Emergence of Deglobalization: With A Changing Global Paradigm

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Abstract

Since 2008, deglobalization has affected state-to-state economic integration and interdependence. Events like the 2008 financial crisis,and the COVID-19 pandemic may disrupt global trade and boost local consumption. Globalization 2.0 includes trade protectionism, cash flow restrictions, people movement restrictions, and information access. The US-China trade conflict has hastened deglobalization and distorted money and commerce. Country integration momentum leads to stronger economic openness but lower trade openness in emerging market economies (EMEs). The 2008 financial crisis slowed globalization, lowering trade as a proportion of GDP from 54.62% in 2004 to 52.47%. The maturing of global value chains and manufacturing dispersion have reduced global trade flexibility. Deleveraging and credit constraints caused by China's rising domestic value added in exports and insufficient trade finance have contributed to this drop. The US-China trade war has deglobalized the global commerce sector, with China's retaliation limited. This study discusses economic evidence of deglobalization. The study shows a reduction in goods, money, and people-to-people transfers. The paper also discusses how US-China strategic rivalry promotes deglobalization in trade.

Keywords: *global trade, deglobalization, US-China Trade war, Globalization 2.0, COVID-19 Pandemic.*

Introduction

Globalization and deglobalization are opposites. Due to globalization's inability to solve global economy's biggest problems—poverty, inequality, unemployment, and economic collapse after a global crisis—researchers felt compelled to show the repositioning, reversal, or decline of existing economic setup. Thus, "deglobalization" was coined. Globalization, the most important economic phenomenon of the 21st century, has garnered academic attention and support for decades, notably following World War II. Globalization has been linked to stronger economic growth, poverty reduction, and reduced inflation. Khan & Riskin (2001) found that economic liberalization in China reduced poverty. Rogoff (2003) also claims that globalization lowers inflation and that reversing production factors would raise prices. Additionally, Tomohara and Taki (2011) argue that foreign enterprises' market access raises local employers' pay.

Since 2008, globalized economic literature has been less optimistic. Hillebrand (2010) believes that protectionism may enhance income equality in certain nations, but that a retreat from globalization would harm the global economy. This article examines trade deglobalization in light of the intense discussion over globalization vs deglobalization and its impact on the global economy.Deglobalization reduces state-to-state economic integration and interdependence. Thus, the word is used to characterize numerous historical times when regional or global economic crises reduced foreign direct investment (FDI) and international commerce. After the 2008 financial crisis, globalization slowed. World commerce fell 20% in the fourth quarter of 2008. Deglobalization may be caused by events other than the financial crisis, such as diminishing global demand, armed conflicts, natural catastrophes, pandemics, trade wars, etc.

This study covers the causes of deglobalization and its effects on the global economy. From the 2008 recession to Brexit, U.S.-China Trade Wars, and now a new wave of disruption from Asia where the COVID-19 pandemic may shrink world trade by 10% to 30% this year. "Aatma Nirbhar Initiatives" in India encouraged administrative and political actions to promote local products consumption. Our analysis uses the aforementioned events to show deglobalization tendencies.

Objectives

1. To study the phenomenon of Deglobalization.
2. To study the driving aspects of Deglobalization.

Methodology

The evaluation of literature from primary and secondary sources, as well as other pertinent phases, formed the foundation of this study's research approach and helped identify the research problem in relation to the Deglobalization.

