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The End of Globalisation

The end of the Cold War in 1991 brought about a new wave of globalisation over the 1990's and 2000's which has had an undeniably crucial influence on economic developments over the past 30 years. Increasing globalisation over this period has boosted economic growth, particularly in emerging markets, and has helped to lower inflation and real interest rates in the developed world. At the same time, it also impacted how growth is distributed, with the integration of several billion workers into the global economy reducing labour's share of income while increasing the share flowing to company profits, propping up global equity markets. After years of support from policy and technology, developments in recent years are beginning to suggest that globalisation may have peaked, with unwanted migration and the emergence of new strategic competitors becoming key issues guiding increasingly protectionist policies in developed countries.

A shift in direction

While the US-China trade war is the key issue which comes to mind when we consider increased protectionism in the developed world, it should be noted that the current wave of globalisation appears to have hit a wall well before the US-China trade war began. Data suggests that while global trade as well as cross-border capital flows rose sharply as a share of global GDP throughout the 1990's and 2000's, it began to level off from around 2010. This reduction in the growth of global trade appears to have then been exacerbated by the recent US-China trade conflict, combined with industry-specific issues which have brought about lower global growth and left global trade at a near standstill.

There are a number of reasons as to why global growth has stalled since 2010. Firstly, most economies are now extremely open, with no new major countries left to integrate into the global economy and therefore significantly boost growth. Secondly, new technologies have simplified previously large and complex supply chains which would previously be globally integrated. Thirdly, governments have begun to question the benefits of some aspects of financial liberalisation that was a central feature of the most recent wave of globalisation, most particularly China, which is unlikely to open its capital markets significantly. This all suggests that we have already reached peak globalisation, with recent developments suggesting that we are now beginning to move away from the concept.

Policy vs. Technology

While technology has played a part in reducing globalisation via supply chain improvements, it can be argued that it has also played a vital role in promoting global trade by boosting productivity and widening consumer choice. In recent years, it is clear that policy, not technology, has caused globalisation to roll back. The trade war between the US and China, increasing trade tensions between the US and Europe, and Britain's decision to exit the European Union represent prime examples of this.

In terms of the US-China trade war, although this has been a key factor moving markets since July 2018, the trade war in itself is not a massive problem given that US-China trade accounts for only 3% of total world trade. Essentially, the trade war is the product of more fundamental strains in the relationship between China and the West after China's emergence as a strategic competitor to the US, and further strains to the relationship pose more of a risk to globalisation. Additionally, there is the risk that the trade war is the start of a broader backlash against globalisation, as it has been argued that globalisation has undermined the power of national governments and can be blamed for rising inequality, cross-border tax avoidance and unwanted migration. As a result, policy-driven de-globalisation, where cross-border trade and capital flows fall as a share of GDP, is looking increasingly likely.

What does de-globalisation look like and what would the impact be?

While a period of de-globalisation is likely, it is uncertain what form this could take due to the use of technology. We could see some regionalisation, in which production is clustered in neighbouring countries, or the world could split into competing blocs. It is likely that this would involve the growing imposition of tit-for-tat tariffs by individual countries.

The impact of de-globalisation on the world economy would of course be negative, however the extent of the negative impact depends on the approach. A regionalisation approach would not have a significant impact, as a significant proportion of trade already takes place between neighbouring countries, while tit-for-tat trade tariffs would not have a significant impact relative to demographics issues combined with low productivity growth and the ineffectiveness of monetary policy.

The key risk would be a deep split between the US and China via the creation of two economic blocs which could see global trade reduce significantly, and potential for a cold war-like situation, with restrictions on trade in specific sectors and products. This would seriously impact global growth and geopolitical stability. It can be argued that we are already seeing the beginning of this. According to new IMF Chief Kristalina Georgieva, "current rifts could lead to changes which will last a generation – broken supply chains, siloed trade sectors, a "digital Berlin Wall" that forces countries to choose between technology systems". The reference to the Cold War here is particularly valid, as Georgieva notes the risk that recent protectionism could lead to de-globalisation and the creation of economic blocs.

Overall

As it stands, trade uncertainty and protectionism are the two largest threats to the global economy, increasing the risks of a domestic economic slowdown in the US and driving wider economic pessimism. It remains to be seen where trade policy moves from here, however recent developments around the world suggest that a gradual de-globalisation is likely, and this represents a risk to global growth which could become more serious over time. As it stands, the outlook is troubling, but risks can be reduced should there be a meaningful resolution to the US-China trade conflict next year, stemming the cooling of global growth and providing a boost to global trade.