1. Spoilers

I hear a lot of complaints that we live in strange and usual times. Actually, this is what people always do, since they think that their era is unique. We seem to live in the times of Trumpism, Brexitism and deglobalization. Our epoch definitely feels like something unique. But it is not. Indeed, our grandparents have been here before. Of course, the voices and characters on the world stage are different. But the stories of the Great Depression of the 1930s and the Great Recession, that we are still living today, are to a large extent similar. The start of the story line, as it is presently being told, is a financial crisis that reduces demand and destroys confidence.[1] Next follows a collapse of world trade and investment that marks the end of decades of intensifying globalization, characterized by increasingly free international trade and capital flows. This world trade (and investment) collapse starts a period of deglobalization that at first remains hidden under the veil of initial recovery, but later becomes clear and measurable. This is what happened in the 1930s and it is happening today.

The most powerful man of the world has been described as a toddler and is perceived by many as an irresponsible president that spoils the international order that sensible men and women have been constructing since the Second World War. A world order in which trade, democracy and peace reinforced one another and have brought tremendous gains in knowledge and material welfare. This is a serious game that is now being spoiled in a reality show that has driven many of my friends and colleagues to stop watching the eight o'clock news. That spoiling is, however, not the motivation for the title of this chapter (although you will, I hope, appreciate the ambiguity). This chapter is the spoiler of the book. The reason is that the book is as scientific and evidence-based as possible when one is writing about a moving target. While this quality will be appreciated by many policy makers, I also know from experience that their time is limited. This is all the more true today where the day-to-day problems push out long-term agenda items, news cycles have shortened and events are becoming stranger by the day. So, I give the main findings regarding the causes as well as the suggestions for a solution away in this short chapter, as if it were a management summary. The key give away is that Trump and Brexit are symptoms. We need to look deeper if we want to solve the problems caused by the new deglobalization phase. And there is a second spoiler.

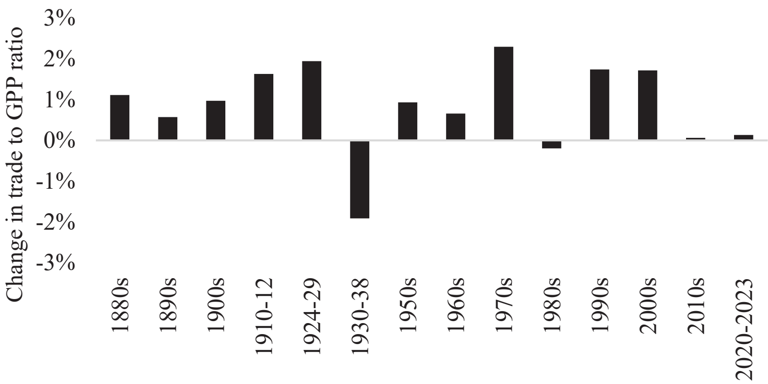
The second spoiler started as an afterthought: why does not everybody agree on the facts and why does so much disagreement exist on the question if the current economic phase can be seen as deglobalization? Rather than discussing this later in the book I decided to use it as a starter and a warning that our knowledge still is preliminary and that this book, while evidence-based, may also give rise to alternative interpretations. This may spoil the quality of convincing you, but it is scientific and honest.

Deglobalization 2.0

To some it is especially worrying that the retreat from globalization appeared to start in democracies, because the Bretton Woods institutions (and likewise the European Union) have been built by democracies (and, indeed, the analysis in this book shows that this is a significant difference with the 1930s when in contrast deglobalization did not move as fast in democracies as it did in autocracies). So, the popular anti-globalist movements currently seem to hit the system at the heart. While I do not want to downplay the issue of populism, it is, however, important to recognize that the turning point of globalization in major economies appears to have occurred around the start of the Great Recession, well before Brexit and the election of President Trump. It is equally important to see that the phenomenon of deglobalization requires a much broader conceptualization than the 'backlash from globalization' or the 'retreat from globalization' phenomena that are already being recognized by many authors. Deglobalization also occurs in countries where support for globalization is still strong, a puzzle that has not yet been addressed.

