

# Is Globalization Under Threat?

By Kazumasa Kusaka

With rising protectionism fueled by income discrepancies, the Japan Economic Foundation has started exploring the issue of “better globalization”, pursuing a balance between globalization and income equality. This reflects some skepticism about the so-called Washington Consensus or market mechanism fundamentalism. Recent populist trends have begun to impact trans-border production, sales, investment, trade and management decisions, for example through the amendment of NAFTA, the US-China conflict and the United Kingdom’s decision to leave the European Union.

What interpretation should we give to these developments? Historically, with the aim of achieving free trade for a stable global economy which their founders believed would be a key to peace, the International Monetary Fund, the World Bank and the General Agreement on Tariffs and Trade (GATT) were created. Under GATT, the most fundamental principle was non-discrimination. Then a series of liberalization efforts such as the Kennedy Round and the Uruguay Round took place. “Liberalization” and “rules and dispute settlement mechanisms” – two major elements of free trade systems – resulted in higher growth rates in trade than that of the overall global economy.

However, it was not through “trade in goods” that people on the street recognized globalization. Foreign direct investment (FDI) carried out by multinational companies (MNCs) destroyed vertical specialization because they had sought for the most competitive production sites with abundant labor as well as rich local markets. On top of that, in the service sector which had been historically thought of as non-tradable, with the Uruguay Round and EU integration, “trade in services” took place, i.e. service providers flowed into local communities and visibly affected such workers as plumbers and florists. Thus FDI and trade in services impacted ordinary people. Now trade in the digital economy will soon be the main player in globalization.

The high speed of globalization beyond our preparedness has triggered political interventions for delaying change. The Seattle WTO ministerial meeting in 1999 was noted for its anti-globalization demonstrations. Having witnessed this setback, Asia pursued bilateral and regional FTAs. Prof. Jagdish Bhagwati, known as a free trade fundamentalist, criticized the movement toward “free” trade agreements as “preferential” agreements contradicting GATT’s non-discrimination principle, as FTAs result in trade diversions which can affect efficiency in production. In reality, FTAs have lowered trade barriers between the parties, accelerated trade and investment, and led to mega FTAs such as the Japan-EU accord and TPP11. FDI, which is the motor of this dynamism, has driven China, which acceded to the WTO, and ASEAN to competitive liberalization to attract more of it.

What does “America First” as espoused by President Donald

Trump mean? What is really happening is trade diversion. China’s agriculture imports have changed from the United States to Latin American countries. A textbook case often taught in US graduate schools is the 1973 US soybean export ban in response to a domestic supply shortage. That decision forced major customers like Japan to switch to imports from Latin American countries, and even afterwards the US has not regained that market. On the import side from China, as soon as risk awareness over US import restrictions rose, it is reported that the first to move their production bases out of China were home-grown Chinese companies. This suggests that business logic is universal regardless of nationality when global supply chains have been fully developed.

Among MNCs, American fables companies depended mostly on production capacity within China while other MNCs tried to divide production capacities between those serving the Chinese market and those in other Asian or East European countries serving third-country markets. This flexibility makes it easier to change the ratio of production in China. The point here is that even though the policy objective was to bring US MNCs back to America, business under global supply chains will not move as presumed by the US government.

Looking at the history of globalization, it seems that the clash between “America First” and “state capitalist” economies is starting to discourage globalization. This clash has recently evolved into a conflict over hegemony in technology, affecting national security. Concerns over China’s behavior regarding intellectual property are shared among OECD countries, but isolating China in technology trade could accelerate its own technological innovations. Can OECD countries maintain their competitiveness to deal with a possible surge in China’s competitiveness? In order to do so, they would have to adopt a holistic approach by understanding the players in the market, what are the sources of competitiveness, and the role of rules, in addition to literacy in national security.

If businesses are intimidated and carry out much less than optimal levels of investment, the world economy will run the risk of depression. We can learn from our predecessors who founded the Bretton Woods System and we should recreate an international system and institutions to reflect economic and political realities, rather than delaying change. It is hoped that China, which plans to systematically open its economy, can contribute to Asian economic integration and major reform of international institutions.

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