

Primo Braga, Carlos A.

Research Report

Foreign direct investment and "peak globalization"

Columbia FDI Perspectives, No. 230

Provided in Cooperation with:

Columbia Center on Sustainable Investment (CCSI) - A joint center of Columbia Law School and the Earth Institute, Columbia University

Suggested Citation: Primo Braga, Carlos A. (2018) : Foreign direct investment and "peak globalization", Columbia FDI Perspectives, No. 230, Columbia University, Columbia Center on Sustainable Investment (CCSI), New York, NY

This Version is available at:

<https://hdl.handle.net/10419/254064>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.



Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues

No. 230 July 16, 2018

Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)

Managing Editor: Marion A. Creach (marion.creach@sciencespo.fr)

Foreign direct investment and “peak globalization”*

by

Carlos A. Primo Braga **

Globalization is characterized by the growing economic interdependence across countries, fostered by international trade, migration, knowledge, and capital flows. Attitudes toward this process vary significantly. More recently, they have been impacted by the global financial crisis and the rise of populist leaderships that blame globalization for job destruction and rising income inequality. Financial globalization has slowed down significantly since 2008. By 2016, global cross-border capital flows had declined roughly 65% vis-à-vis the peak (of US\$12.4 trillion) reached in 2007.¹ Most of this adjustment was associated with the reduction of foreign exposure by Eurozone banks amid the Eurozone crisis.² But FDI flows also fluctuated significantly over the past few years, and they only recovered to levels similar to those reached at the eve of the crisis by 2016.

Merchandise trade had been growing on average 7% per year before the onset of the global financial crisis. Since 2008, however, trade growth has been anemic and in some years below the expansion of world output (e.g., 2.3% at market exchange rates for global GDP versus 1.8% for global trade volume in 2016).³ All of these trends raise the question of whether globalization has reached its peak and is it now retreating. What are the implications for FDI decisions and policies?

There are cyclical factors that help explain the slowdown in trade. Weak aggregate demand and political uncertainty (dragging down business investment that tends to be trade-intensive) are often identified as the main culprits in this context. But there seem to be more structural forces at work. The shortening of supply chains to cope with environmental and geopolitical risks, trade protectionism, increased local content in Chinese exports, and the evolving shift toward services in the world economy are some of the usual suspects identified in this context.

There is evidence that discrimination against foreign commercial interests has increased significantly in the post-crisis era.⁴ Subsidies, localization requirements and trade finance have been playing an important role in this new wave of discriminatory actions that often evade multilateral disciplines. It is difficult to quantify their exact impact on global trade flows, but there is no doubt that they are contributing to the trade slowdown. Moreover, recent

technological developments (as illustrated by the impact of advanced robotics on re-shoring decisions by MNEs) have also impacted globalization trends.

Concerning FDI flows, it seems that efficiency-seeking investments (typically export-oriented) are being affected not only by protectionist policies, but also by the retrenchment of global value chains (as the incentives for process fragmentation decline) and by technology, to the extent that labor costs are becoming less influential in localization decisions.⁵ All these factors are generating incentives for localization in smaller, flexible production facilities closer to end-markets. As a consequence, MNEs are rethinking their localization strategies to adapt to the increased adoption of local content requirement policies and to explore industry 4.0 manufacturing.

It may be too early to announce that we have reached “peak globalization”. One could even argue that we are in a moment of resetting global production structures, and that digital flows associated with e-commerce, social networks and entertainment are today the main drivers of globalization. As the global economy regains strength (as illustrated by the latest IMF forecasts for 2018) and demand for consumer and capital goods recovers, one should also expect a recovery of traditional trade flows. The elasticity of trade with respect to income has already rebounded closer to its historical average (1.5) in 2017.⁶

However, the specter of a less integrated world economy is real.⁷ Recent developments (e.g., Brexit, the adoption of protectionist measures by the Trump administration and reactions from trade partners) underscore the potential for economic disintegration. The volume and composition of FDI flows are bound to be affected by these developments that tend to create incentives for market-seeking investment while feeding doubts about the benefits of export-oriented FDI.