Before the outbreak of the Great Recession, in the era of globalization, it was well recognized by economic historians that globalization was not new and many comparisons exist between the globalization phases of 1870–1914 and the post Second World War wave that ended in 2008.[2]

It is now time to also recognize that deglobalization is not new either, and that it may even be here to stay for quite some time. Figure 1.1 illustrates the cyclical pattern of globalization and deglobalization by means of the average annual change in world openness by decade. For the world as a whole, economic globalization is still below its 2008 peak level and on current projections will remain so until at least 2023. Similar patterns can be observed at the individual level for former (United Kingdom and United States) and potentially new hegemons such as China and Germany. This deglobalization predates the Trumpian trade turbulence as well as Brexit and can be observed along many dimensions and in all regions of the world.



Notes: The estimate for 2010–2023 is (partly) based on IMF forecasts.
Note that the number of available years is limited in the 1910s and 1930s and the absence of the 1940s.

Sources: Maddison (1998) and (2001), World Bank, World Development Indicators and IMF World Economic Outlook Database, accessed July 2018; see the appendix on data construction in this book.

Figure 1.1 Cycle in the openness of the world economy (average annual change per decade and in per cent)

The idea, however, that we have entered a phase of deglobalization is contested by many observers who argue that what we see is the consequence of new technologies that reduce material flows, new modes of finance, new strategies and insourcing of international value chains. Other observers argue that we have a pause in globalization. This disbelief in what the data tells us is matched by the many authors that have predicted that the rhetoric of Make America Great Again would remain words only and that Brexit would be a ripple rather than the tsunami that its exit from the European Union created.

These observers may of course be right and it may be too early to tell, but this book stresses that globalization and deglobalization are recurring phases of our economic system. Because of this recurrence it is important not only to study the current situation but also to look at its major predecessor to find communalities and differences. So we will be concerned with the 1930s (Deglobalization 1.0) and the 2000s (Deglobalization 2.0).

The basic argument is that phases of strong globalization carry the seeds of their destruction, that is: such phases generate the forces that ultimately set limits and force a retreat of internationalization.

A first mechanism, that operates in national economies, is that redistributing the gains from further openness to the people who lost from globalization becomes more difficult at higher levels of globalization. This is a double-edged sword. In the initial phase when a country starts to open up the economy experiences steep increases in productivity and welfare, but once the low hanging fruit has been picked the same increase in the intensity of globalization brings less benefits to the economy. At the same time the costs of redistribution at a low intensity of globalization are initially small, but they are on an increasingly steep path as illustrated in Diagram 1.1.

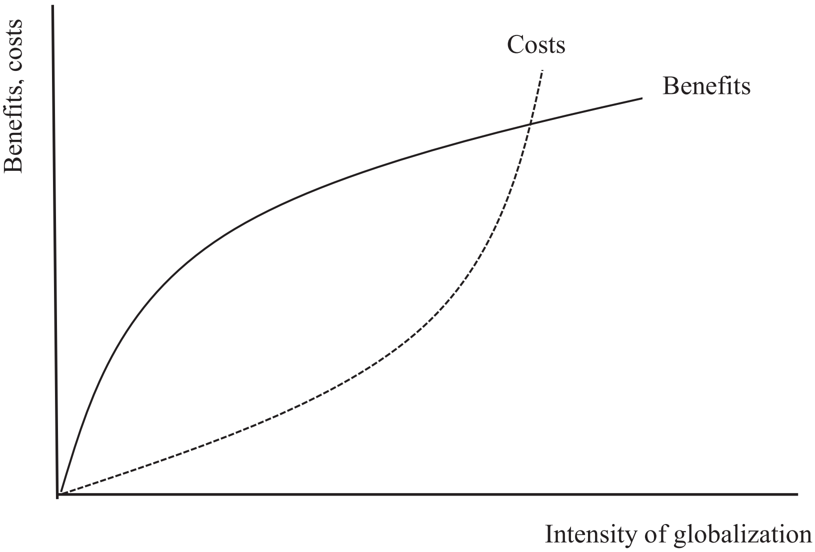


Diagram 1.1 Intensity of globalization, benefits and costs

Diagram 1.1 drives home two messages that are often forgotten. Firstly, also for (de)globalization we cannot have our cake and eat it too: there are no benefits without costs. Secondly, at some point further globalization becomes a loss-making activity (namely when the economy moves beyond the intersection of costs and benefits).

