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Globalization: Uncoupled or unhinged?☆

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1. Introduction

Debate over the future of globalization is as old as globalization itself. In the last 15 years, the Global Financial Crisis and a populist backlash against openness (as manifested in the election of a protectionist U.S. president and passage of the Brexit referendum by the UK) led to questions about whether the heyday of globalization was over. Now three events – the COVID-19 pandemic, Russia's invasion of Ukraine, and mounting tensions between the U.S. and China (as indicated by the White House's (2022a) National Security Strategy, which singles out China as a strategic competitor) – place the prospects in a new light.

In this paper, I ask how the outlook for globalization will be affected by these events. Answering this question requires one to start by describing how the outlook for globalization looked *prior to* these events. With hindsight, it is clear that the Global Financial Crisis brought to a close the era when global cross-border trade and financial flows grew faster than global GDP – what Rodrik (2017) referred to as the age of "hyperglobalization." After having risen sharply for 20 years, world merchandise trade (exports plus imports) as a share of world GDP stabilized around 50 %. (See Fig. 1) That is to say, trade, previously having risen more sharply than output, now instead rose in tandem with it. Global value chains were still unpacked; they just were not unpacked further. All that happened was that the "hyper" (or is it the hype?) was separated from globalization.

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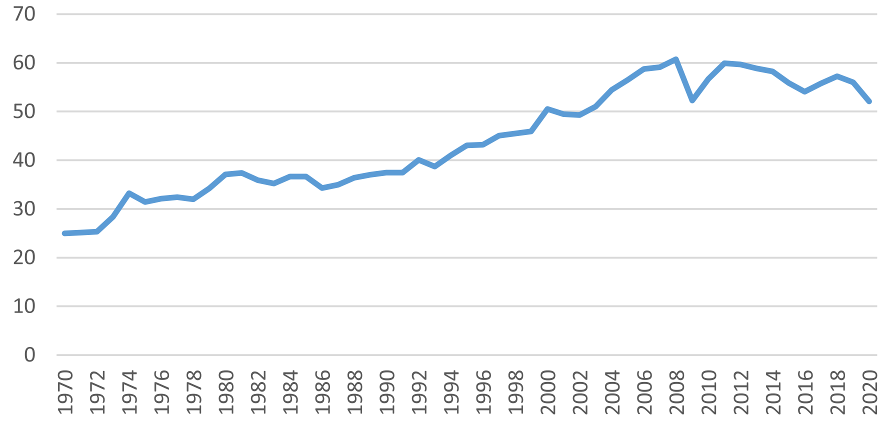

Fig. 1. Global Trade as a Share of Global GDP. (Figures on vertical axis in percent).
Source: World Bank.

The Global Financial Crisis similarly marked a break in cross-border financial flows. Global capital flows having grown more rapidly than global GDP in the decade leading up to the crisis, their growth now slowed. Banks deleveraged, and bank regulation tightened. Cross-border interbank lending (adjusted for exchange rate movements) declined sharply in the decade after 2008.[1] In contrast, other portfolio flows (including cross-border bank lending to non-bank financial firms, non-financial firms and governments) remained buoyant. Cross-border financial assets as a share of global GDP are as high today as on the eve of the GFC. Financial globalization has not been reversed. All that happened post-2008 was removal of the "hype" and changes in the identity of investors, away from banks in favor of pension funds, mutual funds, hedge funds and insurers, and away Europe and the advanced countries generally in favor of China and the Global South.

