Academy of
aib
International
Business

Insights

Vol. 11, No. 4, 2011

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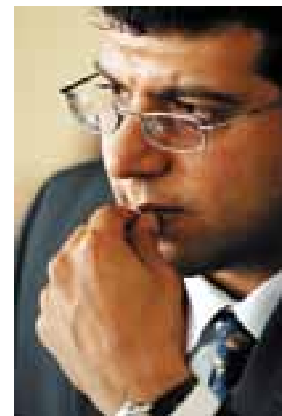
World Trade and Investment: New Realities, Old Myths



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This issue features three articles related to the realities and myths associated with global trade and investment. A shift of power from West to East is underway, with China taking the dragon's share of the attention. The U.S. and China are the "Group of 2" most closely watched; their present and future strategies will affect the new world order. The first article by Professor Tom Lairson discusses how the relations between the two countries will impact the global economic environment. Professor Mike Peng in the second article encourages international business scholars to examine the myths about China that are popularized by the mass media and politicians. The final article, by Professor Alan Zimmerman, discusses the underground economy associated with counterfeit products and suggests that the real magnitude and impact of counterfeit products are still not entirely known.

In the first article, Professor Tom Lairson, Rollins College, suggests that the 2008–10 global financial crisis is a turning point in the global political economy. He reviews the state of U.S.-led global capitalism from 1980 to 2008 and concludes that U.S. expansion of the period was over-reliant on the financial industry, appreciation of real estate and current account deficits financed by capital account inflows. The current account and financial imbalances are especially pronounced with respect to China, requiring a structural adjustment. In contrast, state-led capitalism as practiced by many of the Asian dragons and, most recently, China has enabled the accumulation of both financial and real capital and the development of an industrial infrastructure, leading to sustained economic growth and increased global political influence. Lairson proposes a 2x2 framework which summarizes the possible reactions of the two largest economies' policymakers. *AIB Insights* volume 9, issues 2 and 3, are a good supplement to Lairson's article and relate to the evaluation of the global financial crisis.

In the second article, Professor Mike Peng, University of Texas at Dallas, debunks the "China threat" headlines that dominate popular media. Fear of China is something that is politically expedient and may be good for the media business; it feeds on popular anxiety over recent economic failure coupled with the needs of politicians to vilify China. Peng asks, Are international scholars responsible for addressing popular myths about China? Perhaps addressed more holistically, we can ask, Are international business scholars responsible for addressing misinformation propagated in the media and by political groups? If so, what should be the scope of engagement?

The third article in this issue, by Professor Alan Zimmerman from CUNY-Staten Island, challenges the published trade statistics. The size of the counterfeit market for international goods is on the rise and is not captured accurately by official statistics. By some estimates, the yearly value of counterfeit trade is as high as a trillion U.S. dollars. The state of knowledge on the definition, measurement, antecedents and impacts of counterfeit trade is still limited.

The Global Financial Crisis and the Restructuring of the World Economy[1]

Thomas D. Lairson, Rollins College, USA

Financial crises are like lightning on a dark night: illuminating, if only temporarily, what is otherwise obscure.

The global financial crisis of 2008–2010 marks the end of an era in the global economy and the point of transition to new structures of global economic relations. The deeper causes of the crisis lie in poor economic policies of the United States and the ability of several Asian nations, especially China, to exploit U.S. weaknesses (Lairson, 2010; Reinhart & Rogoff, 2009). The faulty economic structures dating back to the 1980s were unsustainable and led to many large global imbalances and financial crises, including the recent one. Both the United States and China need to make significant structural adjustments to their domestic economies in order to restore a more positive and stable global economy. Unfortunately, the U.S.'s ability to adjust is in doubt, and China's is less than certain. Failure to adjust by either nation will lead to lower cooperation and greater conflict, making much more uncertain existing systems of interdependence and globalization.

Restructuring U.S. Capitalism, 1980–2008

The antecedents of the cascading collapse of markets for homes, home mortgages, collateralized debt obligations, and bank credit in general in 2008 can be traced back across 30 years of economic policies in the United States that led to severe imbalances in the global economy. The most important of these included a series of large cuts in income tax rates, focused especially on the wealthiest persons, combined with policies relating to restructuring the U.S. economy away from manufacturing and toward finance and services. These policies were supported by almost all Republicans and by a large portion of Democrats (Ferguson & Rogers, 1986; Hacker & Pierson, 2010; Vogel, 2003).

Linked to financial and economic elites, over the time from the late 1970s to the early 1990s these leaders reached a set of very important conclusions about future directions for the U.S. and global economies. Specifically, they believed most of U.S. manufacturing could not be globally competitive and that a policy of globalization could be used to restructure the U.S. economy toward finance and services.[2] U.S. manufacturers could remain profitable only if they were able to relocate production in lower cost areas and export back to the U.S.

The centerpiece of this strategy was global promotion of the U.S. financial industry as the most globally competitive sector of the U.S. economy.[3] This involved nothing less than a systematic industrial policy for finance. Wrapped in the legitimating ideology of free markets extolled by economists and business leaders, this policy sought to support the expansion of free markets and the globalization of trade and finance under the leadership of American firms. This industrial policy included the deregulation and elimination of restrictions on financial practices, an aggressive effort by the U.S. government to press for the opening of foreign markets to U.S. investment and financial operations, the institutionalization of liberal ideology in the Washington consensus,[4] and most important of all, providing government support to markets and financial institutions during times of financial crisis. Coupled with the profits made by financial firms in marketing the expanding U.S. debt, lending to governments and firms participating in globalization and supporting foreign investment, financial firms were also the main actor in the restructuring of U.S. manufacturing. Typically, a weakened firm would be broken up and resold, often through a "leveraged buyout" in which banks loan the money for the buyout and then split apart the firm and resell it. Profits in financial firms soared, with the full backing of the U.S. government should a crisis result from accumulated bad decisions (Deeg & O'Sullivan, 2009; Dore, 2008; Epstein, 2005)

