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Rawi Abdelal and Adam Segal

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THE END OF THE WORLD AS WE KNOW IT

ONCE UPON a time, not very long ago, economic globalization—the free worldwide flow of capital, goods, and labor—looked both inevitable and inexorable. Most governments seemed to embrace the very real benefits being offered by rapid technological change and international markets and sought to liberalize their economies in order to maximize these gains. Policymakers worked to prepare their societies for a world of ever-increasing interconnectedness and relentless competition, and the debate—at least within the United States—started to revolve around how to cope with the effects of this new "flat" earth.

Then came the financial crises of the 1990s and the early years of this century in Asia, Russia, and Latin America. The U.S. current account deficit—the difference, broadly speaking, between what U.S. residents spend abroad and what they sell abroad—shot upward. The U.S. dollar fell in value and seemed headed for an even more precipitous drop. As outsourcing accelerated, the American middle class came to feel increasingly insecure. Historians such as Niall Ferguson and Harold James pointed out that the previous era of globalization (which ran from about 1870 to 1914) had once seemed as unstoppable as the current one but had ended disastrously; so, too, they warned, could today's.

RAWI ABDELAL is an Associate Professor at Harvard Business School and the author of the forthcoming *Capital Rules: The Construction of Global Finance*. ADAM SEGAL is Maurice R. Greenberg Senior Fellow for China Studies at the Council on Foreign Relations and the author of *Digital Dragon: High Technology Enterprises in China*.

But will it? Has the current age of globalization already started to come to a close? Will the process of integration continue, or will it grind to a halt?

The paradoxical answer is neither of these scenarios. The technological revolution that has driven the current wave of globalization will continue. Communication will become still cheaper and easier, allowing corporations to spread their operations—research and development, design, and manufacturing—around the planet. Companies will exploit scientific talent in other countries to spark a new wave of technological innovation.

At the same time, certain barriers will start to rise. The institutional foundations of globalization—such as the rules that oblige governments to keep their markets open and the domestic and international politics that allow policymakers to liberalize their economies—have weakened considerably in the past few years. Politicians and their constituents in the United States, Europe, and China have grown increasingly nervous about letting capital, goods, and people move freely across their borders. And energy—the most globalized of products—has once more become the object of intense resource nationalism, as governments in resource-rich countries assert greater control and ownership over those assets.

Taken together, these contradictory trends indicate the shape of things to come. The picture is muddled. Although globalization as a process will continue to sputter along, the idea of unrestrained globalization will wane in force. As Cornell's Peter Katzenstein has argued, globalization and internationalization are not the same. The more prosaic process of internationalization—that is, exchanges across borders—can and will continue, even as the transformative ideological process of breaking down barriers slows considerably.

Much now depends on how national governments respond to these changing circumstances; they could still make conditions better or worse. As the integration of national economies stalls, maintaining the high degree of openness already established will require deft management. U.S. policymakers, in particular, need to do a better job of countering their constituents' wariness of global markets and managing the political backlash against openness that has already begun. The challenge is to sell the benefits of ongoing globalization to a wary public, to make sure those benefits materialize, and then to ensure they are distributed more equitably.

DOUBLE VISION

In retrospect, signs of the current slowdown in globalization have been obvious for some time. Major participants in the process have always had very different ideas about how the integration should occur. As a result, what often looked like a single, steady process turns out to have been conducted along two, sometimes contradictory tracks.

On one side of the ideological split stood the United States. Washington's approach to globalization has long been ad hoc, meaning that it has relied on the preponderant power of the U.S. Treasury and of private U.S. firms to strike bilateral deals directly with other countries. U.S. policymakers tend to be skeptical of global rules and international organizations, favoring individual and specific trade and investment treaties instead. Admittedly, the United States has offered modest support for international organizations at times, but never at the expense of its own preeminent role in the world economy. This approach has been effective from the United States' perspective, as it has placed the country firmly at the center of global markets.

European policymakers, meanwhile, have favored a different tack, trying to drive globalization by creating new overarching rules for the world economy and by empowering international organizations such as the European Union (EU), the Organization for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF), and the World Trade Organization (WTO). The European doctrine of managed globalization envisions a world of multilateral rules that will supersede U.S. power. Over the years, the EU alone has compiled over 80,000 pages of regulations to ensure the interdependence of its members—the greatest body of such rules ever produced.

