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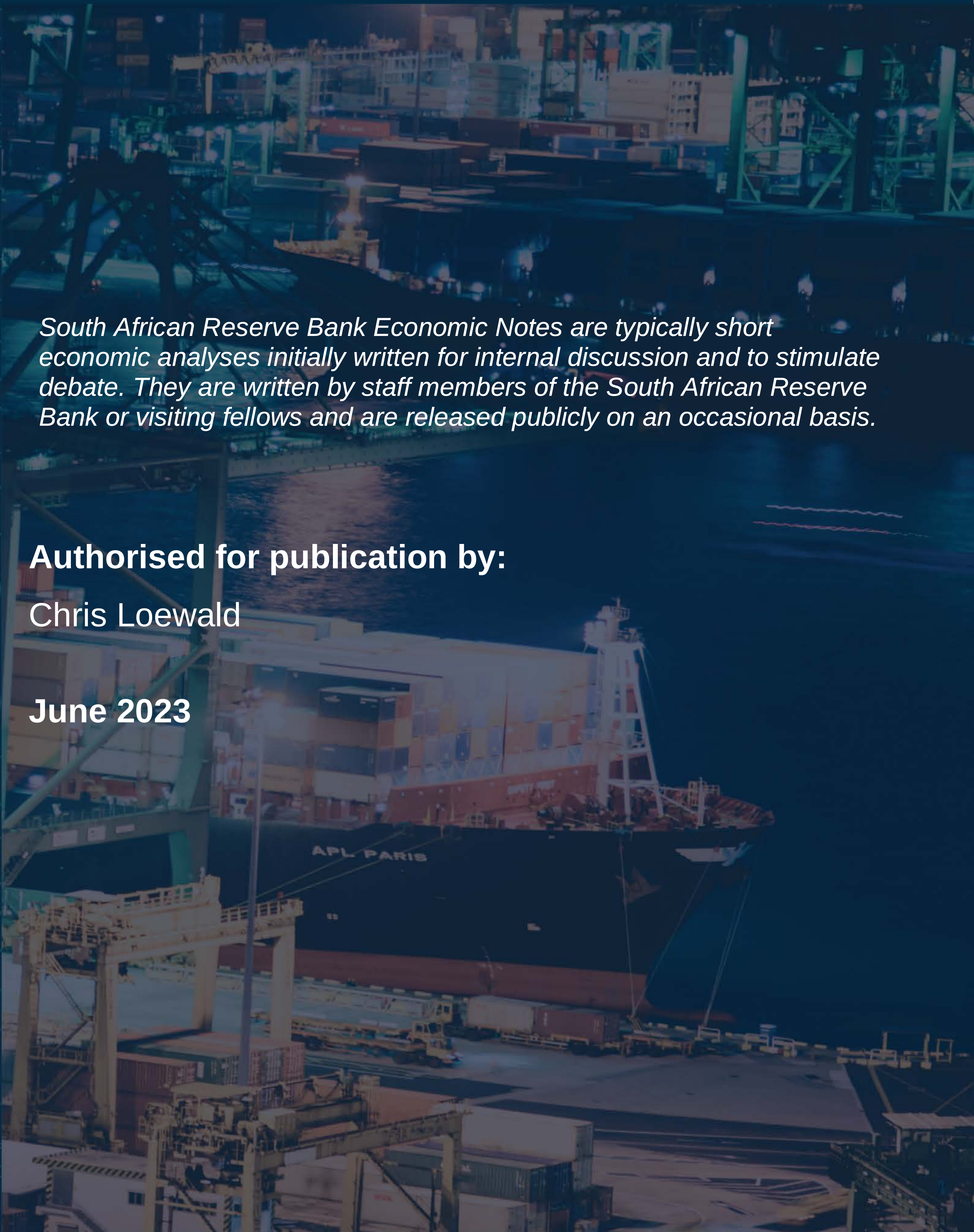

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Deglobalisation – trend or temporary shock?