These policies had a number of other consequences that undermined the sustainability of the system of global economic relations. First, conceding the competitiveness of U.S. manufacturing and relying on "market forces" for restructuring meant failing to expand investment in U.S. workers and accepting the massive downsizing of U.S. firms. With U.S. domestic markets largely open and manufacturing capabilities diminishing, Asian nations geared up their manufacturing capabilities, and exports to the U.S. rose dramatically. Japan, Korea and Taiwan in the 1980–1995 period and China in the time after 1995 enhanced the scope of production, and with foreign direct investment in China from Asian and U.S. firms, this set of nations was in a position to take advantage of the yawning opportunities in the U.S. The current account deficits of the U.S. expanded continuously and at a rising rate, fed by a diminishing U.S. savings rate, a diminishing investment rate and a rising rate of consumption. A second and related consequence was the expanding fiscal deficit of the US government with an even faster rate

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of growth of corporate and household debt. Financial firms were not only at the center of this process, but this also placed financial markets and its main players at the center of a very large part of economic life. This had potentially very negative consequences. One main effect of rising debt and securitizing housing—for homeowners, speculators and mortgage-based derivatives—was to convert stable markets for real assets into inherently unstable markets for financial securities (Davis, 2009; Sassen, 2008; Sinclair, 2005).

Domestic Imbalances and Global Imbalances

A brief review of the data on global imbalances confirms the difficulties created by the U.S. global economic strategy after 1980. In the decade from 1970–1980, the U.S. current account was on a net basis in balance; over the next 30 years it fell into a persistent deficit that averaged 3 percent of GDP before 2000 and rose to 6 percent of GDP after 2000 (Obsfeld, 2005). The U.S. current account deficit more than doubled in size after 1999 to over $800 billion in 2006, and by 2008, 61 percent of the deficit was with Asia, with more than 43 percent of the total deficit with China alone.[5] A normal nation could not incur this kind of imbalance in its international accounts; that the U.S. does so involves the active cooperation of surplus nations and is a result of the U.S. dollar as the global key currency. Several Asian nations have recently played this role, especially China. The explosion of U.S. deficits with China over the last decade has been mirrored by an accumulation of dollar-denominated assets by China. In 2000, China held about $100 billion in such assets; by 2009, this totaled nearly $2.4 trillion (Eichengreen, 2011; Mastanduno, 2009; Setser & Pandley, 2009). These holdings were largely in U.S. government debt, which not only maintained the stability of the dollar-RMB exchange rate but also contributed to keeping U.S. interest rates low.

The imbalances in the global economy were also tracked by a restructuring of the U.S. economy so as to tilt income and wealth decisively toward upper income groups and those possessing globally competitive resources (Hacker & Pierson, 2010). Perhaps the most important indication of this was the ability of a very small proportion of the U.S. population to reap much the greatest part of the gains over the 1980–2008 period. After about four decades of stability, the top 10 percent of Americans were able to receive about 50 percent of income in 2007 as compared to 33 percent from 1942–1979 (Saez, 2009). These gains were even more concentrated at the very top of earners. Over the period from 1979–2007, the bottom fifth received 16 percent and the middle fifth of U.S. earners achieved 25 percent income growth; by contrast, during this time the top 1 percent received incomes growth of 295 percent (Sherman & Stone, 2010). Dramatically paralleling these shifts in income was a significant increase in the level of consumption and a corresponding decline in savings. Three decades of stability in consumption at about 62 percent of GDP was followed by a rise to nearly 72 percent by 2007.[6] The personal savings rate in the U.S. in the same period fell from 10 percent of income to nearly zero.[7] On top of these trends, debt in the U.S. at all levels—government, but even more so in business and households—soared. The same pattern as in so much other data is repeated with debt: total U.S. debt from 1947–1980 is stable at about 150 percent of GDP, but after 1980 it rises rapidly to 360 percent of GDP by 2009 (Coggan, 2010: 15).

The Global Economic Regime and the Global Financial Crisis

The time from 1980–2008 led to several distinctive economic arrangements in the U.S. and the world, quite different from previous decades. This global economic regime was directly responsible for the conditions that produced the global financial crisis. The restructuring of the U.S. economy away from manufacturing and toward finance and services, coupled with the shift from saving to consumption, led to the rise of massive trade imbalances and a corresponding buildup of dollar-based foreign reserves in Asia. The U.S. financial industry recorded stupendous profits and, with virtually no regulation, began to move into increasingly exotic securities such as Collateralized Debt Obligations (CDOs) and Credit Default Swaps (CDSs) while relying on higher and higher levels of leverage (Sassen, 2008). The political power of finance rose in close proportion to its profits (Johnson, 2009; Wray, 2009).

Connected to these events, China and other Asian nations built up a formidable manufacturing capability, complete with production networks across the region, and owned and controlled by firms from across the world. It was this system that supplied the goods for much of the increase in American consumption and directly and indirectly the money to finance it. China particularly became not only the center of global production but also a cornerstone of global banking. These arrangements did lead to growth in the U.S. and elsewhere, but this growth was purchased with the crippling of U.S. manufacturing, misguided systems of investment, a huge increase in debt, rising consumption and declining savings and dramatic gains for a few with little benefits for most (Legrain, 2010; Rajan, 2010).

Large portions of this system were linked to the vast increase in mortgage lending in the U.S. The contradiction between the importance of consumption for economic growth and stagnating income for most Americans led to efforts to boost spending without increasing income. Significant incentives for borrowing against home equity were expanded after 2001, leading to much additional household debt. CDOs purchased with borrowed funds were used as a means to manage risk and provide profits for financial firms. The stability of the system was tied to home values always rising; but when the Federal Reserve reversed several years of credit expansion with the contraction of credit in 2005, home prices began to fall. This generated a cascading series of declines across a series of tightly connected markets: the markets for derivatives went into stress, which placed credit markets into stress, which led to a general loss of confidence and a financial panic (Purdum, 2009).

