

## Regional Approaches to Global Uncertainty

Puia M. George

*Saginaw Valley State University, USA*

[puia@svsu.edu](mailto:puia@svsu.edu)

Potts Mark

*Central Michigan University, USA*

[mark.potts@cmich.edu](mailto:mark.potts@cmich.edu)

### Abstract

*Drawing on the literature and current trends, the authors set forth a hypothesis that crisis has led to regional responses among policy makers, multinational companies, and entrepreneurs. The authors more specifically posit that national policy makers are shifting focus by redefining or withdrawing from larger alliances and solidifying regional coalitions. Multinational corporations operate regionally with narrower supply chains, financial management to insulate them from currency concerns, and regional products. Entrepreneurial financing is increasingly more regional and entrepreneurial firms are more regional and less global. This discussion concludes with the suggestions for further research.*

**Key words:** Crisis, Regionalism, Entrepreneurship, Brexit

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### 1. Introduction

The current global environment has experienced a wave of successive events that many scholars feel has brought the global economic system beyond the critical stage to a period where crisis is the new normal (El-Erian, 2010; Hitt et al., 2016). The elements of this ongoing crisis include the Greek/European financial crisis, the Great Recession, the rise of economic isolationism in the United States and Great Britain, the Arab Spring/North African refugee crisis, the Syrian refugee crisis, and other regional crises. The results of these sequential crises have led to a marked increase in economic uncertainty; globalization and global business have become more risky. It is also quite likely that we have not seen the end of these crises; prior events generated a contagion effect that multiplied across countries over time. Responses to the contagion often created more problems than solutions. It is evident that we are writing from the middle not the end of this phenomenon. The effects from these concurrent multiple crises are profound. Many nations are experiencing lower economic growth, lower employment/higher unemployment (Vuksic, 2014), lower worker mobility (Autor, et al., 2016), lack of financial liquidity (El-Erian, 2016), reduced foreign direct investment (World bank, 2017), and reduced consumer confidence.

Prior to the turn of the millennia, there had been an increasing trend toward globalization. At the nation level, countries were surrendering sovereignty to participate in multilateral agreements like the MERCOSUR, NAFTA, and an expanding EU. Political-economic policy had moved past free trade to common currencies and the free movement of human resources across national borders. The ongoing crises have caused a dramatic slowing if not a reversal of this era of trade liberalization.

To mitigate risks in this difficult context, business leaders and policy makers need to continually craft pathways toward business and economic growth. It is common practice among economic development professionals to look at economic growth as coming from three equally important sources: attracting external firms (FDI), helping existing firms to grow and prosper, and creating a context that facilitates entrepreneurship (Blakely and Bradshaw, 2002; Puia, 2014),

## 2. Common approaches to growth and uncertainty reduction

Crises present policy makers and economic agents with opportunity windows. Depending on the nature of the crisis and nature of the country, turbulent environments provide policy makers the opportunity to make large scale institutional change; changes that can be positive or negative. There are known political risks associated when crisis driven policies. Absent a coordinated government response, history has shown that extremism can become the normative response to crisis environments (Klapisis, 2014). For example, de Bromhead et al., (2013) demonstrated large increases in votes for far-right anti-system parties in 21 European countries following the stock market crash of 1929. In the same article, the authors saw a shift to the far-right following the 2008 financial crisis.

This paper posits that nations, multinational firms, and entrepreneurs are developing strategies to grow while mitigating risks driven by global crises, and that these strategies may have common characteristics. In looking to reduce risk while exploring the three economic development strategies of FDI, local firm growth, and enhanced entrepreneurship, the authors are beginning to detect a move away from global agreements to regional ones. This paper sets forth one grand hypothesis summarized below. The paper further presents three smaller hypotheses that relate to the grand hypothesis.

*Grand Hypothesis: Crisis has led to regional responses among policy makers, multinational companies, and entrepreneurs.*

## 3. Globalization or a new regionalism among nations?

All countries, but especially developing ones, derive economic benefit from cross border trade. Trade presents the prospects of larger markets, better sources of labor and materials, and access to potential new investors to highlight a few of its benefits. While countries and companies benefit from trade, the benefits of full globalization may be much fewer. Trade is driven by companies, and few companies' possess the resources to operate at an integrated global level (Rugman, 2005). Additionally, elements in the current wave of crises are re-shaping national attitudes toward globalization making it difficult to sustain (Corbu, and Stefanita, 2013; Stocker, 2016). One evidence of this is the US withdrawal for the Transpacific Trade Agreement – TPA.

