GLOBALISATION IN RETREAT?
Changing patterns of trade and investment and what it means for companies in Asia
Globalisation has been rising rapidly for the past 70 years. Since the end of World War II, countries have increasingly opened their borders to trade and investment, which in turn has supported rising prosperity. But has globalisation reached its peak? By many measures, the world economy has become less open since the onset of the global financial crisis in 2007. After decades of ever more cross-border trade and investment, the world appears to be retreating into an era of greater protectionism and nationalism. World exports as a share of global GDP rose steadily between 1980 and 2008, but have stayed flat ever since. Global capital flows topped $11tn in 2007, but in 2012 were barely a third of that figure.

Some of this cooling of international trade and investment is cyclical, and may well strengthen when the global economy becomes more stable. But much of it is also the result of deliberate government policy. Across most countries, the desire to regulate markets more tightly and achieve a greater measure of national economic security is strong. Although the world has not retreated into the extreme protectionism experienced during the Great Depression of the 1930s, we are no doubt moving into a world where more subtle forms of protectionism are flourishing.

PROTECTIONISM LURKING IN THE SHADOWS
Instead of raising blunt tariffs or explicit restrictions on imports, governments are supporting protectionism through more covert means. Capital controls have regained popularity as a way to regulate money flows. Governments are also using stealth to protect their domestic companies by providing subsidies, enforcing new regulations that disadvantage foreign businesses, or imposing local-content requirements. Indonesia, for example, requires oil and gas companies to source at least 51% of their goods and services locally. India imposes local-content requirements in its IT and communications sector. Global Trade Alert, a monitoring service operated by the London-based Centre for Economic Policy Research, calculates that since 2009 the world has seen the introduction of 400 new pieces of such subtle forms of protectionism every year.

This is not to say that efforts to break down global trade and investment barriers have completely ground to a halt. But these efforts have taken on a different character.
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World leaders are moving away from multilateral trade deals and instead are focusing more on regional and bilateral pacts that are easier to negotiate and get signed.

Although optimism surrounding the World Trade Organisation (WTO) Doha trade talks has waned, regional trade negotiations such as the Trans-Pacific Partnership (or TPP, which involves 12 countries including the US and Japan, but notably excludes China) have gained a good deal of attention. The US and European Union are also working on a bilateral free trade agreement, representing what could be the largest free trade area in history, covering 46% of world GDP. In Asia, the Association of South-east Asian Nations (ASEAN) has set up trade agreements with China as well as the US, and is in bilateral discussions with many other nations to do the same. Indeed, the number of bilateral trade deals in Asia Pacific has risen dramatically over the past decade (see chart 1). In 2000, there were only five such deals in place. Today, there are more than 70.

Critics argue that the proliferation of regional trade agreements (RTA) is threatening the multilateral trading system. Once countries join an RTA, they discriminate against outsiders and lose interest in multilateral liberalisation. These agreements are accused of diverting as much trade as they create and introducing big distortions. What’s more, having multiple agreements creates a “noodle bowl” of complexity that companies struggle to navigate.

Yet, supporters argue that regional trade liberalisation is still better than no liberalisation at all. One participant at the Economist Corporate Network meeting, a managing director of a global manufacturing firm, noted, “Despite the complexity of managing supply chains and distribution centres across a regionalised world, RTAs are still net positive and we still make good use of them.”

Chart 1:
Number of free trade deals in Asia Pacific

Source: East West Foundation
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NEW PATTERNS OF GLOBALISATION RISING

So the form and character of globalisation are changing, both how it is promoted and negotiated to how it is held back and stifled. Just as significant, the places where globalisation is happening are changing. As emerging markets get richer, new economic corridors are springing up between different parts of the emerging world.

Looking at globalisation over the past 70 years, three distinct phases are clear. Following World War II, the world economy was not only deeply damaged but also deeply divided. In order to promote peace, Western nations began to encourage global integration and cooperation, setting up institutions such as the World Trade Organisation (WTO, formerly GATT), the International Monetary Fund (IMF) and the World Bank. These efforts worked well. From the 1950s to the 1970s, cross-border trade and investment flourished. However, most of these new economic corridors were between countries in the rich world. Globalisation was about Europe and North America deepening their relationships.

Then, in the 1980s and 1990s, a second phase of globalisation emerged in which the developed world in the North started to invest and trade more actively with the emerging world in the South. European and American companies expanded their supply chains to access cheap labour in Asia and Latin America, as well as to seek energy and raw materials there. This North-South integration enabled rich world countries produce their goods and services at lower cost, and at the same time fuelled economic development in the emerging world.

