

Globalization in Remission

Has the Political Trend Changed?

September 2016



Neil Dwane

Global Strategist

Our global strategist says we could be at the tipping point of a shift away from globalization and deregulation toward populism and protectionism, which could have important implications for investors.

Key takeaways

- The two primary forces driving politics today are the rising power of emerging markets and the growing inequality of wealth.
- These forces once went hand in hand with globalization and deregulation, which are fading and could be further unwound by a new breed of populist politicians.
- In this environment, large multinational corporations may hold less sway over policy and taxation issues, which could help mid- and small-size regional companies.
- Politics could become more local, with politicians demanding more regional investment, taxation and representation.

Politics has always been part of the narrative of investing, and just underneath the surface lies an ebb and flow of influences that can direct politicians and their policies. At our recent Investment Forum in Frankfurt, we considered some of the many factors that are keeping politics at the top of investors' minds today – like

the Brexit decision in June, the US presidential election in November and Italy's upcoming referendum. As we took a closer look, we found that these events may not be part of the usual tide of relatively unrelated political occurrences; rather, they seem to be connected by a longer-running and deeper momentum.

Consider that from 1980 through to the Global Financial Crisis (GFC), the world witnessed a clear political trend toward globalization, deregulation and closer international cooperation. This trend benefitted consumers globally as traded goods prices fell – albeit at the cost of hollowing out many domestic manufacturing industries – and it helped big multinational companies that could capitalize upon and optimize their selling prices and logistics.

The “winners” of globalization were mostly multinational corporations and mercantilist economies and companies in Asia, particularly in China, where wages were low and the ease of competition and technology transfer high. The “losers”, on the other hand, were the lower- and middle-class workers and domestically oriented businesses in the developed world that could not match these imported prices. For decades, governments competed to attract multinational companies and their investment power, even though they contributed little save for employment and offered local economies only a small amount of value added. This dynamic helped fuel the debt-funded global consumption boom as trade surpluses were recycled back, and it contributed to the growing wealth effect for those not hurt by globalization – a phenomenon that has accelerated with the integration of the internet and mobile telephony that now rests in consumers’ hands.

A political tipping point

Today, however, there is much evidence that we are seeing globalization slow if not reverse, leading us to believe the world may be at a political tipping point:

- The Brexit vote and themes raised in the US presidential race suggest that many voters in the developed world feel the markets no longer work for them, and that the benefits of globalization have been offset by its weaker wage and employment prospects.
- Multinational companies appear to have been gaming the global tax system, with the result that they have no obligation to pay taxes on goods and services as they play one government off against another.
- The weak, dull economic growth seen since the GFC has not created wealth and welfare for many parts of society – and government bureaucracy and outdated labour legislation have made matters worse.
- A growing number of millennials – those born after 1985 – are already burdened by high education loans and poor job prospects, and they are becoming

increasingly disenfranchised by democracies that concentrate on satisfying their Baby Boomer parents – creating a source of inter-generational tension.

- The “haves” and “have-nots” have always been part of human history, but today’s rising levels of economic and forced immigration have denied wage increases to local workforces and lowered living standards. This has added to a growing sense of wealth and income inequality, fuelling nationalist fears and populist politics.

De-globalization’s implications for investors

While much remains uncertain in the realm of politics, it is now clear that the former trends of globalization and deregulation have slowed or are in danger of being reversed. Once any trend like this has started, it could last for some time, if history is any guide. Consider that the last prolonged period of globalization culminated in the Great Depression in the 1930s and the Smoot-Hawley trade tariffs in the US, which did not get redressed until the early 1980s by President Ronald Reagan. Of course, while it may be too soon to say what the exact effects of this political trend will be for investors, we have identified a few early implications:

Less global trade means less global growth

Politicians are rowing back on several major global trade agreements currently under discussion, such as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership, which will inevitably add grit to the global gears. With global trade constituting approximately 40 per cent of global gross domestic product, this could slow economic growth at a time when it is already fragile. If global trade were an economy, it would be the largest in the world – nearly twice the size of the US economy – but it is rarely viewed in this way by policymakers.

Corporate responsibility must be redefined

Many multinational corporations have benefitted from decades of globalization, especially in terms of trade and finance, but this could eventually become a headwind if politics increasingly favours local brands and forces local taxation. More immediately, the recent Apple/European Commission tax rulings could increase inter-regional tax friction, which could hinder the allocation of capital and reduce returns to shareholders. The world does not need more friction; remember how protectionism became a key theme in the 1930s, when the world tried to stabilize after a previous period of globalization. For our part, we at AllianzGI are committed to engaging with management teams and

governments to ensure that corporate responsibility is viewed in the widest manner possible – beyond just earnings per share or tax revenues.

Fiscal spending should be fiscally responsible

Dull levels of economic growth may be met with growing calls – such as those heard this past summer – for more fiscal and infrastructure spending, though there should be mounting concern over the affordability of such outlays. Enormous investments are certainly needed in the big economies of the future such as India, Indonesia and Africa, not to mention the repair and maintenance needed in the developed world. Yet rather than be funded by more borrowed money, these investments must both cover the cost of financing and add to these regions' economic prosperity and productivity. If not, they are simply Ponzi schemes.

Keeping promises is expensive

Soon, politicians in the developed world will have to confront the cost and financing of their welfare states, or risk seeing their millennial children revolt against honouring the unfunded promises made to their parents. These structural reforms are currently eluding demographically

challenged areas such as Japan and much of Europe, and the longer these challenges are left unanswered, the bigger they will become. Indeed, even in the US, the current outstanding debt-to-GDP level of 100 per cent is dwarfed by the promises on the books that are yet to be accounted for – entitlements that add up to more than 500 per cent of US GDP, or USD 130 trillion.

The Western world view may be fading

Immigration and the recent rise of radical Islam across Europe and Central Asia will create more political tension in the foreseeable future – tension that may sustain higher levels of populism and nationalism than any we have experienced since World War II. The secular Western perspective of the modern world, under *Pax Americana*, is ending and being replaced by a return to an older-world version of countries and states that predates the WWII-era solutions imposed by the US and the UK. This revision is also taking place in a region full of oil and replete with many long-standing histories and frictions – another example of today's political trends connecting in a new way with the politics of the past.