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Perils of a Different Globalization

Morgan Stanley & Co. Incorporated

Stephen S. Roach
Stephen.Roach@morganstanley.com

Economics and politics are on a dangerous collision course. As the forces of globalization strengthen, the drumbeat of protectionism is growing louder. Made in France, the European strain of protectionism reflects a newfound nationalism that strikes at the heart of pan-regional integration. Made in America and exacerbated by fear of the “China factor,” a different strain of protectionism plays to the angst of middle-class US wage earners.

Whether the threat is perceived to be from the inside (as it is in Europe) or the outside (as in the United States), the responses of increasingly populist politicians are worrisome, to say the least. French Prime Minister Dominique de Villepin is seeking to protect “strategic” industries from foreign ownership. In the US, it’s not just resistance to foreign takeovers; bipartisan support is also building in the Senate to impose steep tariffs on China. All this harkens back to the demise of an earlier globalization that many date to the enactment of the infamous Smoot-Hawley Tariff Act of 1930 — a political blunder that may well have been key in turning a US stock market crash and recession into worldwide depression. Like the circumstances over 75 years ago, the current global trade dynamic has played an increasingly important role in boosting the world economy. Protectionism and the contraction in global trade it would trigger puts all that at risk.

Today’s world, of course, is very different than it was back then. So, too, is the fabric of a globalization that is causing such a powerful political backlash. In the early part of the 20th century, the world was brought together by the cross-border exchange of manufactured products. In the early part of the 21st century, globalization has swept beyond tradable goods into a very different realm of commerce — information flows, financial capital, and services.

A globalization that moves from tangible tradable goods activity to the more intangible functions of the Knowledge Economy is not well understood. But the impacts of this shifting character of cross-border integration could well be more powerful than they were in the past. That’s because the incidence of the disaffected — the workers who feel the brunt of intensified global competitive pressures — is shifting into a segment of the global labor market that has never really known the meaning of job anxiety and stress. Blue-collar workers in factories have, of course, long been on the front line in facing the ups and downs of business cycles, as well as the intensification of global pressures. By contrast, white-collar workers in services-based enterprises have not. That is now changing. The rules of engagement on the battleground of globalization are being rewritten. The services economy is now on the leading edge of feeling the stresses and strains of an increasingly competitive and open world economy.

This is a truly extraordinary development in the continuum of economic history. Economists have long dubbed services as “nontradables” — underscoring the time-honored proposition that service providers had to be in close proximity with their customers to offer in-person delivery of expertise, advice, or assistance. In the Internet Age, the boundaries between tradables and nontradables have become blurred. Now, with the click of a mouse, many once-nontradable services can be offered up from anywhere in the world. At work is the globalization of software programming, engineering, design, medicine, accounting, consulting, and a multitude of other professional services. Labor input — and the knowledge-based content of the service it delivers — is now beamed to your desktop on a real-time basis from Bangalore, whether you like it or not. This compresses both the quantity (i.e., headcount) and the price (i.e., real wage) of higher-cost labor input in the developed world — with most of the impact presently showing up in the form of a persistent stagnation of real wages. The result is an IT-enabled globalization that throws long-sheltered knowledge workers into the global competitive arena for the first time ever.

As in the early 1930s, the new strain of globalization has spawned a political backlash. But the pressures are very different as they migrate from manufacturing to services. That’s not to say blue-collar workers aren’t feeling the heat in today’s world. Unfortunately, there just aren’t that many of them left. Factory sector workers currently account for only about 15% of total employment in the G-7 collection of major industrial countries (the US, Canada, Japan, France, Italy, Germany and the UK) — about half the 29% share prevailing as recently as 1970. While there could well be more to come in the attrition of manufacturing employment — the US portion is now close to 10% — simple math tells us this aspect of the hollowing has just about run its course.

With the pendulum of global competition now swinging toward services, the resulting white-collar shock has added a new and very destabilizing element to the globalization debate. It has created a deepening sense of anxiety that afflicts workers who have long harbored the belief that they would not face pressures from low-wage offshore talent pools. The persistent stagnation of inflation-adjusted wages in the developed world — even in a high-productivity-growth US economy — has shattered that sense of security. It is an exceedingly painful, but perfectly logical outgrowth of an increasingly powerful global labor arbitrage.

