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Defining the Business of Politics.

Globalization and deglobalization

It's single most important trend of the past half century. Simply put, the various processes by which ideas, information, people, money, goods, and services cross borders at unprecedented speed and with unprecedented depth.

Those processes are world-changing, and many of them are still accelerating. But just as the soviet collapse didn't bring the end of history, **globalization hasn't made the world flat**. Today's ever-smaller world still has as many peaks and valleys: more clearly visible to one another, but still every bit as sharp in relief. That in turn is creating fragmentation, as a wide variety of deglobalization trends gain currency and momentum. The two sets of forces are interlinked and yet rarely considered together. Proponents of utopia and dystopia are getting ever-louder… and talking ever more past each other.

I think it's worth considering the arguments for both globalization and deglobalization. To stack up the most important factors on both sides of the aisle, and see where we end up.

First, let's look at globalization:

migration. The world is crossing borders at record speeds. international tourism receipts are increasing, on the back of a strongly growing global middle class and a steady rise in visa-free travel: above average growth for six years straight; and for the fourth year in a row, global tourism spend has grown much faster than merchandise trade. The rise of China is dominant here, with 120 million Chinese now traveling abroad every year; a trend showing no sign of slowing (interestingly, around the world, only tourism from the former eastern bloc is significantly shrinking). It's also developed world interest in ever-more global destinations: even North Korea's repeated arrests of visitors has not deterred westerners from reaching as far as the hermit kingdom.

The same trend holds for international students. 2015 saw nearly 1,000,000 international students coming to the United States (by far the most important destination for higher education); a 10% year-on-year increase, and the fastest rate of growth since 1979. The rise of China again drives the trend; making up 31% of the total foreign student count (India has 14%, Korea 7%, and Saudi Arabia 6%).

Overall, international migration figures are sharply up; reaching 244 million in 2015, up 40% since the beginning of the century. 3.3% of the world's population is composed of migrants; 50% of them come from Asia, and 2/3 of migrants live in either Asia or Europe. Not all of this travel is welcome. Te fastest recent migration growth has been in refugees — generally forced by climate change and/or conflict, and creating the biggest refugee crisis since World War II. 1 in 122 individuals on earth has been forcibly displaced, for a total of 60 million people. That in turn creates the potential for greater and faster contagion of externalities such as terrorism and disease — the latest illustration of which being the rapid spread of the Zika virus (prompting a realization that normal tourism flows make postponing the Olympics of little use; very much an illustration of our points here on the tension between globalization and deglobalization).

There's pushback to all this moving around. Some as a consequence of the refugee flows: walls being built, tougher border checks — leading to freedom of movement being curtailed. That's been easiest to accomplish in areas where borders are well guarded — most notably Europe in response to the refugee crisis, with what's amounted to a de facto suspension of the Schengen agreement — while across the middle east and in sub-Saharan Africa there's been little effective policy response to growing northbound flows.

Open borders are also being filtered by growing interstate conflict. Take the tourism ban between Russia and Turkey. Iran and Saudi Arabia have cut off direct travel and restricted use of each other's airspace; most significantly with the Iranian government forbidding its citizens from traveling to Saudi Arabia for the hajj. And, finally, there's been some enforcement of travel restrictions out of broader stability concerns from authoritarian regimes; with Russia and china implementing restrictions on government and public sector international travel — an effort to maintain loyalty and control. But these are outliers. Overall, vastly more people are moving across borders. freedom of the seas and air travel continues to be largely unfettered. On balance, the impact of these trends has been unprecedented internationalization of ideas and culture — a strong factor for continued globalization.

Communications. The communications revolution has made it easier for people of all walks of life and every corner of the world to be in touch with one-another. Smart phone and internet penetration now stands at nearly 50% of the entire world population, and infrastructure improvements should continue to increase those rates in the coming decade. And, as anybody reading this knows, it's a life changing technology, a real-time and near-completely immersive default connection of citizens to the rest of the world. Virtual networks have become a critical component — and, for many, the defining component — of personal identity.

To effectively restrict communication, governments would need to dominate technologies whose forced control is a double-edged sword — when social instability spikes, internet shutdowns work at best sporadically and risk leading to greater discontent and violence. Enterprising citizens and new technologies quickly find workarounds. Despite all the hype around China's great firewall, efforts to completely shut out international communications are increasingly seen by government actors as unworkable. While, for their part, non-state organizations of every stripe use virtual networks to their advantage — corporations and non-profits with new collaboration models, the Arab spring and colored revolutions' operators everywhere, and, of course, even terrorists. More common and larger-scale cyber-attacks (from Sony pictures to Spanish renewable energy companies) are yet another example of this unprecedented "communication" flow; just as growth of the dark web has allowed for more effective connections in illegal activities — drug trade, human trafficking, and the like. For better and for worse, communications are becoming far more global and efficient.

