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Opportunities in Economic Crisis

Can the low-end manufacturing potential of the Post-China 16 states benefit a faltering global economy? Karen Hooper thinks so. These countries not only have a readily available labor force, they have also enacted policies that allow them to exploit their political, regulatory and geographical advantages.

By Karen Hooper for ISN

Five years into the financial crisis and global economic growth remains lackluster. What growth there has been in European Gross Domestic Product (GDP) is too small to signify a recovery, and unemployment rates throughout the continent remain untenably high. While the United States' economy is showing signs of recovery, the country's job market has not kept pace. Chinese economic activity has also fallen sharply in the wake of the crisis, triggering a political evolution inside the country. It appears, therefore, as though the world is undergoing a period of profound change as the three main pillars of the global economic system falter.

Europe's stagnation and the United States' slow recovery will inhibit export-driven growth for most countries, particularly industrial and manufacturing exporters, which have been hit harder than commodities exporters. But opportunity also exists within these misfortunes. Eventually the dust will settle and global consumption will rise again. However, the ongoing crisis is changing the nature of the economic system, and exporters will face fierce competition for market access to an increasingly diversified set of importers.

Looking beyond China

In June 2013, Stratfor identified 16 countries that in recent years have made strides in attracting low-end, export-oriented manufacturing. Located in Southeast Asia, Latin America and Eastern Africa, these states – known collectively as the Post-China 16 - have the potential to benefit from the changing global economic structure by attracting low-end manufacturing while boosting exports of basic value-added products. These include textiles, an industrial sector that often serves as a leading indicator of investor interest in developing countries.

The Post-China 16 are growing in economic significance because labor costs are rising in China, and companies that might otherwise have invested there are now turning to other countries that can offer a competitive advantage. There is no one country -- except perhaps India, which continues to struggle with bureaucratic barriers -- that has the population and resources to completely replace China as a destination for low-wage, low-skill manufacturing. However, China is slowly moving up the value-added chain and becoming a manufacturer of more sophisticated products. This means that low-end manufacturing is moving elsewhere. As a result, the countries that stand to benefit are those that have underutilized populations and the requisite political, regulatory and geographical advantages. These countries span the globe, from Sri Lanka to Ethiopia to Peru.

Major economic growth and social mobility, almost as a matter of course, have always started from low levels of development. In the 1990s, several great economies emerged in the aftermath of the Cold War. China began to fundamentally reform its economy in the 1980s, a process that former leader Deng Xiaoping expedited in 1992 when he embarked on his now-famous Southern Tour. The next two decades were characterized by unrivaled growth as China became the preferred destination for export-oriented manufacturing. Though the 1990s were economically tumultuous, other countries ranging from Mexico to Brazil to Russia experienced political changes that have since broken apart restrictive domestic economic relationships and opened the countries up to trade and foreign investment, to varying degrees of success. The result was a wave of growth around the world as untapped populations, resources and assets came in contact with new consumer markets and sources of capital.

At this point in history, there are few of these readily available markets waiting to be opened. Of course, there are some, including Argentina, Iran and North Korea, where a political opening that facilitates access to Western capital and consumer markets would undoubtedly release decades of repressed economic activity. But these countries are exceptional. In a world of low tariffs and increasingly free financial flows, the majority of countries that seek to gain a foothold in the current global economic environment have already lowered all the major political barriers to economic integration. In this context, the gains of further economic openings through free trade agreements and regulatory harmonization should be seen as sources of only marginal benefit, not opportunities for radical change.

Accordingly, countries that want to sustain or radically increase export-driven growth in GDP but lack the capital necessary to drive industry fiercely compete with one another for a finite pool of internationally mobile, export-oriented investment. For political reasons, many (if not most) of these countries would prefer to attract manufacturing investment over commodity investment. Value-added industries usually create more jobs than commodities industries -- energy extraction or agricultural production, for example. Both kinds of investment rely on technology and capital from overseas, but whereas a politically difficult country with significant natural mineral reserves (such as Venezuela or Nigeria) can attract investment to extract those minerals, countries seeking value-added investment must exploit any and all marginal advantages in geography, infrastructure, labor and political relationships to remain competitive.

A Change of Scenery

The most determinative factor for countries pursuing export-driven growth is competitive access to consumer markets. This is where the global picture becomes increasingly complex. Demand in the United States and Europe drove China's ability to surge exports over the past two decades. But now Europe is stagnating, and it can be expected to do so for the foreseeable future, considering its demographic trends will work against economic growth. The United States is growing economically, but with the revolution in energy production technology taking place in U.S. oil fields, there is some evidence that companies are seriously considering "re-shoring" manufacturing capacity to the United States, which could help the country reduce its reliance on some imported products.

Yet, even in the absence of a demographic crash in Europe or a major re-shoring of manufacturing back on home soil, both the European Union and the United States are gradually becoming less important in international trade markets. The United States still imports more than any other country in the world, with $2.3 trillion in goods and services imported in 2012. For its part, the European

Union is the largest unified market, importing $5.7 trillion in goods in 2012. But both markets are getting smaller as a percentage of total trade. The United States and the European Union imported 19 percent and 39 percent of the total non-hydrocarbon traded goods in 2001, respectively. In 2012, those percentages dropped to 13 percent and 32 percent. The implication is that although the United States and the European Union remain key markets for global exporters, other importers -- including China -- are emerging as important sources of import growth.

What this means is that investment destinations will vary as China's economic profile transforms -- and at the same time, the profile of consuming markets will also change. While Europe stagnates, other marginal demand growth opportunities for exporters will present themselves. It also means that at this point in history, the global economy is becoming an increasingly complex environment for nations to navigate.

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