Clearly the point where costs equal benefits is not the point of bliss where globalization is optimal. Indeed, an economy could improve its welfare by *decreasing* its intensity of globalization because the benefits of globalization would then exceed the costs so that globalization would provide a net contribution to society. When the economy, however, is in the left-corner and starts to globalize it wins by *increasing* the intensity of globalization. So somewhere in between these two points where the costs of globalization equal the benefits of globalization must be the optimal level of globalization.

We can find this optimal level by looking at the marginal costs and marginal benefits of one 'unit' of globalization (Diagram 1.2). On the one hand, the marginal gains of globalization decrease. In the initial phase large benefits can be reaped in terms of efficiency gains, consumer welfare, product variety and product quality, but, at some point, moving from large openness to larger openness does not bring much more new opportunities for international specialization. On the other hand, the marginal costs of adjustment and redistribution increase due to the distortive impact of high marginal taxes.[3] So the winners win less, and it is more costly to compensate the losers of openness. Where marginal benefits equal marginal costs the contribution of globalization is at its maximum.

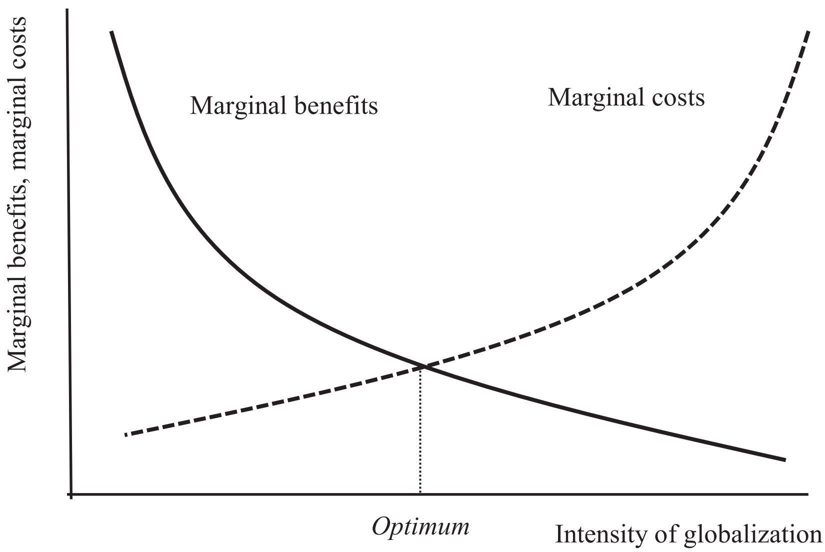


Diagram 1.2 Marginal costs and benefits of globalization

A second mechanism operates in the international arena. (Note that Diagrams 1.1 and 1.2 can also be used to illustrate the costs and benefits in the international arena; the earlier discussion related to costs at the domestic level and are relevant for every country, but the costs and benefits to be discussed relate to the leading economic power only). We can observe both in the Great Depression of the 1930s and in the Great Recession that the leading power of the time (the hegemon) deserted the rules of the game that underpinned globalization and were actually designed by its interest in an open trade and investment climate. An open stable and relatively peaceful system allows other countries to develop and grow faster capturing a larger share of the benefits of globalization. In the early phase of globalization a smaller share from a larger economic pie may still be an improvement. At some point the costs of being a hegemon, however, outweigh the benefits. It is ironic, but sad, that the United States and the United Kingdom (the hegemons that helped to build a constellation in which trade, democracy and peace were reinforcing aspects of the world order) are spoiling global and European governance.

