



The Microeconomics of Globalization: A look at productivity, growth, and offshoring

A course syllabus based on the
McKinsey Global Institute anthology series

| March 2007

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anthology series:

The Productivity Imperative: Wealth and Poverty
in the Global Economy

Driving Growth: Breaking Down the Barriers to Global Prosperity

Offshoring: Understanding the Emerging Global Labor Market

Published by Harvard Business School Press
Edited by Diana Farrell, Director, McKinsey Global Institute

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Course opportunities

This syllabus may be used effectively in a number of different courses because it relates directly to:

- Globalization
- Economics
- Strategy
- IT
- Operations
- Marketing
- Public policy
- International relations

Series overview

This new series develops three critical economic issues—productivity, growth, and offshoring—to provide a structured look at the microeconomics of globalization. Consisting primarily of articles drawn from the extensive research undertaken by the McKinsey Global Institute (MGI), each volume presents expert perspectives on the issues essential to anyone trying to understand how business and governments operate in today's global economy.

Beginning with *The Productivity Imperative: Wealth and Poverty in the Global Economy*, we look at the factor that, we believe, most determines whether an economy will flourish or stagnate economically. Experts examine the impact of productivity on a nation's economic well-being and identify barriers to productivity based on analyses of industries and nations around the world. With *Driving Growth: Breaking Down Barriers to Global Prosperity*, we debunk several myths about what makes economies and companies grow, and help assess the potential impact of growth drivers such as information technology and innovation, manufacturing and service industries, and the informal economy. Then, in *Offshoring: Understanding the Emerging Global Labor Market*, we

offer suggestions and facts to assist the understanding of the potential of the emerging global labor market—including the size of the global talent pool, how to choose an offshore location, and how to interpret the implications of offshoring for public policy.

While there are many ways these materials may be sequenced, here we outline a proposed structure comprising three modules. We have also indicated how the content of each module can be organized and, wherever possible, indicated additional reading and questions that could enrich discussion on a given topic.

MODULE 1: UNDERSTANDING PRODUCTIVITY

The first module explores a problem that has long challenged economists: how to increase an economy's growth rate. It is as critical a question for recently developed economies with stalled growth rates as it is for mature economies in Europe where voters expect prosperity to continue to rise. Using a microeconomic lens, the articles scrutinize these economies sector by sector. This bottom-up approach reveals that increasing labor productivity is essential to accelerating GDP growth, and that policy makers play a critical role in aiding firms by creating the conditions for fierce but fair competition in each sector. An important theme throughout is why economic performance at industry level should be assessed against a set of global benchmarks rather than national ones.

The 11 articles in *The Productivity Imperative: Wealth and Poverty in the Global Economy* are grouped in two sections to demonstrate the importance of these truths.

The first section shows how competition promotes economic growth by explaining the relationships between GDP growth, increasing productivity, competition, and regulation. Chapter(s) to accompany this section:

- Chapter 1: The power of productivity
- Chapter 2: Regulation that's good for competition

The second section gives examples of the productivity imperative at work, showing how measures to increase competitive intensity within an industrial sector—especially regulatory reforms—have resulted in rising levels of sector productivity, and vice versa. Chapter(s) to accompany this section:

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- Chapter 3: What's right in the US economy
 - Chapter 4: Reviving French and German productivity
 - Chapter 5: Sweden's golden opportunity
 - Chapter 6: Turkey's quest for stable growth
 - Chapter 7: Asia: The productivity imperative
 - Chapter 8: China and India: The race to growth
 - Chapter 9: India: From emerging to surging
 - Chapter 10: A richer future for India
 - Chapter 11: How Brazil can grow

Supplemental readings: The ideas examined in this module may be informed by several readings that are not part of the MGI anthology. Those readings include:

