

ECONOMICS U\$A
21ST CENTURY EDITION

PROGRAM #27
INTERNATIONAL TRADE

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(MUSIC PLAYS)

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FRANK STASIO: Economics USA, a 21st Century Edition Audio Supplement designed to explore 21st Century challenges to micro and macroeconomic principles. The subject of this is international trade. My guest is Blair Sheppard. Dr. Sheppard is Dean and Professor of Management at the Fuqua School of Business at Duke University. I am Frank Stasio.

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FRANK STASIO: Dean Sheppard, welcome.

BLAIR SHEPPARD: “Thank you, delighted to be here.”

FRANK STASIO: Let’s start with a very big question. How did international trade change with the fall of the Soviet bloc in the late 80’s and early 90’s?

BLAIR SHEPPARD: “It’s interesting whether the Soviet bloc fell because of the changes in trade, or trade changed as a result of the falling of the Soviet bloc. So I think essentially what happened is two very important points. First, large parts of the world became part of the global economy and established entrepreneurial activity in their countries as a driver in economic change, so you saw it in China. You saw it in India. You saw it in Korea. You saw it in those places in the world, who had previously been under some of the constraints of a command economy, and the second thing that happened is the supply chain got distributed in multiple locations around the world. So, most products passed through ten, twelve, thirteen, fourteen countries before they actually became a product, and so there isn’t such a thing as a company in one country.”

FRANK STASIO: But that was all the run-up. So you’re saying that some of that actually contributed to the fall of?

BLAIR SHEPPARD: “I actually think that information technology and travel contributed to it, that if you look at what caused it all, it’s probably the case that the evolution of telecommunications, the internet, and the ability to interact with each other, which means the classic ways of managing a firm, which required a face to face or locale, were no longer required; and the ability to move things around the world became much, much, easier, because you could track them, you could manage them. So two things occurred. We were able to devolve capability to other places where they were less expensive or more capable in a certain thing, and still managed the haul, and as a consequence of that you actually got entrepreneurial activity in those countries driving growth independently. So if you looked at China as an example, China was first a place that did some of our most simple manufacturing and a little bit outsourcing activity, developed its own internal capability. Now it’s this gigantic consumer engine that is running of its own speed. It’s still exporting, but there is this huge engine inside the country, so huge evolution over twenty years.”

FRANK STASIO: And China is a little different than the soviet bloc in that the governments really changed in those soviet bloc nations, and the systems changed, and as China, we pretty much had the same form of government. Once those governments fell, and Soviet bloc, and Eastern bloc nations, then how do things change? Was it more dramatic, or was it just more of the same?

BLAIR SHEPPARD: “The interesting issue is there was this really interesting set of research, some of which was being done here, at the time around, were you better to go cold turkey or evolve? And I think the record shows evolve was better than cold turkey right? Now it varied, and so in countries where there was a kind of extant infrastructure that could adapt to market economies well, cold turkey worked pretty well, because it had an earlier history of it. In countries like Russia where there wasn’t such a peace, it became a disaster for a long period of time. The education system went to hell in a hand basket; they were one of the best education systems in the world that became awful, why? Because they couldn’t pay their teachers, and they had sort of lost focus on that as a meaningful thing to do, crime evolved to a huge degree. They lost competitive advantage in industries where they had competitive advantage. It was being held together through a command economy, and so they just didn’t have, and huge discrepancies in wealth, so a few people who had a lead took advantage of it. So the coupons, they acquired all the coupons. They got wealthy, and left everybody else badly off, and so they didn’t have the infrastructure. If you take Czech Republic as an alternative, they actually had some memory, sort of atrophied muscle tissue, if you think about it, that was left over from when they were a market economy so they came back much easier.”

FRANK STASIO: You talked about comparative advantage, and of course it’s a key principle in trade economics. Is that term still relevant in the age of global information?

BLAIR SHEPPARD: “Oh yeah. I think it may be less in a country level and more at a regional level, but there’s no question that you still get agglomerations of comparative advantage, and if we’re doing our best to make sure it doesn’t sustain. Silicon Valley is a place that generates businesses at a rate that no one else does, and if you take a look at it, it’s because it’s this interconnecting web of VC and startup companies, and talent that moves around.”

FRANK STASIO: VC is Venture Capital?

