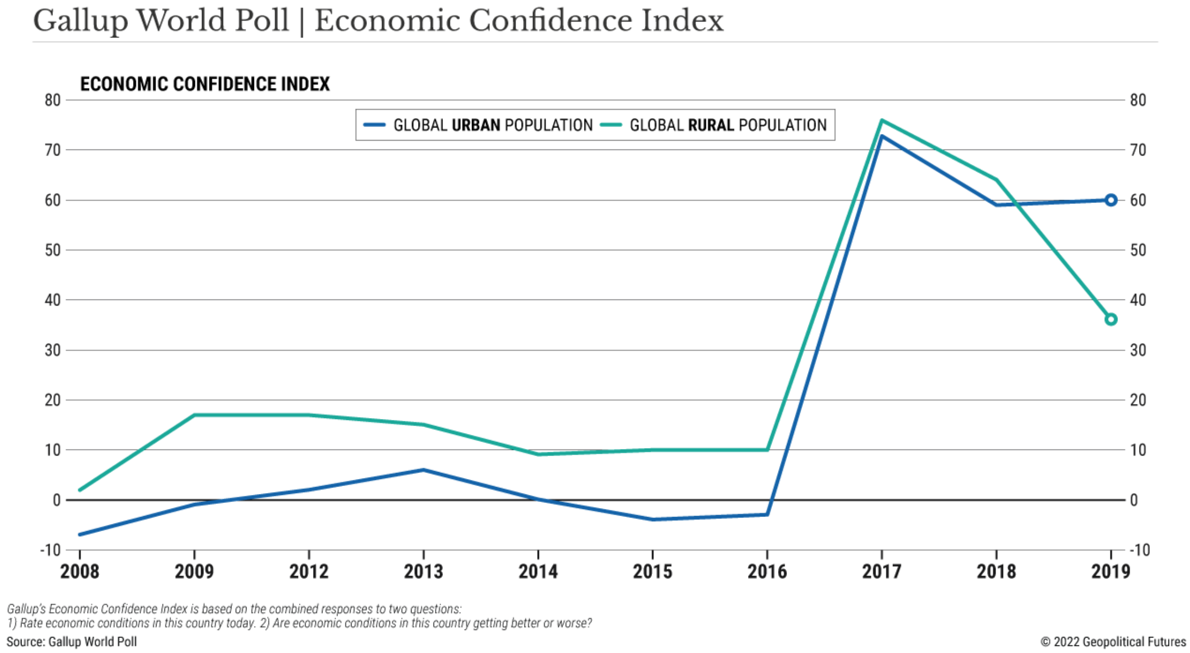
Globalization After the Pandemic

by Antonia Colibasanu - January 3, 2022

We enter 2022 with the same hope that we had as we entered 2021: that the pandemic will end soon. This time, we will have even more vaccines and treatments for COVID-19. But we also have a new variant of the virus and the near certainty that there will be more. However this plays out, something profound has happened to humanity since the pandemic began. Disease is always a threat to mankind, but it’s a threat we ignore most of the time. Now that that’s not possible, we are stricken with uncertainty, which on a societal level translates into a general lack of confidence about the future.

In geopolitics, confidence matters. Leaders act on what they know or, more precisely, what they believe they know. Diminished confidence in the economy, for example, could shift an entire national strategy. And there are many reasons for low confidence in the economy. The pandemic triggered a supply chain and energy crisis, labor shortages and, ultimately, inflation, disrupting economic and social life and exacerbating inequality within and between countries. Most important, it accelerated the decline of globalization at a time when global cooperation is more important than ever.