The Financial Crisis and Structural Adjustment: U.S. and China

The system of global political economy constructed by the U.S., with the cooperation of China and other nations, was unsustainable. The lack of income growth for most Americans for several decades, propped up by adding debt that could not be repaid, could not continue to sustain purchases of goods produced in China. And the willingness of China to lend much of the money to support this system was not infinite. Further, the financial crisis leaves in its wake much bigger budget deficits and much larger and persistent unemployment. Thus new forms of domestic and international structures must be created.

For the U.S., the necessary way forward is clear, though political and economic elites are deeply divided over how to proceed. Put simply, the U.S. must cut consumption and raise savings to provide the resources for building a stronger economy. To close the fiscal gap in the U.S. government accounts, shared sacrifice is required: income taxes on the rich must be raised and benefits to the middle class in retirement and health care must be cut. And a new domestic economy can only come from a set of national investments focused on raising competitiveness, including especially new investments in workers. Shifting the U.S. economy away from purchasing foreign goods and instead exporting high value products, while reducing its debt burdens, can rebalance an otherwise unsustainable system and generate economic growth shared by all (Ip, 2010).

For China, its imbalances are the mirror image of those in the U.S.: too little consumption and too much investment and saving. One ironic result is that inequality of income in China is about the same as in the U.S. This is also reflected in the extremely low consumption rate in China, about 37 percent of GDP (Devan et al., 2009: 4). But making such changes will not be easy. The ability of the Chinese government to maintain a consistently high GDP growth rate depends on the ability to control and direct investment. And the lack of credit and effective social safety nets means the Chinese consumer must save in order to buy or in order to retire. Most important, wages as a proportion of national income must increase for consumption to increase. Each of these will involve significant structural changes but will actually increase the competitiveness of China's economy at the level of higher value added production.

The Political Economy of U.S. Structural Adjustment

There is considerable reason to doubt the ability of the U.S. to make the changes needed to rebalance its economy. The U.S. government has always found large changes difficult because power is divided deliberately to make government action very hard. Equally important, the last 30 years have led many to expect rising incomes, and they will be reluctant to embark on a new path with uncertain outcomes, especially when sacrifice is expected. But most important, the largest and most powerful interests in the U.S. are aligned against these structural changes. The policies for structural adjustment will pit a political coalition framed around continued consumption against a coalition framed around increased competitiveness.

Many of the most powerful political and economic forces in the United States are aligned against making the structural changes outlined above. This coalition is united around preserving the position of finance, the large role for consumption and the preeminence of carbon fuels in the economy. Thus, the industries of oil, coal, retail, finance, tourism, construction and health care stand ready to oppose any significant change from the policies of the past three decades. In opposition and supporting efforts to improve competitiveness by saving, investing and reducing debt are the industries of new energy, education, threatened manufacturing and technology. Large sections of the electorate are on the sidelines, failing to understand the issues or the stakes associated with these choices. By any measure, the consumption coalition has the capacity to win this struggle because of the large economic resources at its disposal and the structure of the U.S. political system, which makes change very hard. Only a very determined political leadership will be able to make the needed structural changes.

Structural Adjustment, or Not

The pattern of structural adjustment by the United States and China will have substantial consequences for the future relationship between these two nations and for the configuration of the global economy. The potential for defining a mutually beneficial system of political economy, and for patterns of conflict and cooperation, will depend of the ability of both nations to make major changes. Failing this outcome, global cooperation will be undermined by the conflicting positions of the two economic giants.

This is summarized in Table 1, where we consider the implications of different patterns of structural adjustment.

Table 1: Adjustment Outcomes Matrix

	China adjusts	China does not adjust
U.S. adjusts	Both increase competitiveness Imbalances decline Basis for win-win coop U.S. growth returns to 3–4% U.S. GINI declines China GINI declines	Imbalances decline U.S. competitiveness increases China fails to upgrade firms Global coop declines China is free rider U.S.-China conflict rises
U.S. does not adjust	Imbalances increase China competitiveness increases U.S. forces China to adjust U.S. economy in LT decline U.S. is free rider Global cooperation declines U.S.-China conflict rises	Imbalances remain Promote more conflict U.S. protectionism Global cooperation collapses Spheres of influence Spirals of conflict

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Only in a situation where both nations adjust do we see global imbalances decline as a result of the increased competitiveness of both nations. This also provides a stable basis for continuing large-scale economic exchange and for making improvements in the domestic distribution of economic gains.

However, this is a most unlikely outcome given the political resistance in the U.S. to structural change. Because the Chinese government has a much greater role in the Chinese economy, it has a greater chance of making significant structural changes. Moreover, these changes will help it adapt to a world in which the U.S. remains mired in debt, consumption and weakening competitiveness. The most likely outcome is a U.S. adjustment failure and a Chinese adjustment success. But this will weaken the system of global economic cooperation, hasten the relative economic decline of the U.S., and even increase the chances for conflict. The U.S. effort to force China to adjust its exchange rate rather than address its own structural problems is a foreshadowing of what is to come (Kaletsky, 2010).

Possible Future Scenario

The system of liberal capitalism as practiced in the United States has been seriously damaged by 30 years of bad policies and the resulting financial crisis. An economy focused overwhelmingly on finance was unable to generate sustainable growth with an equitable distribution of the gains from growth. Overconsumption, low savings, failure to invest adequately in workers and poor governance of the financial system led to weakened global competitiveness and to a global financial crisis. Though structural adjustment of this system is in the national interests of the U.S., political dominance by economic groups committed to policies with narrow benefits focused on their economic interests means the U.S. will not make these changes. The political system is in a state of paralysis, which provides large benefits to those who gain from the status quo. The result is the U.S. may face many years of low growth and increasing inequality. This will also undermine the U.S. ability to manage the global economy and provide the public goods needed for stability.

The most likely outcome is that Chinese state capitalism will make the needed structural adjustments and U.S. liberal (state) capitalism will not. The failure to adjust by both creates larger economic problems and increases potential for conflict. This will increase the rate of divergence in economic growth between the U.S. and China, all but eliminate a mutually advantageous economic relationship and produce a breakdown in the system of global cooperation. The U.S. retains considerable economic and political power and, facing continuing domestic stagnation and foreign economic vitality, it may use this power in destructive ways.