Josina Solomons

Abstract

Since the 2008–09 global financial crisis (GFC), the rate of growth of global trade has been slowing. Global trade is likely to remain under pressure over the short to medium term, but a broad reversal of globalisation seems less likely. Trade and global value chains could become more resilient through greater diversification of suppliers as well as some degree of reshoring or near-shoring. South Africa has been slow in integrating into global value chains. However, an improved business operating environment, effective industrial policies and the development of stronger regional trade ties could help improve the country's global integration.

1. Introduction

Globalisation has provided clear economic benefits, including promoting economic growth and reducing poverty, but it has also exposed the negative effects of income inequality and the lack of job security, particularly in major advanced economies. Although the pace of globalisation has slowed over the last decade, it is still too early to label it as deglobalisation[1]. Global trade is likely to remain under pressure over the short to medium term, but a broad reversal of globalisation seems less likely. More time would be needed to assess whether factors relating to the COVID-19 pandemic and the ongoing war in Ukraine represent a deglobalisation trend rather than a temporary shock.

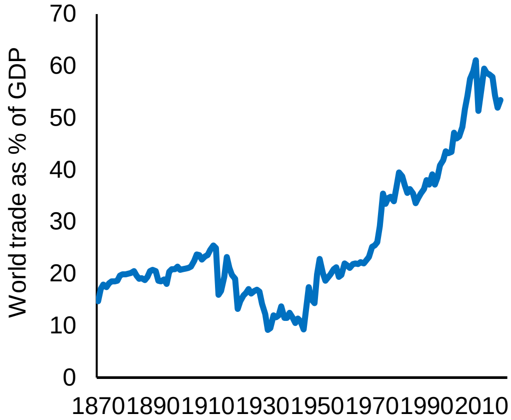
While the concept of globalisation is quite broad, the focus of this economic note is on goods and services. Sections 2, 3 and 4 provide a brief history of globalisation, its benefits, and its drawbacks for the world economy. Section 5 assesses the potential drivers of deglobalisation. Finally, Section 6 provides an outlook for globalisation as well as the implications for South Africa.

1 Deglobalisation is generally defined as a movement towards a less connected world, where economic agents are increasingly cutting their international ties and beginning to reshore economic activity toward their domestic economies.

2. A brief history of globalisation

Over the last few centuries, there have been various waves of globalisation (Figure 1). Since the 2008–09 GFC though, there has been a slowdown in the rate of growth of global trade, exacerbated by events such as the withdrawal of the United Kingdom (UK) from the European Union (Brexit) as well as the United States-China (US-China) trade dispute. The impact of the COVID-19 pandemic disrupted trade even further, while the ongoing war in Russia and Ukraine raised the prospects of continued disruptions to global trade.[2]

Figure 1: Globalisation over time

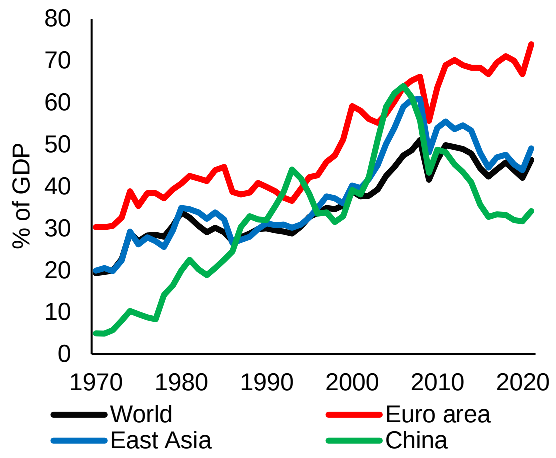


Source: World Bank

Evidence of deglobalisation, however, has been mixed. Global trade as a share of gross domestic product (GDP) appears to have peaked around 2008, due to slowing goods trade. Over the last two years, however, goods trade has gradually rebounded on account of pent-up demand for goods as economies opened after the COVID-19 pandemic (Figure 2). Services trade, on the other hand, continued its solid increase over the past decade (Figure 3). It was really during the pandemic that trade services – especially travel and transport – took a large hit.

