

MERCER / VOICE ON

GROWTH ECONOMIES

INSIGHTS FOR ACTION
ON HEALTH, WEALTH
AND CAREER



WEALTH

IS IT TIME TO RETHINK
GLOBALIZATION?

Andrew Kirton and Dave Stuart

FALL 2017

IS IT TIME TO RETHINK GLOBALIZATION?

For all the benefits of globalization, recent political events have revealed that its effects are not entirely benign. In this article, we critically examine globalization's impacts and present cases for and against the scaling it back.



ANDREW KIRTON
Senior Partner, Global Chief Investment Officer

Andrew has over 30 years of experience in the investment consulting industry. He advises clients in addition to his leadership responsibilities as the Global Chief Investment Officer at Mercer.



DAVE STUART
Chair of Global Dynamic Asset Allocation and Chief Strategist for Mercer Funds, Pacific

Dave leads the Dynamic Asset Allocation (DAA) specialist team, including asset allocation positioning for Mercer's multi-asset-class diversified fund range. He also works on client consulting projects.

International trade volumes are falling, income disparity is growing, immigration is under attack, and nationalism is on the rise. While few in international finance would argue that globalization should be abandoned, we can make an argument for re-examining its impacts and adjusting policies accordingly.

THE CASE FOR RETHINKING GLOBALIZATION

Globalization creates winners and losers, but in recent years there have been more losers than winners. Most of us are familiar with McKinsey data showing that the majority of US households have experienced falling incomes over the last 10 years, and we know that income distribution is markedly skewed to the richer end of society. As President Obama famously stated in 2014, the top 1 percent own 40 percent of the wealth in the US, while the bottom 80 percent own just 7 percent.

This is fundamentally important because income inequality damages the well-being of societies. As the biggest single determinant of social cohesion, it correlates strongly with every measure of health and well-being.

Figure 1. The Importance of Income Equality



Source: Wilkinson & Pickett, The Spirit Level (2009)



Globalization also unleashes powerful financial forces. For example, in hindsight we know that the emergence of China as a consumer-based economy “exported” deflation, leading to low interest rates, substantial debt accumulation and, eventually, the financial crisis.

Furthermore, under globalization, multinational corporations have gained power at the expense of sovereign governments. They have exploited significant advantages of scale and job arbitration on a global stage, permitting tax avoidance and indirectly affecting the ability of nations to educate their people and maintain infrastructure. Related to this, globalization has not resulted in increasing political freedom to the degree anticipated.¹

Also related to jobs, successive waves of technological advance spread by international trade have brought benefits, but also rendered many jobs redundant. Today the seemingly rapid development of artificial intelligence raises at least the possibility of mass unemployment.²

¹ Freedom House

² www.oxfordmartin.ox.ac.uk/downloads/academic/The_Future_of_Employment.pdf

Much can be done to curb the excesses of globalization while still harnessing its benefits, and this is our best hope of averting a significant backlash. Policy changes in all of the following areas could bring much-needed moderation:

- **Politics:** Politicians need to better reflect their constituents and be more flexible. For example, a bit of flexibility by the European Union perhaps could have averted Brexit.
- **Education:** Nations must focus on establishing and meeting standards of education and training, with not only governments but also corporations - if needed to be incentivized or coerced - being obligated to fund them.
- **Regulation:** Ten years after the financial crisis, some are already calling for deregulation. Experiences shows us that we must effectively regulate the financial system in order to prevent its abuse.
- **Taxation:** Fix the system such that local profits are declared and taxed locally. The ability of multinational companies to subvert local politicians' wills is a significant stress factor on local economies.
- **Fiscal policy:** Depending on the extent of technological disruption, governments may have to consider a basic income provision