As wealth rose in the emerging markets, so a third phase of globalisation has been unleashed, whereby places such as China, Brazil and Nigeria are becoming ever more connected. This so-called South-South trade has been rising dramatically, and is commanding an ever larger share of global trade (see chart 2). It’s a similar picture for
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investment: more and more of the foreign investment going into emerging markets is coming from companies based in other emerging markets.

This picture of deepening connectivity between emerging markets has only just begun. In the years ahead, the value of trade and investment that flows along these new economic corridors will continue to rise. So too will the flow of ideas and innovation and people.

Increasingly, these new economic corridors will also be the routes that companies use to grow into emerging markets. While every country is different, emerging markets do share common traits that are distinct from developed ones. Incomes are lower, infrastructure is weaker, regulations are fluid, and risk is higher. Companies that want to do well in emerging markets must build a distinct set of capabilities, and develop products and services that are appropriate to the local conditions. While it is not easy, once a company has built a successful business model in one emerging market, the chances are that it can export that model to a similar market.

Many companies are already doing just this. Bharti Enterprises of India is a good example. In 2010, the company made a US$10.7bn acquisition for the African operations of Zain, a Kuwaiti telecoms group. It was the biggest acquisition that Africa has ever seen. Bharti had built a successful low-cost telecoms operation in India, and believed it could replicate the model in Africa.

ASIA’S CHANGING ROLE IN SOUTH-SOUTH GLOBALISATION
As the connections and corridors linking the emerging world deepen and grow, it’s clear that Asia is taking a dominant role in this new landscape of globalisation. In part this is because of Asia’s huge scale. The region is home to more than half the world’s population, and accounts for almost a third of the global economy. What’s more, the region is growing faster than any other part of the world, ensuring that its economic dominance will continue to rise. Unsurprisingly, companies are highly focused on the growth opportunities in Asia, and investing more in the region to capture these rising opportunities.

Up until now, much of the investment coming into Asia has been about tapping into the region’s abundant pools of low-cost labour, and building global value chains, both in manufacturing and services. But as Asia’s economies have grown and become richer, wages have risen. This is causing many companies major headaches. The response to such issues may well lie in pushing ever deeper along South-South corridors and re-ordering global value chains across the emerging world. Textile manufacturers in China, for example, are shifting factories into Bangladesh and Cambodia. Africa is proving a new destination for outbound investment from China too. For example, one of China’s biggest shoe makers, Huajian, opened its first factory in Ethiopia in 2012, with plans to employ 100,000 factory workers there.
As Asia loses some of its lustre as a source of low-cost labour, it is also gaining global attention for new types of investment. Companies have long invested in the region looking for markets and revenue growth, and this continues to be an ever more important driver of investment into the region. Just as important, Asia is also becoming an important contributor to global R&D and innovation. More and more global companies are setting up R&D centres in China, India and other Asian destinations with the goal of developing new products and services focused on emerging market opportunities. Indeed, Asia is rapidly emerging as the hub for R&D aimed at serving global emerging markets.

One participant at the meeting, a senior executive based in India, noted that his country is spearheading the development of “frugal” products that appeal to lower-income customers. Although India’s frugal innovation is used to find low-cost solutions to local problems, these ideas and products are relevant for all emerging markets. Indeed, ever more of them are finding their way into developed markets too. “In the past India’s companies were only about producing things with cheap labour. But now it is different: Indian companies like Wipro and Infosys are actually leading the innovation cycle,” he says.

As Asia’s economies get wealthier, and their industries move up the value chain, so they will also buy intellectual property as well as generate it themselves. Outbound mergers and acquisitions from Asian companies have been rising sharply in recent years. Much of it has gone looking for commodities to feed local growth. But a rising share is also seeking access to technology and ideas. For example, a major motivation for China’s Shandong Heavy Industrial Group to buy a 75% stake in Italy’s Ferretti, the world’s largest yacht maker, was to gain expertise in designing high-end yachts to meet demand from China’s emerging luxury consumers.

**COULD A CHINA SLOWDOWN CAUSE GLOBALISATION TO SOFTEN?**

Many executives at the meeting expressed concern about the outlook for China’s economy and whether a slowing China would cause globalisation to stagnate. As the world’s second biggest economy, China has become a major engine of global growth, and especially of global trade and investment flows. As the country developed its global manufacturing platform—effectively becoming the factory of the world—its demand for imports grew at a phenomenal pace, supporting high rates of growth in the rest of emerging Asia. In addition, as China embarked on a giant investment boom to support its economy, commodity exporters such as Australia and Indonesia benefitted greatly from the country’s ever rising thirst for raw materials.

