



## A ROUTINE CHAT TIPPED OFF HANKAMER SCHOOL OF BUSINESS PROFESSOR LES PALICH THAT CHINA'S ROCKETING PACE OF ECONOMIC EXPANSION WAS ABOUT TO COOL OFF.

About two years ago, he received a call from a colleague who was spending several weeks in the port city of Shanghai, as he does each year.

The friend reported noticing a decline in freighter traffic from his spot overlooking the bay. "He said he had been there for five weeks and it was very clear that traffic was significantly lighter," recalls Palich, who holds the Mrs. W. A. Mays Professorship in Entrepreneurship. "Not too long after that call, things really started slowing down in China."

The anecdote characterizes several of the fast-moving, complex and often contradictory dynamics defining the current state of

global trade in the turbulent wake of the financial crisis. This state is both a decidedly mixed bag and historically impressive.

"The current moment is neither the best, nor the worst, of times for the global economy," reports Herman Brown Professor of Economics Steve Gardner, who also serves as chairman of the department of Economics and director of Baylor's McBride Center for International Business.

Palich's Shanghai call illustrates the way advances in travel and communications technology have helped propel global trade. The leading indicator (declining freighter traffic) also shows how swiftly a country's economic situation – no matter how robust (and China's growth was historically staggering at the time of Palich's Skype session) – can shift on a dime. The fact that China's current gross domestic product (GDP) growth rate of roughly 7.8 percent (a rate other companies would delight in posting) qualifies as a slow down (from years at 10 percent) attests to the contradictory and complex nature of the global economy. Finally, the anecdote highlights the importance China plays in the global marketplace, a factor that is not lost on Baylor University, whose business and education connections with the country date back to 1907.

BY ERIC KRELL





**A CENTURY LATER,** a painful economic crisis began, and its ongoing wake continues to shape global trade in 2014. The Federal Reserve Board of Dallas recently estimated, “conservatively,” that the crisis and its difficult aftermath cost the U.S. economy anywhere between \$6 trillion and \$14 trillion. The latter figure being roughly equivalent to one year of U.S. economic output.

“The current global economy is characterized by an unusual degree of uncertainty,” explains Joe McKinney, professor of Economics in Baylor’s McBride Center for International Business. “We are in uncharted waters with regard to the unconventional monetary expansions that have been employed as a result of the global financial crisis.”

This monetary expansion in the U.S. concerns many economists, including Gardner, who sees a troubling parallel between the present moment and the late 1970s and early 1980s when relatively low interest rates—compared to the cost banks needed to pay to acquire funds back then—helped contribute to the U.S. savings & loan (S&L) crisis. Today, interest rates are far lower, and the number of 30-year loans with interest rates below 4 percent is extremely high.

“The likelihood that market interest rates will stay that low for that long seems awfully low,” Gardner notes. Many lenders today are not concerned

about these low odds because they sell these loans shortly after completing them. “This is similar to what got us into trouble before,” Gardner adds.

The future of this current monetary policy, which has ripple effects around the world, represents a major source of uncertainty. The degree to which developing economies, including China, India and Brazil, implement reforms that enable market forces to play strong roles in their economies also qualifies as a major uncertainty. And uncertainty surrounds the future of the European Union’s common currency, given the struggles of Greece, Spain and Portugal, in particular.

These and other factors help explain why the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD) and the U.S. Conference Board have ratcheted down their estimates for global economic growth for 2014. As McKinney points out, the OECD late last year revised downward its 2014 estimate from 4 percent to 3.6 percent.

Despite widespread uncertainty, there is reason for optimism. By many longer term measures, the world economy has never been stronger. For example, the global rate of extreme poverty—defined as living on less than \$1.25 a day—has decreased from 43.1 percent in 1990 to 20.6 percent in 2013, according to the World Bank.

“During the past 20 years, 13 countries have had **ANNUAL ECONOMIC GROWTH RATES OF 7 PERCENT OR MORE**, rates at which national incomes double in ten years or less,” explains McKinney. “During the past three years annual growth rates of national income exceeded 7 percent for 31 countries, and [growth rates] exceeded 5 percent for 63 countries. Economic progress of this magnitude is historically unprecedented.”

## 3 KEY DYNAMICS:

WITH PROGRESS, OF COURSE, COMES CHANGE. ONE OF THE MOST INFLUENTIAL CHALLENGES THE WORLD WILL DEAL WITH IN THE COMING YEARS AND DECADES IS THE SHIFT OF ECONOMIC INFLUENCE TOWARD ASIA. **GROWING GLOBAL TRADE COMPLEXITY AND AN ONGOING SHIFT TOWARD REGIONALISM** FIGURE TO BE TWO OF THE MOST INFLUENTIAL FORCES THAT WILL INFLUENCE THE GLOBAL MARKETPLACE IN 2015 AND BEYOND. THERE ARE THREE KEY FACTORS THAT AFFECT GLOBAL TRADE:

# 1

## PROTECTIONISM

**IN RESPONSE TO FINANCIAL DOWNTURNS, MOST COUNTRIES TYPICALLY TURN INWARD TO SHORE UP THEIR OWN ECONOMIES.** “If it looks like all of your jobs are going overseas during a stretch of high unemployment,” Palich notes, “politicians tend to take notice of that.” This attention often leads to protective measures that appeal to political constituencies but hamper global trade.

From September 2012 to September 2013, global trade monitoring group Global Trade Alert (GTA) reports that 431 new protectionist measures appeared around the world. During that same time period, the GTA reports 141 measures were instituted by governments to boost trade worldwide. This balance between protectionism and trade liberalization will help the state of global trade in the coming years.



# 2 TRADING COMPLEXITY

IN SOME RESPECTS AND FOR SOME COUNTRIES, CONDUCTING GLOBAL BUSINESS WAS EASIER IN THE MIDDLE OF THE PAST CENTURY.