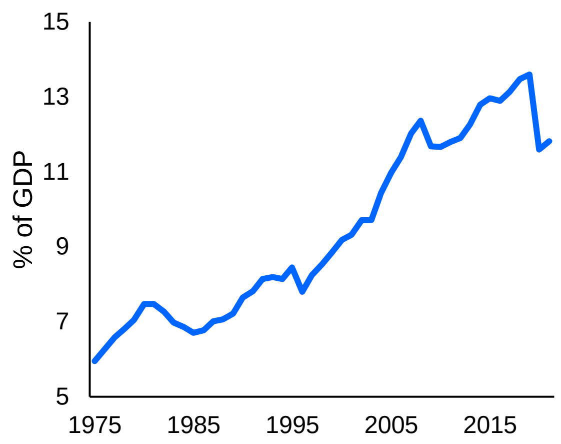
2 Various other factors have potentially contributed to this slowdown, including the increasing weight of emerging market economies in global economic activity. Martin Wolf argues that globalisation has lost its dynamism due to factors such as slowing global growth, the exhaustion of new markets to exploit and a rise in protectionist policies around the world ('Globalisation has lost its dynamism', *The Irish Times*, October 2016).

Figure 2: Goods trade as share of GDP



Source: Haver, World Bank

Figure 3: Services trade as share of GDP



Source: Haver, World Bank

3. Benefits of globalisation

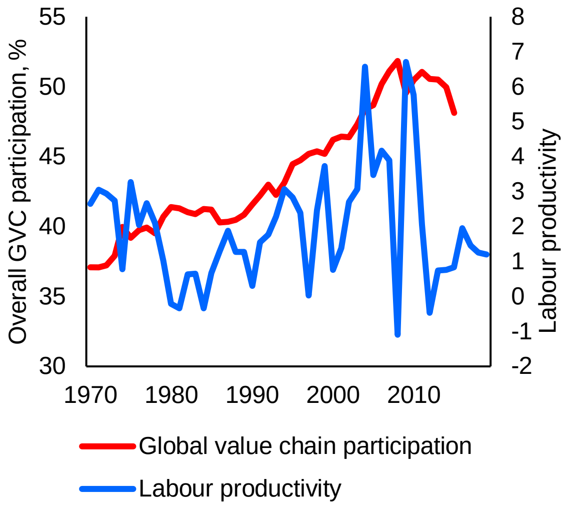
3.1 A boost in productivity and living standards

A key feature of globalisation has been the rise of global value chains.[3] The overall share of global value chain trade in total world trade rose sharply between 1980 and 2008. According

[3] This can be described as a process which breaks the production of goods into various stages and locations around the world. A car manufacturer, for instance, may design a car in Japan, produce its parts in the US and have it assembled in Mexico. Global value chains allow some countries, especially relatively small

to the World Bank,[4] a 1% increase in a country's global value chain participation could boost its per capita income by more than 1%. Globalisation has also contributed meaningfully to the rise in global productivity from 1980 to the late-2000s, and consequently to higher living standards. However, the slowing globalisation trend is one of the factors contributing to lower productivity trends over the last two decades.

Figure 4: Global value chains and productivity*



Note: *Global value chain participation computes the share of global value chain exports in total world exports
Source: World bank, World Penn Tables

3.2 Globalisation and the great moderation

Globalisation has been associated with rising economic growth[5] and low inflation (Figures 5 and 6). Reversing globalisation could potentially have negative implications for the world economy. The President of the European Central Bank recently noted that a breakdown in global value chains could push world inflation up by around 5% in the short term and by about 1% in the long term.[6]

Countries that have sharply increased their trade openness, such as China, South Korea and Thailand, have benefitted meaningfully from higher growth in real per capita incomes. Regression estimates on a group of emerging markets have found that trade openness is

emerging market economies, to be part of a complex production process which they would be unable to fully run on their own.