The global middle class. The biggest "winner" of the past decades of globalization has been the rise of a global middle class. Vast poverty reduction in china in particular, and in emerging markets more broadly, has depended on access to international markets. 700 million have been lifted out of poverty since the turn of the century, with global poverty essentially dropping under 10 percent for the first time – even though most of the world's new middle class remains financially vulnerable. The resulting empowered billions of people may not support the Washington consensus, but they're no less interested in smartphones, cars, and the other fruits of globally-connected supply chains. Without an acute war-type crisis, few political leaders will attempt to override popular demands for global goods. This all means economic power becoming more evenly distributed around the world, even as global inequality compared to the world's top earners has grown within countries.

Corporations. The rise of the global middle class, particularly in Asia, means that most western-based multinational corporations around the world continue to see their most important growth as global (even as see technology-driven “onshoring” trends for production facilities makes a comeback). There’s also been a sea change coming from China itself, with Beijing’s largest companies now embracing a strong interest in global expansion strategies as they try to replicate their domestic significance in the international market. Alibaba group has made international expansion its top priority in recent years, on both the sales and hiring fronts. There’s also a globalization trend emerging in small and medium enterprises: the so called “micro-multinational;” mid-sized firms deploying new technological strategies to allow them access into new markets earlier in their growth process.

Indeed, the world’s most dynamic economic actors have a powerful interest in maintaining global connectivity even when governments falter. Google, Microsoft, and Facebook are doubling down on undersea cabling. Jack Ma has bought an English-language newspaper and listed his company in New York. Vodafone built a mobile payments system in Africa that is far superior to those in western markets. Multinational corporations face challenges from slowing growth and more market volatility, but neither trend will derail an ever-increasing globalization trend.

Commerce. Alternative payment systems enable globalization. Paypal and Venmo allow global transactions to be made instantaneously. With bitcoin, there’s no need for even an exchange process. Movement of money is becoming faster and easier through both legitimate and illegitimate channels. Then there’s the growth in real estate acquisitions by foreign investors, particularly in global cities like New York and London. Silicon valley start ups raising money from Saudi venture capitalists. And explosive growth in collaborations for commerce in the cultural arena — movie and music industries cutting across Hollywood, a nascent Chinese industry, Bollywood, and even Nollywood (in Nigeria).

Energy. Energy supplies long acted as a globalization chokepoint. Today, they are a driver of it. A nuclear deal has brought Iran back as one of the world's largest energy producers. Cuba reconciled with the united states in part due to Venezuela’s diminished energy clout (and of course limited ability to provide a socialist alternative to the Americans). The biggest shift is technology ending "peak oil;" an unconventional energy revolution quickly making the united states the world's largest producer. All of which has decentralized production, stripping government control out of global energy markets and essentially ending OPEC.

Climate change. After decades of "north versus south" and climate change skeptics holding sway over policy in a number of core carbon-emitting nations, there’s now growing international consensus on the scale of the challenge and the importance of policy redress. Decades of limited cooperation among central governments in a series of failed global summits — all the while extreme climate conditions created greater human impact — has led non-governmental actors to take up a leadership role in the climate change agenda, notably creating incremental but meaningful success in last year's Paris meeting. It's the first meaningful example of a global crisis creating progress (albeit to date limited) toward global governance.

<u>Now, the forces of deglobalization:</u>

Geopolitics. Geopolitical volatility is at unprecedented levels in the world today. The middle east is both imploding and exploding due to failed models of governance, increasingly stretched economies, and fracturing security. Failed states across the extended middle east, north Africa, and south-central Asia; an unprecedented refugee crisis; and the world’s most powerful ever terrorist organization are all having profound spillover effects across those regions and into Europe (though, notably, that's not been true of east or southeast Asia, and it's certainly not true of the western hemisphere).

Then there's the fact that the United States — globalization's standard-bearer for nearly 75 years — is now proving to be considerably more reluctant to be the world's indispensable nation. That means less appetite for upholding global security, promoting global trade, or cheerleading global values. There's recently been slightly more support among Americans for foreign policy intervention than during the historic lows of 2013, but the overall tendency is still less engagement and more unilateralism, if not isolationism (a solid majority of Americans — democrats and republicans alike — thinks the united states does too much internationally, and wants whoever takes power in 2017 to focus on domestic rather than foreign affairs). Meanwhile the world's other largest economies — china and japan — have neither the willingness nor the capacity to step into the breach.