At the government level, there is evidence to suggest that developing nations are moving from globalization toward to a new regionalism, one where regional partnerships provide the basis for better security and trade arrangements. Once such example would be the Shanghai Cooperative Agreement (SCO). Russia, China, and Central Asia call this a 'partnership' and not an alliance. While outsiders have viewed this as potentially a military alliance, it really forms the basis of a broad trade and financial alliance (including the Petroyan).

Similar to the SCO is the China-South Korea Free Trade Agreement (CKFTA). The 2015 agreement promises to reduce tariffs on 90% of goods between the two countries within 20 years at a time when South Korea's trade with China has already surpassed its trade with Japan, the United States and EU combined (Ye, 2017). At a time of great uncertainty, the CKFTA agreement represents a diplomatic sea change away from the West toward neighboring China.

Europe provides another example. To derive the benefits of trade, nations need to be relatively competitive. While there has been an expectation that harmonized EU policies would lead to equivalent levels of national competitiveness, this has not been the case (Potts and Puia, 2011); differences in competitiveness among EU members states has declined slowly (Balcarova, 2016).

It is difficult to write of a European approach to regionalism in this timeframe as the business landscape is evolving so quickly. Less than two years after the addition of Croatia, Latvia, and Lithuania to the EU, the UK voters endorsed Brexit. Additionally, the refugee crises have severely strained sentiment toward the Schengen agreement. While there is great uncertainty in regards to trade and economic growth as a result of Brexit, there is scholarship that suggests that reduced uncertainty and positive outcomes in the longer term are quite feasible (Whyman and Petrescu, 2017). Further, in normally stable Germany, we have witnessed the great difficulties the incumbent leader has faced in building a coalition government. While there is not liquidity crisis as yet, the

problems of government formation in Germany do not bode well for a system that has relied heavily on the German central bank for its financial stability.

These regional approaches suggest significant new directions in economic development. Government policy makers may be moving from a global trade platform to a regional one. In this new regionalism, one could imagine business attraction/FDI occurring more regionally than globally. It is easy to imagine China investing in innovative capacity in Korea and raw materials development in Russia, or in the reverse direction, Korea and Russian eyeing business growth in China's industrial markets.

These trends and the corresponding literature lead us to the following proposition (hypothesis one – h1):

*H1: In response to the ongoing crises, national policy makers are shifting focus by redefining or withdrawing from larger alliances and solidifying regional alliances.*

#### **4. Multinational Corporations: going global or going regional?**

Similarly, there has been an ongoing trend for MNCs to pursue regional rather than global strategies (Rugman, 2005). Additionally, anecdotal evidence seems to suggest that firms are also exploring regional supply chain solutions as a means to minimize risk inherent of lengthy supply networks in times of crisis. Further, in the search for talent, as nations like the United States and Great Britain begin to limit global immigration, regional workers may become the major source for talent that is absent in the local economy.

At the firm level, O'Hagen-Luff & Berril (2016) noted half the MNCs in their research reduced overall foreign sales but with few decreases in the regions in which they operate. They saw the majority of firms in their sample pursuing a semi-global strategy. Multiple scholars have identified trends away from global business interactions toward regional ones. In his work, Rugman (2001) argued that we were already reaching the end of globalization and a move toward new regional economies. Additionally, the literature suggests that firms benefit from shorter and more agile supply chains in the face of potential disruptions (Kleindorfer and Saad, 2005). These trends lead us to a second hypothesis (h2):

*H2: In response to crisis, multinational corporations operate regionally with narrower supply chains, financial management to insulate them from currency concerns, and regional products.*

#### **5. Regional entrepreneurship as a response to crisis**

Government policy makers tend to underestimate entrepreneurs for two reasons: entrepreneurs have less political capital than large established firms, and their impact on the economy is less immediate. The literature identifies 'high-impact' entrepreneurs as those who can create 20 new jobs in five years (McDougal-Covin et al, 2014). While the short-term impact of entrepreneurs is modest, the long-term impact can be transformational. Further, in times of crisis, entrepreneurs may represent a transformation force for change. In comparison to governments or even MNCs, entrepreneurs can move more quickly, require less capital, and are by definition willing to accept more risk.