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Endnotes

[1] An extended version of this paper was published (in Mandarin) in *Fudan American Review*, 2011.

[2] This conclusion, though correct in many respects, can be criticized on several counts. First, there was little strategic thinking devoted to analyzing which parts of U.S. manufacturing could be saved through a targeted investment program. Second, little provision was made for helping the transition of workers out of manufacturing and into other sectors, specifically by enhancing their global competitiveness. Third, the increasing reliance on consumption to support U.S. economic growth conflicts with a policy that depends on relative falling wages for much of the U.S. population.

[3] This analysis of U.S. economic strategy does not depend on a "conspiracy" by U.S. elites. Rather, it is based on understanding of large power asymmetries in society, publically expressed and supported policies and the complementary but usually uncoordinated actions of those who benefit from these policies.

[4] The ideological element in the role of free markets comes from concentrating only on those groups that gain from free markets and ignoring those that lose. Free markets create sharp differences between winners and losers and the role of ideology is to minimize and explain away losses and extol the gains.

[5] Author's calculations based on data from Bureau of Economic Affairs, http://www.bea.gov/international/bp_web/simple.cfm?anon=71&table_id=10&area_id=35.

[6] U.S. Department of Commerce, Bureau of Economic Analysis, http://www.bea.gov/.

[7] http://www.bea.gov/national/nipaweb/PrintGraph.asp?Freq=Year.

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The Social Responsibility of International Business Scholars: The Case of China[1]

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What is the social responsibility of international business (IB) scholars? We argue that the social responsibility of IB scholars is to seek truth, disseminate learning, and make a difference on issues crucial to the global economy. Instead of making philosophical and abstract arguments, we focus on a leading debate of our time: How to view the rise of China's outward foreign direct investment (OFDI)?

While the IB literature on China's OFDI brought by its multinational enterprises (MNEs) is expanding, discussion of this topic is no longer limited to the AIB community. There is no shortage of media reports produced by non-scholars. If we summarize the hundreds of media reports and books on the rise of China in the West, one pervasive theme seems to be a sense of the "China threat." David Lampton (2010), a leading China scholar in the United States, has labeled this literature "China on steroids." To the best of our knowledge, no previous IB research has confronted this crucial question: How should we as IB scholars respond to the "China threat" portrayed by the "China on steroids" literature?

We argue that IB scholars have a social responsibility to join this debate and clear the air. As scholars, we have unique advantages relative to other groups, such as journalists, policy gurus, and social commentators who are visible in articulating the "China threat" view. We are more empirical, we have a deeper respect for data and facts, and we are less ideological. This article focuses on the core areas of IB scholarship, FDI and MNEs.[2] Our central argument is that the so-called "China threat" brought by Chinese MNEs' OFDI is a myth that cannot be substantiated.

The "China on Steroids" Literature

The "China on steroids" literature suggests that emerging multinationals from China are such a dominant force "intent on buying the world" (*BusinessWeek*, 2009: 36). Overall, three impressions emerge: (1) China is a dominant player in OFDI in the world, (2) China is the number one OFDI player among emerging economies, and (3) Chinese OFDI has significant global reach. As scholars, we need to ask: Really?

What Do the Data Suggest?

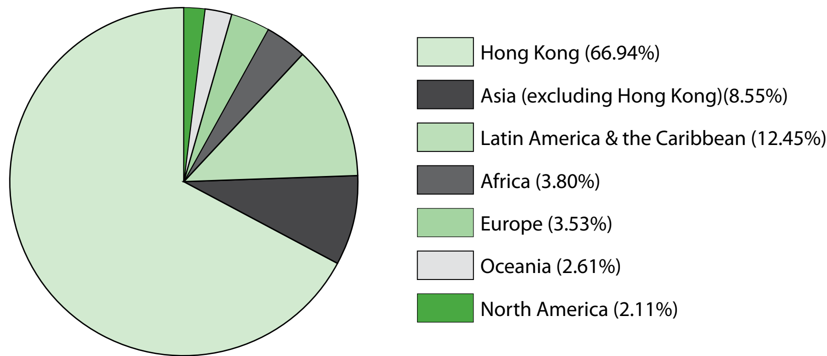
The data suggest that none of three impressions can be substantiated. First, in terms of China's alleged "global dominance," in 2009 (the most recent year on which data are available), China was not even among the top five OFDI generating economies. It was a distant number six. The United States, France, Germany, Japan, and Hong Kong generated far more OFDI than did China.

BusinessWeek (2009), which (mis)leads readers to believe that China is "buying up the world," reveals a startling (but accurate) data point: total stock of Chinese OFDI is only 1/30th of total U.S. OFDI. If China's tiny sum of OFDI stock could indeed buy up the world, then U.S. MNEs would have bought up the world 30 times! On a worldwide basis, China's share of global OFDI stock was only 1.21 percent in 2009 (UNCTAD, 2010: 172–175). In 2009, it represented only 4.4 percent of global OFDI flows (UNCTAD, 2010: 167–171). Now, how can MNEs from a country that has just over 1 percent of the global OFDI stock be in a position to "buy up the world" (even if they wanted to)?

A second impression one easily gets from the media is that China must be the largest OFDI originating emerging economy among BRIC countries. Again, this is not the case. Russia is. While China's OFDI stock is indeed more than both India's (0.41 percent) and Brazil's (0.83 percent), Russia's (1.31 percent) OFDI stock is greater than China's (UNCTAD, 2010: 172–175). Yet has anyone heard of "Russia on steroids"?

A third impression on the alleged global reach of Chinese OFDI can be refuted by the actual geographic distribution of Chinese OFDI stock. Data show that Chinese MNEs are not comfortable competing globally. Figure 1 illustrates that despite media headlines about China's OFDI in Africa, only 3.80 percent went to Africa. Hong Kong commanded a lion's share of 66.94 percent, while the rest of Asia received another 8.55 percent. Of the 12.45 percent that went to Latin America and the Caribbean, the Cayman Islands and the British Virgin Islands (BVI) absorbed 11.65 percent. China's OFDI stock in the more competitive, developed economies of Europe (3.53 percent), North America (2.11 percent), and Oceania (2.61 percent) was insignificant. Overall, Chinese OFDI is not very global. Instead, it is very regional (Rugman, 2005).

