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Rise of Nationalism Frays Global Ties

Trade, Environment Face New Threats; Balkanized Internet

By Bob Davis

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The world isn't as flat as it used to be.

During the long march toward globalization, international borders and trade barriers came down. Communism fell. Protectionist walls in Latin America and elsewhere were dismantled. Governments -- long prone to meddling in trade -- took a back seat to broader market forces.

SEE A PHOTO SLIDESHOW

Homeless Russians in downtown Moscow, Dec. 24, 1998. See how national governments' support for globalization has waxed and waned for more than a century. ILLUSTRATION: GETTY IMAGES

In a globalization manifesto, New York Times columnist Thomas Friedman declared that the Internet and other planet-spanning technologies were erasing national boundaries. The world, he said in a 2005 best seller, was flat.

No longer. The global economy appears to be entering an epoch in which governments are reasserting their role in the lives of individuals and businesses. Once again, barriers are rising. Call it the new nationalism.

"The era of easy globalization is certainly over," says Pulitzer Prize-winning author Daniel Yergin, whose 1998 book, "The Commanding Heights," detailed the triumph of markets over nations, starting with British deregulation under Margaret Thatcher. "The power of the state is reasserting itself."

Just a decade ago, Asia, Latin America and Russia were on financial life support from the International Monetary Fund and World Bank. The U.S. was planning yet another round of global trade negotiations. The European Union was writing a constitution to shift power to Brussels from member nations.

Now borrowers shun the IMF and World Bank. Trade talks are shelved. Barriers to foreign investment are rising around the world. State-owned companies are expanding, particularly in oil and gas. Public support of immigration restrictions is growing in countries from the U.S. to India.

The rising influence of governments can be seen in massive state-funded investment pools, many backed by countries that were reeling financially a decade ago. Sovereign wealth funds from Asia and the Middle East are now propping up wobbly financial institutions in the U.S. and Europe, and may hunt next for real-estate bargains. The growth of state power may also serve to make dealing with global climate change -- the most borderless of all issues -- even more difficult.

Security Concerns

What accounts for governments' bigger role? The terrorist attacks of Sept. 11, 2001, refocused the world on security concerns that can be addressed only by national governments. Countries enriched by the commodity boom are increasingly asserting their power, with Venezuela nationalizing oil fields and Russia threatening to cut off natural-gas supplies to Western Europe. A backlash against economic integration has also pressured national governments to retreat from multilateralism: Big pluralities in 21 of 34 nations polled by BBC World Service in December said the "pace of economic globalization" is moving too quickly.

The changes don't presage an era of full-blown protectionism. The 15 countries that have shared the euro since 1999 will, despite occasional grumbling, continue to do so. Governments continue to obey rulings by the World Trade Organization, even if they must rewrite their own laws to comply. Mr. Friedman, the flat-world theorist, says that the reassertion of state power may turn out to be an "episode" rather than a trend, and that technologies will continue to empower individuals across boundaries.

Even so, there are mounting indications that governments are on the ascendant.

National boundaries are going up even on the Internet, the emblem of the borderless world. The Internet was designed to be beyond the reach of governments, shifting power to individuals or private organizations.

Now, pressured by Russia, China, India and Saudi Arabia, the U.S. company that assigns Internet addresses is working on ways for countries to use characters from their home languages. The familiar .org, .com and country codes in Web addresses will be replaced with their equivalents in Chinese, Hindi and many other languages. While that should help locals navigate the Web, it would also put many sites behind curtains to users from abroad. That would spell the end of the days when anyone with a keyboard that produces Latin letters can see sites in any land -- essentially taking the "world wide" out of the World Wide Web.

"We're facing a step-by-step Balkanization of the global Internet," says Columbia University law professor Tim Wu. "It's becoming a series of national networks."

The rising strength of national governments expresses itself in different ways. For rich countries, it generally means higher taxes and more regulation. In the 30 mostly rich countries of the Organization for Economic Cooperation and Development, tax revenue as a percentage of the local economy was higher in 2005, the latest year surveyed, than a decade earlier. That's because of the rising cost to governments of health care and social security.

In the U.S., the severity and scope of the current financial crisis has eroded the case for letting markets operate with ever-lower government guard rails. The current question is not whether regulation will increase, but by how much. All three presidential candidates say they would pass tougher financial-market regulation and would also boost government programs to retrain workers battered by the global economy.

In rich and poor countries alike, immigration has become a powerful political issue, as improved transportation makes it easier for people to move across borders and compete for jobs with locals. There are backlashes against Burmese in India, Haitians throughout the Caribbean, Bolivians in Argentina and Zimbabweans in South Africa. In 44 of 47 countries polled by Pew Research Center last fall, majorities supported further restrictions on immigration.

In poorer countries of Africa and Asia, meanwhile, rising global food prices are prompting governments to erect new export barriers. "There is no place in the world that grows the food we need if we're forced to import," says India's finance minister, P. Chidambaram. "Therefore we have to be nearly self-sufficient in all food items."

Growing Influence

Capitals that once had little sway on the global scene now have a lot. The influence of Brazil, for example, has grown along with its economy. A week after WTO trade talks collapsed in July 2006, U.S. Trade Representative Susan Schwab jetted to Brasilia to confer with the country's foreign minister, Celso Amorim, who also handles trade issues.

Mr. Amorim has become an unlikely power broker in the bid to wrap up the negotiations, which began in 2001. The talks broadly involve a prospective deal: The U.S. and Europe would slash agricultural subsidies if developing nations would lower their tariffs for industrial goods and broaden foreign financial firms' access to their markets.

