

Eurasia Group Global Trends Quarterly



Executive Summary

In collaboration with PricewaterhouseCoopers, Eurasia Group is monitoring and assessing major trends shaping the global business environment. This document summarizes the findings of five white papers. The extraordinary breadth and depth of the current worldwide economic turmoil, and its evolution, create new uncertainties in international and local political environments. Now, more than ever, it is crucial to understand emerging global trends.

Privatization

National Champions

Climate Change

Energy

China

Crisis Spurs Shifts in Privatization Trends

Key Points

The worst economic and financial crisis since the Great Depression has caused little political instability in emerging market (EM) countries. However, policymakers in those nations now believe that the so-called Anglo-Saxon regulatory model is discredited and will probably take a more cautious stance regarding financial sector liberalization and deregulation. Concerned about the possibility of “reverse contagion,” emerging market countries are likely to be more selective and more cautious before selling additional assets to foreign investors, especially in strategic sectors such as banking and energy. This does not mean that they will scrap plans for further privatization altogether, but they are expected to pursue a more gradual and selective approach. However, the bottom line is that there does not seem to be a common approach by EM countries toward privatization in the aftermath of the crisis. A variety of internal and external economic and political factors is shaping each country’s attitude toward the issue.

EM nation’s approaches to privatization in the aftermath of the global economic and financial crisis

Full steam ahead	Poland, Romania, Ukraine, India, South Korea
Wait and see	China, Turkey, Philippines, Thailand
Wary	Mexico, Indonesia, Vietnam, Malaysia
Statist	Argentina, Brazil, Russia, South Africa

Source: Eurasia Group

Business Implications

- IMF deals trigger privatizations in central and eastern Europe:** IMF loans and stand-by agreements with various European emerging market countries will boost privatization IPOs in late 2009 and 2010. Companies should watch Ukraine and Romania carefully, but less so Hungary, where pickings will be slimmer. The short timeline means more nimble and agile investors will have an edge. Overall, the situation created by the global crisis will be a boon to privatization efforts in central and eastern Europe.
- Investors should prepare to exploit opportunities:** Investors must build local networks now in order to take advantage of later privatization opportunities in countries where the sale of state assets is temporarily frozen due to the adverse markets conditions. This group includes large EM countries such as China, Thailand, Turkey, and the Philippines.
- Russia could surprise investors by resuming state sell-offs:** Investors must pay close attention to privatization opportunities that may emerge in Russia during 2010. The need to raise revenues for the budget could prompt Russian policymakers to sell stakes in ports, airports, shipping companies and, possibly, Rosneft.

The Rise of the National Champion

Key Points

National champion companies are a defining feature of the business environment in emerging markets. National champion companies—such as natural gas giant Gazprom in Russia, Brazil’s metals company Vale and oil producer Petrobras, and Saudi Aramco in Saudi Arabia—are often used to achieve a range of political aims, including bolstering industrial infrastructure, boosting employment, and projecting economic power abroad. While multinational corporations sometimes enjoy a privileged status in their home market, they are generally less susceptible to the heavy state influence that national champion companies are subjected to. In the wake of the global economic crisis, governments in emerging markets are expanding their efforts to maximize the economic and political returns on their investment in national champion companies. Some governments also view increased reliance on national champion companies as a way to insulate their economies and markets from the vagaries of global capital flows. For all of these reasons, the operational and investment decisions of national champion companies—regardless of whether they are directly controlled by government—often are heavily influenced by political agendas, and this creates both opportunities and risks for their business partners and competitors. Broadly speaking, the role of national champion companies, both as players within a domestic market as well as on the global stage, is set to keep growing, and this trend merits greater attention from business strategists.

Business Implications

- **National champions’ political baggage creates opportunities for competitors:** Strategic and investment decisions made by national champion companies are a function of myriad inputs, demands, and requirements and they are frequently driven more by international or domestic political agendas than by bottom line concerns. This subversion of the profit motive will frequently confuse competitors of national champion companies, because they may seem to act in an economically irrational manner. However, it may also create opportunities for profit-oriented companies, if national champion companies are distracted by non-business goals.
- **New national champions likely will emerge:** There is the growing possibility that enterprises not previously viewed as national champions will evolve into de facto examples if they become targets of foreign acquisition. The attempted takeover by Coca-Cola of Chinese juice maker Huiyuan, for example, incited an unexpected nationalist furor, and by blocking the acquisition the Chinese government in effect elevated Huiyuan to the status of a national champion. Firms should be especially cautious when approaching brands that could spur national and patriotic sentiments.