Review of Literature

Bergejik's article titled "Deglobalization 2.0: Trade and Openness" Trump and Brexit can be seen as manifestations of a cyclical pattern of globalization and deglobalization, which has been driven by wealth inequality and a global withdrawal. This pattern has been observed during both the Great Depression and the Great Recession. According to the book, deglobalization is not a recent phenomenon. While it initially offers significant benefits, it incurs expenses that render it unprofitable and give rise to socio-economic conflicts, ultimately leading to deglobalization. Postelnicu, Dinu, and Dabija (2015) argue that the deceleration in the growth of the globalization index prior to the 2008 financial crisis serves as an indication of global deglobalization. The 2008 financial crisis did not solely cause deglobalization. Other contributing factors include a significant decrease in global demand, natural disasters, armed conflicts, and more. Financial crises have a greater impact on developed nations compared to emerging nations. According to James (2017), there is a phenomenon known as globalization 2.0, followed by a wave of deglobalization. This refers to a shift in the world economic system towards trade protectionism, regulations on capital flow, restrictions on people's movements, and limited access to information. The author suggests an alternative approach to globalization, referred to as Globalization 2.0, which focuses on maintaining economic connections through investments in infrastructure. In "One is Not Enough!" by Peter A.G. van Bergeijk, the author highlights the obstacles to global economic commerce posed by cyclical and structural factors. The primary factor contributing to the significant decline in global trade in 2009 was weak demand, which accounted for 90% of the slump. Global trade is hindered by various structural factors such as the maturation of value chains, slow recovery of overall demand, inadequate trade financing, and increasing protectionist measures. In "From Globalization to Deglobalization: Zooming into Trade," Alpa Ghosh examines the impact of the U.S.-China trade war on deglobalization. The author highlights the escalation of deglobalization through multiple rounds of tariff and non-tariff retaliatory measures that have been implemented since 2018. This pattern has the potential to disrupt global trade and financial flows, leading to a reduction in the level of globalization within the global economy. Arslan, Contreras, Patel, and Shu (2018) examine globalization trends in emerging market economies. EMEs exhibit greater economic openness but lower trade openness due to the impetus of country integration. Gravity models continue to demonstrate that trade volume is influenced by distance and geographical factors.

Comparing 1930s and 2000s Deglobalization

The degree of deglobalization in the 2000s differed from that of the 1930s. During the initial three years of the Great Depression, the average decrease in the import to GDP ratio was 17%. In contrast, this ratio declined by 31% in the 2000s. The political significance in the 1930s and 2000s was significant, but the impact differed. Autocratic rule and dictatorship were linked to increased deglobalization during the 1930s, while democracy was associated with heightened deglobalization during the 2000s.

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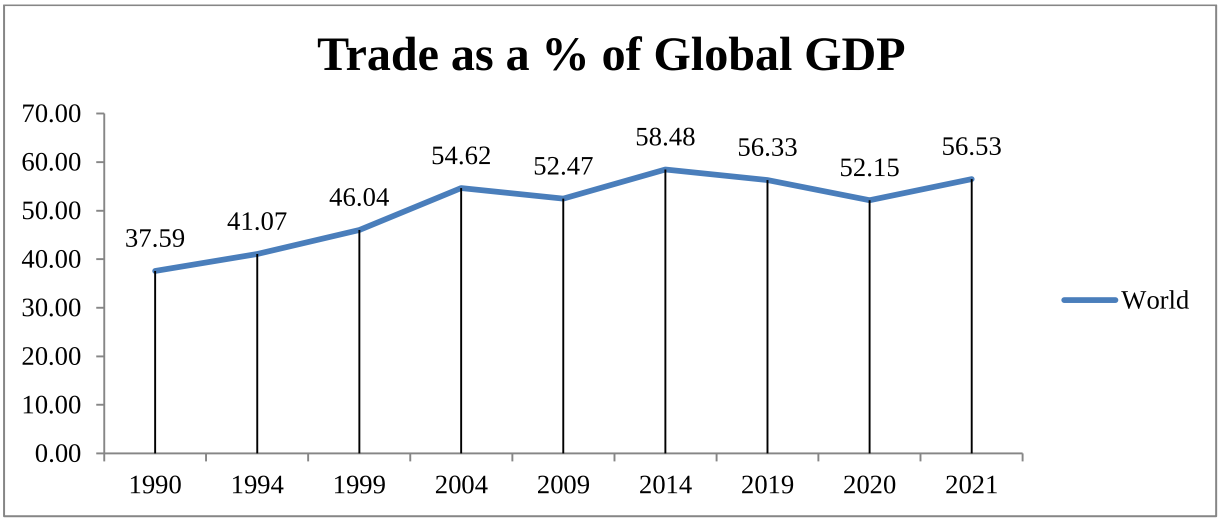
Driving Aspects Of Deglobalization