These two mechanisms explain to a large extent why deglobalization is occurring in the advanced economies and may also clarify the motivation of politicians to change course. Imagine that the ruler of a country expects to lose her or his power base. This ruler would discount the future post-election benefits of globalization because she or he will probably not be in power while the current costs of globalization have a direct impact on the franchise. This shifts the marginal costs in Diagram 1.2 down, reduces the optimal level of globalization for the ruler and motivates a policy towards deglobalization.[4]

Undoubtedly the timing of the retreat from globalization is bad, because today concerted action is necessary in view of many interrelated urgent challenges, including the need to feed a still increasing world population, global warming, the new scarcities of water and land, and mass migration. Coordination of policies in the economic domain remains essential because the world economy is still fragile, the effects of the unwinding of quantitative easing are uncertain and crises of confidence are recurring. International and regional differences suggest different policy mixes. Global leadership is urgently needed; so what can we do?

If anything the deglobalization phases that are studied in this book substantiate the need for protection against the powerplay by big economic nations. The procedures, rules and regulations of the World Trade Organization (WTO), although certainly not perfect, provide that protection to the developing nations and the smaller advanced economies. It should (and if not, it will become increasingly) clear that protectionism does not protect and also that the costs of deglobalization are borne by those that lost from globalization: low-skilled, low-income ordinary people.

The long-run perspective that this book develops substantiates that it is in particular problematic that the leading role is in the hands of one nation and also that this role is and will always be contested by new nations. Losing power is not an easy process as we witness especially nowadays. Nostalgia for the grandeur of the past appears to be a strong force for building anti-globalist (election) platforms. Also, therefore, strong globalization carries the seeds of its own destruction. We thus need to get rid of the hegemon in a traditional sense, because the next hegemon will probably in the end not do better.

Currently two candidates for the role of hegemon exist: China and the European Union. Both explicitly support the open multilateral trading system. Both are able to develop long-run policies (for example, regarding the environment). Both suffer from the actions of the previous hegemons. Both (and this is actually the best part) appear to be unwilling to play that role. The current disorder may therefore actually help to build a coalition of the unwilling that is needed to move the leadership of the world economy to the level where it belongs: the world community at large. This will not be an easy process of course and I am well aware about the fundamental differences that also exist between the European Union and China in terms of human rights and freedom.

The coalition of the unwilling should be based on a common understanding that with the US retreat from global leadership, the world needs constructive and deep cooperation of Brussels and Beijing to change the rules of the game where necessary in order to make global governance more transparent, fair and open to contestation. International organizations and institutions will remain important elements. Not just as the guardians of globalization but also of deglobalization.

Why is not everyone convinced?

While I am quite persuaded by the data that deglobalization currently is a real world phenomenon with which we have to deal, others are clearly not. Lund and Tyson (2018) use a provocative title 'Globalization Is Not in Retreat' to point out that the slow-down of world trade in physical goods may be due to increasing e-commerce and digitalized services. By implication the traditional metrics of globalization show a decrease due to this substitution effect. Constantinescu et al. (2016) ask the question, 'Does the global trade slowdown matter?' Yet another disbeliever Bordo (2017) adds: 'The Second Era of Globalization is Not Yet Over' arguing that we are witnessing a slowdown of globalization or a pause rather than actual deglobalization. According to Bordo it is simply too soon to tell and the apparent slowdown of world trade may have been caused by subdued global demand and reorientation of international value chain activity. Bordo also points to increased regulation of banks and institutional investors as this may explain the slowdown in financial flows. Martin (2018) is very explicit: 'Keeping it real: Debunking the Deglobalization Myth'.