However, there are signs that China’s export-led and investment-driven growth model is running out of steam. China remains a formidable player in global manufacturing, but rising costs mean it is losing competitiveness to other countries...
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as a place to assemble goods for the world. China also needs to move away from its investment-led model of development, because much of the investment is fuelled by an unsustainable build-up of debt.

The aspiration is to shift China away from its dependence on exports and fixed asset investment towards a more balanced picture in which private consumption has a bigger role. As this process happens, the structural growth rate in China will slow, from an average of 10% a year for the past 30 years towards a rate of around 5% by 2020 and 3% by 2030. China’s rapid slowdown will not only have a huge impact on the rest of Asia, but on the wider global economy too.

Many countries are already grappling with the implications of China’s slowdown. Senior business leaders in Australia expressed worries that their country would struggle to grow in the face of slowing demand growth for commodities. As one Australian executive put it, “We have had five years of remarkable prosperity following the 2008/09 global financial crisis, on the back of massive commodity export growth, mostly to China. This has caused us to suffer from complacency and the so-called Dutch disease, where the benefits of exporting natural resources have led to the neglect and atrophy of other sectors. The success of the mining sector has in fact come at the expense of other sectors—it has pushed up the local currency exchange rate and the costs of doing business, making other parts of Australia’s economy uncompetitive. Unless we build up our competitiveness in other sectors soon, our economy will suffer as the demand for resources cools down.”

The same is true for Indonesia. Much of Indonesia’s investment into infrastructure over the past five years has been to support the boom in its resources sector. Meanwhile, not enough investment has gone into building roads, ports, schools and other infrastructure needed to support further development. Coming off the commodities boom, capital needs to be re-directed to more productive sectors of the economy, including education, healthcare, and financial services. The impressive growth rates that Indonesia has achieved in recent years have, to a large extent, papered over the country’s urgent need of structural reform. Unless Indonesia manages to improve its business and regulatory environment, the country will struggle to achieve its growth potential.

WILL ASIA RAISE THE BARRIERS?
Faced with lower structural growth rates, one danger for Asia is that governments will face rising pressures from their electorates to be more protective of their respective economies, local jobs, and domestic businesses. Already, countries such as China, Indonesia and Singapore appear to be becoming more nationalist, making life harder for foreign companies operating in these places. In response to mounting political
pressures, even policymakers in Singapore—known to be one of the most open economies in the world—have recently taken steps to restrict the inflow of foreign workers and encourage the employment of locals instead.

Governments in Asia are also looking to protect their domestic industries by preventing foreign investment in local companies. As one senior executive based in Australia noted, “We are seeing creeping parochialism regarding foreign investment, particularly towards sovereign wealth funds or large investors from China who want to buy Australian companies or assets in sectors such as food production. These foreign investors have faced a lot of barriers from our foreign investment review board and received a lot of negative attention in the press.”

In some cases, politicians remain committed to providing government support to flagging local industries, to the detriment of the overall health of the economy. For example, although it is becoming clear that Australia can no longer sustain a vibrant traditional manufacturing sector, policymakers continue to hand out generous subsidies to industries such as the auto industry. As published in a recent article by The Australian, Gary Banks, former chairman of Australia’s Productivity Commission revealed that: “Every job ‘saved’ in the auto industry by assistance through the government costs Australian taxpayers around A$300,000... The car industry has been the most successful rent-seeker in Australia’s history, and the accumulated cost to the community and other local industries has been enormous.”

In Japan, the problems are even more deep-seated and extensive. Large sectors of Japan’s economy, especially in agriculture, remain effectively closed off to foreign competitors. For instance, the government imposes tariffs of up to 770% on imports of rice. Since Japan joined the TPP trade negotiations—putting the country under international pressure to eliminate tariffs on all its imports—powerful vested interests have voiced loud opposition to these efforts to liberalise trade.

But participants at the event also pointed to signs of optimism that some Asian governments will continue to open up their economies to foreign trade and investment. India, for example, has traditionally been known for its deeply unfriendly investment climate for foreign firms, but is now changing tack having learnt the hard way how protectionism can damage an economy. As one senior executive in India noted, “India has missed some opportunities of globalisation. In the past few yeas, the government has put up many barriers that have deterred foreign investment, which has in turn slowed India’s growth in investment and infrastructure. But the government is now trying to change that—it is becoming more welcoming to foreign investors. For example, the central bank has recently introduced new policies to liberalise India’s financial sector, which will help to attract capital flows and support growth.”