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What is Globalization?

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Globalisation refers to the integration of markets in the global economy. Markets where globalisation is particularly common include financial markets, such as capital markets, money and credit markets, and insurance markets, commodity markets, such as markets for oil, coffee, tin, and gold, and product markets, such as markets for motor vehicles and consumer electronics.

Why has globalisation increased?

The pace of globalisation has increased for a number of reasons:

Developments in ICT, transport and communications have accelerated the pace of globalisation over the past 30 years. The internet has enabled fast and 24/7 global communication, and the use of containerisation has enabled vast quantities of goods and commodities to be shipped across the world at extremely low cost.

Increasing capital mobility has also acted as a stimulus to globalisation. When capital can move freely from country to country, it is relatively straightforward for firms to locate and invest abroad, and repatriate profits.

The development of complex financial products, such as derivatives, has enabled global credit markets to grow rapidly.

Trade has become increasingly free, following the collapse of communism, which has opened up many former communist countries to inward investment and global trade. Over the last 30 years, trade openness, which is defined as the ratio of exports and imports to national income, has risen from 25% to around 40% for industrialised economies, and from 15% to 60% for emerging economies.[1].

The growth of multinational companies (MNCs) and the rise in the significance of global brands like Microsoft, Sony, and McDonalds, has been central to the emergence of globalisation.

The advantages of globalisation

Globalisation brings a number of potential benefits to international producers and national economies, including:

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Providing an incentive for countries to specialise and benefit from the application of the principle of comparative advantage.

Access to larger markets means that firms may experience higher demand for their products, as well as benefit from economies of scale, which leads to a reduction in average production costs.

Globalisation enables worldwide access to sources of cheap raw materials, and this enables firms to be cost competitive in their own markets and in overseas markets. Seeking out the cheapest materials from around the world is called global sourcing. Because of cost reductions and increased revenue, globalisation can generate increased profits for shareholders.

Avoidance of regulation by locating production in countries with less strict regulatory regimes, such as those in many Less Developed Countries (LDCs).

Globalisation has led to increased flows of inward investment between countries, which has created benefits for recipient countries. These benefits include the sharing of knowledge and technology between countries.

In the long term, increased trade is likely to lead to the creation of more employment in all countries that are involved.

The disadvantages of globalisation

There are also several potential disadvantages of globalisation, including the following:

The over-standardisation of products through global branding is a common criticism of globalisation. For example, the majority of the world's computers use Microsoft's Windows operating system. Clearly, standardising of computer operating systems and platforms creates considerable benefits, but critics argue that this leads to a lack of product diversity, as well as presenting barriers to entry to small, local, producers.

Large multinational companies can also suffer from diseconomies of scale, such as difficulties associated with coordinating the activities of subsidiaries based in several countries.

The increased power and influence of multinationals is also seen by many as a considerable disadvantage of globalisation. For example, large multinational companies can switch their investments between territories in search of the most favourable regulatory regimes. MNCs can operate as local monopsonies of labour, and push wages lower than the free market equilibrium.

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Critics of globalisation also highlight the potential loss of jobs in domestic markets caused by increased, and in some cases, unfair, free trade.

Globalisation can also increase the pace of deindustrialisation, which is the slow erosion of an economy's manufacturing base.

Jobs may be lost because of the structural changes arising from globalisation. Structural changes may lead to structural unemployment and may also widen the gap between rich and poor within a country.

One of the most significant criticisms of globalisation is the increased risk associated with the interdependence of economies. As countries are increasingly dependent on each other, a negative economic shock in one country can quickly spread to other countries. For example, a downturn in car sales in the UK affects the rest of Europe as most cars bought in the UK are imported from the EU. The Far East crisis of the 1990s was triggered by the collapse of just a few Japanese banks.

Most recently, the collapse of the US sub-prime housing market triggered a global crisis in the banking system as banks around the world suffered a fall in the value of their assets and reduced their lending to each other. This created a liquidity crisis and helped fuel a severe downturn in the global economy.

Over-specialisation, such as being over-reliant on producing a limited range of goods for the global market, is a further risk associated with globalisation. A sudden downturn in world demand for one of these products can plunge an economy into a recession. Many developing countries suffer by over-specialising in a limited range of products, such as agriculture and tourism.

Globalisation generates winners and losers, and for this reason it is likely to increase inequality, as richer nations benefit more than poorer ones.

Increased trade associated with globalisation has increased pollution and helped contribute to CO₂ emissions and global warming. Trade growth has also accelerated the depletion of non-renewable resources, such as oil.