Regionalism is not a new concept to entrepreneurs; it is the normative way in which start-up enterprises internationalize (Johanson and Vahlne, 1977). In their more recent work, Johanson and Vahlne (2009) view the business environment as a web of relationships rather than an arms-length market. As such, outsidership is the root of uncertainty; the more distant a business is from its customers, the greater the uncertainty. With these thoughts in mind, the new China-South Korea agreement opens opportunity vistas for their national entrepreneurs, giving entrepreneurship in stabilizing the economy post-crisis.

Despite the importance of entrepreneurship to European growth goals and the push toward common policy frameworks, significant differences still exist between individual countries in their support of entrepreneurship in terms of regulatory and investment contexts. Empirical evidence suggests that lower entrepreneurial regulation, more flexible regulation of entrepreneurial finance,

and access to early investment resources results in higher levels of patented innovation and business start-ups (Potts and Puia, 2018). It is important to note however that early stage entrepreneurial funding varies greatly across nations in general and European nations in specific. National entrepreneurs likely need to access emerging regional angel and venture funds to secure growth financing.

These trends lead us to our third hypothesis (h3):

*H3: In response to crisis, entrepreneurial financing is increasingly more regional and entrepreneurial firms are more regional and less global (i.e. fewer firms are being born global but are acting more bilaterally or regionally in terms of customers and suppliers); fewer entrepreneurs are addressing global needs as opposed to bilateral or regional ones*

## 6. Conclusions

As the ongoing crisis environment becomes a new reality, policy makers, executives and entrepreneurs face a challenging new frontier. In terms of growth through cross-border business attraction, *global* FDI has fallen. In this context, policy makers and firms are beginning the process of building new regional alliances. While regional investment has not replaced lost FDI to date, the realignment of partnerships suggests that FDI will follow these configurations.

In the political environment, it is hoped that policy makers will not forget the lessons learned in the past three decades in regards to trade and entrepreneurship. Reducing the burdens of unsuitable regulations, maintaining or lowering tax rates, finding ways to support entrepreneurship despite potential opposition from incumbent firms, and discovering ways to support business growth are basic elements of success. It may also prove valuable to explore at least in the short-run regional alliances that reduce risk while providing the benefits of trade.

At the firm level, research posits that executives will benefit from reducing their global expectations and focusing upon opportunities within a limited set of regions. Shorter supply chains can reduce uncertainty. Neighboring markets reduce the liability of foreignness. MNCs can benefit from a regional approach.

Entrepreneurship may provide the greatest challenges and the highest potential long-term rewards. In the event of a liquidity crisis, nations are likely to have far more urgent priorities than entrepreneurial funding. Further, they may feel pressure to raise government income through tax increases. Reduced levels of funding and higher taxes have a well-documented negative effect on entrepreneurship and innovation. Because the return on investment in entrepreneurship is not immediate, entrepreneurship may not make it to the top of a government's priority list. This could have severe long-term consequences.

Significant research is necessary to test our hypothesis, specifically to our hypothesis regarding policy makers (h1). It is important to discover if changes in policy result shift nations toward regional trade or merely result in a reduction in trade. Similarly, shifting national fortunes could create significantly greater volatility in exchange rates. It will be interesting to explore if economic actors pursue the use of cryptocurrencies (e.g. bitcoin) as a mechanism for individuals and firms to navigate increased financial market fragmentation by policy makers.

Regarding multinational corporations (h2), we ask if there is significant evidence that multinationals are abandoning global product lines or supply chains. One might find empirical support for this if there is a decline in the significance of global brands and increasing importance of regional or local brands. It will be important to investigate if multinational firms are abandoning doing business in selected regions altogether.

To address our entrepreneurship (h3) study is needed to identify if there is evidence that less firms are being born global? Is there evidence that fewer firms are forming to address global needs (e.g. antivirus software, material science), but rather regional or cultural needs (e.g. prepared foods, clothing). Further, there is need to investigate the extent to which entrepreneurs will seek regional rather than global customers and/or suppliers.

Clearly, we are mid-chapter in terms of adjustments to the new-normal crisis environment. The current research is still somewhat ambiguous as to the direction that nations must take to maintain and grow their respective economies and to reduce the environmental uncertainty that makes business decisions more complex. Research can contribute to policy makers, executives and entrepreneurs as they face this complex and dynamic environment.

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