Figure 1: Regional Distribution of China's Outward Foreign Direct Investment Stock



Source: Adapted from: Chinese Ministry of Commerce (MOFCOM). 2010. *2009 Statistical Bulletin of China's Outward Foreign Direct Investment*. Data refer to 2009. Total OFDI stock from China was $246 billion as of 2009.

After taking out Hong Kong's share, the rest of the world receives only 0.40 percent of the global OFDI stock from China (1.21 percent of total global OFDI stock × 33.06 percent of Chinese OFDI that does not go to Hong Kong). For example, in North America, total Chinese OFDI represents a tiny sum of 0.026 percent of global FDI stock (1.21 percent of global total × 2.11 percent). Rather than "threatening," Chinese OFDI is clearly "negligible" in North America (Scissors, 2010: 8).

Overall, none of the three widely held impressions can withstand scrutiny from an empirical, evidence-based standpoint. Stemming from these three unsubstantiated impressions, a lot of the opinions on the "China threat" are therefore uninformed, biased, and often "absurd" (Scissors, 2010: 7).

Three Hypotheses on the Myth

It is not an exaggeration to suggest that the "China threat" has now become a myth in the West. Although typically disconnected from realities and unsubstantiated by facts, myths have a tendency to take on a life of their own. Why has the "China threat" myth risen in the first place? We suggest three hypotheses.

First, by influencing the media, the U.S. government may be interested in taking advantage of China's rise as a new "Sputnik moment" in an effort to revive the U.S. economy. The Sputnik moment refers to Americans' shock in 1957 when the Soviets launched the first satellite to outer space. President Obama said in December 2010, "Our generation's Sputnik moment is back, we need to do what America has always been known for: building, innovating, educating, making things" (*Economist*, 2011: 43).

A second hypothesis is that certain branches of the U.S. government and their stakeholders – in particular, the military and defense industry – may have vested interests in fueling the myth on the "China threat" in order to protect their budgets and jobs. During an age of skyrocketing government deficits and shrinking defense budgets, emphasizing a "threat" from a rival makes sense.

The third hypothesis stems from the nature of the media industry. It suggests that the media industry, due to its competitive nature, has an inherent bias to exaggerate new phenomenon and to ignore non-supportive evidence. Unlike scholars who take the time to systematically gather and analyze evidence, journalists compete on the timeliness and provocativeness of their reports. Focusing on "hot news," media reports are almost entirely anecdotal. Reports about "Nobody was murdered last night" or "Norway's OFDI made the top 10 in 2009 but threatened nobody" are unlikely to garner much attention and result in higher news sales. Unfortunately, approximately 20,000 journalists lost their jobs since 2008. We can further hypothesize that the remaining journalists may have a tendency to produce more extreme, more biased reports on what they deem to be newsworthy events, such as the rise of China's OFDI. The notion of the "China threat" thus becomes a self-fulfilling prophecy.

Embracing the Social Responsibility of IB Scholars

As society's "brain trust," scholars have the sacred social responsibility to seek truth, disseminate learning, and make a difference. Following Globerman and Shapiro (2009) and Peng and Xiao (2011), we argue that IB scholars cannot shy away from the leading debates of our time. To embrace our social responsibility, IB scholars need to intensify our engagements in three areas.

First, seek truth by undertaking more insightful research. Decades of IB research has focused on MNEs' technological and managerial capabilities, and has underappreciated the role of institutions – both at home and abroad. Rugman's (2005) work on CSA is an example of paying more attention to the specific institutions associated with various country environments. Such thinking has recently been broadened to become a part of the institution-based view (Dunning & Lundan 2008; Peng et al., 2008). While the proposition that "institutions matter" is hardly novel, we have yet to unlock the institutional "black box" behind the rise of China's OFDI (Peng, 2012). Specifically, we need more research on how the domestic institutions in China, especially unequal tax and other treatments between domestic and foreign firms, give rise to China's OFDI. Existing theories on FDI and MNE have totally ignored capital round-tripping. From an institution-based view (Peng et al., 2008, 2009), firms that undertake capital round-tripping essentially engage in institutional (or regulatory) arbitrage. Clearly more solid research is needed.

Second, as educators, we need to teach our students not to believe every word that is printed by today's media. Enhancing critical thinking skills is not only a time-honored (but largely informal) tradition for all educators, but is now an explicit formal AACSB mandate for business school professors. Media reports obviously are not textbooks. For any

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students deeply believing in the thrust of the "China on steroids" literature, we can point out: What happened to the "Japan on steroids" literature a generation ago? Is there any "Japan threat" anymore?

Finally, IB scholars need to seek to influence the views of the media, practitioners, and policymakers by fostering dialogues, disseminating new evidence, and helping craft sensible and balanced media reports, industry practices, and public policies. In our view, the ultimate social responsibility of IB scholars is to promote world peace by enhancing the trade and investment links in the world. The United States and China are the two largest economies in the world. While US OFDI has a long (30-year) history in China, China's OFDI in the United States is a very recent episode of this important relationship. Given the forces inside the United States fueling the "China threat" sentiments (which, rightly or wrongly, have fueled the "anti-U.S." sentiments in China), protectionism is likely. If the United States launches protectionist moves, China will certainly retaliate. Such exchange of (trade) blows will not only damage the bilateral relationship, but will undermine global confidence. The upshot? When countries curtail or stop trading with and investing in each other, war becomes a less costly policy. This is not a theoretical speculation. The protectionist mechanisms put up by various countries after the Great Depression directly led to the outbreak of World War II. In another example, the Japanese in 1941 only made up their mind to attack Pearl Harbor when the United States cut off all exports crucial to the Japanese military at that time. IB scholars need to draw on these historical experiences to make our case for the necessity of strengthening the trade and investment links among countries for the sake of world peace, in addition to traditional goals such as economic development and corporate profits.