These two very different visions of how globalization should progress have never been harmonized, and this conflict has weakened the foundations of globalization in recent years. Consider the role of capital. In the last few years, restrictions on the flow of investment between countries have increased despite some regional attempts to move in the opposite direction. The EU, for example, forbids its members from restricting the movement of capital within Europe, and the OECD requires its members to maintain open capital accounts. But there is no global rule requiring all countries to permit unhindered foreign investment. That institutional void is not for want of trying; during the 1990s, the IMF's management attempted to get its members to give the organization the authority to mandate the lowering of investment barriers. But the proposal lost steam after the financial crises of 1997 and 1998, and its fate was ultimately sealed by the skepticism of the U.S. Congress.

The closest the world ever came to a consensus that capital should be allowed to flow freely between countries was in the autumn of 1998. Since then, practices have changed dramatically. The IMF is now much more cautious about encouraging countries to liberalize their foreign investment rules, and it often warns developing countries not to move too quickly. The OECD has also retreated from its unqualified support for such measures. These days, the two dominant credit rating agencies, Moody's and Standard & Poor's, often warn developing states about the risks of capital liberalization, and they have praised China and India for moving cautiously.

DOHA DECLINE

A SIMILAR RETREAT has occurred with trade in goods and services. In the last few decades, a variety of regional agreements have been struck in North America, South America, and Europe to promote the liberalization of trade. The IMF, under its original mandate, has encouraged governments to eliminate foreign exchange restrictions that hamper the growth of trade. And the WTO has been strikingly successful in its first decade of existence as the world's primary authority on facilitating global trade. But the organization seems to have reached the zenith of its powers.

This is unfortunate, since many of the WTO's existing mechanisms—especially those relating to rule enforcement—are highly imperfect. The problem is not with the WTO's rulings about violations of free-trade rules; these are generally thought to be fair. The problem is that when countries found to have broken the rules refuse to change their policies, the WTO cannot force them to; instead, it leaves it to the country that won the dispute to take matters into its own hands by applying WTO-

sanctioned retaliatory tariffs. Not surprisingly, this strategy tends not to work when the winner is much smaller than the loser—especially when the loser happens to be the United States or the EU. Indeed, U.S. and European intransigence in the face of adverse WTO decisions has weakened overall faith in multilateral trade regimes. Countries around the world are instead showing a new preference for bilateral and regional trade agreements; according to *The Economist,* the total number of such agreements—250—has doubled in the last ten years.

Meanwhile, the crisis in the current Doha Round of trade talks has highlighted another deepening divide: between rich, developed countries and poor, developing ones. For years, developing countries have been frustrated with the hypocrisy of U.S. and European governments, which constantly push for greater market access while protecting their own agricultural and light-manufacturing sectors through tariffs. Now these developing states have had enough, and the talks have broken down, primarily because the United States and the EU have failed to offer a constructive way forward. The damage to Doha will not necessarily be fatal.

After all, the Uruguay Round took more than seven years to complete, and behind-the-scenes negotiations will continue. But the days of clear progress and the ever-broadening mandate of the WTO seem long gone.

Tension has also increased over the free movement of labor. The current era of globalization has not even approached the cosmopolitanism and openness to migration that characterized the pre-1914 phase. According to James, who teaches at Princeton, 36 million people left Europe for the Americas between 1871 and 1915. Nothing approaching that kind of population shift is likely to occur today. The European public has grown highly skeptical about the EU's ability to absorb and assimilate new immigrants from Muslim and African countries. Indeed, even within the EU, barriers have started to go up as the union's older members have restricted immigration from new members such as Poland, Hungary, and Slovakia. In the United States, meanwhile, immigration—especially the status of the 12 million illegal immigrants already inside the country—has become a similarly contentious issue. President George W. Bush has, at some political cost to his administration, proposed to address the problem through a package that would include better border enforcement and an offer of earned citizenship for the illegal immigrants already inside the country. But so far, Congress has failed to move any legislation forward, and the most likely outcome appears to be the construction of a massive fence along the border with Mexico.

THE CHAMPIONS' CHANGE OF HEART

ONE OF THE most worrisome aspects of the general decline of globalization today is the growth of public skepticism and the increasing popular dissatisfaction with the uneven distribution of globalization's benefits both across and within countries. These sentiments, now evident virtually everywhere, are perhaps most striking in two countries: the United States and China. In both places, they are already starting to force policymakers to erect economic barriers.