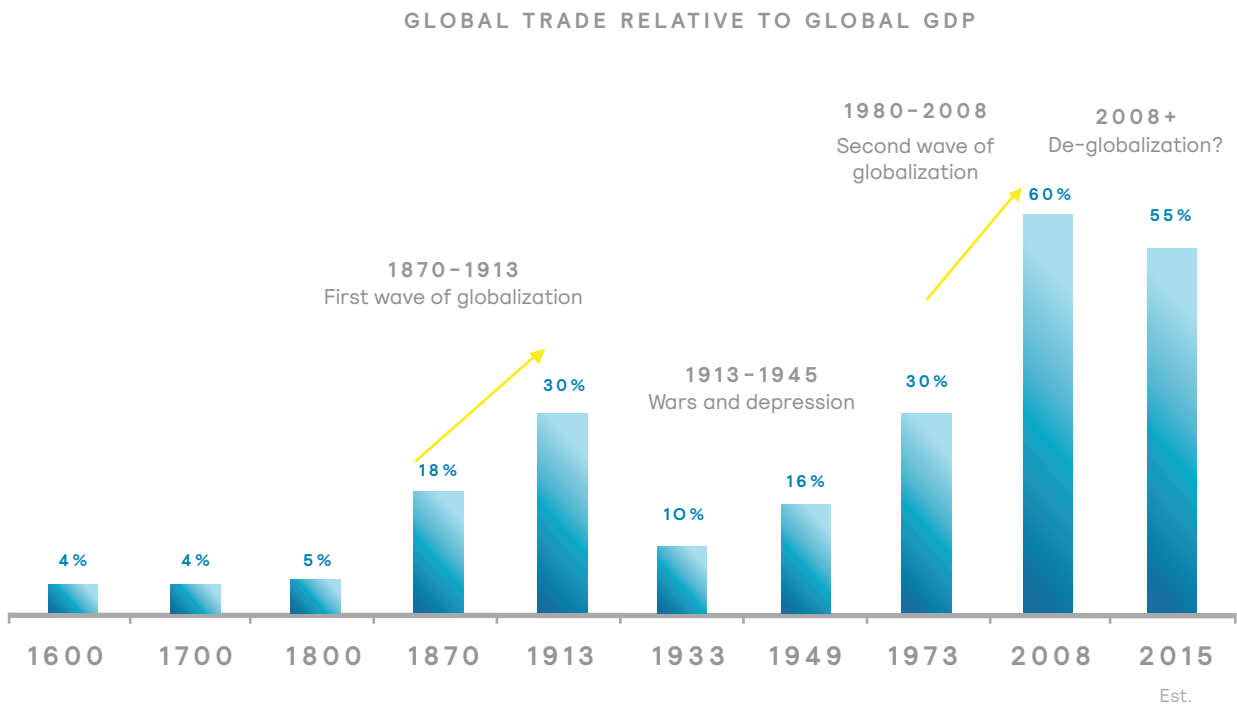
The above doesn't amount to a dismantling of globalization. It is really a call for politicians to assert their responsibilities and take more control with constructive and well-thought-out agendas.

THE CASE AGAINST RETHINKING GLOBALIZATION

Certainly the world faces economic challenges. However, globalization is being used as a convenient scapegoat by populist politicians. In reality it is not the source of problems, but rather a force for good.

A historical view shows a doubling of global trade relative to GDP (a measure of the extent of globalization) between 1870 and 1913, the outbreak of the First World War. Between the two world wars we had a period of deglobalization —and the Great Depression.

Figure 2. Globalization is not new



Source: Morgan Stanley

The historical evidence thus suggests that intercountry trade reduces political tensions and lessens the likelihood of major wars.

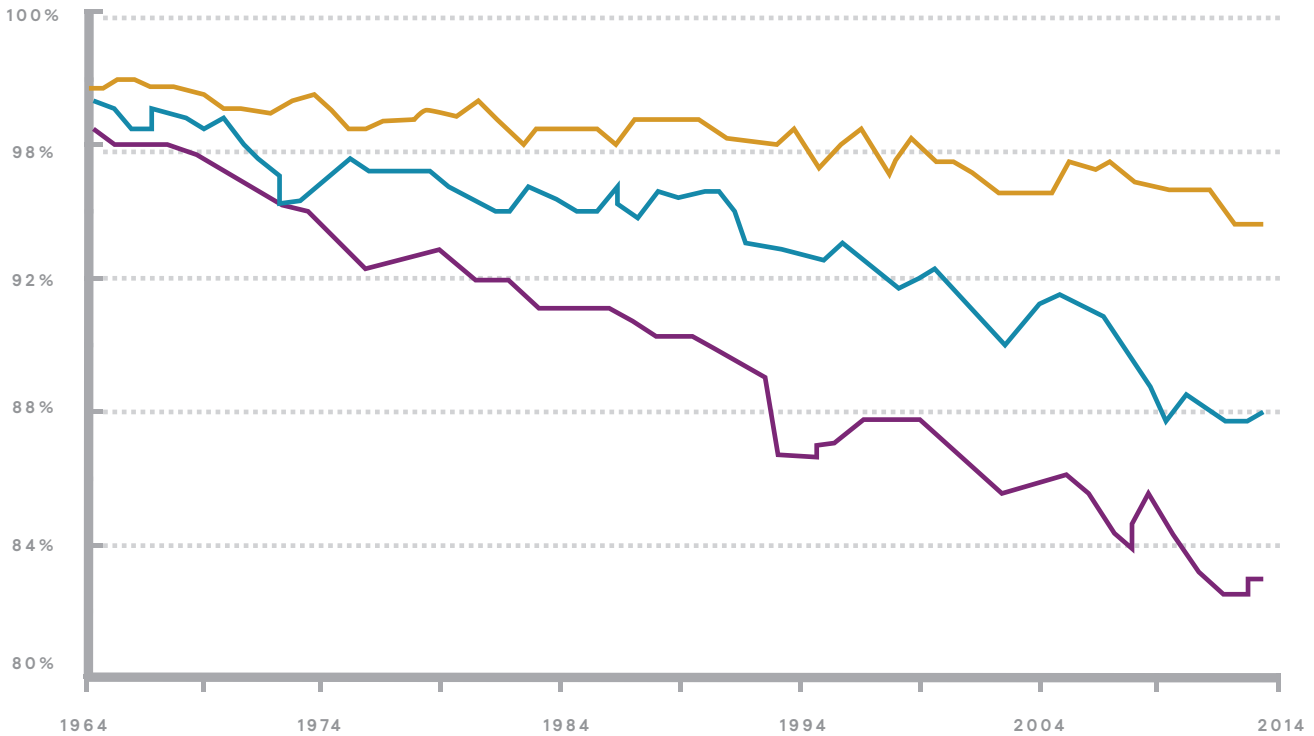
Moreover, globalization has done great good by elevating living standards. According to the World Bank ³, since 1850 the level of global poverty has dropped from 83 percent of the world's population to only 11 percent. Meanwhile, life expectancy has doubled in nearly every country.

