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How Does the Russia-Ukraine War Affect Asia's Political Economy?

Multinational companies must find new solutions in an era of accelerating deglobalization.

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Significant changes have occurred in the global political and economic structure under the COVID-19 pandemic and geopolitical tensions. Countries have imposed sanctions on each other in the name of political and economic security. The global supply chain, industrial chain, and value chain system built up in the past decades has been dealt a heavy blow. Currently, the chaos caused by the pandemic has not yet ended, and the Russia-Ukraine conflict has plunged the world into another critical situation. Multinational corporations have taken the initiative to or been forced to adopt corresponding response strategies in this deglobalized era.

The Cloud of Deglobalization Looms Large

As the champion of globalization over the past four decades, the United States has shown prominent isolationist and protectionist characteristics in recent years in its foreign political and economic policies. These U.S. policy adjustments have weakened the process of globalization and induced policy countermeasures among different camps and interest groups. The statistics published by the U.S. Department of Commerce show that the U.S. goods and services deficit in 2021 was $859.1 billion, an increase of 27 percent over the previous year, accounting for nearly 4 percent of GDP and a record amount.

Since 2016, Donald Trump's election as U.S. president, Brexit, and the China-U.S. trade war are all warning signs of a globalized system that is increasingly difficult to sustain. The COVID-19 pandemic and the impact of the Russia-Ukraine war have exacerbated the existing stresses and further display the vulnerability of national economies to unexpected economic turbulence, weakening the consensus on globalization. As of April 11, Yale University statistics indicate that more than 600 multinational corporations have divested from Russia or ceased operations.

These deglobalization forces "could have profound and unpredictable effects," according to Laurence Boone, chief economist at the Organization for Economic Cooperation and Development (OECD). Under this new trend toward regionalism, the economic security constructed by the global supply chain, industrial chain, and value chain has suffered drastic impacts. Undoubtedly, the current global political and economic landscape is in a new and unprecedented adjustment period, and the uncertainty brought by economic decoupling is the first to hit multinational corporations.

However, it also creates opportunities for countries that have the absorptive capacity to attract and accommodate firms in search of new markets and economic opportunities.

Multinational Corporations' Strategies in the Context of Deglobalization

As the conflict between Russia and Ukraine continues to intensify, the confrontation between Western countries and Russia has extended from the national level to the corporate

level. British Petroleum announced on February 27 that it would give up as much as 19.75 percent of its stake in Rosneft, a Russian integrated energy company, which accounts for about half of BP's oil and gas reserves and a third of its production. The withdrawal could cost it $25 billion. In addition, dozens of energy companies, including Statoil, Shell, ExxonMobil, and others, have ceased operations in Russia or announced plans to abandon their Russian operations.

As early as after the financial crisis in 2008, multinational corporations, represented by Citibank, began to respond to operational risks arising from inconsistent regulatory measures in various countries by shrinking and selling their businesses. Since 2008, Citibank has sold off its retail and related businesses in Germany, Turkey, Brazil, Egypt, and a dozen other countries. In March 2022, Citi has agreed to sell its Indian retail banking sector to Axis Bank, India's third-largest private bank, for approximately $1.6 billion. It's the latest step in the streamlining of Citi's business by CEO Jane Fraser, who wants to exit retail banking in 13 countries to focus on more lucrative institutional and wealth management businesses.

Citi is not the only bank responding to the challenges of deglobalization by shrinking and selling its businesses. HSBC has also embarked on a massive global asset slimming program since 2011 to respond to the trend of deglobalization. HSBC's strategy to shift to Asia includes the sale of properties in Turkey and Brazil and increased investments in Asian regions such as the Pearl River Delta region of Guangdong, China, and Southeast Asia. HSBC's decision to re-emphasize the role of Asia in its growth strategy would definitely strengthen its leading position in Asia, since Asia has always been the bank's largest source of earnings among its five regional markets. According to the 2021 financial report, HSBC's pre-tax profit in the Asian market was $12.249 billion, accounting for 64.8 percent of the group's total profit.

Nevertheless, HSBC is still regarded as a British bank. Since 1992, when HSBC acquired Midland Bank, one of the four largest local banks in the U.K., and after completing various integrations in 1993, the century-old HSBC officially moved its headquarters from Hong Kong to the U.K., with its senior management and operation team based in London. HSBC is currently listed on the London, Hong Kong, New York, and Paris exchanges. Its top 10 shareholders include Ping An Insurance, BlackRock, Bank of New York Mellon, Vanguard, and other global asset management companies. Due to HSBC's multinational corporation attributes, it also has to be subject to both British regulations and U.S. long-arm jurisdiction. It has become caught in a complex game of big countries because of its focus on the Asia Pacific, especially the business of mainland China and Hong Kong.

