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State of the World Economy

COVID-19 and Its Impact: Is Globalisation Dead?

By Pradumna B Rana

SYNOPSIS

COVID-19 has amplified the deglobalisation trend that began after the Global Financial Crisis in 2008. However, this new phase of deglobalisation will most probably be milder and less disruptive than the one during the Inter-War period.

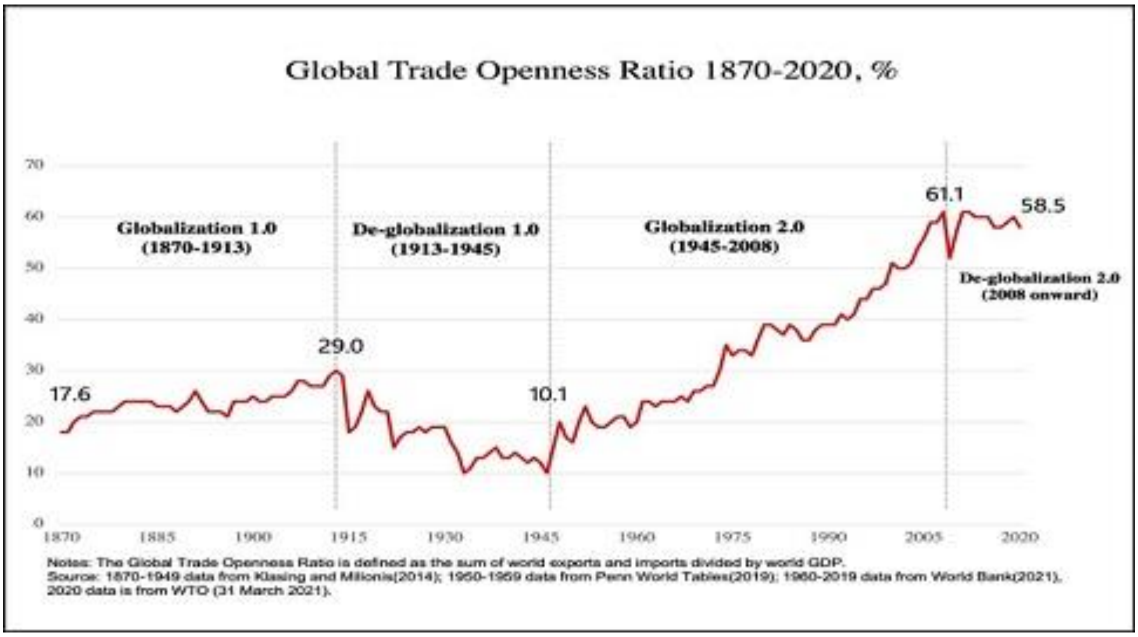
COMMENTARY

AFTER DECADES of increasing globalisation that brought economic prosperity worldwide, signs of deglobalisation emerged after the Global Financial Crisis (GFC) in 2008. COVID-19 has amplified this trend. How serious is the situation and is globalisation dead?

Globalisation has many components: cross-border flows of trade, investment, finance, people including migrant workers and tourists, data, and digital technology. Over the years, it has led to closer economic integration at the global level. One way to assess how integrated the global economy has become is to focus on the global trade openness ratio. Defined as the sum of world exports and imports divided by world GDP, it is regarded as a reasonable and commonly-used proxy for global economic integration.

Globalisation 1.0: The First of Four Phases

During the past one and a half century, globalisation has passed through four phases (figure below).



Globalisation 1.0 refers to the period 1870-1913 when the world was on the gold standard. During this period exchange rates of currencies were fixed to gold which in turn was freely mobile across countries. Central banks were also not permitted to intervene in currency markets. Strict observance of these rules contributed to monetary stability and the global trade openness ratio increased from 17.6% to 29% during this period.

Deglobalisation 1.0

During the Inter-War period, or Deglobalisation 1.0, the global trade openness ratio fell sharply from 29% in 1913 to 10% in 1945.After 1913, countries abandoned the gold standard to pursue independent monetary policies in order to finance World War I (WW I). Absence of rules and regulations led to chaos and instability. Russia withdrew from the world trading system after the communist revolution of 1917.