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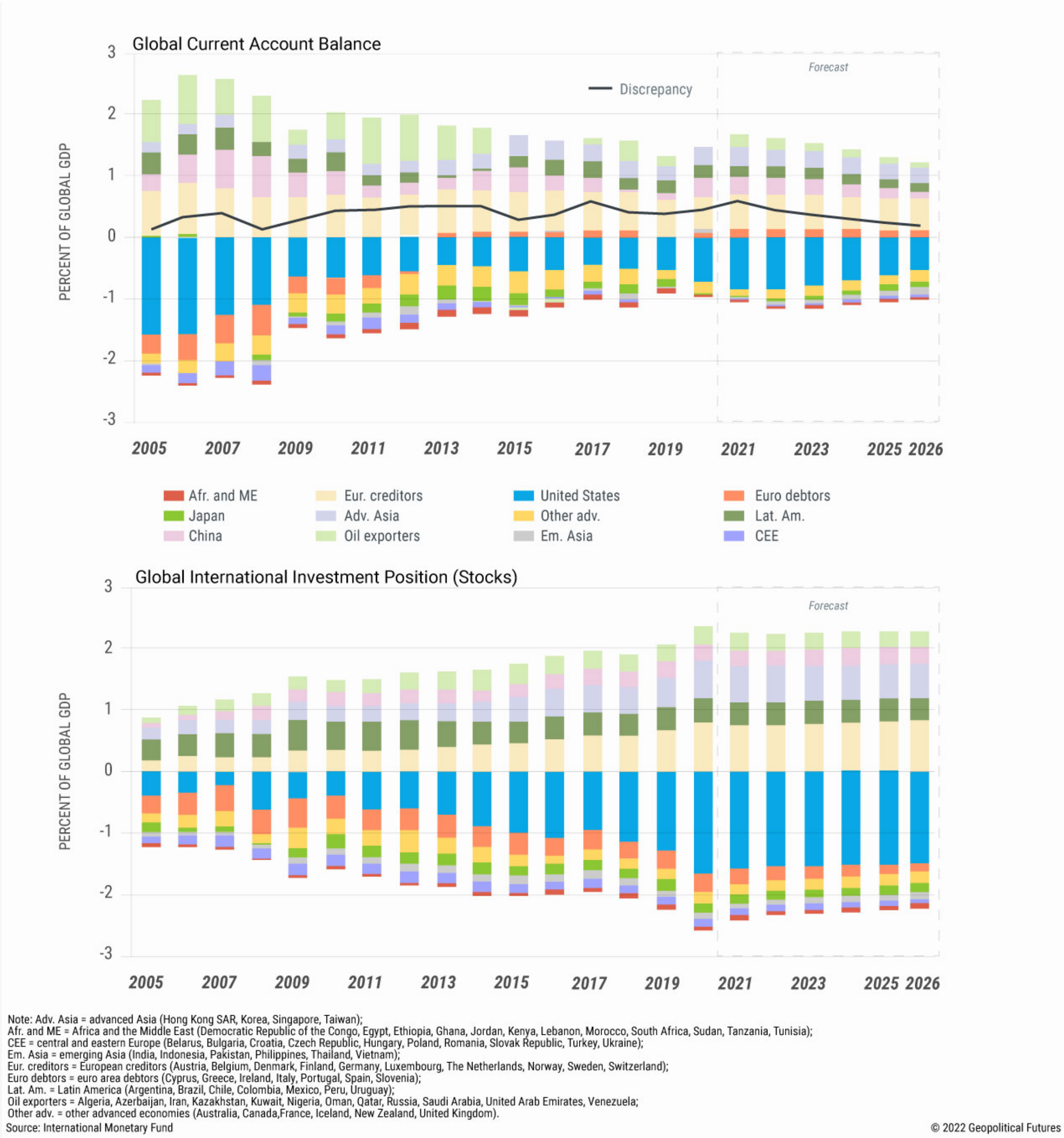
From 2008 to 2022

Deglobalization started in 2008 with the global financial crisis and slowly unfolded over the next decade-plus, until COVID-19 threw it into overdrive. Deglobalization is an economic process, but more than that it's driven by the growing lack of confidence in the global economic system and its supporting beliefs. After 2008, people doubted the belief that globalization could only bring positive change to people's lives, and that interconnectivity and interdependence were forces of stability. It marked the end of the post-Cold War world and the beginning of a new age in which the nation-state was called on to protect society from the negative forces of globalization. The rise of nationalist and populist movements heralded this change, along with indications of increased protectionism worldwide. Brexit and the U.S.-Chinese trade war were the most visible signs of deglobalization, but there's also the decline in global capital flows (even as capital stocks grew) since 2008, as well as a general decline in international trade.