Following World War II, only a small number of relatively similar and relatively wealthy countries had the capacity and need to form free trade agreements. The largest impediment back then consisted of tariffs (taxes countries attached to certain groups of imports or exports), which were the primary negotiating point in putting together trade agreements under the General Agreement on Tariffs and Trade (GATT). Created in 1947, GATT was used until 1994, when it was replaced a year later by the World Trade Organization (WTO).

For more than a decade, WTO countries have been trying – fruitlessly – to reach a new multilateral trade agreement through negotiations referred to as the Doha Development Round. The reasons for this impasse are manifold. Less

developed countries balk at U.S. subsidies to U.S. farmers, which prevent India, for example, from exporting agricultural goods to the U.S. For its part, the U.S. has a major issue with the way many developing countries regulate and enforce – or fail to – the protection of intellectual property (IP) rights. These are only two of the issues with which more than 159 WTO member countries with vastly different characteristics and needs are grappling.

“Today, you have a much larger group of countries that have a wider range of circumstances,” Gardner explains. “Some are very rich, some are poor, some are developing and some are still going through transitions from having been centrally-planned economies to trying to become market economies. This means all of the issues that are being negotiated are much more complicated.”

It also means consumer preferences, the availability of manufacturing materials, infrastructure quality, supply chains, and legal and regulatory requirements can vary – sometimes dramatically – country by country and region by region.

IN THE ABSENCE OF LARGE, MULTILATERAL TRADE AGREEMENTS, “THE WORLD HAS INCREASINGLY BEEN DIVIDED UP INTO REGIONAL TRADING BLOCS,” Gardner adds. These blocs include the North American Free Trade Agreement (NAFTA), which has understandably received renewed attention. In a Baylor University conference, “NAFTA in the Context of a Changing Global Economy” last October, Robert Zoellick, the former World Bank president and former Deputy Secretary of the U.S. State Department, laid out issues NAFTA should consider addressing if it is to make North America and its 500 million residents “well-positioned to contend with 1.3 billion Chinese – and other lands and peoples around the world.”

Additionally, the U.S. is participating in both Trans-Pacific Partnership (TPP) negotiations, with Australia, Brunei, Chile, Canada, Japan, Malaysia, Mexico,

New Zealand, Peru and Singapore, as well as the Transatlantic Trade and Investment Partnership (TTIP), negotiations on a trade agreement between the U.S. and the EU, billed as “the biggest trade deal in the world” on the European Commission’s website.

While regional free trade agreements offer some progress in the face of the stalled Doha negotiations, they also pose problems. Each agreement features “different regulations and rules of origin that complicate the international trade environment for business firms and impose unnecessary costs on them,” McKinney explains. Plus, McKinney continues, U.S. Congress has yet to give the President trade promotion authority that would be required to successfully conclude and implement current regional trade negotiations amid public skepticism concerning the benefits of trade liberalization. Despite those hurdles, notes Financial Times writer Shawn Donnan in a recent article mentioning the Baylor NAFTA conference, “This is the era of megaregionalism.”

## REGIONALISM

# 3



### OTHER FORCES, SUCH AS THE AVAILABILITY OF NATURAL RESOURCES, ALSO SHAPE GLOBAL TRADE;

however, most, if not all, of these forces combine to pose similar demands on businesses. Like global trade itself, these demands are complex.

The pressure to reduce costs is intensifying throughout the global business world, Palich notes, but so, too, is the need to produce more and better innovations (a process that requires investments). Technology and communications advances have made business innovation much more transparent; more companies around the world can peer into a market leader’s products and processes, reverse-engineer what works best and quickly bring to market lower cost products and services (of similar or even superior quality).

Flexibility and/or agility are commonly cited by leading business minds as the most valuable organizational capability in the global marketplace. Increasingly, though, it takes even more to thrive in this global marketplace. “You have to be much more courageous than ever before to succeed at international business,” Palich asserts.

Developing and applying that courage requires “stepping out of your own, and your company’s, comfort zone,” says Jim Anderson, manager of Baylor Business Global Connection for the McBride Center for International Business and adjunct professor of International Marketing at Baylor.

Anderson has managed and led global businesses for more than 30 years. Of all the key components that determine international business success, including the right market, the right product, the right logistics, and risk management capabilities, Anderson says that market partners – finding a knowledgeable local company to work with under various structural options – often represents the most important success enabler. “Even the largest companies cannot

get by without a market partner,” Anderson says, adding that achieving a sufficient level of cultural awareness enables companies to select the best partners in new markets.

Particularly, this is the case in markets defined by complex regulations and heavy government involvement like China. “We all watch China very closely because they are so important to what we experience and what we do,” notes Palich.

Some current and future leaders are able to watch and understand China more closely. Nearly 15 years ago, Gardner received an email from an 80-year-old woman in Shanghai. She was the daughter of the first Chinese president of the University of Shanghai, which worked with Baylor in the 1950s, and whose origins date back to 1907. The email encouraged Gardner, and the Hankamer School of Business, to

rekindle its relationship, which is exactly what Gardner and Hankamer have done since then.

In 2007, Gardner and a contingent of Baylor University professors travelled to Shanghai to participate in the celebration of the 100th anniversary of what is currently known as the University of Shanghai for Science and Technology, an institution founded by Baptist missionaries in 1907 as the Shanghai Baptist College. Gardner and his colleagues returned to China on an education delegation last summer. Additionally, Hankamer’s i5 Experience is a five-week course focusing on technology entrepreneurship, China’s culture, and history and multi-cultural teamwork.

“The good news is that there is all sorts of cooperation between the U.S. and China,” Gardner adds, “and Baylor has been busy in that part of the world.”

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