All of which means **the geopolitical condition I call the g-zero is intensifying**, and weighing on a world that's more de-globalized than at any point since the end of world war II. I don't view today's state of dis-equilibrium as sustainable, but **it's unclear whether what replaces the g-zero is a return to a more globalized geopolitical order or something even more fragmented. For now, I'd bet on the latter**.

State capitalism. One of the most acute forces of deglobalization is the rise of state capitalism, with China — soon to be the world's largest economy — dominated by a government player. Yes, Beijing is reforming. But China is growing faster than it's reforming, and as a consequence it's projecting its domestic model of government heavy-handedness on the international stage. That means the end of the global free market and its replacement with a model marked by bilateral, rather than multilateral, political and commercial ties, with Beijing playing a greater role in directly determining outcomes. That will lead to growing necessity for economic actors to align themselves with china in many markets, as well as a significant increase in the growth of strategic sectors — sectors in which companies need to be seen as strategically compelling to governments in the countries in which they invest.

The growth in importance of strategic sectors is arguably the most important new dimension of this new global economy when it comes to impacting multinational corporations; which is happening in ways that are fundamentally opposed to a world meant to be marked by increasingly borderless globalization. the technology sector is a good example: in many countries (including Russia, and now increasingly Iran), local industries tend to flourish independently of (and shielded from) the government; but as soon as their growth, success, and strategic importance becomes evident, they're taken over by government oversight. Whether this also happens in developed countries as technology gets added to the usual military-industrial dyad is one of the most important questions for the future of the global marketplace.

Global architecture & standards. Playing into the tension between (growing) state capitalism and (historically-dominant) free market is China's ongoing development of its own version of the Marshall plan — displaying the world's only global economic strategy driven by a trillion-plus dollars of investment into international infrastructure. China's plan involves very different strings than the postwar American checks did: no interest in promoting the rule of law, free markets, and (US-led) global standards, but a rather simple "buy from Chinese state owned corporations, accept Chinese currency, employ Chinese standards." Foreigners perceive both the American and Chinese models as threatening and are looking to create "third way" alternatives (think European regulatory approaches to technology).

The fault lines undercutting the prospect of globally-unified standards are also at play within countries, as each private sector company seeks to push its own version of a global industry model in areas such as the internet of things: Tencent vs. Huawei, Apple vs. Google vs. Intel. Such competition's only normal when McKinsey's estimated gains of over $11 trillion in the next ten years. Tech companies like Google are already facing backlash in Europe, Apple in China, Huawei in the US. That competition will only get greater as the prospects of economic gains become more evident.

Populism/nationalism. Populist movements are expanding across the world, with the strongest and most sudden trajectory found in developed states. That's a direct reaction from populations hollowing out economically and feeling faced with otherness culturally — it's essentially the other side of the coin of the rise of the globalized middle class. It's the Brexit movement and Euroskepticism more broadly. The rise of Donald Trump and Bernie Sanders in the United States. European far right and far left movements, now showing record levels of support in Austria, France, Italy, and beyond. It's separatism in Scotland, Catalonia, and northern Italy. It's the erosion of rule of law and legitimacy of political institutions across east, central, and southeast Europe. It's a growing belief that political outsiders aren't welcome; that European supranationalism is a mistake.

Many of the core constituencies driving global integration and connectivity over the past 30 years have now abandoned it. The populist argument is that globalists have used powerful institutions to gut what these countries and their cultures stand for. Populists want more homogeneity. In the United States today, frontline politicians cannot be seen to favor free trade, let alone for the reform of global institutions like the united nations; IMF quota reform took intense pressure and came little and late. Europe is more interested in breaking up its own integrating structures than establishing new global relationships; not to mention its rapid abandonment of the principles of free movement in reaction to the refugee crisis. And, critically, as technology removes labor from the capital equation globally, these trends are very likely to expand to the world's emerging markets — a key trend playing against globalization in the coming years.

Protectionism. In lockstep with increased populism, protectionist sentiment is growing among many in the developed states, who don't believe free trade benefits them personally. Yes, citizens have benefited from cheaper products. But real wages have been flat — in some cases even shrinking — and job opportunities in the developed world have become more limited. this was less of a problem in the 80s with the rise of Japan, but the rise of china has proved a larger shift… and the rise of technology greater still. That's led to significant pushback against free trade, now making transpacific partnership ratification at best a toss-up, and the transatlantic trade and investment partnership (TTIP) effectively a dead letter.

