A Theory of Globalization Evolution: History of and Reflections on Globalization over the Past Two Centuries

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In view of the ongoing proliferation of the coronavirus disease (COVID-19) around the world, with fast economic and political changes, it is hard to foresee global economic prospects in the next few years. However, through a historical perspective on globalization in the past two centuries, it is still possible to suss out the salient points as reference.

Trends of globalization and deglobalization

The first wave of globalization emerged around 1820 and ended with the outbreak of the First World War in 1914, when a wave of deglobalization unfurled, lasting till the early 1960s. This in turn signified the start of the second wave of globalization continuing for four decades, which ground to a halt due to the 2008 financial tsunami. With the outbreak of the China-US trade war in 2018, bilateral relationship between the two countries has turned icy cold. Coupled with the unprecedented COVID-19 pandemic, this has led to an unparalleled upsurge in trade protectionism and anti-Chinese sentiment, making deglobalization irreversible.

The late 19th century saw the steam engine being widely used in manufacturing and shipping. This, together with the rapid expansion of highway and rail transportation networks, facilitated the integration of the global market. An international financial network with London as its centre was conducive to global cargo and capital flows.

However, as the first wave of globalization was apparently not policy-driven, various countries were wavering between trade protectionism and liberalism. Apart from the UK, only Japan, Denmark, and Sweden were among the handful of countries which subscribed to trade liberalization. From 1861 to 1933, to protect its domestic manufacturers from foreign competition, the US kept raising tariffs – by 40% to 50% on average – on imports (see Note 1).

Trade contractions, together with the trade barriers during the First World War, constitute a major cause of deglobalization. With the decline of the British empire after the War, the driving force behind the international trade system greatly diminished. At the same time, nationalism and protectionism were on the rise throughout the world. For example, the US Hawley-Smoot Tariff Act, a result of the promise of trade protectionism by Herbert Hoover as a presidential candidate in 1928, closely mirrors Donald Trump's campaign promise in 2016 followed by the China-US trade war. America's high tariffs were later on commonly regarded as one of the factors that intensified the 1930s Great Depression. As a result of various geopolitical factors and the global economic depression (owing in part to deglobalization), the Second World War broke out in 1939 and the first wave of deglobalization went on.

Soon after the Second World War, various international organizations were established under the auspices of the Bretton Woods system, including the World Bank, the International Monetary Fund (IMF), and the General Agreement on Tariffs and Trade (GATT). To the US as the new leading force of the world, the global trade system was seen as the key to its economic prosperity. With the sobering experience of two world wars, most countries in the West shared this view.

The cold war between the US and the USSR took place in the 1950s, when it was a common belief in the US, Japan, and Western Europe that a multilateral trade system could prevent Third World countries from leaning towards the communist bloc led by the USSR. European countries also endeavoured to pave the way for the European Union by way of common markets. More and more countries lowered their trade barriers and entered into bilateral trade agreements or regional trade agreements, or joined the World Trade Organization (WTO). By the same token, many developing countries (particularly those in Asia) lowered trade barriers as part of their economic reform programmes. The second wave of globalization thus unfolded.

Similar to its predecessor, the second wave of globalization was also technology-driven. As emerging markets launched into the development of transport infrastructure, the concurrent lowering of international transport costs and blossoming of information and communication technology (ICT) became the most powerful stimulus for the thriving of international trade in the second half of the 20th century. As pointed out in *The Great Convergence*, the pioneering work by the renowned economist Richard Baldwin published in 2016, the second unbundling brought about by ICT allowed division of labour in industrial production. As such, different tasks can be undertaken by different manufacturers and in different countries, facilitating the flourishing of global supply chains.

Unlike the first wave of globalization, trade was oriented towards intermediate goods rather than ultimate goods during the second wave of globalization. Decline in the manufacturing industries and their wages in developed economies correlated with division of labour of these industries moving to emerging markets (particularly China). At the same time, despite the narrowing gap of economic strength among various countries, domestic income and wealth inequality on their own soil deteriorated as a result of globalization. However, while being just one of the underlying factors, trade and immigrants alike are often singled out by politicians as scapegoats, creating anti-globalization sentiment among the general public.

Insights from the current crisis

During the financial tsunami, rising unemployment rates became a common phenomenon in developed countries. It took the US almost a decade to get its economic growth back on track. Before the outbreak of COVID-19 this year, some European countries were still economically recovering from the 2008 crisis. Quantitative easing as an economic stimulus implemented by central banks has led to ongoing appreciation in asset market values, pushing wealth inequality to record high levels.

These economic conditions created a perfect storm for anti-globalization. The post-financial-tsunami rebound of global trade was strong but short-lived, with an annual growth rate of less than 3% since 2011, which is far lower than the 7% annual growth rate prior to the financial crisis. The WTO predicts an even worse trade collapse this year, with an annual decrease of up to 32% under the worst-case scenario and a future growth rate of less than 3% each year following a temporary rebound.