The irony of this trend is that both the United States and China have benefited handsomely from globalization. Yet politics in these two states now constrain their governments from further embracing cross-border flows of capital, goods, and labor. As Ben Bernanke, chair of the Federal Reserve Board, suggested in August 2006, the problem "arises because changes in the patterns of production are likely to threaten the livelihoods of some workers and the profits of some firms, even when these changes lead to greater productivity and output overall. The natural reaction of those so affected is to resist change, for example, by seeking the passage of protectionist measures."

Consider what has recently happened in the United States. The country is now confronted with the largest current account deficit ever—a deficit that necessarily must be matched by capital inflows, that is, borrowing from abroad. And yet, just when the United States needs foreign investors the most, popular sentiment has turned against them. In recent years, intense public pressure has essentially forced Washington to reject two high-profile transactions: an attempt by CNOOC, a giant Chinese oil firm, to acquire the U.S. firm Unocal and Dubai Ports World's move to take over a British company that administered several U.S. ports. Now, ongoing legislative efforts to reform the Committee on Foreign Investments in the United States threaten to politicize the approval process further. Even as the United States' need for foreign investors to finance the current account deficit grows, members of the U.S. Congress are acting as though the country were still in a position of strength and able to dictate the terms of such deals.

Washington's commitment to the free flow of goods—especially Chinese goods—has also started to falter. The Bush administration has refused to endorse accusations by the media and legislators that Beijing deliberately keeps its currency weak in order to boost Chinese exports. But Congress has been far less reticent: Senators Charles Schumer (D-N.Y.) and Lindsey Graham (R-S.C.) have proposed a highly punitive 27.5 percent tariff on Chinese goods, and Senators Max Baucus (D-Mont.) and Chuck Grassley (R-Iowa) have sponsored a more moderate (and more WTO-compliant) version. Another worrisome factor is that fast-track trade-negotiating authority, given to the president in 2002, expires in 2007. Before the November congressional election, Democrats announced that they would not renew this authority if they won control of the House and the Senate—which would make any new trade measures that much harder to win approval for.

A similar retrenchment has occurred in China. Access to commercial banking, communications, and real estate remains severely limited for foreign investors, and Chinese officials have started giving more scrutiny to potential foreign investment in other sectors as well. A bid by the private equity firm the Carlyle Group to take over China's Xugong Group Construction Machinery Company has been held up for months, and Carlyle recently reduced its proposed ownership share to 50 percent in an effort to limit political opposition to the deal. Beijing also introduced measures in August 2006 to require government review of mergers and acquisitions that could affect China's "economic security" or that involve "key industries" or popular domestic trademarks. And a new antimonopoly law primarily targets multinationals that the Chinese government believes have too much market power.

Underlying these moves, the very nature of the Chinese development model has, with little fanfare, changed in recent years. In 2005, Beijing concluded that its previous model, which had been in place since around 1978, had been too dependent on greenfield foreign direct investment (that is, foreign money that goes to the construction of new facilities and new technologies). Foreign investors in China had received better tax and regulatory treatment than domestic entrepreneurs. Beijing decided to reverse this orientation, and in November 2005, China's National Development and Reform Commission, a sort of overarching reform ministry, accordingly issued the innocuous sounding Measure 39. Under this regulation, domestic venture capitalists now receive much better tax and regulatory treatment than do their foreign counterparts. China will still, to be sure, find a place for foreign investment, but Beijing will no longer give it the protected status it once enjoyed.

Beijing, like other governments, is also coming under increasing pressure to address the inequalities brought on by rapid economic development and globalization. According to Chinese sources, the richest 10 percent of households in China now account for more than 40 percent of the country's wealth, whereas the poorest 10 percent of households account for only about 2 percent. The regional income gap is also increasing, with coastal provinces now enjoying a per capita gross domestic product more than ten times that of the poorest interior provinces. President Hu Jintao has publicly recognized the need to address these disparities by making the attainment of a "harmonious socialist society" one of his government's central goals, and he is slowly taking measures, such as simplifying and reducing the tax burden on farmers, to effect it.

OIL OF ONE'S OWN

One of the best ways to measure the health of globalization worldwide is to look at energy markets, and those for oil in particular. Oil has become the ultimate global commodity, unparalleled in importance. As go oil markets, therefore, so goes the global economy. And here, too, the signs are worrisome.

Both sets of states in the oil market—those countries that have oil and those that do not—have changed the way they do business in recent years. Among the haves, the rising price of oil has increased the temptation of governments to assert control over the resource. Throughout Latin America, governments have reasserted their authority over extraction projects that they once had ceded to foreign firms. Moscow has similarly muscled its way into direct control over Russia's vast oil and gas wealth and has used that control to extend its strategic influence.