International Trade and Investment



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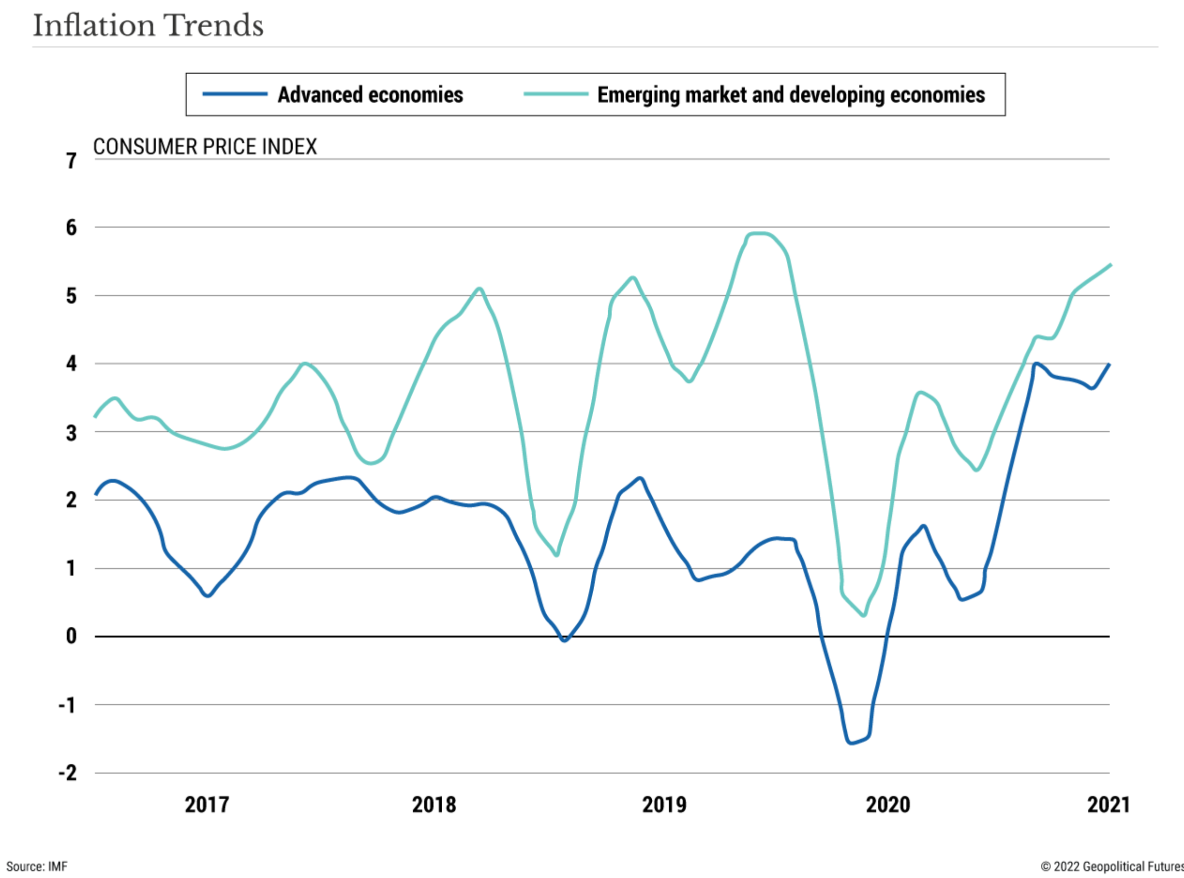
2021 witnessed a stunning economic recovery after the collapse of 2020, but the unexpectedly large surge in global consumption set off a supply chain crisis and was the main cause of the energy crisis. Restrictions on travel deprived the shipping industry of low-wage workers at the same time that existing workers in the sector – already under intense strain – left their jobs in huge numbers. Already high shipping costs increased nearly tenfold compared with 2020. These disruptions produced scarcity, which drove up prices for nearly everything.



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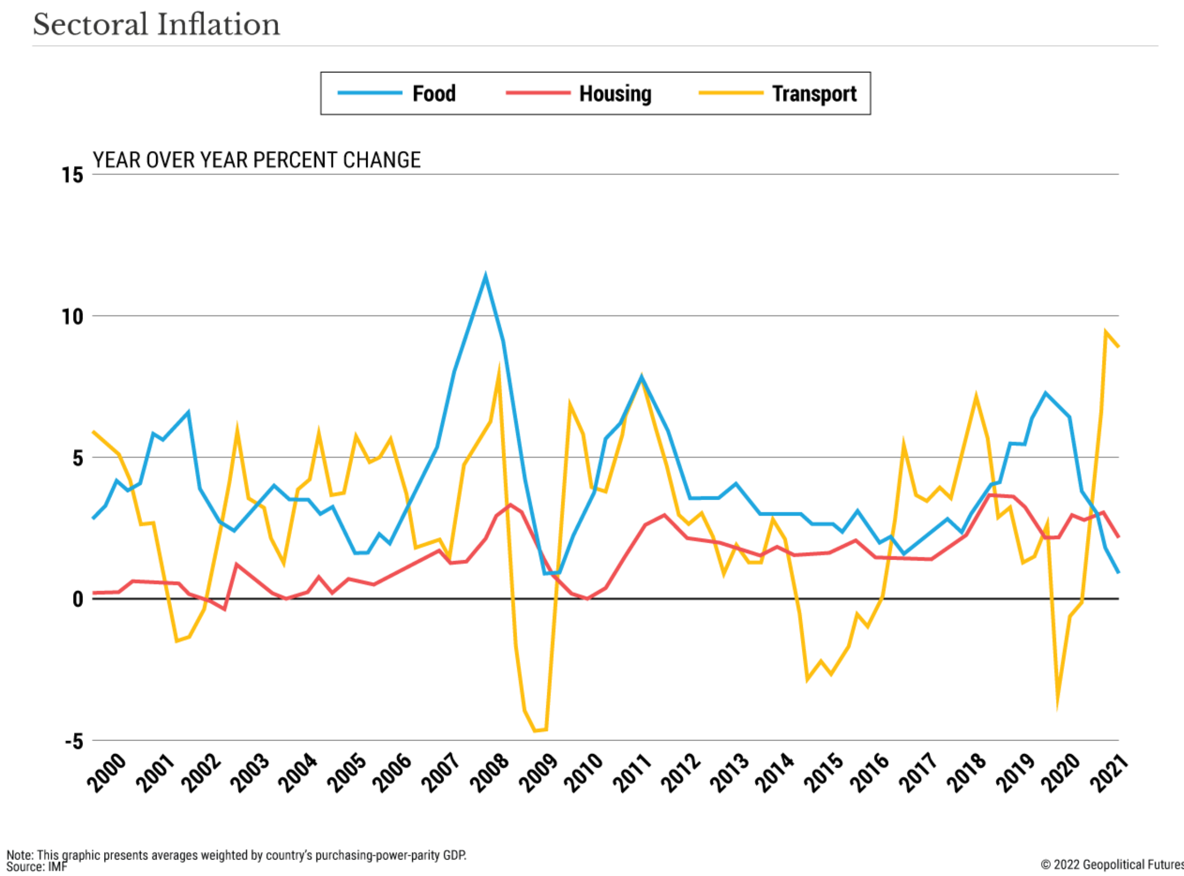