Politicians have been quick to come to the defense of the new warriors of globalization. The numbers leave them with little choice. Unlike the sharply reduced ranks of manufacturing employees in the developed world, services are the dominant source of work, income generation, and political power. In the G-7 countries, services currently account for close to 75% of the total workforce — literally five times the share of manufacturing. And yet that's where the current strain of globalization is playing out with greatest intensity and, accordingly, where it meets its greatest resistance from the politicians. Little wonder that services reforms have stalled in Europe, or that the Doha Round of global trade liberalization has been stymied by a highly contentious debate over services.

Significantly, the new globalization could be far more disruptive than the strain of the early 20th century. That's due importantly to the extraordinary speed of the transformation now at work. A century ago, the burst of globalization was also spectacular, but the new "connectivity" of the early 20th century still faced very real physical constrains — namely, the expansion of shipping capacity and the construction of ports and overland transportation networks. The modern-day strain of globalization does not have to face such daunting physical constraints. The only limiting factors today are growth in IT-enabled connectivity and bandwidth — both of which have continued to expand at explosive rates long after the "law of large numbers" might have produced slower growth rates. By Mary Meeker's reckoning, the rapid expansion of global Internet usage continued in excess of a 15% annual rate in 2005 — even though total worldwide penetration pierced the 1 billion threshold toward the end of the year.

In other words, the infrastructure of today's globalization of intangibles is being installed at a much more rapid pace than was the case in the globalization of tangibles a century ago. In essence, that's because the hurdle rates of disseminating the new technologies of connectivity are much lower today. That key differentiating development, in conjunction with the rapid growth in offshore knowledge-worker talent pools, has enabled the global labor arbitrage to move much more rapidly up the value chain than was the case in the early 20th century. Five years ago, when the debate was first joined on white-collar offshoring, the focus was on relatively low-value-added data processing and call centers. Today, the whole gamut of higher-value-added professional services workers is feeling the heat. As a result, the current strain of white-collar shock dwarfs the impacts of the blue-collar shock of a century ago.

The debate breaks down over what needs to be done. Rich countries are flirting dangerously with protectionism while poor countries continue to bet on export-led growth. Meanwhile, the new competition fostered by IT-enabled globalization hurtles ahead at breakneck speed. At the same time, the global labor arbitrage is forcing a realignment of relative wages in the world economy — with the rich developed world fearing a "race to the bottom" while the poor developing world is hoping to ride the rising tide. The combination of IT-enabled globalization and real wage stagnation in the developed world creates an angst that is too tempting for populist politicians to resist. The hyper-speed that drives this disruptive integration of the world is a perfect set-up for a protectionist backlash.

Unfortunately, there is no easy resolution of these political and economic tensions. In the end, the competitive profile of any knowledge worker reflects the interplay between skill-sets and fully-loaded costs. A nation's stock of human capital is key in shaping the former, while the ever-declining price of IT-enabled connectivity puts an important new wrinkle into the cost calculus. Countries that sign up for globalization must meet both aspects of this challenge head-on. The hyper-speed by which the rules of a new competition are changing in the Internet Age adds a critical urgency to the politicization of globalization — and to the protectionist pressures it has evoked.

The orthodox prescription is to counsel patience — that the "win-win" of globalization eventually will raise living standards in the developing world while creating new markets to be tapped by industrial countries. Yet the unprecedented speed of an IT-enabled globalization draws the rewards of that patience into serious question — at least for the foreseeable future. In the end, politicians are usually at their best in counting votes. With workers in services outnumbering those in manufacturing by a factor of five to one, the body politic in the industrial world has cast its ballot in favor of protectionism. Opportunistic politicians are taking the bait — seemingly unconcerned about the tragic lessons of the 1930s. While globalization is very different today than it was back then, the risks of making an equally tragic mistake on trade policy should not be minimized.

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The Americas
1585 Broadway
New York, NY 10036-8293
United States
Tel: +1 (1)212 761 4000

Europe
25 Cabot Square, Canary Wharf
London E14 4QA
United Kingdom
Tel: +44 (0)20 7425 8000

Japan
4-20-3 Ebisu, Shibuya-ku
Tokyo 150-6008
Japan
Tel: +81 (0)3 5424 5000

Asia/Pacific
Three Exchange Square
Central
Hong Kong
Tel: +852 2848 5200