4 World Development Report 2020, 'Trading for development in the age of global value chains', 2020.

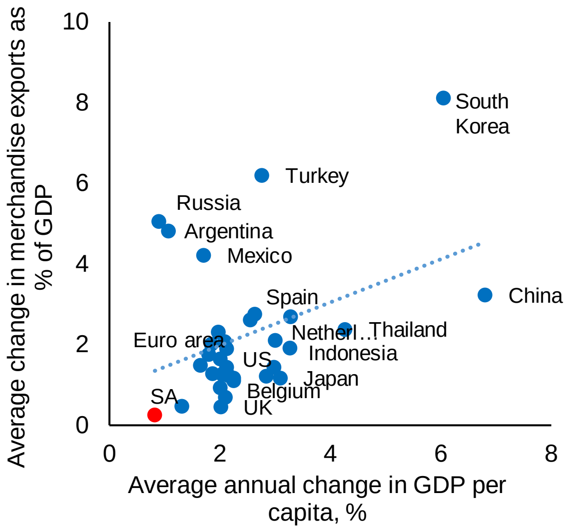
5 Broda and Weinstein find that trade enhances a country's economic growth through the increased product variety that globalisation makes possible (C Broda and D E Weinstein, 'Globalisation and the gains from variety', *The Quarterly Journal of Economics*, May 2006, 541–585).

6 C Lagarde, 'Central banks in a fragmenting world', speech at the Council on Foreign Relations' C. Peter McColough Series on International Economics, New York, 17 April 2023.

generally associated with higher GDP growth.[7] Globalisation is also widely considered to have helped reduce poverty in some emerging market economies.

Meanwhile, the literature suggests that several other factors, including the size of a country's economy and its distance from major markets, are key determinants of the gains from globalisation.[8] South Africa, as a small open economy where export intensity has stagnated over the last few decades, has seen little growth in per capita incomes over the years. South Africa's integration into global value chains has also been slow compared to its emerging market peers and has partly been undermined by a deteriorating economic operating environment, including business infrastructure and logistics services.

Figure 5: Economic growth and trade

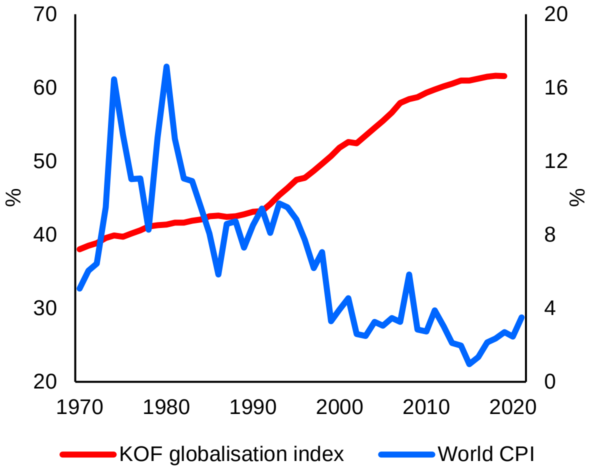


Source: Haver, World Bank

[7] A Dreher, 'Does globalisation affect growth? Evidence from a new index of globalisation', *Applied Economics* 38(10), 2006.

[8] G Miao, 'South Africa's integration into global value chains: status, risks and challenges', *SARB Working Paper Series*, WP23/01, 2023.

Figure 6: Globalisation* vs world inflation



Note: *The KOF globalisation index measures globalisation along the economic, social and political dimensions for countries in the world on a scale of 1 (least) to 100 (most globalised)

Source: SARB

4. Drawbacks to globalisation

Despite the many benefits of globalisation, there has been a backlash against it in recent years from several advanced economies as well as criticism from emerging market economies.