The process of negotiating TPP concessions for agriculture, cars, and other traditionally-protected industries has been protracted at best. Protectionist measures grew at their fastest pace since 2009 in 2015; led by India, Russia, and the United States. In latest data, for the first 10 months of 2015, governments around the world passed 539 protectionist measures, up from 407 in the same period of 2014 and 183 in 2012. It's easier to erect trade barriers than to tear them down, as what starts off as "anti-dumping" can quickly become "protect our workers." Measures put in place in response to populist anger (Trump's China penalties, Ukraine's Russian embargo) are particularly hard to dismantle. global free trade deals have stalled, giving way to bilateral and regional alternatives. all while the fora for resolving disputes — the WTO, the ICJ — are being increasingly ignored by their principal actors (the US, China).

Capital flows & foreign exchange. There was a significant slowdown in net capital flows into emerging markets from q4 2014 through q3 2015 (and it's likely q4 2015 was just as bad). in 2010, net capital inflows into emerging markets amounted to 3.7% of GDP. By 2014-2015, emerging markets had a 1.2% of GDP net capital outflow — due to a fall in inflows and high outflows. There were a few reasons: the transition from FED quantitative easing to anticipation of interest rate hikes and worries about the impact of lower commodity prices and slowing Chinese growth.

When it comes to foreign exchange, average daily trading volume in April 2016 was $4.6 trillion dollars, slightly lower than the $4.8 trillion of April 2015, with volumes little changed over three years. Beyond the cyclical uncertainties affecting trading volumes, there may also be structural factors at play, particularly an official rethink of the benefits of open capital accounts, and fast-money cross-border capital flows in particular. The greater respectability of capital controls is one of the most important trends in global finance today. At least for now, we've passed the peak of traditional financial globalization.

The global internet. The promise of the internet is souring as digital infrastructure fails to keep pace with the capabilities of states and malicious private actors. Major hacking incidents have become routine. Unlike in finance, the ability of governments to step in and stop a cyber panic, in which individuals would withdraw from online life and commerce, is untested.

But even more threatening that the asymmetric capabilities of non-state actors is the risk of internet fragmentation stemming from government actions. The Chinese are well known for their attempts at taming — and reshaping in their own image — the global internet. Beijing's attempts at ending anonymity on the internet by seeking to force all users to have real name registration will prove a strong pushback on globalization. The coming years will see far more top-down filtering and surveillance from Beijing. and many other countries are interested in taking from the Chinese model for their own security and safety. That means different surveillance models, different governance models, and different economic winners and losers. What had been the clearest "win" for globalization in a single open internet is now fragmenting into a number of differently-governed online spaces.

<u>and some factors where the impact isn't so clear</u>

Information. This is the most difficult issue to address on the globalization/deglobalization spectrum. On the one hand, the advantages of big data becoming a source of global economic growth are clear and driving game-changing business models in most every sector. So too, the ability for consumers to have access to information flows from all over the world, with virtually no (direct) cost to the individual. But filtering and segmentation of information is at least as important a global trend, and it firmly weighs on the deglobalization side.

Both of these trends are strong, and move in precisely opposite directions. There's vastly more information out there. But it's channeled much more among like-minded people (and in many cases marshaled — and profited upon — by top-down systems). The proliferation of news sources sends most people to media outlets that confirm their prejudices. This is a strong form of self-censorship. While when it comes to traditional censorship, control of information is a contest between censors and users that is likely to swing in both directions. One will gain an advantage, and then the other will respond. On balance, I'd say information flows have leaned rather in favor of globalization when it comes to data, and against it when it comes to how people actually relate to, and use, it.

Economic sanctions. Not only has the united states used sanctions extensively as a non-lethal tool of power-projection in the past few years, but this behavior has encouraged a range of other countries to follow suit; from the EU to Russia, turkey, and Saudi Arabia. So, at first glance, the trend isn't encouraging when it comes to keeping the world globalized. But it's also becoming ever harder for Americans employing unilateral coercive diplomacy to convince other important economic actors, allies as well as non-allies, to play along. That may ease US sanctions use a bit going forward. The United States is also starting to realize that its "weaponization of finance" will increasingly lead to blowback in an increasingly non-polar world, and hence isn't sustainable in the long run. Finally, the opposite policy approach is bearing success: Washington has begun opening – rather than closing – doors, as evidenced by the Iran deal, the Cuba rapprochement, and the possibility of a warming up with Russia if a compromise is eventually found over Minsk.