While China "has the same right to engage in international commercial activity as any country" (Scissors, 2010: 10), China's OFDI, like all OFDI, will not be perfect. We suggest that policymakers in host economies embrace pragmatic nationalism as opposed to being exclusively influenced by the "China on steroids" literature. Pragmatic nationalism refers to "considering both the pros and cons of FDI and approving FDI only when its benefits outweigh its costs" (Peng, 2011: 193). If China's OFDI in certain areas are deemed detrimental to host economies, a case can certainly be made to disapprove such specific deals. But an indiscriminant, one-sided, negative approach is not warranted.

On issues of grave importance not only to the IB field but also to the wider world, such as the rise of China's OFDI, IB scholars have the sacred social responsibility to shed light and clear the air by drawing on our time-honored, evidence-based scholarly tradition (Globerman & Shapiro, 2009; Peng & Xiao, 2011). If we fail to do that, we will be failing both our students and the international community that we seek to serve. That, in our view, is the essence of the social responsibility of IB scholars.

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Endnotes

[1] This article is a condensed version of a previously published, longer article by Mike W. Peng, Sunny Li Sun, and Dane P. Blevins, 2011, The social responsibility of international business scholars, *Multinational Business Review*, 19(2): 106–199. Some of these ideas were first developed for a keynote speech delivered at the "China Goes Global" Conference at Harvard University Kennedy School of Government (co-chaired by Ilan Alon) in October 2009. I thank Alan Rugman (Editor-in-Chief, MBR) and Ilan Alon (Editor, *AIB Insights*) for their encouragement and support, and Sunny Li Sun and Dane P. Blevins for their collaboration on the MBR paper.

[2] In other words, we do not cover non-direct investment from China (such as purchases of U.S. Treasury bills).

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Accepting "Conventional Numbers": Determining the Size of the Worldwide Counterfeit Goods Market

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Click on "counterfeit goods market" or any similar Google search terms and about 100,000 websites pop up instantly. Even a cursory glance at some of these sites shows a remarkable commonality in the estimates for the size of the worldwide counterfeit goods market — something like $500 billion annually. Sources as diverse as the *BBC*, the *Sydney Morning Herald*, the Comptroller of New York City (2004) and the Progressive Policy Institute quote figures in this range with great authority. But searching behind this well-worn estimate reveals a serious problem with this "accepted wisdom." Estimates of the counterfeit goods market range from as low as $200 billion or $600 billion to as high as $1 trillion. Since there is little agreement on definitions and serious problems of measurement, it is not really clear what the right number is. This paper explores these problems.

Measuring the Counterfeit Market Is Extremely Difficult

Attempting to measure the global value of counterfeit products is excruciatingly difficult. This is understandable given the illegal nature of the activity. The only real data are surrogate indicators such as seizures of pirate product by police or customs authorities. In addition, there is no agreement on factors that should be considered when calculating the scale of counterfeiting. Should the estimate include sales lost by specific brands and at what prices, damage to brand equity, total sales of counterfeits or some combination of these factors (Green and Smith 2002)? The latest attempt to quantify the counterfeit goods market was completed by the U.S. government's General Accountability Office (GAO). In developing their information the GAO interviewed government officials, representatives of industry associations, academic institutions and firms and reviewed as many existing documents and studies as they could find. They concluded that counterfeit product is a significant problem, but "quantifying the economic impact of counterfeit and pirated goods on the US economy is challenging primarily because of the lack of available data" (GAO 10-243).

The GAO report focuses on two key assumptions in measuring counterfeit goods –substitution rate and value. The former is the rate at which the buyer is willing to switch from a fake good to the genuine product. If the rate is assumed to be one-to-one, it must be assumed that the fake is nearly identical to the real product, the buyer is paying full price for the fake and the buyer is not aware of buying a fake. These assumptions are rarely all true at the same time. Value focuses on the level in the production chain at which the good is priced – production cost or retail price for instance.

The GAO found that commonly-cited figures for counterfeit products are often attributed to U.S. government sources such as the Federal Bureau of Investigation (FBI) or the Customs and Border Protection Service (CBP). However, the FBI, when asked about their numbers by the GAO, says they have "no record of source data or methodology" for their estimates and the CBP could not identify the origin of their figures and has informed its staff to discontinue their use (GAO 10-243).

Several methods have been used to calculate the size of the counterfeit goods market including extrapolation from counterfeit goods seizures, survey of supply and demand, use of economic multipliers and even the "rule of thumb." Each of these methods faces daunting challenges to accuracy and none of them can be relied upon.

Some economists even question the idea that there *are* losses associated with counterfeiting. The point is that consumers who buy fakes are in a market segment that purchases counterfeit because of their inability to afford the genuine product. Therefore, buyers in that segment do not really represent lost sales as those consumers wouldn't have bought the genuine product anyway.

The Organization for Economic Cooperation and Development (OECD, 2007) states, after an in-depth look at the attempts to measure this market, "the overall degree to which products are being counterfeited and pirated is unknown, and there do not appear to be any methodologies that could be employed to develop an acceptable overall estimate."

The Counterfeit Goods Problem Appears to Be Growing

Despite the lack of reliable data, it does appear that product counterfeiting is significant in total size and growing (Croxon 2007; IACC 2007; UNECE 2007). Tracing the growth of the various estimates is interesting. In 1982 the International Trade Commission estimated the worldwide

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sales of counterfeit goods at $5.5 billion (Abbott & Sporn, 2002). Since that time many estimates of the global counterfeit goods markets have been made. In 1984 the International Anti-Counterfeiting Coalition estimated it at $25–$30 billion (Stern, 1985). By 1996 the *Economist* even found a source that gauged the market at $1 trillion. In 2001 the International Chamber of Commerce (ICC) estimated that 5–7 percent of world trade was in counterfeit goods and that the counterfeit market was worth $350 billion. This 5–7 percent figure initially was used by the Chamber in 1997 which even then called the percentage only a "general assumption" (Bialik, 2007). This became the "rule of thumb" estimate mentioned above. As the OECD report (2007) politely puts it, "the metrics underlying the ICC estimates are not clear." The OECD report adds that the ICC estimates "reflect judgments that are not supported by clear data."

