Anti-Globalization Picks Up Steam

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Ongoing tariff negotiations are shifting short-term economic winners and losers, and perhaps even changing the long-term pace and/or direction of globalization.

As we alluded to in earlier posts, the long-term megatrends of trade and capital-market liberalization have been good for global growth, and many parties (countries, industries, and individuals) have benefited.

China is a good example. Its size and growth, along with its entering the World Trade Organization (WTO) 20 years ago, accelerated the pace of global trade. Manufacturers of goods could get cheaper raw materials and labor from China, and that allowed them to sell their goods for lower prices, benefiting the global consumer.

Over time, however, policies often evolve in unexpected ways, and the perceived winners and losers are constantly reevaluated. That has been the case with globalization. Today, there's a growing awareness of its potential downside, at least from the perspective of citizens of the developed world.

Balance of Power Shift

In the case of China, specifically, there has been a perception that the country, because of its size and success, may have developed more global influence more quickly than expected. The balance of power has changed.

A reaction to that is natural. The other major power involved—the United States—is reevaluating whether its relationship with China is beneficial to Americans, at least in the way it was originally envisioned.

While that change in perspective is widely perceived as a political shift, it isn't driven only by the Trump administration. Even the Obama administration, which was more pro-liberalization, was starting to acknowledge some WTO exploitations by China. So policy leaders began rethinking whether the state of play was fair some time ago.

The underlying politics behind the shift away from globalization, then, need not be controversial or complicated. We simply need to renegotiate some trade agreements or enforce terms of the WTO, for example.

But the manner in which the shift has been communicated—with bluster and bravado, often via Twitter—detracts from the underlying motivation for the shift. Many consider this manner of doing things unbefitting for these types of geopolitical negotiations, which are generally fought out in back rooms, not on front pages.

Behind the scenes, however, the idea that there is some degree of unfairness in our trade agreements has become more mainstream.

Thus, I expect the anti-globalization movement to gain more traction, and we could even see a more pronounced reversal of the one-way globalization trend.

In the short term, this trend has made some people reluctant to invest in emerging markets, particularly China. The Chinese government appears nonchalant about the situation, but the business people we speak with on our research visits confirm that uncertainty around tariffs is creating uncertainty around corporate decision-making and investment.

That shouldn't surprise anyone: corporate confidence indicators all show that when uncertainty increases because of any situation, economic or political, businesses' desire to invest and grow declines. That's what we're seeing in China, and this is one reason the Chinese equity market underperformed the U.S. equity market in 2018. (China was down 18.8%, and the United Sates was down 5.6%.)

Other Factors Driving This Trend

But as in many situations, there are confounders. What else, in addition to the underlying politics, could be driving the shift away from globalization?

One possibility specific to China is Xi Jinping's consolidation of political power. The Chinese who have benefited the most from globalization have been the wealthy elite who live in large urban areas. But now Xi appeals much more to the lower end of the population spectrum.

The businesspeople with whom we interact aren't thrilled with this political outcome, and are concerned they might be constrained by Xi's policies. So as global winners and losers shift, winners and losers within China might also be shifting, and that might be changing corporate behavior as well.

Another phenomenon around globalization is consumer preference, which may be shifting. In some emerging markets, we have seen a preference for local goods over global goods among the lower- to middle-end consumer.

Chinese parents may no longer want Procter & Gamble diapers; they want the local product. It's the wealthy elite who have favored the aspirational international brands, who want to own the Gucci handbag. The question is, have international branded goods companies reached the saturation point in every global market? Or has the opposite happened with emerging markets selling into developed markets—have Americans bought just about as many Korean TVs as they're going to buy? This, too, could affect globalization.

Related but different is the labor cost arbitrage game that was played for four decades. Not long ago, it seemed as if trade was all about "Made in Japan." Then it was "Made in Taiwan," and then it was "Made in China." Now, it's "Made in Vietnam." How long will it be before it's "Made in America" because human labor isn't as necessary to make a widget?

Nike is a great example. Although most of its products are made in Vietnam now, shoes can be entirely fabricated on automated computer numeric control (CNC) machines. It's certainly some time before the wage gap between Vietnam and the United States closes, but are we in the later innings of labor arbitrage? Even if it's 20 years away, if it's already been in progress for 40 or 60 years, we're a lot closer to the end than we are to the beginning.

Bilateral Trade Agreements Increase Concerns

While my focus has been primarily on China, it's worth noting that the Trump administration's seeking of negotiated bilateral agreements rather than omni-party agreements is more broadly concerning to many people.

The outcome of any such tactic is that somebody wins and somebody loses. This could lower long-term economic activity by leading to higher prices and lower growth.

As a result, we're aware that the U.S. economic cycle seems to be more pronounced. In other words, the next phase of the economic cycle—slowdown—will likely come upon us more quickly than expected.

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