Nor have there been sharp changes in the international monetary system that provides the backbone for these transactions. The GFC was supposed to have created widespread disenchantment with the prevailing dollar-centric international monetary system. The advent of the euro and China's efforts starting in 2009 to internationalize its currency were supposed to create serious competitors to the dollar as the dominant global currency. Instead, along multiple dimensions (share of outstanding international debt securities, share of international bank loans, share of import invoicing, share of over-the-counter foreign exchange turnover), the dollar remains dominant. The dollar's share of identified foreign exchange reserves has fallen modestly, from about 65 % of the global total at the time of the GFC to 59 % today. But this is only a continuation of a trend already evident in the decade preceding the crisis. The euro has been held back by a dearth of AAA-rated government bonds ("safe assets") to act as the bedrock of central bank, commercial bank and corporate investment portfolios. Renminbi internationalization has been slowed by China's underdeveloped infrastructure for cross-border payments. Early on, this meant its maintenance of capital controls. Now it means slow progress in developing the Cross-Border Interbank

[1] This according to the Bank for International Settlements' Locational Statistics. This retrenchment was dominated by large European banks, notably large Euro Area headquartered banks.

Payments System (CIPS), which is intended to compete with the New York-based Clearing House Interbank Payments System (CHIPS).[2]

In fact, the main change in the structure of the international monetary system is that the dollar has ceded modest amounts of ground to the currencies of smaller economies. Three quarters of the decline in the dollar's share of global foreign exchange reserves since the turn of the century has had as its counterpart gains for the currencies of smaller countries (Arslanalp, Eichengreen, & Simpson-Bell, 2022a). A number of these currencies, the Australian dollar for example, have seen sharp increases in foreign-exchange-market turnover. It is tempting to attribute these trends to new technologies, notably the rise of electronic trading platforms featuring automated market-making and liquidity-provision algorithms. These technologies make it easier to trade these currencies for one another as well as for traditional international currencies. These technological developments were not anticipated a decade ago when observers asked instead whether the dollar would be challenged by the euro and the renminbi.[3]

Such was the state of globalization prior to the pandemic, the war in Ukraine, and the Biden Administration's efforts to "re-shore" manufacturing (White House, 2022b) while denying China access to advanced semiconductor designs and equipment (U.S. Department of Commerce, 2022). What has or will change as a result?

2. COVID-19

The most dramatic changes wrought by the COVID shock will be those affecting Global Value Chains and supply networks. Before getting there, though, it is important to recall the shoes that didn't drop. First, there was an unprecedented decline in portfolio capital flows to emerging-market economies with the outbreak of COVID-19 – much more dramatic than following the Global Financial Crisis, the 2013 Taper Tantrum and the 2015 China stock market selloff (OECD, 2020). Following the shock, however, there was stabilization and recovery. No emerging market resorted to capital controls in response to the shock.[4] There were few if any changes in exchange rate arrangements. Debt distress in low-income countries is widespread, but there have been few changes in the capital-flow regime and few reasons to think that there will be sharp shifts in the role of portfolio capital flows and foreign direct investment due to the COVID shock.

Second, there was a decline in immigration worldwide as governments imposed lockdowns and as air and sea transport was largely suspended. The United Nations (2022a) estimates that there were some 2 million fewer international migrants in 2020 due to the pandemic. But after that, international migration largely bounced back to pre-pandemic levels. "Permanent-type" migration to OECD countries as a share of recipient-country population matched its 2012–20 average already in 2021 (OECD, 2022).[5] Although some governments have modified their policies toward refugees and more generally continue to adjust the administration of immigration policies, there is little sign of durable change in the immigration regime as a result of COVID.

[2] Where the latter has a head start temporally and an installed base of users that is an order of magnitude larger (Eichengreen, 2022). I return to this below.

[3] I plead guilty to having been one of these observers (Eichengreen, 2011).

[4] Some countries such as Venezuela, Argentina, Lebanon and Turkey tightened preexisting controls, but whether this was due to the COVID-19 shock, as opposed to other country-specific problems, is questionable.

[5] In addition, there was some decline in temporary workers (aside from seasonal workers in agriculture) and a decline in new asylum applicants, although this recovered strongly in 2021–2.