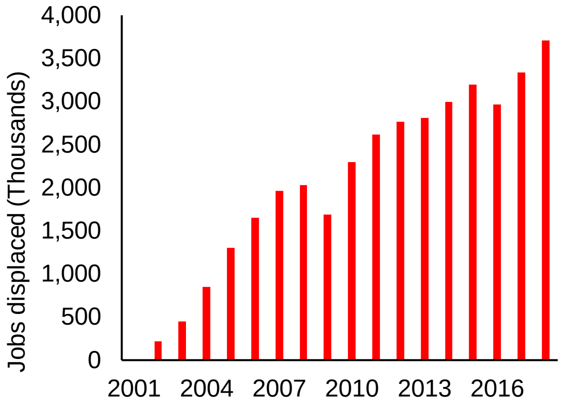
4.1 Globalisation and job security

While increased trade openness has been associated with improved living standards, there have also been concerns that some workers lose out from globalisation. A major criticism of globalisation, especially in advanced economies, is that it leads to increased job insecurity.[9] Over the last few decades, many manufacturing companies, especially in major economies, began outsourcing their manufacturing activities to other countries, such as China and India, where costs of manufacturing and wages are lower. This has led to job insecurity and higher unemployment in some advanced economies, as these skills were no longer in demand, resulting in political backlash against globalisation that gave rise to Brexit in the UK and the US-China trade dispute around 2016–17. Between 2001 and 2018, around 3.7 million jobs (of which 2.8 million were in the manufacturing sector) were reportedly lost in the US because of growing trade with China (Figure 7).[10]

9 OECD, *Globalisation, jobs and wages*, policy brief, June 2007.

10 US Bureau of Labor Statistics, and US International Trade Commission Interactive Tariff and Trade DataWeb database. Adapted from R Scott and Z Mokhiber, *Growing China trade deficit cost 3.7 million American jobs between 2001 and 2018*, report, Economic Policy Institute.

Figure 7: US jobs displaced since 2001



Source: US Economic Policy Institute

4.2 Globalisation and inequality

Another criticism of globalisation is that the benefits are not distributed evenly across and within countries. Various research studies show that globalisation has meaningfully contributed to rising wage inequality in the US.[11] Another study[12] shows that between 1991 and 2007 lower-wage manufacturing workers experienced large and lasting earnings losses, while higher-wage workers in the same industries did not.[13]

The elephant curve highlights the distributional consequences of globalisation.[14] The curve illustrates how a large group of people (referred to as the elephant's body), mostly located in China and other emerging markets, experienced strong real income gains between 1988 and 2008, while the working class in advanced economies (the lower part of the trunk) made almost no real income gains during the period and the lowest income groups (the tail of the elephant) did not experience any gains. Instead, large real-income gains were concentrated in the highest percentile of the global income distribution, which represents those who operated and owned the global value chains and thus benefitted through higher salaries and/or higher capital income. This phenomenon seems to explain the growing disappointment of the working class in many advanced economies over the last decade.

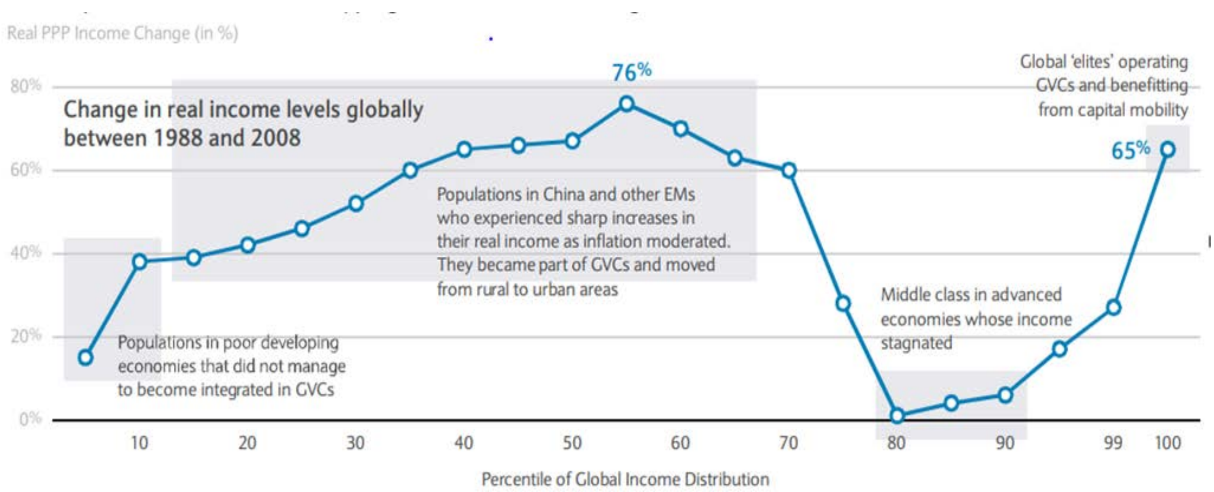
11 One explanation for rising inequality in the US is that technological advancements are reducing the demand for certain low- and middle-income workers and increasing the demand for high-skilled workers.

