at the beginning of the 1970s, they accounted for at least one half by 2000. Although there are a large and diverse group of service sector activities, 85 percent of service FDI was in trade-related activities and financial services. The same percentage of the stock was located in developed countries, where they took advantage of the growing demand for consumer services from rising real incomes, the growing technological, information and knowledge component of many activities, and the new opportunities offered by deregulation and liberalization.

By 2004 if the level of world FDI was related to the world output, the globalization of international business was approaching that obtained before World War I. Corporations had a much greater flexibility to locate different parts of their value-added activities in different parts of the world. Production of goods and services became internationalized at a deeper level than in the past. A striking manifestation of these trends was a rapid growth of **intrafirm trade** in manufacturing, especially in high technology industries such as p. 40 automobiles and machinery which had experienced the greatest rationalization on a ↳ world scale. In 1970 intrafirm trade was estimated to account for around 20 percent of world trade. By 2000 the share was over 40 percent. Multinationals were the drivers of world trade growth.

As the integration of international production by multinationals proceeded, organizational forms evolved. Although in many industries giant corporations were created by mergers, boundaries of firms also became more porous, as they had been in the first global economy. During the 1970s and 1980s many large US and European-owned M-form corporations suffered from growing managerial diseconomies caused by size and diversification. Large corporations, although spending large sums on R & D, experienced growing problems achieving successful innovation (Christensen 1997). The result was a general trend towards divestment of ‘non-core’ businesses, outsourcing of many value-added activities once performed within corporate borders, and the formation of many alliances with other firms, which acted as suppliers and customers, or as partners in innovation. The new global economy was complex. Large corporations were powerhouses of innovation spending and market power. Yet the economy could also be seen as a ‘worldwide web of interfirm connections’ (Mathews 2002).

It remained less evident that the global economy had spawned a multitude of ‘global firms’. Trade flows remained more regional than global. Only a handful of large multinationals really operated on a ‘global scale’. In most instances, firms continued to generate a high proportion of their revenues from their home regions. A study of the 500 largest companies in the world in 2000 identified 380 for whom the geographical distribution of sales existed. Defining ‘global’ as a firm having 20 percent of its sales in each three parts of the Triad, but less than 50 percent in any one region, Rugman and D'Cruz (2000) could only find nine ‘global firms’. These were mostly in the computer, telecom, and high-tech sectors, such as IBM, Sony, and Intel, but included Coca-Cola. In the new global economy, one study concluded, the multinational was a ‘national corporation with international operations’ (Hu 1992). As global competition intensified, geography and location remained central to corporate strategy.

SUMMARY

Globalization has a long history. However, the flows of people, trade, and capital across borders has not been a linear one, but one with major ebbs and flows. The process accelerated rapidly in the nineteenth century as technological change resulted in sharply falling transport and communication costs. The spread of modern economic growth following the Industrial Revolution created a worldwide search for markets and raw materials. Imperialism forcibly overcame resistance to the spread of global capitalism. By 1914 a remarkably integrated global economy was in place. Entrepreneurs and firms were the drivers of this integration. Chapters 3, 4, and 5 will examine in closer detail how their strategies were pursued in different sectors, Chapters 6 and 7 will show how they built organizations which could manage operations over distance.

Beginning with World War I, the first global economy was progressively destroyed by political and economic shocks. Much European FDI was eliminated through wartime sequestration and the Russian Revolution. Barriers to the mobility of people were erected which have never been removed. Barriers to investment and trade grew to dramatic heights. Multinationals proved flexible. Many existing organizations remained intact, although there was not a great deal of new investment during the 1930s and 1940s. Multinationals
p. 41 responded ↳ to the new environment by becoming more ‘national’ in their operations. They also entered numerous cartel agreements to control prices and restrict output.

Between the 1950s and 1970s there was a rebuilding of the global economy. Trade barriers and exchange controls, if not immigration controls, were removed between North America and Western Europe. However, China, Russia, and other Communist countries remained entirely divorced from global capitalism, and many developing countries erected barriers against it. The very large amounts of multinational investment in resources and related services in developing countries dwindled in importance through localization and nationalization. There were worldwide restrictions on multinational investments in many services. The

Japanese ‘economic miracle’ of these years included the explicit exclusion of foreign firms. However, multinationals also resumed strategies of integrating economies by building regionally integrated businesses in Europe. Service providers diffused knowledge from the United States to the other capitalist economies.

From the 1980s the integration of global capital and commodity markets intensified. Multinational investment drove this process. Its importance to world output finally surpassed that reached in 1913. By the new century two-fifths of world trade alone was intrafirm. Multinationals were the primary drivers of the integration of China into the world economy. However, the influence of location and geography seemed as strong as ever. As Chapters 9 and 10 will explore, multinational investment remained extremely unevenly spread around the world.

There were always winners and losers as global capitalism spread. In the eighteenth century a booming Atlantic economy created lucrative opportunities for merchants, some of whom grew rich transporting African slaves across continents. In the late twentieth century China boomed, but incomes in Africa fell. Later chapters will explore how far the strategies of multinationals explain the pattern of winners and losers
p. 42 from globalization. ↳