COVID-related disruptions to shipping and production clearly have led to some rethinking by firms relying on lengthy supply chains and just-in-time production. Yet historical evidence suggests that global value chains evolve slowly, mirroring gradual changes in logistics and foreign direct investment flows (McKinsey Global Institute, 2022). Apple has diversified its sourcing by adding iPhone production in India and Vietnam to its existing contracting in China. But it has not brought that manufacturing back to the United States.[6] In November 2022 its CEO indicated the intention of purchasing processors for iPhones from a foundry in Arizona to supplement the processors it purchases from Taiwan. Whether this is mainly a response to problems with sourcing in Asia revealed by the pandemic is questionable, however. More likely, the decision was taken in response to U.S. tensions with China and, specifically, to Taiwan's uncertain geopolitical prospects (more on which below). If, as some observers predict, supply chains become more regionalized (see e.g. Conference Board, 2021), this will be as much a function of growing consumer demand in emerging markets, the same place where production is located owing to favorable costs, as it is to any advantages of co-locating different stages of production.

Finally, any rebundling and localization of manufacturing is likely to be accompanied by further unbundling and globalization of services. Outsourcing to low cost countries will remain attractive for firms in information services, business and financial services, research and development, telemedicine and digital diagnostics. Globalization of services is not as advanced as globalization in manufacturing.[7] Scope for shifting sourcing to emerging markets will widen with further expansion of the pool of young university graduates and the rollout of 5G. The globalization of services is not threatened by port shutdowns and shipping container shortages.[8] Aside from tourism and study abroad, which have since recovered, the globalization of services was not obviously slowed by COVID-19. If anything, the shift to remote work accelerated this trend.

3. The Russia-Ukraine War

Does Russia's attack on Ukraine have implications for the future of globalization? Russia's policies, if not reversed, will almost certainly result in its economic isolation. But Russia accounts for less than 3% of global GDP. It is important in world markets only for energy and minerals. There will be some trade diversion if Western Europe maintains its embargo on energy imports from Russia and if more Russian oil and gas exports consequently flow toward Asia. Asia will import more from Russia and less from the Middle East, while Europe imports less from Russia and more from the Middle East. There will be some deglobalization of energy markets, as countries seek to reduce their dependence on unreliable energy exporters and increase their self-sufficiency on the basis of renewables and nuclear power. Globalization may give way to regionalization of the energy market, as neighboring countries mutually insure by better connecting their energy grids and storage facilities, along the lines of efforts underway in Europe.

[6] In 2021 the company announced the intention of adding 20,000 jobs in the United States over the next five years, said to be for research on 5 G wireless, artificial intelligence and silicon chips.

[7] Thus, trade in services grew twice as rapidly as trade in goods in the decade preceding the pandemic according to the World Trade Organization.

[8] One can imagine this process being slowed by unreliable electricity supplies or attacks on the submarine fiber optic cables that are the backbone of the internet. But the process is ongoing.

It is suggested (see e.g., Das, 2022) that the Russia-Ukraine conflict and financial sanctions on the Bank of Russia will have implications for the international monetary and financial system. The decision by the United States, in cooperation with other G7 countries, to freeze the reserves of the Bank of Russia, bar the country from SWIFT, and prohibit U.S. banks from doing business with Russian counterparts is not entirely unprecedented. Previous executive orders by U.S. presidents froze the reserves of the Iranian and Afghan central banks, for example. But this is the first time the action was taken without the U.S. president affirming that the actions of the target country "constitute an unusual and extraordinary threat to the national security and foreign policy of the United States" and declaring a national emergency in accordance with the provisions of the 1977 International Emergency Economic Powers Act. This action has fed fears that these financial powers may be used more frequently. It has pointed to the possibility that the U.S. and likeminded countries may not adhere to the 2004 United Nations Convention holding that central bank reserves are covered by sovereign immunity.

If recent events indeed augur further weaponization of the dollar, then central banks and governments, contemplating even the remote possibility that they might end up in the U.S. government's crosshairs, may seek to diversify away from the dollar and U.S. banks for cross-border payments. In Russia's case, relying more on other G7 currencies and institutions for interbank payments is not an option, since G7 governments are cooperating in imposing sanctions. But one can imagine instances where G7 countries do not cooperate, as was the case of sanctions that the U.S. unilaterally reimposed on Iran in 2018.