Global trade. Lots of anti-globalization types talk about the diminishment of global trade, but it's hard to make a call on which way trade is heading. On the one hand, trade volumes have flattened among advanced economies and are shrinking for emerging economies — subtracting about half a percentage point a year from the overall growth rate in the developed world since 2012. The reason to worry is that trade growth typically outpaces GDP by a wide margin; and after a post-recession rebound in 2010 to 12%, trade growth slipped to 7% in 2011, stagnated at 3% for the next three years and then fell below 2% for 2015 — well below GDP for the first time since 9/11 (the 1987-2007 average was 7.1%).

Global trade looks even more alarming when measured in price terms: having fallen 13% in 2015 to 16.5 trillion from 19 trillion in 2014 (though this reflects both exchange rate effects (a stronger dollar) and price effects (lower commodity prices)). China focusing on domestic demand rather than exports for growth is worth watching closely: if wheels start falling off Chinese reform, that's the tipping point for a big hit to globalization.

But that diagnosis is complicated by issues that relate specifically to the way the Chinese business cycle is presently working. Global trade growth appears to have slowed because China is importing less in both price and volume terms (the price effects being directly related to the volume effects); this will in part reflect a slowdown in Chinese growth. At the same time, as China rebalances its economy away from investment and towards consumption there'll be a decrease in import intensity because consumption (especially services consumption) is less import-intensive than investment. Furthermore, an increase in domestic technological capacity will mean that a larger portion of the value added in exports is added onshore in China (so goods wholly or partially made in china will cross the country's borders fewer times). not sure any of that is a structural move away from globalization.

Supply chains. Like global trade, there's been a lot of negative talk… but not yet a structural change. Overall, I'd accept the argument that **supply chains are going to get considerably shorter**. From Adidas to GE, companies are producing closer to their markets, since labor is becoming a much smaller input cost in total production. Plus, 3d manufacturing and just-in-time production capabilities argue for smaller supply chains; as does greater decentralization in energy production and markets. Companies won't need to ship as much. And so, there'll be fewer disruptions in bringing goods to market, but also bigger investment concentrations in the west. Like global trade, supply chains are probably now a trend towards deglobalization, but it's too early to make a clear call.

<u>Who is winning?</u>

First, a subtlety. One striking revelation is that the same countries that most depend on a globalized world (the United States, China) are also the ones leading the charge in harming globalization/creating deglobalization. Second, there's a difference between one-hub globalization and multiple-hub globalization. Americans are used to one-hub globalization (the post-war world, particularly since 1990), in which Americanization and globalization were effectively the same thing. So you could easily mistake the rise of alternative hubs coexisting alongside the dominant hub as a retreat from globalization. That's a fair point from a purely us perspective. But, by creating multiple networks, alternative hubs can actually increase the resilience of globalization, provided they are interoperable. In this context, it's a long term positive for globalization that alternative countries are developing international architecture like Asian infrastructure investment bank, the Brics bank, and the like. The AIIB's willingness, for example, to fund projects the more conservative Asian development bank won't because of pressure from developed market non-governmental organizations is arguably good for future globalization.

The biggest single takeaway is that **things/processes/technology tend to be globalizing. It's the people that aren't.** They're resisting primarily because many don't feel globalization benefits them. In part that's a drive from the hollowing-out developed market middle class...that may soon extend to the emerging market middle class. And in part an increasingly powerful Chinese government that supports aspects of economic globalization but strong political deglobalization...that may soon become more challenged by globalization overall.

That resistance is only going to grow in coming years, as there's very little that gives near-term hope in changing the calculations of globalization's "losers." Given that the losers of globalization aren't being particularly effective at stopping it, and given that the processes I've identified driving globalization themselves aren't diminishing… there's a good chance the forces for deglobalization are only going to get stronger. And so, with an increasing push on both sides of the equation, we're not likely to see a resolution.

For the coming years, I'd bet on more on momentum from the forces of deglobalization. More risk-driven volatility. More differentiation between sovereigns, sectors, and companies. Because as much as "things" matter, they're ultimately shaped by governance, architecture, and "rule spaces"… all of which are becoming more deglobalized than not.

But I expect that's not the end of globalization per se. Rather, it's a downward cycle on a curve that ultimately swings up… the question being how far down it goes (and can it functionally break the curve). I hope not. But we're going to find out soon.