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## Ukraine and the challenges of globalization and economic trends

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### Abstract

*The wealth of a nation is today usually defined by its ability to produce goods. Due to the increased globalization, production of IT software has become a large industry in Ukraine, which offers more prosperity for Ukraine as a nation and great opportunities for Ukrainian IT specialists. However, the majority of the products are owned by foreign investors, which may raise some concerns on longer terms.*

*This short paper takes a brief look at the historical development of international economy and trade, and the implications that the recent economic developments could have on business in Ukraine in general and the IT outsourcing industry in particular.*

### Globalization of trade

As far back as the Stone Age people have produced goods and traded the surplus. In the beginning people traded mainly with neighbours; however, when surplus (wealth) began to grow, people began to specialize and form cities and state communities and the growing wealth also meant that more and more people began to work with production of not only goods but also services. Legal services, transportation services and banking services, for instance, have been around for thousands of years.

As far back as 1500 BC, merchants from ancient Egypt travelling to Mesopotamia on business trips did not bring cash with them in the form of gold or silver. Instead, they went to the local international bank, typically a family run merchant trading house with offices in several other countries and paid in their valuables. In return, they received clay tablets with the same value marked on them. The tablets were verified with the seal of the bank and the owners. When the bearer of the tablets presented them to the corresponding bank in Syria or Mesopotamia they were paid the stipulated amount in gold or silver minus a service fee, and could then buy the goods they were looking for.

In Western Europe in the 15th and 16th century, double entry accounting was invented and the first stock exchanges were created. They traded not only goods but also money and all kinds of credits and futures, just like today. Today we have electronic accounts and internet trading; but the basics are the same – nothing has basically changed for past five hundred years!

Ukraine has been a part of the international trading system for more than a thousand years, trading north with Scandinavia, south with Constantinople and Byzantine Empire and west with Germany and the rest of Europe.

Growth of science and technology and the industrialization since the 18th century has given an incredible increase in trade and the resulting wealth, as can be seen in the figure below, where the global trade of goods is seen as a percentage of the global GNP. In 2008, it amounted to more than 50%.

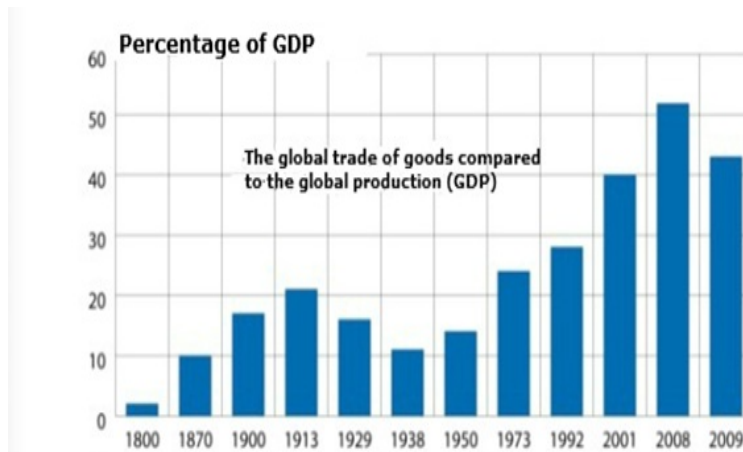


Figure 1 - Annual Trade Report 2010 by WTO

In the 18th century Adam Smith wrote his famous book “The Wealth of Nations”. Among his observations were, that the work/labour/production was the key to wealth of a nation. From these ideas it became evident that the more profitable trade a nation is involved in, the richer it will become. This may seem obvious to many of us today; but in the old days, people believed that the more gold a state amassed the richer it would become, and subsequently that closed borders and high tariffs were a good thing.

### Globalization of services and production

As Adam Smith pointed out, labour and production is the key to wealth. During the last 50 years, businesses have benefitted not only from producing goods in countries with low salaries; but due to the increasing efficiency of information technology, it has also become possible to trade services.

In the old days a labourer was not mobile. He worked on a farm or in a factory. If conditions were really bad, he could move to another part of the country or emigrate, if he thought that it would help, and if he was

allowed to do so by the state, which was often not the case. If a company wanted cheap labour, it would have to establish a factory or office where the labourer was living. The only exception was slavery, where nations could take labourers from their native country and set them to work wherever needed.

IT has made it possible to trade services. The term used is often outsourcing. Both production of goods and services can be outsourced. This means that a lot of knowledge labourers are now developing software, writing documentation and performing other functions very far away from where the employer is located.

Companies in West Europe and USA have outsourced service work farther and farther away, literally to "the end of the world" in search for lower salaries, and now there is not really any new place to go looking for cheaper labour.

## Conclusion

So what does this mean for us here in Ukraine, when we develop software or perform other IT services? Well quite a lot!

Even if a person is a knowledge worker and works with complicated matters, he is still a worker. He may have a good salary and live a comfortable life compared to workers in the old days, who were poor and often treated badly. But work outsourced to Ukraine can disappear again if the economic conditions change – and they are presently changing fast.

As can be seen from the previous figure, trade of goods dropped sharply from 2008 to 2009. The same drop has been experienced with services (work/labour). What is really surprising is how big a change is observed over a period of just one year!

The economic crisis in EU is gaining momentum, and it is only a question of how fast the Eurozone will break up. The important thing, however, is the amount of debt accumulated in EU. In order to get rid of the debts, people will simply have to work more and at lower salaries in order to be competitive. In Germany, salaries have been stagnating for several years, and in most EU countries, salaries will now begin to decrease.

On top of this, there is also another trend that has to be considered. Adam Smith pointed out that value is created by work/labour, which implicitly means that a sustainable value is the ability to continue to work more efficiently or to innovate.

There is presently a lot of scientific discussion about how a business can innovate, and it is increasingly becoming clear, that if a company outsources too much production or development, it loses the ability to innovate and thereby loses a sustainable competitive advantage.

Knowing that the analysis in this short paper is not sufficient to methodically defend our conclusions, we still dare make the following assertions: 1. The economic crisis will reduce salaries in EU and USA, 2. There is nowhere else to go for outsourcing (salaries in China are growing fast), 3. Outsourcing will be reversed and services will tend to be produced in EU and USA again, 4. The need for the ability to innovate will speed up the whole process.

What is the solution for IT service industry in Ukraine?

**Focus on manufacturing own products. Use the level of technical expertise to develop digital products/goods to supplement production of services and engage in international marketing and brand building of these products.**

## References:

1. International Economy 2nd Edition by Henrik Kureer, Systime. <http://www.systime.dk/henrik-kureer.html>
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3. Adam Smith. An Inquiry into the Nature and Causes of the Wealth of Nations, 1776.