This unique structure of misaligned markets, operating teams, and territorial regulation has laid the seeds for the HSBC Group to face tax and regulatory cost increases and be stuck in the middle of the China-U.S. confrontation. Although HSBC has repeatedly considered spinning off its Hong Kong operations and relocating its headquarters back to Hong Kong since 2015, the wait-and-see approach to the U.K. financial markets has prevented this plan from materializing. Currently, as Hong Kong's major note-issuing bank, HSBC is being sidelined by both the Chinese and U.S. governments due to a series of issues arising from introducing the National Security Law in Hong Kong. Apparently, the plan that was not implemented in 2015 may be the only way out for the HSBC Group today: to spin off the Asia-Pacific business into a more independent subsidiary listed in Hong Kong, which could solve the misalignment mentioned above.

The Way Out for Multinational Corporations in This Changing World

The COVID-19 pandemic and the escalation of the Russia-Ukraine war have significantly reduced multinational corporations' response cycle in the face of deglobalization. With more and more sanctions imposed on Russia by the West, many countries that are not staunch partners of the United States are now more aware of the dangers of being economically tied to the United States and its allies. It is a strategic challenge for the CEOs of multinational corporations to assess how those sanctions risks imposed by the West have begun to merge with related risk areas, including cyber threats, emerging protectionism, global mobility, moving operations, corporate and contractual considerations, and the impact on government contractors. The multinational corporations mentioned above, represented by HSBC, face multiple dilemmas. All the more reason for the above companies to prepare early and find a suitable way out in the context of deglobalization.

To better avoid the risks brought by such sanctions in the Asia-Pacific region in the future, there are four measures multinational firms can take: (1) move away from a globalized supply chain and markets toward a new reality of fragmented globalization, where localization and regionalization loom on the horizon; (2) shift from forced decoupling to selective decoupling and from comprehensive decoupling to targeted decoupling; (3) build a diversified supply chain system to guarantee the whole industrial chain and (4) attach importance to the Chinese market and create a "win-win global growth chain."

A New Reality of Fragmented Globalization: In the current international political and economic landscape, the elements and scope of national security have been gradually expanded. In addition to traditional security threats, technological security, cybersecurity, environmental security, and energy security have been paid more and more attention by countries. The regulatory rules set up by various governments based on different security requirements often conflict with the guidelines adhered to by free trade.

Multinational corporations inevitably need to choose among these rules. However, no matter which rules are adopted, multinational corporations are unable to achieve effective hedging due to the complexity of the many different national regulations and the lack of mutual transparency. Therefore, localization or regional integration of business for different markets or interest groups will be a general trend in the future. Multinational corporations can only effectively avoid known or unknown regulatory policy risks by setting up different systems.

Moving Toward Targeted Decoupling: Since the U.S. adopted a decoupling policy toward China under the Trump administration, bilateral economic cooperation and cultural exchanges between China and the U.S. have been affected in various aspects. However, in general, cooperation between China and the U.S. is still running smoothly to a certain extent. Now that the massive economic break between the West and Russia has proved the possibility of a comprehensive decoupling, the Asia-Pacific region should set up a mechanism in time to deal with this possible situation.

Instead of passively facing the risk of forced decoupling, multinational corporations should adopt a selective decoupling strategy to ensure their global development. After the comprehensive decoupling with Russia, governments began to realize the high risk of a broad-brush approach and are expected to decouple in critical areas such as high-tech industries in the future. Based on the above situation, multinational corporations should clarify their business types, adopt the selective decoupling strategy, and form a company layout with global, local, and regional facets.

Building a Diversified Supply Chain System to Guarantee the Whole Industrial Chain: The global supply chain system has been greatly affected by COVID-19. Risks encountered in different countries' industry chains cross over each other, further elevating the risk. Coupled with the recent intensification of geopolitical conflicts, the already fragile supply chain makes the operating costs of multinational corporations relying on global cooperation rise continuously. Therefore, actively broadening and breaking down supply chain channels is important in securing supply chain security.

At the same time, the essence of the current international competition is the competition for control of the industrial chain – especially the competition for core technology in the industrial chain. On the one hand, multinational corporations should pursue self-supply in the industrial chain and master the core technology to the greatest extent possible. On the other hand, they should extend the cross-border dependence of the industrial chain to include local factors and consumer markets, so as to enhance the economic rationale for maintaining the security of the industrial chain.

Create a "Win-Win Global Growth Chain": China's Belt and Road Initiative has become a symbol of global cooperation even amid the broader trend toward deglobalization. Its attributes are in line with the goals of multinational corporations. The Belt and Road Initiative brings new opportunities for global businesses, allowing multinational corporations and small-to-medium enterprises alike to explore emerging markets and expand business opportunities with China, ASEAN, the Middle East, and Central and Eastern Europe. China's non-financial direct investment in Belt and Road countries will be $20.3 billion in 2021, up 14.1 percent year-on-year.

Multinational corporations should seize this opportunity and use their global networks and operational experience to deepen infrastructure construction, optimize the investment environment and cultivate future markets in Belt and Road countries. At the same time, multinational corporations should also take advantage of the internationalization of the Chinese renminbi to reduce the risks in settlement and hedging in specific markets. This approach could ensure these multinational corporations can fully enjoy the dividends of the Belt and Road Initiative while effectively avoiding the risks involved.

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