Policy-makers need to resist the temptation to adopt policies that further advance these trends, such as restrictions of FDI flows designed to force technology transfers. More attention should be given also to the rules of the game and the infrastructure required to promote digital globalization. For example, rules on local data storage/processing and cross-border data transfer should be carefully evaluated since they may threaten the business models of digital firms and hamper FDI flows in this new era of globalization.

*** The *Columbia FDI Perspectives* are a forum for public debate. The views expressed by the author(s) do not reflect the opinions of CCSI or Columbia University or our partners and supporters. *Columbia FDI Perspectives* (ISSN 2158-3579) is a peer-reviewed series.**

****** Carlos A. Primo Braga (carlos.braga@affiliate.imd.org; cbraga.associado@fdc.org.br) is Associate Professor, Fundação Dom Cabral, Brazil, and Visiting Professor, IMD, Switzerland. The author is grateful to Manuel Agosin, Helge Hveem and Patrick Low for their helpful peer reviews.

¹ Susan Lund, et al., “The new dynamics of financial globalization,” *McKinsey Global Institute Report* (2017).

² Bank for International Settlements, *87th Annual Report* (Basel: BIS, 2017).

³ WTO, “Strong trade growth in 2018 rests on policy choices,” Press/820.

⁴ See, <http://www.globaltradealert.org>.

⁵ See M.P. Timmer et al., “An anatomy of the global trade slowdown based on the WIOD 2016 release,” *GGDC Research Memorandum*, 162 (University of Groningen, 2016).

⁶ WTO, “Strong trade growth in 2018 rests on policy choices,” *Press release 820* (April 12, 2018).

⁷ For a detailed discussion, see Carlos A. Primo Braga, “The threat of economic disintegration,” in Carlos A. Primo Braga and Bernard Hoekman, eds., *Future of Global Trade Order* (EUI, IMD and FDC, 2017), pp. 29-47.

The material in this Perspective may be reprinted if accompanied by the following acknowledgment: “Carlos A. Primo Braga, ‘Foreign direct investment and “peak globalization”,’ Columbia FDI Perspectives, No. 230, July 16, 2018. Reprinted with permission from the Columbia Center on Sustainable Investment (www.ccsi.columbia.edu).” A copy should kindly be sent to the Columbia Center on Sustainable Investment at ccsi@law.columbia.edu.

For further information, including information regarding submission to the *Perspectives*, please contact: Columbia Center on Sustainable Investment, Marion A. Creach, marion.creach@sciencespo.fr.

The Columbia Center on Sustainable Investment (CCSI), a joint center of Columbia Law School and the Earth Institute at Columbia University, is a leading applied research center and forum dedicated to the study, practice and discussion of sustainable international investment. Our mission is to develop and disseminate practical approaches and solutions, as well as to analyze topical policy-oriented issues, in order to maximize the impact of international investment for sustainable development. The Center undertakes its mission through interdisciplinary research, advisory projects, multi-stakeholder dialogue, educational programs, and the development of resources and tools. For more information, visit us at <http://www.ccsi.columbia.edu>.

Most recent Columbia FDI Perspectives

- No. 229, John Gaffney, “Could BITs and BATs be combined to ensure access to human rights remedies?” July 2, 2018
- No. 228, Felipe Hees and Pedro Barreto da Rocha Paranhos, “Investment facilitation: moving beyond investment promotion,” June 18, 2018
- No. 227, Rob van Tulder and Jan Anton van Zanten, “MNEs and the Sustainable Development Goals: what do first steps reveal?” June 4, 2018.
- No. 226, Khalil Hamdani, “Investment facilitation at the WTO is not investment *redux*,” May 21, 2018.
- No. 225, Michael J. Enright, “To succeed in China, focus on interests rather than rules,” May 7, 2018.

All previous *FDI Perspectives* are available at <http://ccsi.columbia.edu/publications/columbia-fdi-perspectives/>.