12 D Autor, D Dorn and G Hanson. 'The China shock: learning from labour market adjustments to large changes in trade', National Bureau of Economic Research (NBER) working paper no. 21906, 2016.

13 M Kolb, 'What is globalisation? And how has the global economy shaped the US', Peterson Institute for International Economics, 2018.

14 C Lakner and B Milanovic, 'Global income distribution: from the fall of the Berlin Wall to the great recession', Policy Research Working Paper Series 6719, The World Bank, 2013.

Figure 8: The elephant curve



Source: Branko Milanovic (2012).

4.3 Globalisation and the environment

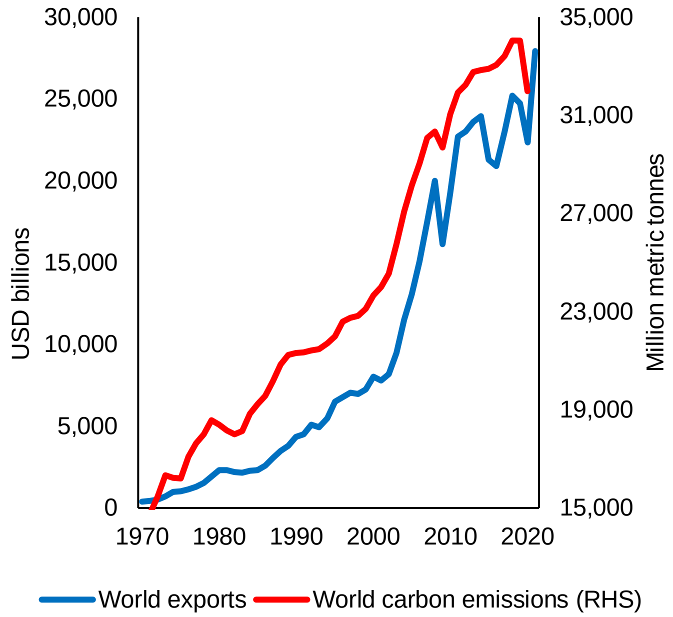
Globalisation has coincided with some challenging environmental trends. An increase in the share of energy-intensive manufacturing sectors has brought with it greater environmental risks, such as increased emissions of greenhouse gases. Sectors such as energy and transportation are estimated to account for about 75% of global greenhouse gas emissions.[15] There is also a tight link between trade openness and carbon dioxide emissions[16] (Figure 9). According to the World Trade Organization, the world's largest emitters of greenhouse gases are typically large economies,[17] such as China, the US, India and Russia.

15 World Trade Organization, 'The carbon content of international trade', *Trade and climate change*, Information brief no. 4.

16 Q Wang and F Zhang, 'The effects of trade openness on decoupling carbon emissions from economic growth – Evidence from 182 countries', *Journal of Cleaner Production* 279, 2021.

17 World Trade Organization, 'The carbon content of international trade', *Trade and climate change*, Information brief no. 4.

Figure 9: Trade openness vs global carbon emissions



Source: World Bank, Bloomberg

5. Potential drivers of the slowdown in globalisation

Some argue that the globalisation period of 1980 to 2008 was simply unsustainable and that a period of deglobalisation is inevitable.[18] Over the short to medium term, global trade is likely to remain under pressure from lasting consequences related to the COVID-19 pandemic as well as the Russia-Ukraine war. There is also a real risk that geopolitical tensions, such as a 'Cold War' type of situation between the US and China and other powers, could bring about a process of deglobalisation.