The United Kingdom attempted to go back to the gold standard but it was unsuccessful. Subsequently, countries adopted “beggar thy neighbour” policies. For example, in the early 1930s, the United States, UK, and France resorted to competitive currency devaluations. These tit-for-tat policies partially contributed to the Great Depression of the 1930s when the volume of international trade halved and world output fell by 15%.

The League of Nations was founded after WW I to promote peace. But it failed to prevent WW II and was replaced by the United Nations in 1946.

Globalisation 2.0

After World War II (WW II), policymakers in the US realised that they alone could lead global affairs. Hence at the Bretton Woods Conference of 1944 the US helped establish the rules-based world economic order comprising the IMF (for monetary stability), the GATT and its successor the World Trade Organisation (WTO) (for open trading environment) and the World Bank (for poverty reduction).

Rules set by these global economic institutions ushered in the Golden Age of Globalisation when world trade expanded several times faster than world output.

Global supply chain trade comprising trade in parts and components also started to gather pace after the Information and Communications Technology revolution of the 1980s. During this phase, Globalisation 2.0, the world trade openness ratio increased six-fold from 10% in 1945 to 60% to 2008.

Deglobalisation 2.0

Globalisation was a key driver of the world economy for much of the post- WWII period. But this stopped after the global economic crisis in 2008. Global supply chains which accounted for about 50% of world also ceased expanding. Deglobalisation 2.0 started to set in for a number of reasons:

First, the slow economic recovery after the GFC led to rising nationalism and protectionism in the Western world and eventually elsewhere.

Under the former president Donald Trump, the US embraced the "America First" policy and protectionism shifting away from trade liberalisation of the past. Tariffs were imposed on about 20% of total imports of the US mainly from China. The US also sought to disband China-centered supply chains.

Similarly, European countries also initiated policy actions to protect their economies especially from rising inflows of migrant workers from the Middle East.

Countries around the world retaliated and became more inward-looking. Although it remains an export powerhouse, China has turned inwards to some extent. Since 2020, India has also adopted a more self-reliant policy.

COVID-19's Impact on Globalisation

Second, COVID-19 affected globalisation in several ways.

Because of the lockdowns, international trade and tourism "fell off the cliff" during the second quarter of 2020. Although the volume of world trade has rebounded more strongly than expected since then, the March 2021 forecast from the WTO expects a 5.3% fall in 2020.

COVID-19 also disrupted global supply chains as intermediate products could not be transported with ease between production blocks located in different parts of the world. COVID-19 laid bare the risks of relying on complex "just in time" value chains and raised awareness of the need to diversify sources and shorten global supply chains by onshoring, near-shoring, and sourcing regionally rather than globally.

Many countries also questioned their dependence on import of essential medical equipment (e.g., PPEs) and medical supplies of which they might be deprived in an emergency. They, therefore, imposed temporary export bans.

Third, since the mid-2010s, national security has become a crucial cause of the deterioration in US-China relations and trade. It is argued that China's accession to the WTO in 2001 has led to a large negative impact on US manufacturing. China's presumed systematic practice of industrial and cyber-espionage has also led to stiff tariffs and bans on China's acquisition of US technology.

Fourth, the Doha Round of multilateral trade negotiation has been stalled since 2008. In its stead regional trading agreements have proliferated.

When will Deglobalisation End?

Is globalisation dead? No, it is not dead, but it is in a partial retreat.

When will the retreat be over? It is difficult to say precisely but it may take some time for protectionist sentiments around the world to turn around and for national security concerns in the US vis-a-vis China to abate.

But Deglobalisation 2.0 will probably be milder and less disruptive than Deglobalisation 1.0 which lasted for about 30 years and when the global trade openness ratio fell by nearly 13 percentage points. This time around the ratio has fallen much less, by only about three percentage points – so far.

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