Even if there is cooperation between the U.S. and its allies, there remains the possibility of holding reserves in the form of gold, which can be vaulted at home, and as securities and deposits in non-aligned countries. Russia had repatriated 100% of its gold reserves by 2020 (Bank of Russia, 2021). Its central bank shifted reserves out of dollars and into renminbi, making it the single largest holder of renminbi reserves.[9] This creates the possibility of using that currency and China's Cross-Border Interbank Payments System for international transactions. More countries doing likewise would not fatally undermine globalization. But it would represent some additional fragmentation of cross-border payments and throw grains of sand into the wheels.

But gold vaulted at home isn't easily be used to pay for imported goods and services.[10] It can't be posted as collateral or swapped for currencies in financial transactions. Renminbi reserves and payments by banks participating in CIPS can be used only for transactions with banks and firms with an appetite for renminbi balances.[11] A limited number of international banks participate in CIPS.[12] Revealingly, the vast majority of China's own foreign lending has been denominated in dollars, not renminbi (AidData, 2021). Available data suggest that less

[9] Arslanalp, Eichengreen, and Simpson-Bell (2022b) look at past instances of sanctions imposed by the U.S., UK, Europe and Japan and find a relatively small but significant positive impact on the share of reserves held in the form of gold by the target country.

[10] Venezuela famously loaded gold onto an Iranian government-chartered aircraft to pay for Iranian oilfield supplies (Laya, Patricia & Ben Bartenstein, 2020), an exception that proves the rule.

[11] Chinese banks could exchange renminbi deposits of Russia or another sanctioned country for dollars they hold on deposit with U.S. banks, but those Chinese banks might then become the target of secondary sanctions, which would act as a deterrent.

[12] CIPS's website lists about 10% as many international banks as participate in CHIPS. It may be that some of these banks only agree to be listed as a courtesy to their Chinese counterparties without actually engaging in transactions. I owe this point to Clement Berthou. Some argue that the renminbi will leapfrog the dollar in wholesale payments when China finishes rolling out its e-CNY (Warsh, 2022). I have my doubts.

than 1% of global trade is invoiced in renminbi (Georgiadis, Arnaud, Helena, & Cedric, 2021).[13] These limitations of gold and renminbi reserves may cause governments and central banks to conclude that reserves have less utility than thought previously, leading them to hold less. If they indeed rely less on reserves to finance payments imbalances and resort instead to controls to prevent the emergence of such imbalances, then this would be a step in the direction of financial deglobalization.

4. Sino-American Tensions

Finally, U.S.-China tensions. Anticipating their implications for globalization requires being explicit about what exactly one means by tensions. Concerns in the U.S. over China's subsidy policies, state-owned enterprises and intellectual property regime have given way, or now been supplemented, by worries about the country's military posture, treatment of human rights, suppression of democracy, and efforts to re-make international institutions in its image. As a result, the Biden Administration has not rolled back its predecessor's tariffs on imports from Chinas. It has taken the further step of banning U.S. exports of high-tech designs and equipment to China and prohibiting U.S. companies from investing in the capacity to produce them there. The U.S. Department of Commerce's Bureau of Industry and Security has expanded its so-called Entity List, which effectively prohibits U.S. companies from conducting business with designated Chinese counterparts. In September 2020, China announced its own Entity List in return. The Bureau's approval rate of export licenses for China declined from 82 % in 2018 to 67 % in 2021. The Bureau authorized 58 % fewer exports to China by value in 2021 compared to three years before.[14] China has retaliated by requiring export licenses for drones, artificial intelligence-related services, and other sensitive technologies (Garcia-Herrero, 2022).