1. **Slowbalization after 2008 Financial Crisis**
2. **U.S. China Trade War**

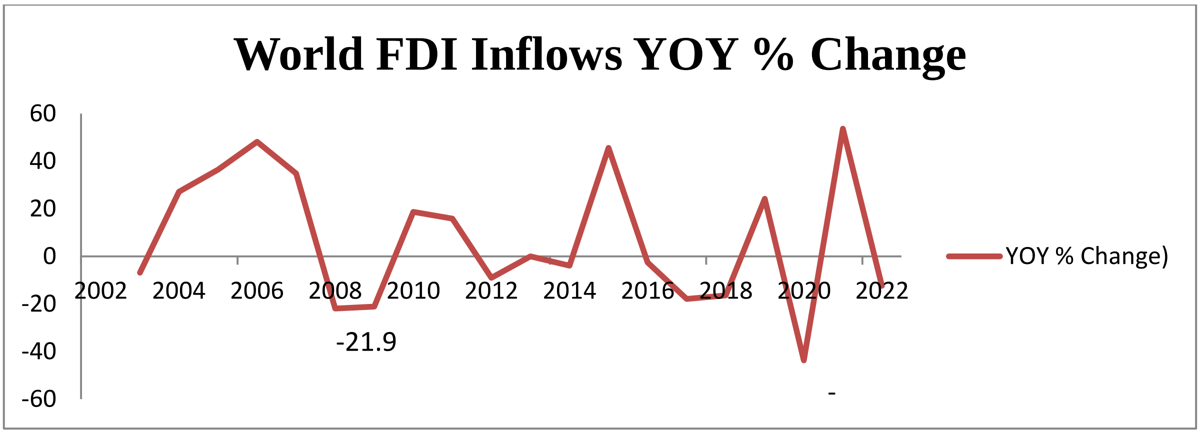
Slowbalization after 2008 Financial Crisis

Slowbalization occurred after the 2008 financial crisis when trade and foreign investment lagged GDP. Thus, wave no.1 hindered global trade. Due to bank failures, it also renationalized finance. World commerce fell 20% in the fourth quarter of 2008. Global commerce has averaged 3.4 percent annual growth through 2012, except for a 13 percent comeback in 2010 after the recession. This pace is well below the pre-boom norm of roughly 7% each year. Thus, recent global trade performance has been poor.

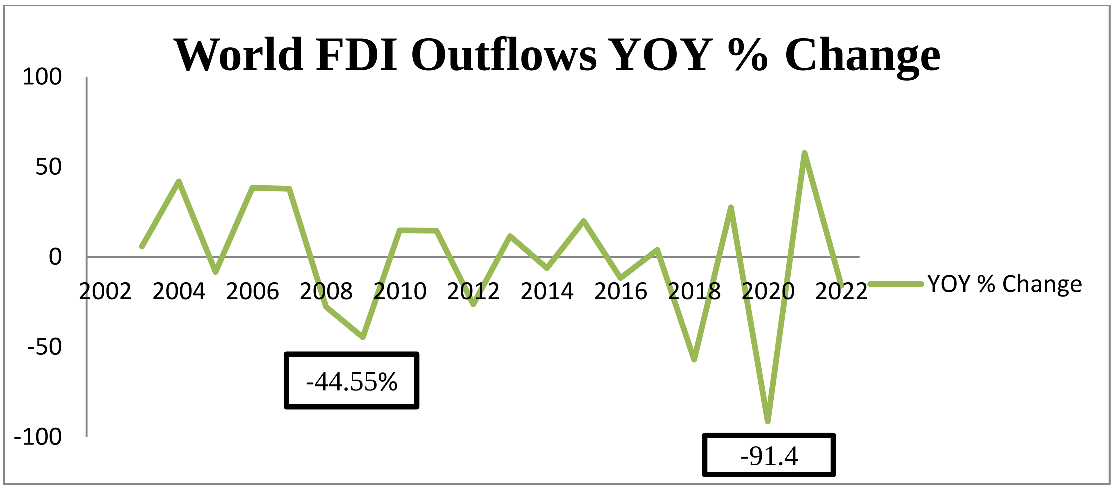


(Source: WITS)

Since the 2008 global financial crisis, globalization, encompassing free trade, money, and people, seems to have stagnated. After a steep decrease in 2008, trade as a per cent to GDP fell from 54.62 per cent in 2004 to 52.47 per cent post 2008, trade was expected to rebound at pre-crisis rates. This hasn't happened. From 2009 to 2018, trade volume expanded by 3.5%, compared to 7.6% before the 2008 financial crisis (Chart 1). Due to the US-China trade war and other protectionist waves, trade as a percent to global GDP declined to 56.33 per cent in 2019 and then to 52.15 per cent in 2020 due to disruption of global supply chains during COVID-19 Pandemic.