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Pandemic-related disruptions also caused businesses to reassess their priorities and vulnerabilities. In Germany, Europe's export powerhouse, 19 percent of manufacturing firms said in a recent survey by the Munich-based Ifo Institute that they plan to reshore production. Nearly two-thirds of these firms said they will look for German suppliers, while the rest said they will try to meet their needs in-house. This is an important shift for such a trade-dependent economy. About 12 percent of total inputs used in Germany's export sectors (e.g., automobiles, machinery, electrical equipment, electronics) are imported from low-wage countries like China, other parts of Asia or the Balkans. The picture is similar in other countries. And while this development is being led by businesses, governments are sure to adjust their policies as well, considering the potential impact on society and growing calls for protectionism.

Inflation, Automation and Implications

These production shifts are accelerating the process of deglobalization. The pressure they add to the global economy will be felt in 2022.

Since the late 1980s, pro-globalization trends have helped to keep inflation at bay, as lower-cost producers provided inputs for advanced economies. If deglobalization is sustained, it may lead to a supply-side shock that will increase already high inflationary pressures. Coupled with slowing innovation and a limited labor force in developed economies' manufacturing sector, this could create more shortages and even, eventually, a depression.

A potential salve would be the accelerated adoption of automation. In the low interest rate environment that followed the 2008 financial crisis, the cost of investing in robots fell, encouraging firms in rich countries to automate where they could and to reshore some production. Germany is a world leader in robot adoption, with 7.6 robots per 1,000 workers, compared with South Korea's six and just over four in Japan. The United States, on the other hand, has just 1.5 robots per 1,000 workers. It's unclear whether these developed economies currently have high enough levels of automation to decouple from low-wage countries. What's more, the slow rate of adoption since 2011 and the unequal adoption between the developed and developing economies is cause for skepticism. Over the long term, however, automation will likely play an important role in developed economies.

Another effect of deglobalization is that national markets will become less vulnerable to external shocks. Instead, they will be more susceptible to domestic shocks. And as firms shorten their supply chains, their exposure to regional disruptions will increase.

The New Paradigm

Since the end of World War II, and especially since the Soviet Union's collapse, the U.S. has shepherded the rise of globalization. Integration translated into cheaper goods for Americans and for the world. Outsourcing was seen as a boon, not a threat, to domestic prosperity. But 2008 shattered the public's confidence in those ideas, and economic security returned as a top priority of policymakers. The pandemic further reinforced this trend, a bitter reminder that profit is nothing without resilience and robustness.

In the new paradigm, bilateral alliances will supplant multilateral ones, even if the latter endures. The European Union, for instance, will maintain its core advantage of hosting the largest common market in the world. It will continue developing strategic trade deals with countries like Japan and, most recently, Vietnam. In the face of perceived Chinese aggression, the U.S. and EU will continue to work on establishing trade and investment deals in strategic industries like semiconductors and steel. At the same time, evolving alliance structures like the U.S.-U.K.-Australia pact known as AUKUS (built on the Five Eyes intelligence-sharing structure that has existed since the end of World War II) will complement trade agreements like the Trans-Pacific Partnership, which the U.K. (and China) are attempting to join.

The pandemic created distortions (like inflation) that highlight the need for global collective action. Climate change is pushing leaders of advanced economies to put forth ambitious plans to “green” global finance. Domestic pressure to rein in multinational firms, especially big tech, paved the way for a groundbreaking global minimum corporate tax agreement late last year. At the same time, developed economies are growing further apart from the rest of the world, and there are growing aspirations to rebuild political and economic communities behind national borders. One thing is clear: 2022 will be a year of tension in the global economy.

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