BLAIR SHEPPARD: “Venture Capital, and so it’s a basic advantage. So you still have good auto manufacturing capabilities in England. You still have technology revolving around Cambridge. You still have technology around Bangalore, and so yeah, it matters. Maybe even more because technology permits a place to serve the whole world for the thing it’s particularly good at.”

FRANK STASIO: So if you’re particularly good at it, it’s because you have been historically, but the fact that I can now serve the whole world from almost anywhere else, doesn’t that mean that I could get good?

BLAIR SHEPPARD: “Well it means that if you have an initial advantage, and you can accrue people and capital and capacity to you, you extend that advantage. So I think what you find with people as well, that the introduction of a market economy benefits those who are already slightly better than those who aren’t, and the gap gets bigger. So I think what you’re finding is comparative advantage is even more important than it used to be, not less.”

FRANK STASIO: Interesting. Now one of the promises of globalization is that it would increase competition, is that happening?

BLAIR SHEPPARD: “Yeah. Clearly it’s happened in competition, and it increases globalization, and it’s happened in some interesting ways. So part of what’s happened is when you serve a relatively poorly off economy, you develop a business model, and set of processes that are simpler, better, more streamlined. They don’t produce a kind of elegant product, but they’re way more efficient. They create capacity that then slowly comes up-scale and starts to eat away at those who have been serving the well-off, and so you have a much tougher, meaner competitor in the sense that they’ve had to make money in a tough place. The second one is, you have competition for elements of the supply chain, rather than the whole supply chain. So I get really, really, really good at certain parts of the process, and if we emphasize that because the world can come to us, we can actually accrue most of it to us. So places like Qincheng China, which is a tiny little city, has a fifth of all the exports coming out of China, because it’s just really good at certain kind of things.”

FRANK STASIO: Does this apply mostly to manufacturing? I am thinking in terms of other very large companies that seem to have corner their markets --Amazon, Google, Microsoft, Cisco, and Wal-Mart.

BLAIR SHEPPARD: “So one of the interesting things is, take Cisco which is a company in the IT space which is an example of the kind of company you’re talking about right? Ask yourself how many of their personnel actually now live in California and how many personnel now live in India, around Hyderabad and Bangalore? And it turns out they have more people working in India than they have working in California. Now, it’s not all parts of India, it’s Hyderabad and Bangalore, which are places where IT people like to hang out with each other, and so you’re getting this intense advantage in certain places in the country rather than the whole country itself.”

FRANK STASIO: What’s the role of regulation in a globalized economy? Does it make sense anymore for nation states to even try to regulate their businesses when capital is flying the borders in all directions?

BLAIR SHEPPARD: “I think we have no choice but for nation states to regulate, because we have no other governing body. There is this interesting anomaly, which is an awful lot of the activity that needs to be regulated crosses borders, but the only entities that have the regulatory authority are actually within borders. So there are few, there are small entities that are growing; but we do have a dilemma which is our regulatory regimes are within country, primarily. So what happens is certain countries take the lead in establishing a regulatory construct for others; and I think you’re going to find an interesting fight between China and the US over the next twenty years about who takes the bigger part of that lead. For a long time UK and the US have been, sort of ‘it’. There are some other pretenders to be thrown about which established regulatory regimes.”

FRANK STASIO: Regulation does tend to impose cost, but then it does create a level of certainties. You said there has to be some kind of regulation in order for this to go a sense of fair play encourages business. So does that mean that nations like US and China can afford to compete over which regulations will apply, or will there at some point have to be some kind of international body that regulates global trade?

BLAIR SHEPPARD: “The key piece about regulation, which is forgotten in some business schools, is that it’s a good thing, because markets in a purer sense, left to their own devices, do occasionally bad things, and so we need them. I think that what you’re going to find is that certain things are regulated globally and certain things get regulated domestically, and there is going to be competition over who sets the global standard. It’s not the differences between different countries will go away, it’s that they’ll vie for who’s point of view holds. For example, right after the crisis, Europe was growing. Their monetary regimes and their banking regulations

were way better than ours. It turns out they weren't. They got into the same kind of trouble we did, but we might have looked at Canada and Australia as examples of what good regulation could have been because they didn't get in anywhere near the kinds of challenges we did. So I think the variability across country is a good thing, because we will get to see which things work in different circumstances, but we do need normalization around the world-- sort of things like intellectual property controls vary dramatically around the world, and that makes it hard to compete and hard to know when I can enter another country or not. Those will get normalized as countries become wealthier."