National champion companies: Roles, objectives, and key players

Country	Impact trend	Primary objective/s	Sectoral focus	Key examples
Russia	↑	Project economic power globally; support domestic industry	Oil, gas, banks	Gazprom, Rosneft
Saudia Arabia	↑	Impact oil price; support of population	Oil	Saudi Aramco
China	↑	Support domestic economy; global competitiveness; nationalism	Oil, banks, other	CNPC, Sinopec, ICBC
Brazil	↑	Support domestic economy and government industrial policy	Metals, oil	Vale, Petrobras

Source: Eurasia Group

Climate Change Policy Pressure Will Continue

Key Points

As the December 2009 deadline for an internationally brokered treaty on climate change approaches, governments are moving to implement domestic policies that will inform multilateral talks. However, domestic political and economic constraints will limit how ambitious emissions reduction policies can be. In addition, the global financial crisis and economic downturn have significantly restricted countries' ability to curb emissions. Nevertheless, backsliding on climate change policies in their entirety is unlikely, and the long-term trend toward gradually tightening carbon constraints will continue. Industrialized countries are under the greatest pressure to undertake ambitious emissions reduction measures. The EU has been at the forefront of the movement by initiating an emissions trading scheme in 2005. The US Congress is also attempting to pass a cap-and-trade program, as is the Australian government. Japan's newly elected government has recently expressed its commitment to deep emissions cuts heading into Copenhagen. However, concerns about economic costs and industrial competitiveness mean that carbon regimes in these countries will be guided by cost-containment measures that will moderate the expense of compliance. Developing countries such as China and India have resisted internationally binding emissions targets, but are also undertaking policies to reduce their emissions growth trajectories. Given that

political realities will make it challenging for countries to enact aggressive emissions reduction measures, climate change policy is likely to develop in fits and starts, increasing policy uncertainties for businesses operating under carbon regimes. Higher energy costs can also be expected, with decreasing opportunities for coal and oil and increasing opportunities for clean energy sectors. The impact and timeframe will vary from country to country.

Business Implications

- Technological opportunities will grow:** Shifts in the fuel mix under carbon caps will be inevitable, and this will open up new opportunities for technology over the longer term. Climate change policies are likely to favor cleaner fuels at the expense of coal and oil. Moderate carbon caps along with concessions for some sectors will, however, favor natural gas. In contrast, a robust carbon price or supplemental policies in the form of mandates and subsidies will create opportunities for new markets and technologies, particularly in the area of renewables, nuclear power, clean coal with carbon capture and storage, advanced biofuels, and electric vehicles.

Direction of climate policy, select countries

	Approach/policy	Copenhagen position	Business implications
EU	Cap-and-trade; renewables standards; subsidies for alternative energy	Up to 30% reduction from 1990 levels by 2020	Higher energy costs; more difficult environment for coal and oil; uncertainties surrounding shape of future ETS phases; opportunities in clean energy sectors and natural gas
US	Cap-and-trade; renewables standards; subsidies for alternative energy	14%–17% reduction from 2005 levels by 2020; stalled domestic legislation makes commitments difficult	Higher energy costs; more difficult environment for coal and oil over long term; uncertainties surrounding passage of ETS; opportunities in clean energy sectors and natural gas
Australia	Cap-and-trade; renewables standards	Up to 25% reduction from 2005 levels by 2020	Higher energy costs; uncertainty over ETS passage; opportunities in clean energy sectors; gas favored over coal
Japan	Subsidies to alternative energy; possible cap-and-trade or carbon tax	Up to 25% reduction from 1990 levels by 2020	Higher energy costs; uncertainty over policies of new government; opportunities in clean energy sectors
China	Subsidies to alternative energy; energy-intensity targets for industry; possible carbon-intensity targets	No firm targets; possible intensity targets; contingent on industrialized country commitments to emissions cuts and financing for developing countries	Fossil fuels still dominant fuel source; opportunities in clean energy sectors
India	Incentives for energy efficiency; subsidies for solar power	No firm targets; contingent on industrialized country commitments to emissions cuts and financing for developing countries	Fossil fuels still dominant fuel source; opportunities in clean energy sectors