In response, a number of the oil have-nots have taken measures to insulate themselves from a disruption in their oil supply. This helps explain China's seemingly illogical drive to acquire stakes in oil production facilities abroad. So long as oil remains a global commodity, consumers need not own the means of its production; they can simply buy all they need on the world market. China, however, seems to be preparing for a day when oil becomes far harder to acquire and transport and has thus signed various oil and natural gas agreements over the last five years with Angola, Brazil, Iran, Nigeria, Venezuela, and Sudan. This strategy makes so little economic sense that it can only be explained by an expectation that global oil markets will at some point break down, due to either a worldwide recession or a conflict between China and the United States.

SAVING GLOBALIZATION, SLOWING DOWN

Globalization in its last great era, which ended in 1914, occurred in a completely ad hoc way; that is, it lacked the institutional foundations that have helped cross-border markets flourish during the past 30 years. These institutional foundations may have been weakened of late, but enough rules and organizations remain to ensure that the current global economy is unlikely to suffer the same fate as the last. In other words, although globalization has passed its peak, it is unlikely to unravel completely.

Still, the flaws in multilateral institutions such as the WTO and the growing discontent with globalization will make it harder and harder for politicians to pursue free markets. If the United States, in particular, fails to do more to ensure that the benefits and opportunities of an internationalized economy are spread as widely as possible, there could be an even more potent backlash.

This is where smart policies should come in. The U.S. government must work harder to convince the American public—particularly those Americans who fear losing their jobs to international competition—that the costs of undermining or reversing globalization would be worse than the benefits. There is plenty of evidence to point to. Wal-Mart, for example, may have wreaked havoc on the U.S. retail sector with its relentlessly competitive business model, but it has also brought American consumers declining real prices for their mobile phones, DVD players, and televisions. Similarly, the Chinese manufacturing juggernaut may worry some Americans, but without it there would be no lower-cost products for Wal-Mart to sell.

Washington must also do more to ensure the that United States remains competitive in the global economy. Legislation has been introduced in Congress to enact President Bush's American Competitiveness Initiative, which would double federal support for fundamental research in the physical sciences and engineering, make the R & D tax credit permanent, expand math and science education, and ease immigration for highly skilled workers. But this legislation has not been passed, and its fate remains uncertain. Too little has been done to retrain workers who have lost their jobs to outsourcing. The corporate sector can and should help, not only by publicizing the benefits of openness but also by bearing some of the costs of the resulting dislocation.

Internationally, the United States must resist the temptation to continue down its path of ad hoc globalization. Bilateral treaties have been an effective and convenient way to advance short-term priorities, but they have undermined vital multilateral processes and institutions. Were Washington to embrace the rule-based European approach, it would reinforce the institutions that all countries depend on to preserve the gains of globalization.

Meanwhile, as skepticism about global markets continues to increase, U.S. corporations should prepare for rough going in their international operations. U.S. managers may once have assumed that understanding the politics and rules of the countries in which they traded and invested—and the international organizations of which those countries were members—was a luxury. Such knowledge is now essential, however, and U.S. business leaders should prepare themselves for the new rules and restrictions that they will face—and that the United States itself is considering adopting in the wake of the CNOOC and Dubai Ports World debacles.

Other key stakeholders in the globalization project must also do their part. The multiplicity of EU rules governing the liberalization of markets has come to feel increasingly onerous to Europeans—and too far removed from those rules' original social and political purposes. Last year's constitutional crisis was just the latest symptom of the growing public fear that the EU is causing the marketization of daily life (as opposed to the protection of traditional European practices). Politicians and European Commission officials must start interpreting the EU's rules more flexibly if they are to legitimize the organization and its integrated model in the minds of their constituents.

Chinese leaders face even more serious challenges. The export-driven Chinese economy cannot survive without a flourishing global economy fed by U.S. consumption. Beijing must therefore work to counter the widespread hostility to China in the U.S. Congress by, for example, better protecting intellectual property rights. China must also try to lessen income inequality at home in order to limit the dislocation caused by globalization.

If all or most of these efforts are made, the world will no doubt find a way to muddle through. But this muddling must not be taken for granted; it will require hard and sustained effort by U.S., European, and Chinese leaders. Washington, especially, needs to think hard about how to sell globalization, and not just to the U.S. public but to the world. After all, the U.S. economy can ill afford a serious threat to the open markets on which it and, indeed, all of us depend.