These are steps in the direction of decoupling. As of August 2022, U.S. imports from China were approximately 18 % below where they would have been extrapolating their pre-trade war tend.[15] Yet the two countries remain one another's number one or two trading partners. China remains America's leading supplier of laptop computers, computer monitors, smartphones, video game consoles and lithium batteries. The decline in U.S. imports from China may not be evidence of decoupling; rather, it may reflect the relocation of labor-intensive activities to lower-wage countries as China's labor costs rise. U.S. tariffs on imports from China provide an incentive for the U.S. to purchase the same goods from other Asian exporters (Fajgelbaum, Goldberg, Kennedy, Khandelwal, & Taglioni, 2021). This trade diversion may be inefficient, but it is not deglobalization. Other countries have not joined the U.S. in slapping tariffs on China's exports. And they have resisted joining its campaign to ban exports of advanced chip technologies to that country.[16]

On the foreign investment side, the U.S. government's Committee on Foreign Investment in the United States has been given new powers to examine and block Chinese investments in

[13] The country coverage of the data in Georgiadis et al. (2021) is somewhat limited, and its representativeness can be questioned. Their actual estimate of this global share is less than one quarter of 1 %.

[14] In addition, as part of the Inflation Reduction Act, it has added subsidies for the domestic production of green-tech and high-tech goods previously imported from China (and elsewhere).

[15] Bown (2022) shows that the decline is entirely accounted for by product categories affected by the Trump Administration's tariffs, while U.S. imports of other products from China have continued to grow.

[16] On the case of the Netherlands, which provides the most advanced chip-manufacturing equipment, see Koc and Wu (2022).

companies operating in strategic sectors. Yet the United States is not closing itself off to foreign investment. U.S. FDI inflows and outflows have continued to rise. Both were above pre-pandemic levels in 2021–2 (United Nations, 2022b). The same was also true, albeit more modestly, of China. All that has changed is the direction of those flows, with the U.S. sourcing relatively less FDI from China and more from Europe.

Finally, China is seeking to reduce its dependence on the dollar and to develop its renminbi-based cross-border wholesale payments system, as already noted. Its holdings of U.S. treasury securities have been trending downward for a decade and are now barely a third what they were at their 2013 peak. These efforts will no doubt acquire additional impetus from rising tensions between the two countries and Washington's use of financial sanctions.

But whereas CHIPS and CIPS compete, they also overlap. The big Western banks that participate in CIPS also clear payments through CHIPS. Coexistence of the two systems is not a dire threat to financial globalization, any more than the coexistence of CHIPS (for wholesale payments) and Fedwire (for retail payments) is a threat to an integrated domestic financial system.

But a more extreme scenario – a confrontation between the U.S. and China over what we might cosmetically call "events" in the South China Sea, leading to a breakdown in political and economic relations – would constitute just such a dire threat. U.S.-China trade would be halted. Bilateral financial flows would collapse. There would be no atheists in these foxholes: non-aligned countries would be required to side with one country or the other. The global economy would bifurcate into two blocs. This would be the end of globalization as we know it.

The economic repercussions would resemble the economic fallout from Russia's invasion of Ukraine, from which no one benefitted, except that the economic shockwaves would be an order of magnitude larger. Hopefully, this knowledge will serve as an adequate deterrent to those contemplating aggressive geopolitical steps.

5. Conclusion

This paper started with the question of whither globalization following the COVID-19 pandemic, Russia's war in Ukraine, and rising U.S.-China tensions. My answer is that these events have sealed the demise of hyperglobalization, although hyperglobalization had already expired as a result of the Global Financial Crisis. In contrast, globalization, defined as an integrated global economy in which cross-border transactions and global GDP rise in tandem, is likely to survive these events intact, just as it survived the Global Financial Crisis. To be sure, survive intact is not the same as remain unchanged. The growth of global value chains will increasingly shift from goods to services. They will be shorter, better diversified and more regionalized. There will be some regionalization of energy markets, as countries seek to reduce their dependence on unreliable exporters and increase their self-sufficiency and sustainability. Recent experience with financial sanctions will reduce dollar dominance and accelerate movement toward a more diversified global monetary and financial system, but only slowly, given a dearth of alternatives. The policies of both countries will reduce U.S.-Chinese interdependency, but such policies will divert their trade and financial flows toward other countries as opposed to reducing them overall. Globalization will survive, although not globalization exactly as we know it today.

Of course, if U.S.-Chinese tensions escalate into a serious conflict, all bets are off.

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