Source: Eurasia Group

The Nuclear Renaissance

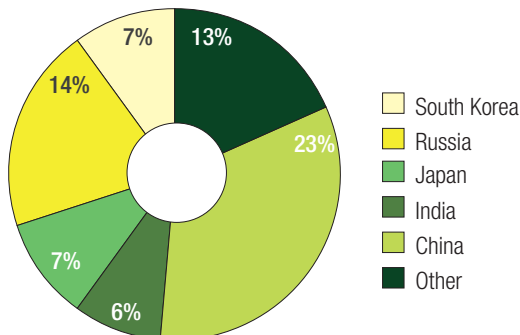
Key Points

As countries pursue strategies to reduce carbon emissions and reduce reliance on fossil fuel imports, the prospects for nuclear power growth appear bright. The realization of these plans will have a significant impact on the private sector, not only in the competition between prime contractors such as Areva, Toshiba Westinghouse, and GE Hitachi, but also in the demand for subcontractors to produce the thousands of components needed for new reactor construction. Government support for the civilian nuclear sector will be crucial in determining which countries that have announced major build-out plans worldwide will actually succeed with those plans. China and India are likely to be the two primary growth markets for new reactors in the coming 20 years. The United Arab Emirates (UAE) provides a case study of how the West will work with countries that are new to civilian nuclear power, and the UAE may prove to be a model for other Persian Gulf countries. The US, the UK, Italy, and Russia also will require significant additional government support in order to reach growth projections, but each face significant political challenges to implementing the right policy framework and incentives for nuclear growth. Clear government signals in support of nuclear power are essential, since new reactors require significant skilled labor and commodity and parts inputs. Supply constraints exist along the entire supply chain, beginning with skilled labor and up to massive heavy forgings needed for reactor cooling vessels.

Business Implications

- **Commodities and equities opportunities:** A resumption of nuclear reactor construction to levels reached 20 years ago will have significant impact on commodities and equities, especially because of nuclear construction's intensive use of concrete, steel, copper, and electrical components. The outlook for the full extent of such a boom remains uncertain, although progress in China, India, and the UAE is clearly reinvigorating the supply chain.
- **Lack of qualified personnel:** Plant operations need 400 to 700 full-time employees, many in highly technical fields that require extensive training. Government education policies will be indicators of a country's ability to meet its nuclear targets over the long term. Shorter-term, the willingness and ability of a country to attract and retain qualified experts through creative and aggressive compensation and recruitment plans will be crucial, especially in the UAE and other Persian Gulf markets that are essentially entering the nuclear market with no existing base.
- **Supply chain risks:** Supply constraints exist along the entire supply chain, beginning with skilled labor and up to massive heavy forgings needed for reactor cooling vessels. Other shortages exist in nuclear grade pumps, heat exchangers, and valves. Given the high cost of starting up nuclear specific manufacturing capabilities, government policies are critical in the determination of manufacturing strategies. The success or failure of nuclear-focused industrial policies in China and India will influence government and industry strategies elsewhere.

Reactors under construction or approved



Source: World Nuclear Association

China Looks to Domestic Firms

Key Points

China's leadership will dedicate significant political and financial resources to state-dominated and private domestic industries over the next two years. This will involve changes to the country's industrial and financial landscape that foreign firms should prepare for. China's private sector will receive significant policy support as Beijing looks for new growth areas in the aftermath of the financial crisis. As the government focuses on its own companies, international firms operating in a variety of sectors will face mounting investment hurdles. More of these firms will need to prove how their investments benefit the Chinese economy. The technological advantage held by these firms, and their willingness to transfer some of it, will likely be their greatest bargaining chip. To meaningfully develop a more robust domestic private sector, the Chinese government will also take steps to make more financing options available to small- and medium-sized enterprises in the next two years. Businesses and investors may be able to benefit from the new fundraising opportunities provided by this push. Ultimately, China is likely to remain reasonably open, but foreign companies will need to tread carefully in sectors where the government is aiming support. However, the Chinese market's broader potential will also hinge on the leadership's ability to pursue needed economic adjustments. If economic reforms remain stagnant through 2010, China's growth prospects will be increasingly called into question, with serious ramifications for the foreign investment environment.

Business Implications

- **Know-how is leverage:** In seeking out direct investments, foreign firms will face growing restrictions in China in the coming two years. The technological advantage held by foreign firms, and the extent to which they are willing to transfer some of their know-how, will probably be their best bargaining chip in accessing the China market. Joint ventures with Chinese firms may become a more viable option for many companies.
- **Foreign firms could be marginalized if economic growth slows:** If economic reforms remain stagnant through 2010, China's growth prospects will be increasingly called into question. This will mean an even more difficult environment for foreign investments, as the leadership would likely focus more fiscal support on domestic firms in order to keep their balance sheets sustainable and maintain employment levels. Foreign firms should be wary that the struggle to reconcile internal disputes could stall needed reforms in the coming two years, which would have serious ramifications for the foreign investment environment and for China's broader economic growth prospects.

Trend	Implications
New openings for private investment in strategic sectors	China's private sector will receive significant policy support as Beijing looks to services and high-tech R&D as new growth areas in the aftermath of the financial crisis.
Heightened requirements for foreign direct investment	Foreign firms will face growing restrictions on investments in China in the coming two years. The technological advantage held by these firms will be their greatest bargaining chip in accessing the China market.
Financial infrastructure changes	International corporations may benefit from the new fundraising and investment opportunities provided by a push to expand the rural financial sector.
Economic "rebalancing" efforts	The struggle to reconcile internal disputes could stall needed reforms in the coming two years, dampening China's economic growth prospects.

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