With economic slowdown and a deteriorating wealth gap, the present situation is similar to that during the first wave of deglobalization. The rise in populism and protectionism, dwindling profits from participation in the global supply chains, and the changing consumption patterns around the globe have all played a part in deglobalization since 2008. On the other hand, as shown in my research study many years ago, China has been moving up the global supply chain and is now able to produce the most sophisticated intermediaries which used to be imported from overseas. The scope of trade for other countries has therefore been narrowed (see Note 2).

In March 2018, following the Trump administration's proposed imposition of tariffs on US$50 billion worth of Chinese imports, tit-for-tat actions by both countries soon escalated into a trade war. As of end of 2019, over 60% of Chinese imports into the US (according to trade statistics in 2017) was subject to a 10% tariff or more. My latest research study finds that from 2017 to 2019, Chinese commodity exports to the US decreased by more than 25%. The corresponding shift of trade has significantly benefited other emerging markets, including Vietnam, Malaysia, Mexico, and East European countries. As pointed out by some studies, exports from these countries to the US, particularly high-end products, cannot readily make up for the shortfall in Chinese exports. The consumer price increase driven by US tariffs has been almost entirely shifted to American consumers (see Note 3).

The COVID-19 pandemic has also created another perfect storm for deglobalization. Serious damage to global supply chains, which initially resulted from production suspension by Mainland manufacturers in February and March, was subsequently caused by supply and demand suspension in various developed economies. After shrinking by 6.6% year-on-year in March, Mainland exports in April – pushed by surge in demand for medical supplies and equipment – unexpectedly increased by 3.5% year-on-year. However, this was not a sign of trade recovery. As global economies bottom out one after another, global supply chains will still be subject to further shocks.

Post-pandemic future of global trade

It has already dawned on people that global supply chains have become more vulnerable than before and that there has been an overreliance in developed economies on supplies from China, particularly essential medicines, medical supplies, and pharmaceutical raw materials. For example, Chinese pharmaceutical firms have captured 90% of the US market for antibiotics and vitamin C (see Note 4).

For this reason, the Japanese government has earmarked US2.2 billion to encourage Japanese companies to relocate production lines out of China. The US Senate and Congress are also drafting legislation along similar lines to move production back to the US by offering tax concessions to American companies. Whether these policies can serve to restructure supply chains remains to be seen. That said, in my opinion, in the context of the deglobalization trend and China-US trade frictions, this is no big deal. In the current pandemic, governments and companies worldwide have even come to realize the risk of long-term reliance on a single manufacturing nation and will diversify investment to develop more flexible supply chains. Their guiding principle will thus be switched from “just in time” to “just in case”.

In light of rising production costs in Mainland China, global supply chains have been moving manufacturing over the years from the Mainland to other emerging countries where production costs are lower. Moreover, price increase in Chinese products brought about by US tariffs has expedited the pace of product supply chains shifting out of the Mainland. Despite the rise in anti-China sentiment in different parts of the world, most manufacturers should know better. Nevertheless, given the unignorable negative impact of the pandemic on the Mainland economy, they will have to minimize risks and cater to customers’ demand.

In the final analysis, as I explained in this column on 8 April, supply chains somehow have a kind of sturdiness all their own and are not easily broken up. Foreign manufacturers would be hard-pressed to leave the Mainland production chains altogether and find a replacement in another country. What is more, industrial production relies on internal and external economies of scale. So long as its manufacturers or customers remain in China, a company will risk great loss of economic benefits if it chooses to leave by itself. According to a business survey conducted by the AmCham China in 2020, 83% of its member companies have neither considered nor started relocation of manufacturing or procurement out of China. Part of the reason may be that the Mainland’s rising middle class has already become a huge consumer market for numerous US companies.

Obviously, as companies are devoting more efforts to diversifying geopolitical and natural-disaster risks in order to build supply chains with greater flexibility, they can only enjoy smaller economy of scale. Efficiency will lower at least for the time being, affecting economic recovery after the pandemic. In view of policies and other factors, some manufacturers will definitely relocate to their home countries. But even so, with advances in artificial intelligence and robotics, such a move may not necessarily create ample employment opportunities for the manufacturing industries back home.

Under the trends of deglobalization, supply-chain fragmentation, and replacement of human workers with robots in developed countries, global economic development will weaken and the wealth gap will continue to widen. Hopefully this will not result in another global disaster.

Note 1: Douglas A. Irwin (2019), “U.S. Trade Policy in Historical Perspective”, NBER Working Paper No. 26256

Note 2: Kee, Hiau Looi and Heiwai Tang (2016), “Domestic Value Added in Exports: Theory and Firm Evidence from China”, *American Economic Review*, 106(6), June 2016, pp. 1402-1436

Note 3: Fajgelbaum, Pablo D., Pinelopi K. Goldberg, Patrick J. Kennedy, and Amit K. Khandelwal (2020), “The Return to Protectionism”, *The Quarterly Journal of Economics*, 135, no. 1: 1-55

Note 4: Yanzhong Huang (2020), “The Coronavirus Outbreak Could Disrupt the U.S. Drug Supply”, Council on Foreign Relations