FRANK STASIO: Have the fundamentals of management, business management, changed in the globalized economy?

BLAIR SHEPPARD: "I think this is the sixty four thousand dollar question. A key premise is really a two part assertion. First people are people, and therefore much of what we know about what it means to manage and run a company is the same around the world, and second there are countries with deep civilization histories, and they're not about to give them up. So I think the answer to your question is "yes". "

FRANK STASIO: And how so?

BLAIR SHEPPARD: "It's a bit of both that, so for example, there's this really interesting conversation going on in China about what does it mean to be a Post- Communist Confucian market economy. I think 20 years ago we wouldn't of even had that discussion, and there's subtle differences, really, really, subtle differences about the role of a governor, what democracy means, what forms of transactions happened, whether or not the greater sin is to harm your family or your close associates, or the greater sin is to violate the contract. There's a whole series of differences that are quite subtle, but fairly important."

FRANK STASIO: And that's the other lesson of China. For a long time there was a correlation, and we thought association between market economies, and democracy. It turns out that they're not correlated or related at all. You can have one without the other.

BLAIR SHEPPARD: "There is this interesting question about whether market economies followed democracy or vice versa. So I think what we know is the closer you get to a large middle class, the more they want to participate in the governance of the country, and so I think democracy will follow. But there were long held views in, "The Economics of Growth," that said there were certain requisites, certain kinds of regulations, certain kinds of governments in place. Turns out China has disabused it of those points of views. We had the idea in some circles that democracy proceeded market economies, or they had to be there at the same time. China has made us ask that question twice."

FRANK STASIO: Well if you looked at it the other way around, if it was in fact the development of a middle class that had demanded and received a greater role and participation, you could get to the point, couldn't you, where a middle class, if it was doing well, said, "You know, you run the country, I've got a job. I am just fine"?

BLAIR SHEPPARD: "I think as long as everything is going fine, the middle class will put up with it; but the minute you have a hiccup you're going to have a circumstance where people are saying, 'We would like to have greater authority,' and I think there is if you take a look at China now versus China 20 years ago, it's far more democratic than it was 20 years ago, and they would argue because they have elections in their party that they have got a form of democracy-- not what we would consider it, but they have a form, and you're seeing greater involvement, and greater intrusion. So, for example, business people are now elected to major political positions in ways that they didn't used to before. So you're going to see a small loosening up, and there is an important point in this. Amy Chua, who used to be here and moved to Yale, has a really interesting argument that if you put a market economy and democracy in place at the same time, you can cause some fairly interesting populous problems. So here is the story; country gets a market economy, certain individuals do better than other individuals, and typically they tend to be of a type, right? So they are of a class, or of a race, or of a background, and they tend to have trade exchanges that already exist. So they give them an advantage. They get really, really, wealthy. The rest of the population starts to get wealthy, but at a much slower pace. So the gap gets bigger. So you have people who are billionaires when other people are still making two thousand dollars a year. You have a crisis and a person runs for election on a populist argument that says, 'These people are evil,' and what you get is, houses are getting burned down, people are getting killed, and the economy really getting harmed. You had that in Indonesia. You had that in the Philippines. You had it all over Southeast Asia, at certain points in time, and so, we have to be careful about whether countries are ready yet, for both."

FRANK STASIO: Finally, has the nature of business education changed as a result of globalization?

BLAIR SHEPPARD: "I think business education is changing as we speak, and I think you're going to see two fundamental trends. The first is devolution of the great business schools to other parts of the world, and so you are going to have the same competitive forces we were describing in other places happening in business education. In an effort to try to understand what it means to do business in subtly different market economies, for example, what does it mean to do business in Islamic- predicated market economy, what does it mean to do business in a Confucius- predicated market economy, what does it mean to do business in a market economy that was sort of driven by sort of Spanish and Portuguese Catholicism versus the Puritan logic that drove the U.S. economy? They're subtle, but they are actually quiet profound differences that you need to understand how to manage."

FRANK STASIO: Dr. Sheppard, thank you so much.

BLAIR SHEPPARD: “Thank you very much. I’m delighted to be here.”

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FRANK STASIO: Dr. Sheppard is the Dean, and Professor of Management at the Fuqua School of Business at Duke University, and Chairman of Duke Corporate Education. I’m Frank Stasio.

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