World estimates seem to have coalesced around $500–$600 billion annually (IACC, 2007; Punch, 2005; and many others). This estimate includes all forms of intellectual property rights violations involving products and services and sales within and across country borders. The OECD (2007) puts the worldwide volume of tangible counterfeit products at about $200 billion, an amount larger than the GDPs of 150 countries. However even the OECD estimates are based on incomplete information. The OECD (2007) itself says, "available information on counterfeiting and piracy falls far short of what is needed for robust analysis and policymaking," and the organization makes a series of detailed recommendations for the improvement of data collection. According to Bialik (2007) the OECD's estimate was originally extrapolated from customs seizures based on reports from 45 countries who responded to requests for data with enough information to be useful for analysis. The latest attempt to quantify the counterfeit goods market was completed by Frontier Economics. They estimate value of the worldwide counterfeit product market at $465 to $650 billion in 2008 (Frontier Economics, 2011). Their approach is based on customs seizure ratios developed by the OECD. But that approach raises many questions.

> *"The amount of counterfeit product intercepted by customs services around the world is a tiny percentage of the overall estimate of the worldwide counterfeit goods market."*

The amount of counterfeit product intercepted by customs services around the world is a tiny percentage of the overall estimate of the worldwide counterfeit goods market. The OECD (2007) gives the value of seizures by customs services in 35 countries reporting the data at about $769 million in 2005, representing 0.01 percent of total imports for these countries. Nevertheless, the received data were extrapolated by the OECD to the non-responding countries. Researchers used a factor of 5 percent for frequently pirated goods in countries where there are a large number of pirates. Using this factor, researchers calculated a total of $100 billion then doubled that number to account for "statistical variability in their model" (Bialik, 2007).

An organization called Havocscope also attempts to put a number on the total counterfeit goods market. Their estimate for counterfeit and piracy is $606 billion, and their estimate for the total availability of counterfeit products in the United States is $225 billion. However even a cursory review of this organization's website reveals problems with the methodology. Figures are developed from published sources such as newspapers and government studies (which as we have seen are often all quoting the same questionable sources). The organization also states that "the manner in which the original source determined the figure is not always available" and "the numbers will include a high level of uncertainty. A majority of the figures will be based on estimates and will be difficult to verify" (Havocscope, 2009).

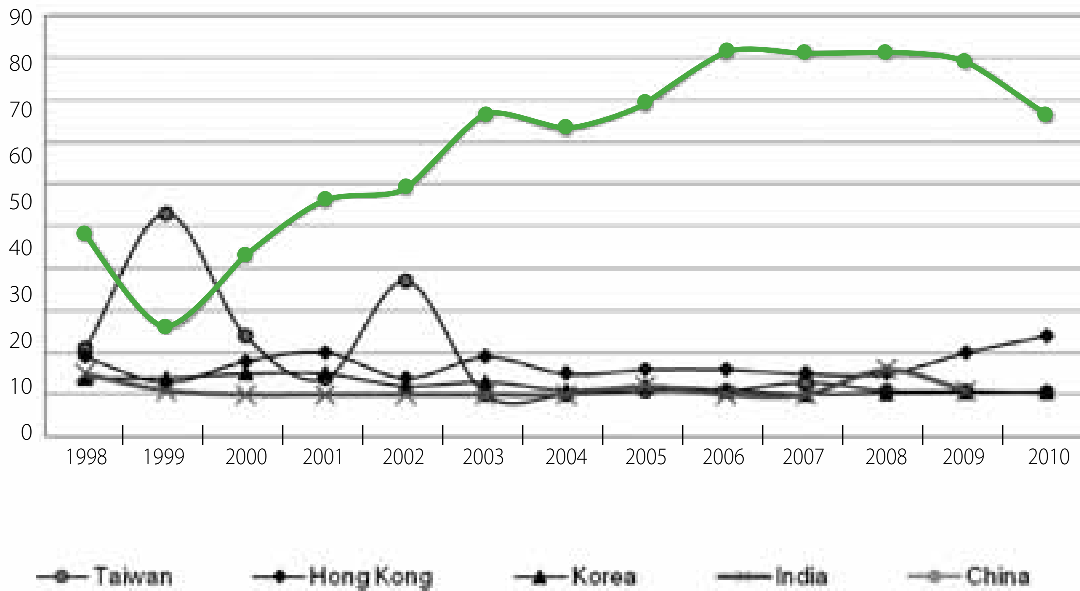
In Canada the cost of counterfeiting was estimated at $30 billion annually. This figure, used repeatedly by many, including U.S. Ambassador David Wilkins in a March 2007 speech, originated with the Royal Canadian Mounted Police (RCMP) in 2005. Careful research by Geist (2007) of the University of Ottawa Law Faculty revealed that the $30 billion number was derived from two main sources – an IACC claim that 20 percent of the Canadian market is made up of counterfeit product and an estimate that 3–4 percent of Canadian two-way trade consists of counterfeit product – given by the chief economist for the Canadian Manufacturing and Exporters Association in 2005. The $200 billion OECD world estimate and the $30 billion Canadian estimate cannot both be correct.

As we have seen the same numbers from very few sources are repeated over and over. Even the original sources have expressed many doubts about their own methodology and estimates. In truth it is virtually impossible to determine the real size of the worldwide counterfeit product market.

What is the true effect on the U.S.?

There is some confusion as to the true impact of counterfeit product on U.S. firms. As long ago as 1994 estimates of U.S. losses stood at $200 billion per year (Nill & Schulz, 1996). The U.S. Customs service recently estimated that the U.S. economy was losing between $200 and $250 billion per year and a total of 750,000 American jobs because of product counterfeiting (ICE, 2007), although these numbers have since been disavowed by ICE. It is not clear whether these figures are meant to refer to lost sales on a worldwide or domestic basis. Since many U.S. firms achieve 50 percent or more of their sales in overseas markets it seems reasonable to believe that this figure most likely includes all worldwide sales. Certainly in order to agree with the OECD estimate of $200 billion for counterfeit products on a worldwide basis, the effect on U.S.