Source: https://unctad.org/publication/world-investment-report-2023



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As trade has slowed down, so has the flow of funds between countries. This is true in a broad sense, especially when it comes to foreign direct investment (FDI), which is the most safe and possibly useful way for money to move from one place to another. It's important to note that FDI has dropped a lot, hitting amounts similar to those seen in 2008 (as shown in the picture above). Since 2002, the average growth rate of foreign direct investment (FDI) abroad has been only 0.8% per year. In 2018, this growth rate went down by -28% because of rising trade disputes. It's hard to figure out why FDI growth has stopped, because it could be because of a drop in demand or because owners are having trouble running their businesses. Due to the differences in profits between receiving countries, the current drop in foreign direct investment (FDI) could be a sign that global capital markets are becoming much more fragmented. Due to the COVID-19 pandemic, the Global FDI Inward and Outward per cent change (Year on Year) showed the biggest negative rates of (-)43.76 and (-)91.40 in 2020.

Why has trade slowed down around the world?

Global trade may have slowed down because of the following:

A) Cyclical Factor: Weak Demand

Analysts attribute the majority (90%) of the trade decline in 2009 to a decrease in demand. The impact extends beyond the period of crisis. The import demand was 19% lower than the predicted value five years after the financial crisis. In high-income countries, the crisis has been primarily caused by a lack of demand. The GDP levels in the US and the Euro Area are currently 8 percent and 13 percent lower than their historical average growth rates. High-income nations exhibit low import volumes, suggesting weak demand despite other factors. High-income nations, which account for 65 percent of global goods imports, have a significant impact on global trade recovery due to their weakening.

B) Changing Trade-Income Relationship as a Structural Factor

Currently, global income fluctuations have a reduced impact on world trade. From 1986 to 2000, a 1% increase in global real GDP resulted in a corresponding 2.2% increase in world commerce. From 2001 to 2014, the trade elasticity decreased to 1.3%. This shows that global commerce is expanding slower because income growth is weaker and trade has become less sensitive to income growth.4 reasons that might have led to the low trade elasticity are:

1. shifting global value chains,
2. demand composition,
3. inadequate trade financing,
4. growing trade protectionism.

1. <u>*shifting global value chains –*</u>

The decline in the trade-GDP responsiveness may be due to the development of global value chains, particularly among major countries. This is in contrast to the increase in trade elasticity, which is supported by the growing fragmentation of production across countries. The decline in global trade elasticity can be attributed largely to China and the United States, based on estimations of trade elasticity by major trading blocs over time. China's exports experience a reduction in trade elasticity due to the rise in domestic value added. The proportion of Chinese imports of parts and components in China's total exports has decreased from 60 percent in the mid-1990s to 35 percent currently, suggesting a decline in the fragmentation of the manufacturing process. Chinese firms replacing domestic inputs with international inputs contributes to the growth of domestic value added in trade.

2. *Demand Composition-*

The import elasticities of different components of aggregate demand vary, thus altering the composition of aggregate demand leads to changes in total elasticity. Investment is a significant component of domestic demand, with consumption following closely behind. The decline in capital goods imports can be attributed to the sluggishness of investment, particularly in the post-crisis period, as investment is the sector most sensitive to import fluctuations. The slow recovery of aggregate demand components with higher import intensity may account for the low elasticity.

3. *Inadequate Trade Financing-*

Deleveraging necessitates financial institutions to curtail lending expansion in order to augment their liquid assets. Short-term trade finance instruments that can be easily converted into cash are particularly susceptible to credit crunches. Exporters and importers, particularly small and medium-sized enterprises (SMEs), encounter financial challenges.