- Bart van Ark, Robert H. McGuckin III, Performance 2005: Productivity, Employment and Income in the World's Economies, Conference Board, May 2005
- William Nordhaus, "Sources of the Productivity Rebound and the Manufacturing Employment Puzzle," NBER working paper, May 2005
- Dale Jorgenson, Mun Ho and Kevin Stiroh, Productivity Volume 3: Information Technology and the American Growth Resurgence, MIT Press, 2005
- Barry Bosworth and Jack Triplett, Productivity in the US Services Sector; New Sources of Economic Growth, Brookings Institution Press, 2004
- Mary O'Mahony and Bart van Ark, EU Productivity and Competitiveness: An Industry Perspective; Can Europe Resume the Catching-up Process?, European Commission, 2003
- Nicholas Crafts, The Solow Productivity Paradox in Historical Perspective, London School of Economics, November 2001
- Martin Neil Baily and Robert M. Solow, "International Productivity Comparisons Built from the Firm Level", Journal of Economic Perspectives, Volume 15, Number 3, Summer 2001

Questions for discussion: Several questions can be used to probe discussion—in class or via written response—about the readings covered in this module. Questions for potential use include:

- What is productivity and why is it important?
- What role does the exposure to competition play in driving productivity growth?
- What are the advantages of evaluating an economy at the industry level and benchmarking against a set of international comparisons?

MODULE 2: WHAT DRIVES GROWTH?

The second module explores the theme of micro regulations at the industry level and the enforcement of those regulations as a means of driving growth. The module is organized around three misconceptions about what it takes to stimulate productivity, arguing that belief in these misconceptions often leads decision makers to advocate strategies that actually hinder productivity—in some cases severely.

The first misconception pertains to the so-called “new economy,” suggesting that a direct correlation exists between investment in information technology and productivity. The second holds that productivity in service industries—especially local services such as retailing, accountancy and electricity supply—is of minor importance in countries seeking rapid GDP growth when compared with performance in manufacturing or high tech. The third belief is that, in any particular country, the extent of the informal economy, made up of enterprises that evade taxes and ignore most business regulations, has little or no impact on productivity and growth in the modern formal economy. The 11 articles in *Driving Growth: Breaking Down Barriers to Global Prosperity* are organized in three sections which respectively demonstrate the case against each misconception.

The first section looks at the real relationship between IT spending and productivity, arguing that IT investment alone does not automatically result in higher productivity from the firms making the investment, but if properly channeled can facilitate it. Chapter(s) to accompany this section:

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- Chapter 1: The real new economy
 - Chapter 2: Getting IT spending right this time
 - Chapter 3: A road map for European economic reform

The second section examines the impact on growth posed by productivity in services, arguing that policymakers have underestimated the contribution to GDP growth that can be made by improving productivity in domestic, as opposed to traded, services. Chapter(s) to accompany this section:

- Chapter 4: Domestic services: The hidden key to growth
- Chapter 5: Boosting government productivity
- Chapter 6: Beyond cheap labor: Lessons for developing economies
- Chapter 7: Don't blame trade for US job loss

The third section looks at the role of informality, arguing that large informal economies seriously distort competition and thus restrict growth in both output and employment. Chapter(s) to accompany this section:

- Chapter 8: The hidden dangers of the informal economy
- Chapter 9: Reining in Brazil's informal economy
- Chapter 10: The cost of the gray market in Turkey
- Chapter 11: Regulation that's good for competition

Supplemental readings: The ideas examined in this module could be informed by several readings, which are not part of the MGI anthology. Those readings include:

- Hernando De Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, Basic Books, September 2000
- Robert Barro and Xavier Sala-i-Martin, *Economic Growth*, second edition, 2003
- *Going for Growth*, OECD, various issues
- Ricardo Hausmann, Lant Pritchett and Dani Rodrik, "Growth Accelerations," NBER working paper, Number 10566, June 2004

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- Robert J. Gordon, “Two Centuries of Economic Growth: Europe Chasing the American Frontier,” NBER working paper, Number 10662, August 2004
 - Andrew Henley, G. Reza Arabsheibani and Francisco G. Carneiro, “On Defining and Measuring the Informal Sector,” World Bank Policy Research working paper, March 2006
 - Friedrich Schneider, “Shadow Economies of 145 Countries all over the World: What Do We Really Know?,” Center for Research in Economics, Management and the Arts (CREMA) working paper, 2005
 - Doing Business, The World Bank (IFC)
 - Simon London, “Buried Treasure,” Financial Times, December 12, 2004

Questions for discussion: Several questions can be used to probe discussion—in class or via written response—about the readings covered in this module. Questions for potential use include:

- What are some examples of product and land market regulations that drive or impede growth?
- Why does enforcement of regulations matter?
- What role did IT play in the US productivity boom? What else drove this boom?