Figure 1: Seizures by Country of Origin (% of seizures)



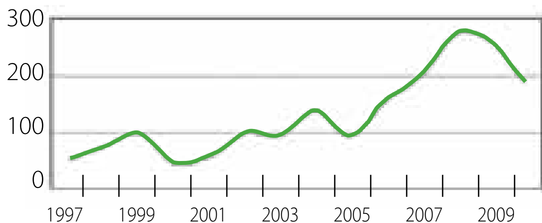
Source: U.S. Customs and Border Protection, 2011.

markets would have to be far smaller. The U.S. International Trade Commission recently completed an extensive study of the effects of China's product counterfeiting on the U.S. They estimate U.S. firms' losses from IPR infringement in China at $48 billion in 2009 (USITC, 2011).

Not surprisingly, the number one source of counterfeit product coming into the U.S. continues to be the People's Republic of China. China is the origin of at least two thirds of all pirated goods seized by customs since 2005 as can be seen in Figure 1.

Over the years U.S. Customs has generally increased the number of counterfeit product seizures. Figure 2 shows the dollar volume of seizures made from 1994 through 2010.

Figure 2: U.S. Customs Seizures (US$mil)



Source: U.S. Immigration and Customs Enforcement, 2011.

In 1994 U.S. Customs stopped about $38 million worth of counterfeit products. Seizures increased to $99 million in 1999 and then declined in 2000 and 2001, only recovering to $99 million once again in 2002. Customs made counterfeit product seizures in 2006 of nearly 15,000 different shipments valued at about $155 million. The dollar amount of seizures has continued to increase, moving up to nearly $200 million in 2007, over $270 million in 2008 but slipping to about $190 million in 2010 (US Customs and Border Protection, 2011).

The growth of counterfeit product seizures is certainly commendable, but an earlier study by the GAO (GAO 07-735) suggests that the percentage of the U.S. market accounted for by counterfeit product may be much smaller than has been previously thought. Inspecting 287,000 randomly selected shipments from 2000 to 2005, the GAO found counterfeiting violations in only 0.06 percent. The GAO also stated that customs seizures in 2005 amounted to only .0017 percent of the value of goods in product categories likely to be subject to counterfeit. The GAO analyzed all products imported into the United States and developed a list of IP-related product categories. For 2005 imports of these products totaled approximately $555 billion. This list was based on products where IP-related seizures had been made over the last five years. It hardly seems possible that the U.S. level of counterfeit goods would reach nearly 40 percent of all imported IP-related products which would be the case if the $200 billion figure is used.

Recently, the *number* of seizures has been increasing. In 1997 customs stopped 1,943 shipments of pirated goods. This increased to more than 3,000 in 1998 and moved steadily up to over 8,000 in 2005. Since that time the number of shipments has held steady in the 14,000–15,000 range. The number of shipments intercepted held steady in the 14,000–15,000 range from 2006 to 2009 and then increased to over 19,000 in 2010. This can clearly be seen in the graph below. Since the dollar value

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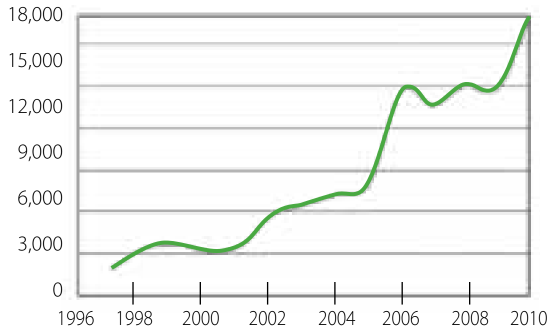
of seizures has decreased while the number of shipments taken has increased, it is obvious that the average value of an IPR seizure dropped significantly, from $17,566 in 2009 to $9,425 in 2010.

Figure 3: U.S. Customs Seizures (number)



Source: U.S. Customs and Border Protection, 2011.

The earlier GAO study raises questions about the usability of the customs seizure data as an indicator of the size and growth of the counterfeit market. First it appears that enforcement varies widely between ports with some ports finding 100 times the amount of counterfeit products as other ports. Only 10 ports accounted for a quarter of seizure value and 84 percent of penalty cases since 2001. The pressure to move product through ports and airports is very high especially since imports had grown from about $1.2 trillion in 2001 to about $1.7 trillion in 2005, and shipments filed with customs up about 25 percent over the same period.

Lessons for IB Researchers from "Conventional Numbers"

Although specific numbers are blithely cited in scholarly and popular media, in reality the measurement of the counterfeit products market is extremely difficult. Given the illegal nature of the activity, no direct measurement is possible. Compounding the problem is defining what exactly is being measured. Those making the estimates, such as the OECD and the International Trade Commission, have readily admitted their methodologies are flawed. Nevertheless, estimates abound. Some claim the global value of counterfeit products at $200 billion. Others see the number as much higher and state that 5–7 percent of world trade is in counterfeit. Since the actual seizures by Customs agencies around the world represent approximately one tenth of 1 percent of total imports, one must say the true number is not known with any confidence today.

Despite this, as we have seen, the $500 billion figure is repeated in many sources. The use of this commonly accepted number for the counterfeit goods market points to a larger problem in international business research. Inherent in our research is the difficulty of getting accurate measurements. Even such basic information as national export and import data are far from totally accurate as seen by the need to insert "Net Errors and Omissions" into Balance of Payments statements (Federal Reserve Bank of New York, 2010). We need to be careful when using figures provided by others and we need to point out the serious limitations inherent in these estimates. Just restating what I have called "conventional numbers" without any disclaimers leads to acceptance of flawed data. IB researchers must exercise extra caution where the difficulty of finding reliable numbers is apparent.

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