Technology, not global trade, is the main cause of job losses in developed countries. Participation in the US job market, for example, has dropped significantly over the past 50 years for people with less education. Significantly, this decline took place steadily throughout this period, even though global trade only picked up significantly in the last 25 years. It follows that globalization is not the primary cause of those job losses.

Imposition of tariffs, and especially trade wars, would result in exacerbated inequality and lower growth. The most vulnerable populations would in fact suffer the most, as low-income people rely most heavily on cheap imports to meet their needs. Curbs on immigration also tend to come with increased persecution of minorities. Overall, the result would be exacerbated inequality and lower growth.

Figure 3. Lack of Education is costing jobs

US PARTICIPATION RATES BY EDUCATIONAL ATTAINMENT



Source: Bureau of Labor Statistics, Current Population Survey (Annual Social and Economic Supplement) CGA calculations

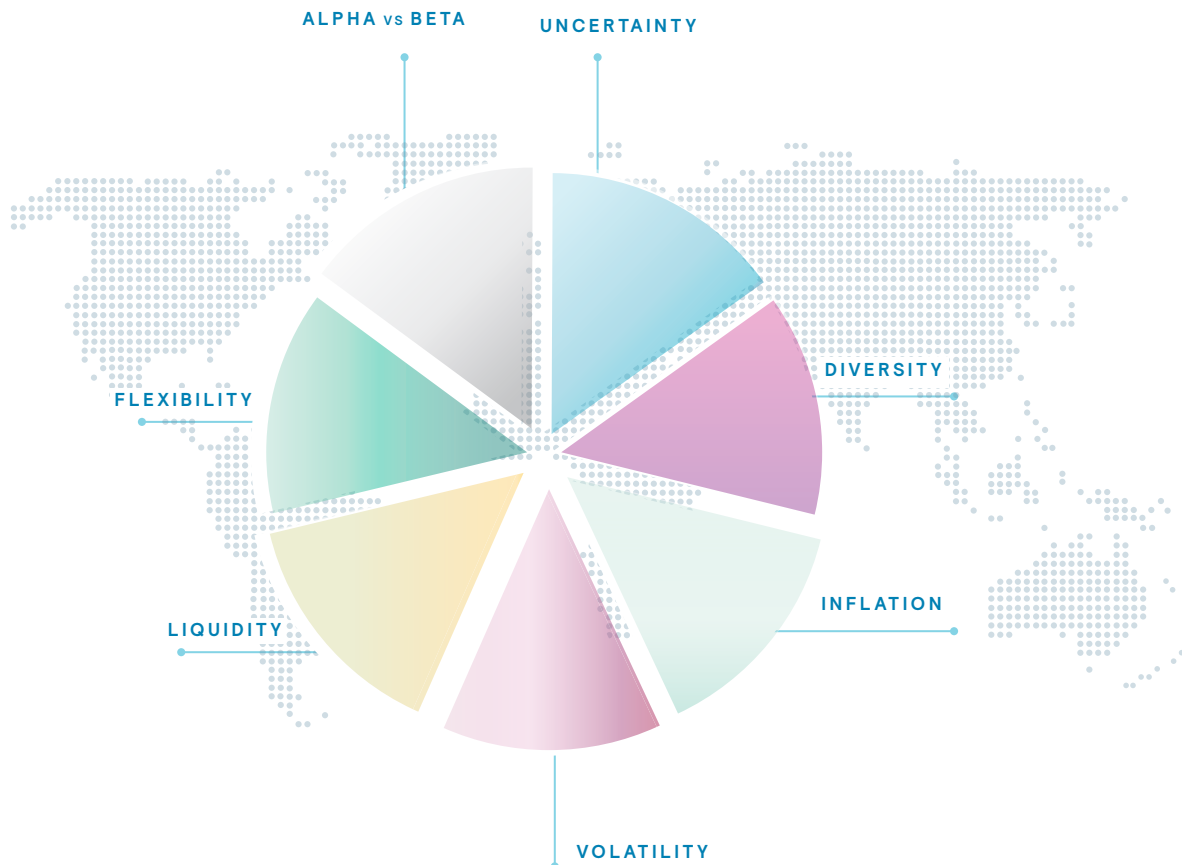
³<https://ourworldindata.org/extreme-poverty/>

