INTRODUCTION

Innovations in modern technology and ICT have ushered in the age of economic globalization by reducing transaction costs and creating a level playing field for competitors. But technology cannot reduce all transaction costs, thereby hindering trade and integration between certain regions. But they also create possibilities for comparative advantages for regions that know how to deal with these challenges.

OBSERVATIONS

- According to Thomas Friedman, a ‘flattist’, the global market of the 21st century renders historical, geographical and cultural differences irrelevant.
- Saskia Sassen, a ‘reliefist’, stresses the role of ‘global cities’ (which are opposed to ‘world cities’) as hotspots of economic activity in terms of their specialized services and production, role as innovation hubs and market concentration, in the changing configuration of the global economy.
- The gravity model of trade, developed by Jan Tinbergen, states that economic trade between two economic actors is dependent on their economic size and distance. Empirical research confirms the distance dimension.
- A recent overview study by the IMF shows that national borders hinder economic trade.
- Singapore, Manama, Hong Kong, Dubai and Amsterdam are the top 5 Globalization Hotspots in 2015, in terms of the intensity of their international trade flows. London and New York occupy #46 and #76 respectively, despite being the only two Alpha++ cities of the world.

ANALYSIS

Innovations in modern technology and ICT have significantly reduced transaction costs and spurred economic globalization. The internet and smartphone enable Chinese consumers to order Dutch tulips with only a few mouse-clicks. But there are still significant barriers that haven’t been taken down by technology. That’s why international trade interactions are significantly less intense than domestic interactions. Furthermore, international interactions are dampened by administrative, cultural, economic and geographical barriers, showing that relative distance matters for trade. These are what Pankaj Ghemawat calls ‘the law of semiglobalization’ and ‘law of distance’. What determines the logic of these laws?

The idea is that technology and ICT only reduce a certain form of transaction costs. As we noted elsewhere, transaction costs can be divided into two groups. Hard transaction costs are transaction costs that are often clearly visible and easy to point to, originating from formal and discernible sources like tariffs or the costs of moving products from A to B. They primarily reduce information costs, search costs, communication costs, formal trade costs and transportation costs. On the other hand, soft transaction costs are transaction costs that arise from informal sources that are less clear-cut, like cultural differences, mutual distrust, clashing norms and so on. The internet reduces (hard) transaction costs when selling tulips to Chinese consumers, but still significant soft transaction costs stay in place that technology cannot eliminate, like unintentionally offending Chinese business rituals, differences in expectations about product quality, miscommunication because of language barriers and distrust in the other’s credibility and reputation.

Players who know how to reduce soft transaction costs will disproportionally benefit from international integration and trade. But this type of transaction costs cannot easily be reduced by technology and ICT: WhatsApp eases communication but doesn’t foster trust or mutual understanding between parties. However, there are other mechanisms that are vital in reducing soft transaction costs which cannot be enforced nor are easily constructed, like social capital, trust, shared norms and values or a community’s intrinsic motivation to play by the rules. From this perspective, globalization hotspots are successful in reducing soft transaction costs, facilitating global trade and positioning themselves as a hub in the global economy. For example, the Dutch culture facilitates the Netherlands’ position as a digital hub because it reduces soft transaction costs, as we noted before. Soft transaction costs make our world of economic globalization less ‘flat’ than we think, and continue to shape the peaks and valleys of the economic globalization plateau.

POTENTIAL BENEFICIARIES

- Cities and organizations that cultivate an environment and implement strategies that reduce soft transaction costs.
- Regions with strong traditions and informal institutions that promote trade and economic interaction with others.
- Companies with relevant in-house expertise (like historians, anthropologists, sociologists or philosophers) to organize a global value chain between several globalization hotspots.