4. *Rising Protectionism-*

The fraction of global trade impacted by distortionary measures—including tariff and non-tariff barriers—began to climb under Barack Obama but has risen more significantly under Trump, now at roughly 40%. The 2008-09 recovery proved this. As governments promote export-led development via export promotion agencies and tax incentives, non-tariff measures have proliferated.

1. Trade War between the United States and China

The trade war between United States and China has been a significant event that has contributed to the rise of deglobalization forces in the field of trade. Since February 2018, the US has shifted its focus from broad measures affecting solar panels and washing machines to more specific measures targeting China, which indicates a departure from the current global status quo. This shift was made due to China's violation of intellectual property rights, leading to additional import duties of 25% for $50 billion worth of imported goods from China.

Due to its inadequate import volume from the US to match import taxes, China's trade response to US trade measures has been limited. This explains China's second set of $60 billion punitive measures. In March 2019, the US raised taxes on $200 billion of Chinese goods from 10% to 25%, ending the ceasefire. Huawei was banned from buying from US corporations in May after being placed to the entity list. In June, China raised taxes on $60 billion in goods by twenty-five percent, twenty percent, and ten percent. President Xi and President Trump have repeated trade conversations before important summits after tensions rise. However, these conversations routinely disappoint the market by suddenly losing momentum.

The China-US trade war has disrupted the global supply chain with frequent disagreements and reconciliations. The worldwide supply chain has been disrupted by periodic disagreements and reconciliations since early 2018. The Sino-US trade conflict accelerated commercial deglobalization. Since 2018, global commerce has declined in value and volume due to supply chain disruptions. The July World Economic Outlook of the International Monetary Fund downgraded global growth due to economic uncertainty, which hurt investment.

The US-China trade war's volatility has boosted protectionism, hurting market confidence and global risk appetite. Because of geopolitical risk in China and Asia, particularly US sanctions on Vietnam, firms are moving their operations away from China and maybe the rest of Asia. This tendency will disrupt global commerce and money flows, deglobalizing the economy.

Other than trade, the US has used other tools against China. The US requested Huawei's top finance officer's arrest in Canada on December 1, 2018, showing its willingness to militarize via rulemaking. China's largest telecom corporation, Huawei, has faced other limitations in addition to the arrest. The US has added Huawei to its entity list, barring US businesses from doing business with it, to regulate technology transfer to China.

Technology protectionism is spreading beyond the US to other industrialized nations, notably the EU, which launched an investment screening process in April. Geopolitical concerns seem to be driving financial decoupling and technology sector protectionist actions. Chinese corporations like the SMIC and Alibaba's have voluntarily delisted from the American stock markets. Voluntary delisting may diminish USD issuance and liquidity. Due to the US banking system's large USD funding role. China created the Shanghai Stock Exchange STAR Exchange and relaxed financing laws to encourage technology company investment. Financial decoupling raises fears about deglobalization.

Conclusion

In recent years, there has been a shift away from globalization, which had been steadily growing for several decades in terms of trade, capital flows, and movement of people. The article shows falling trade, capital, and, to a lesser degree, people-to-people transfers. The paper emphasizes the importance of China and the United States strategic rivalry in trade. The deglobalization trend continues. Dissatisfaction with growth plans has led to protectionism and anti-globalization views. Globalization is criticized for its negative consequences on trade and investment, such as dislocation and competitiveness. Additionally, there is concern regarding the lack of effort or willingness by states to provide compensation to those who are negatively impacted by globalization. The world has undergone multiple periods of integration, but in the 1990s, there was a significant expansion of the trading system, leading to China emerging as a global manufacturing hub. The 2008 financial crisis resulted in a phenomenon known as slowbalization, which was subsequently followed by the China and United States trade war. The BRICS nations experienced regionalization due to geo-political realignment, and the global trade has been significantly disrupted by the Covid-19 pandemic, resulting in a contraction of trade by 10-30%. As economies resume operations, there will be a recovery in activity. However, it is unlikely that we will return to a world of unrestricted free trade. The COVID-19 pandemic is expected to politicize trade and investment, leading to a stronger emphasis on self-reliance. This could hinder economic recovery, increase vulnerability, and contribute to geopolitical instability.

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