GLOBALIZATION: IMPLICATIONS FOR INVESTORS

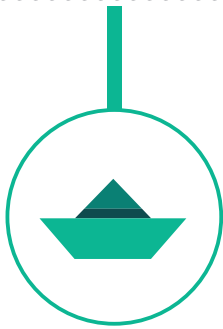
Whether the world ends up taking steps to mitigate globalization's potentially deleterious effects, or if globalization continues on its current course, there are several prescriptions that investors can take to safeguard their objectives:

- **Diversify:** While diversification in asset allocation is always wise, uncertain times make it even more critical.
- **Prepare for inflation:** Coming off of five-plus years of deflation, it's time for a mental adjustment. Look at how your portfolio might perform if inflation were to increase, either in your domestic economy or overseas economies in which you are invested.
- **Prepare for volatility:** If we see policy disruptions and discussion of unusual trade policies, volatility may return to equity markets. Ensure that your portfolios are set up to cope with that—or take advantage of it.
- **Increase liquidity:** When markets and policies change significantly, a set-and-forget approach is not valid. Be prepared to adjust your asset allocation in the light of new information which may require more liquidity. Be wary of relatively illiquid assets.
- **Be flexible:** Be ready to adjust your view along with changing conditions, in consultation with your advisors.
- **Seek alpha:** Look at alpha sources and utilise good fund managers to take advantage of rapidly changing circumstances.

Figure 4. Implications for asset allocation



POTENTIAL DEGLOBALIZATION POLICIES



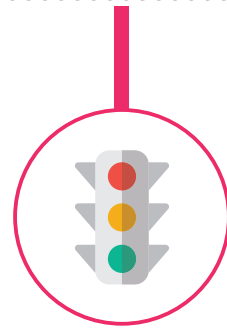
IMPORT
TARIFFS



EXPORT
SUPPORT



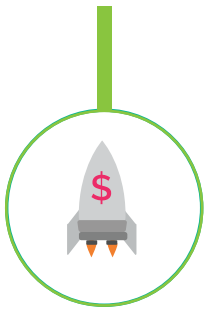
BORDER
TAX



RESTRICTING
INMIGRATION



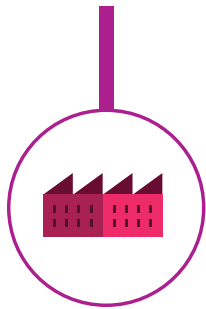
...OUTCOMES



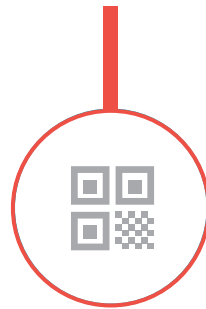
HIGHER PRICES
OF GOODS



TRADE
WARS



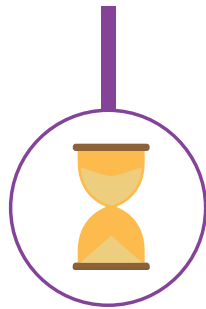
"FEATHERBEDDED"
INDUSTRIES



MINORITY
PERSECUTION



HIGHER
INEQUALITY



LOWER
GROWTH



The information contained in this publication is not intended to be taken as advice and should not be relied on as such. In particular, nothing shall be construed as forming part of any offer or solicitation or invitation to sell or to provide any regulated services or products in any country. All rights in the publication are reserved, including but not limited to copyright, trademarks, know-how and other proprietary rights of any type under the laws of any governmental authority.