Special report:
World Economy

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The gated globe

The forward march of globalisation has paused since the financial crisis, giving way to a more conditional, interventionist and nationalist model. Greg Ip examines the consequences.

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FIVE YEARS AGO George W. Bush gathered the leaders of the largest rich and developing countries in Washington for the first summit of the G20. In the face of the worst financial crisis since the Great Depression, the leaders promised not to repeat that era’s descent into economic isolationism, proclaiming their commitment to an open global economy and the rejection of protectionism.

They succeeded only in part. Although they did not retreat into the extreme protectionism of the 1930s, the world economy has certainly become less open. After two decades in which people, capital and goods were moving ever more freely across borders, walls have been going up, albeit ones with gates. Governments increasingly pick and choose whom they trade with, what sort of capital they welcome and how much freedom they allow for doing business abroad.

Virtually all countries still embrace the principles of international trade and investment. They want to enjoy the benefits of globalisation, but as much as possible they now also want to insulate themselves from its downsides, be they volatile capital flows or surging imports.

Globalisation has clearly paused. A simple measure of trade intensity, world exports as a share of world GDP, rose steadily from 1986 to 2008 but has been flat since. Global capital flows, which in 2007 topped $11 trillion, amounted to barely a third of that figure last year. Cross-border direct investment is also well down on its 2007 peak.

Much of this is cyclical. The recent crises and recessions in the rich world have subdued the animal spirits that drive international investment. But much of it is a matter of deliberate policy. In finance, for instance, where the ease of cross-border lending had made it possible for places like America and some southern European countries to run up ever larger current-account deficits, banks now face growing pressure to bolster domestic lending, raise capital and ring-fence foreign units.

World leaders congratulate themselves on having avoided protectionism since the crisis, and on conventional measures they are right: according to the World Trade Organisation (WTO), explicit restrictions on imports have had hardly any impact on trade since 2008. But hidden protectionism is flourishing, often under the guise of export promotion or industrial policy. India, for example, imposes local-content requirements on government purchases of information and communications technology and solar-power equipment. Brazil, which a decade ago compelled its state-controlled oil giant, Petrobras, to buy more of its equipment from local companies, has been tightening restrictions steadily since. And both America and Europe imposed,
or threatened to impose, tariffs on Chinese solar panels, alleging widespread government support. At the same time, though, Western countries themselves offer hefty subsidies for green energy at home.

Capital controls, which were long viewed as a relic of a more regulated era, have regained respectability as a tool for stemming unwelcome inflows and outflows of hot money. When Brazil imposed a tax on inflows in 2009-10, it was careful to emphasise that not all foreign investment was unwelcome. “Nobody here is rejecting people that want to invest in our ports or our roads,” says Luiz Awazu Pereira, a deputy governor at the central bank. “But if you are here just because you are running an aggressive hedge fund and noticed that our Treasuries pay 10% while US Treasuries pay zero, this is a less desirable outcome.”

The world has not given up on trade liberalisation, but it has shifted its focus from the multilateral WTO to regional and bilateral pacts. Months before Lehman Brothers failed in 2008, the WTO’s Doha trade talks collapsed in Geneva largely because India and China wanted bigger safeguards against agricultural imports than America felt able to accept. Shortly afterwards America joined talks to form what is now called the Trans-Pacific Partnership, which also includes Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. Barack Obama has held up the TPP as the sort of agreement China should aspire to join.

The trend in foreign direct investment, too, is still towards liberalisation, but a tally by the UN Commission for Trade and Development shows that restrictions are increasing. Last December Canada allowed a Chinese state-owned enterprise to buy a Canadian oil-sands company, but suggested it would be the last. “When we say that Canada is open for business, we do not mean that Canada is for sale to foreign governments,” explained Stephen Harper, the prime minister.

The flow of people between countries is also being managed more carefully than before the crisis. Borders have not been closed to immigrants, but admission criteria have been tightened. At the same time, however, many countries have made entry easier for scarce highly skilled workers and for entrepreneurs.

Mr Obama sees globalisation not as something to be stopped but to be shaped in pursuit of broader goals. He wants other countries to raise their standards of labour, environmental and intellectual-property protection so that American companies will be able to compete on a level playing field and, perhaps, pay decent middle-class wages once again. When a clothing factory collapsed in Bangladesh in April, killing more than 1,000 people, Mr Obama suspended America’s preferential tariffs on many imports from Bangladesh until it improves workers’ rights.

A clear pattern is beginning to emerge: more state intervention in the flow of money and goods, more regionalisation of trade as countries gravitate towards like-minded neighbours, and more friction as national self-interest wins out over international co-operation. Together, all this amounts to a new, gated kind of globalisation.

A state of imperfection

The appeal of gated globalisation is closely tied to state capitalism, which allowed China and the other big emerging markets—India, Brazil and Russia—to come through the crisis in much better shape than the rich world. They proudly proclaimed their brand of state capitalism as superior to the “Washington consensus” of open markets and minimal government that had prevailed before 2008. But the system also covered up structural flaws that are now becoming more obvious. In China, state-owned enterprises and state-directed lending have siphoned credit from the private sector and fuelled a property bubble. In India and Brazil, inadequate investment in infrastructure has resulted in rising inflation and sharply slowing growth.

The globalisation in the West before 2008 certainly had its flaws. The belief that markets were self-regulating allowed staggering volumes of highly levered and opaque cross-border exposures to build up. When the crisis hit, first in America, then in Europe, the absence of barriers allowed it to spread instantly. Voters, who had never been keen on wide-open borders, took this badly, and support for anti-globalisation parties grew.

A few constraints on global finance are not necessarily a bad thing. Limiting banks’ foreign-currency borrowing, as South Korea has done, makes them less likely to fail if the exchange rate falls. But gated globalisation also carries hidden costs.
Policymakers routinely overestimate their ability to distinguish between good and bad capital, and between nurturing exports and innovation and rewarding entrenched interests. The opening up before the crisis had done wonders for channelling capital to the best investment opportunities, lowering prices for consumers and promoting competition. Interfering with this process reduces a country’s growth potential.

This special report will seek to answer two big questions. Is gated globalisation merely a pause on the path to more openness, or is it here to stay? And is it, on balance, a good or a bad thing? The report will look at finance, capital controls, international trade and protectionism in turn to see how gated globalisation affects them for good or ill. Start with finance.

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