MODULE 3: MAKING SENSE OF THE EMERGING GLOBAL LABOR MARKET

The third module explores the process of global industry restructuring and, more specifically, the very contentious issue of offshoring. At best, we argue, offshoring represents the opportunity for multinational companies to create more value at lower cost—effectively providing a boost in productivity for the global economy. But offshoring also increases the pace of change in the societies that it affects, placing new strains on them, and presenting their policy makers with complex choices that need to be managed carefully if the economic benefits of offshoring are to translate into net social gains. Through the 10 articles of *Offshoring: Understanding the Emerging Global Labor Market* we take a close look at some of the issues associated with offshoring in order to develop a firm grasp on the realities of this productivity tool.

The first section looks at the potential magnitude and pace of offshoring, concluding that although it is growing fast, it is a far smaller phenomenon than it could be. Chapter(s) to accompany this section:

- Chapter 1: Sizing the emerging global labor market
- Chapter 2: Ensuring India's offshoring future
- Chapter 3: China's looming talent shortage

The second section tackles the notion that globalization and offshoring must be stopped or limited to protect the rights of displaced workers, showing instead that offshoring actually creates wealth for the US economy. It also demonstrates the positive impact of foreign direct investment on host countries. Chapter(s) to accompany this section:

- Chapter 4: Who wins in offshoring?
- Chapter 5: The truth about foreign direct investment in emerging markets

The third section considers the five stages of global industry restructuring, and the capital/labor trade-offs companies can make to maximize the opportunities in low-wage countries. It also explores the importance of how and where companies pursue offshoring, recommending an analytic approach be employed to select the optimal location so that demand is spread evenly among the many emerging markets where labor supply is deep. Chapter(s) to accompany this section:

- Chapter 6: Offshoring and beyond
- Chapter 7: Smarter offshoring

The fourth section looks at the policy options that offshoring presents to political leaders in developed economies, and recommends some choices that companies and governments alike could pursue to help workers adversely affected by offshoring. Chapter(s) to accompany this section:

- Chapter 8: US offshoring: Rethinking the response
- Chapter 9: How France and Germany can benefit from offshoring
- Chapter 10: Governing globalization

Supplemental readings: The ideas examined in this module could be informed by several readings that are not part of the MGI anthology. Those readings include:

- Jagdish Baghwati, *In Defense of Globalization*, Oxford University Press, October 2005*
- Tom Friedman, *The World is Flat*, Farrar, Straus and Giroux, April 2006*
- Martin Wolf, *Why Globalization Works*, Yale University Press, June 2005*
- Daniel Drezner, "Outsourcing Bogeyman," *Foreign Affairs*, May/June 2004
- Robert Samuelson, "Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Regarding Globalization," *Journal of Economic Perspectives*, Summer 2004
- Jagdish Bhagwati, "Muddles over Offshoring," *Journal of Economic Perspectives*, Fall 2004
- Martin N. Baily and Robert Lawrence, "Can America Still Compete or does it need a New Trade Paradigm?," IIE Policy Brief, 2007
- Alan Blinder, "Offshoring: the Next Industrial Revolution?," *Foreign Affairs*, March/April 2006

Questions for discussion: Several questions may be used to probe discussion—in class or via written response—about the readings covered in this module. Questions for potential use include:

- What is the impact of offshoring on developed countries?
- What impact does foreign direct investment have on developing countries?
- What are the capital/labor trade-offs companies can make to maximize the gains from offshoring and operating in low-cost environments?
- What factors should companies consider in choosing an offshoring location?
- What policies can be pursued to mitigate the impact of offshoring in developed countries?

* These books could also serve as general readings for the course as they explore many issues relevant to globalization.