In the past, developing nations essentially ratified global trade deals negotiated by the U.S. and Europe. But Brazil, India and China are no longer following that script. Mr. Amorim has put together a group of 20 developing nations that want to limit market openings at home while pressing for agricultural liberalization abroad. Their assent is essential to reaching a deal. So far they have withheld it.

"Brazil holds the key to getting this done," says Ms. Schwab.

'It Was a Party'

Citizens of poor countries feel exhilarated by their governments' new power. In Rio de Janeiro, Maria Aparecida Lemos, an AIDS patient who lost her sight, says she "celebrated like it was a party" last year when Brazil's president voided a Merck & Co. patent on an AIDS drug. A Brazilian company now makes the drug, Efavirenz, for a fraction of what Merck was charging. Under global trade rules, developing countries have the right to override patents in emergencies, but few had done so for fear of retaliation.

Merck says it had already reduced the price of Efavirenz and was willing to cut further, but not enough to satisfy Brasilia. "Brazil may not be the kind of place you want to invest in," says Jeffrey Sturchio, Merck's vice president for corporate responsibility. Brazilian officials shrug off such threats, figuring the country's growing wealth makes it a magnet for investment.

Energy companies have been among the first to feel the new nationalism. Since oil prices started rising in 2004, Russia, Venezuela, Bolivia and Ecuador have nationalized foreign-owned oil assets, the first big wave of nationalization since the 1970s. After Venezuela's state-owned oil firm doubled its ownership of heavy-oil projects along the Orinoco River last year, ConocoPhillips pulled out, taking a $4.5 billion charge. Exxon Mobil Corp. left as well, and is suing Venezuela for compensation.

Growing petro-nationalism has prompted Royal Dutch Shell PLC to change the global scenarios its economists create to help the company plot its next moves. In the 1990s, Shell's scenarios assumed government power was diminishing. The company invested heavily in Russia's Sakhalin oil fields, assuming it would see minimal interference. But as the Kremlin tightened its grip on the energy sector, Shell was forced to sell half of its stake in the project to Russia's state-owned OAO Gazprom.

In this decade's models, governments play a more central role. One of Shell's two current scenarios envisions that government dominion over resources -- nearly 80% of world oil reserves are controlled by state-owned firms -- will continue. In the other model, governments are still at the center of decision making but recognize a common interest and agree to address climate change, says Jeremy Bentham, Shell's vice president for global business environment.

Recognizing the powerful role of state-owned oil companies, Shell is investing heavily in unconventional oil sources, many of which have little prospect of expropriation. It recently announced a $10 billion expansion plan in the tar sands of Canada. It has also increased its focus on biofuels made from, among other things, algae and wood chips.

Pitney Bowes Inc., a postal-machine maker in Stamford, Conn., is also trying to adapt. Over the past decade or so, it had moved a lot of its production to China. It also had outsourced back-office computer operations to India.

But more recently, the company has started worrying about the security of those supply lines. "We're always concerned that the nationalists there will come and take over" our suppliers in China, says Cynthia Schmitt, the company's vice president for enterprise risk management.

So over the past three years, the company and its overseas suppliers have begun stockpiling more postage-machine components. Pitney Bowes also began insisting that its vendors in India have backup servers in other countries. So many U.S. companies do business in Bangalore and other Indian cities, Ms. Schmitt fears they could become terrorist targets.

Similar concerns are felt by other big companies. AMR Research Inc., a Boston consulting firm, says it surveyed supply-chain managers at big U.S. firms in March about how they would rank the risks they face doing business globally. About 30% of them rated "country risk" -- geopolitical problems or natural disasters -- as their most significant.

Some companies are seeking havens closer to home. As some U.S. corporations relocate operations from lower-cost spots in Asia, Mexico -- which has a free-trade pact with the U.S. -- has seen a surge in foreign investment, up 21% last year to $23.2 billion.

Some of the world's biggest new investors are government-run investment funds. In the Middle East and Russia, sovereign wealth funds are powered by oil revenue; in Asia, they're fed by other export earnings. In all, the funds have a total of $3 trillion in revenue and have used the money to buy stakes in Citigroup Inc., Merrill Lynch & Co. and other battered Wall Street firms. While the infusions have been lauded by the U.S. Treasury and capital-short Wall Street firms, they also aroused suspicions here and internationally that the investors could have political agendas.

Now, many national governments are raising barriers against such foreign investment. The U.S., Canada, Germany, France, Japan, South Korea, Australia, Hungary and Greece are proposing or enacting restrictions on investment by state-owned firms from other countries, according to a forthcoming study by the Council of Foreign Relations. China and Russia, which have sovereign wealth funds, are staking out "strategic sectors" where foreign investment would be restricted, say the study's authors, investment-law specialist David Marchick and Dartmouth economist Matthew Slaughter.

National Muscle-Flexing

Muscle-flexing by national governments has also made it more complicated to tackle global environmental issues. In 1987, governments sent environmental ministers to Montreal to negotiate a global ban on the chlorofluorocarbons blamed for opening an ozone hole over Antarctica. The ministers expected the treaty would be ratified at home and enforced world-wide through trade sanctions. It was.

A decade later, the Kyoto Protocol flopped because the U.S. didn't sign, and China and India weren't required to limit emissions. Now, with national governments wary of making commitments, negotiators and think tanks in the U.S. and Europe are grappling with how to persuade states to take strong efforts to curtail greenhouse-gas emissions. One possibility: encourage governments to take specific actions to cut emissions now, and hold off on a treaty until states are more confident that their rivals are taking global warming seriously.

New nationalism could play out over a lengthy span, says Michael Klein, chief economist at the World Bank's private-sector arm, the International Finance Corp. "Disparate national interests may pull [countries] in different directions and render global actions more difficult," Mr. Klein says. "We're in for several decades of these centrifugal forces."

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