5.1 Decoupling from global value chains or reshoring

In recent years, there has been a broad slowdown in the expansion of global value chains.[19] While many factors may have contributed to the retreat in global value chains in recent years, there are others that could mitigate a major decline in trade over the short term. For instance, with global value chains generally taking a long time to develop, it is unlikely that factors such as investment and the availability of skilled labour could be repositioned over a short period of time. A recent study[20] found that no country can benefit from decoupling from global value chains. A 2021 World Bank report[21] warned against widespread reshoring, stating that this

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18 P Antras, 'Deglobalisation? Global value chains in the post-Covid-19 age', NBER working paper no. w28115, November 2020.

19 Several factors have contributed to this decline, including the fact that many supply chains have potentially reached their optimal lengths and complexity levels. The decline in global economic growth, especially investment, is also believed to have further contributed to this downtrend. Moreover, trade conflicts between the US and major trading partners have resulted in many protectionist policies that have further slowed global value chains.

20 P Eppinger, G Felbermayr, O Krebs and B Kukharsky, 'Decoupling global value chains', CES ifo working paper no. 9079, May 2021.

21 P Brenton, M Ferrantina and M Maliszewska, *Reshaping global value chains in light of Covid-19 – Implications for trade and poverty reduction in developing countries*, World Bank report, 2022.

could reduce trade and increase poverty in low and middle-income countries; the report also notes that shorter global value chains are not necessarily less vulnerable to shocks.

6. The outlook for globalisation

Over the last two decades, the benefits of globalisation accrued at a much slower pace than before, while discontentment intensified about its drawbacks (e.g., inequality and job insecurity). The COVID-19 pandemic and the ongoing war in Ukraine further highlighted the vulnerabilities of many global value chains to shocks. It is still too early to conclude whether these factors represent a deglobalisation trend rather than a cyclical decline.

While trade and global value chains declined sharply in recent years, the global economy remains integrated and global trade has not collapsed. Globalisation could look very different a decade from now, but a complete reversal of it seems unlikely as there is still broad awareness that large-scale reshoring is in some cases not feasible or would entail significant welfare losses. Trade and global value chains could also become more resilient through greater diversification of suppliers as well as some degree of reshoring or near-shoring.

A further rise in protectionism and a breakdown of multilateralism as was experienced in the period between the two world wars is also less likely. Most major economies have not experienced the scale of disruption (such as the massive numbers of deaths during World War I and the destruction of savings during Germany's Great Inflation period of the early 1920s) experienced by the populations that lived during the inter-war years.

6.1 Implications for South Africa

Over the last two decades, South Africa has been slow in integrating into global value chains. The automotive industry, for instance, has lagged its emerging market peers despite receiving substantial government funding.[22] Factors such as distance from key markets and relatively high labour costs as well as rigid labour markets have made it difficult for South Africa to compete with its peers. The lack of structural reforms has also been a key impediment to the country's competitiveness. Additional structural constraints, such as electricity shortages, have further weighed on the country's attractiveness.

Trade policies that welcome foreign direct investment remain key for South Africa's successful integration into global value chains. The literature suggests that the country's business operating environment needs to be improved to help make existing industrial policies more effective.[23] South Africa could also leverage its large platinum resources to develop linkages in several global value chains.[24] Furthermore, South Africa's proximity to other resource-rich countries in sub-Saharan Africa could help open important opportunities for regional integration as well as for industrial and technological innovation. Research[25] shows that since

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22 G Miao, 'South Africa's integration into global value chains: status, risks and challenges', *SARB Working Paper Series*, WP23/01, 2023.

23 A Andreoni, P Mondiwa, S Roberts and F Tregenna, *Structural transformation in South Africa – The challenges of inclusive industrial development in a middle-income country* (Oxford University Press, 2021).

24 ibid.

25 P Mitchell, 'Covid-19: how mining companies can build more resilient supply chains', EY Global Mining & Metals, 11 May 2020.

the COVID-19 pandemic, global mining companies have actively been exploring broader sources of supply to help manage supply chain risks. This could open opportunities for South African mining companies, provided the right industrial policies are put in place.