Disbelief in deglobalization is not an academic treat only. Global think tanks such as the McKinsey Global Institute (Lund et al., 2017) and international organizations have expressed their views that the developments that we discussed above are too specific and/or not sufficiently broad-based and/or not sustained enough to merit the use of ‘deglobalization’. Incident, pause and slowdown characterize what we see, according to these critical discussants of the ‘deglobalization thesis’.[5] There is more at stake than the profession’s belief in the inevitability of globalization[6], that – while hijacked by the neoclassical orthodoxy – originates in the *Communist Manifesto* (Marx and Engels, 1848):

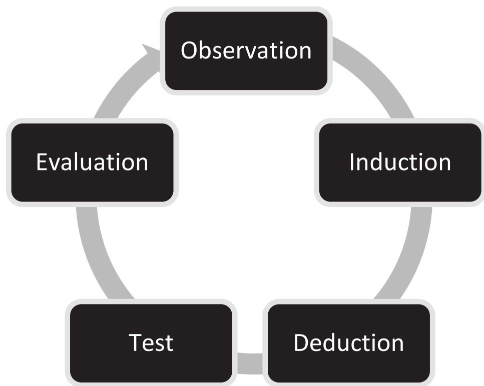
> Modern industry has established the world market (… which gave) an immense development to commerce, to navigation, to communication. This development has, in turn, reacted on the extension of industry. The need of a constantly expanding market for its products chases [it] over the entire surface of the globe. It must nestle everywhere, settle everywhere, establish connections everywhere. It has given a cosmopolitan character to production and consumption in every country.

To understand why disagreement is a common feature of ‘Black Swans’ (high-impact low-frequency events), such as the Great Recession or the Great Depression, and also to help you to see the uncertainty and weakness of the arguments in the deglobalization debate (including my own!) it is helpful to think a bit about how we learn about the real world.[7] The process of scientific discovery and the practice of policy development are both generally seen as heuristic and iterative: typically theory and policy are described as empirical cycles of observation, analysis, proposal, implementation or testing and evaluation (Diagram 1.3).

The idea is that people (even policy makers and scientists) learn from their mistakes. These iterative cycles are not only relevant when we want to understand how a literature on a specific subject develops over time (the empirical cycle) and how this may differ from the views held by policy makers (the policy cycle), but also to better understand our own position. Like the theories and policies of the past that we may want to challenge from our current perspective, we should be aware that this is most likely to also occur in the future when others evaluate our own thinking.

While these cycles are already relevant in general, they are even more so during periods of crisis, especially if no consensus exists yet on the occurrence of a phenomenon, its causes and its impact. Typically the development of theory and policy during ‘Black Swans’ such as a world trade collapse or a phase of deglobalization is characterized by uncertainty of developments and outcomes and by constant learning about the actual real world conditions. Therefore many hypotheses are formulated by different people about possible ‘states of the world’. Contradictions are likely because human nature is such that many people suffer from disaster myopia (‘do not see or believe that the event is coming’) or cognitive dissonance (‘do not understand or are unable to combine the available sets of information') and also because people are willing to accept different levels of certainty in their judgements.

a) Empirical cycle



b) Policy cycle

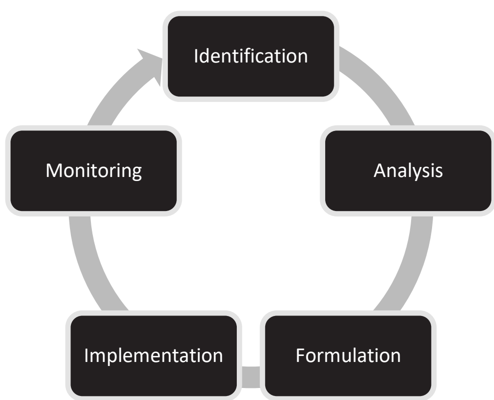


Diagram 1.3 Cycles in the production of knowledge

As more evidence/information becomes available the probabilities of the different possible states of the world are re-evaluated: the weight of evidence determines perceived probabilities.

Five important characteristics of phases following low-frequency-high-impact socio-economic events should be recognized. Firstly, policy making and scientific discovery take place in an evolving context. After the event policy making will no longer be concerned with the original problem, but the scientific discourse can run on for several decades. An example is the issue of a shortfall of trade credit that was initially seen as one of the triggers of the world trade collapse in 2008/9, but on which the academic jury is still out.[8] The point is that this was a policy problem only until the G20 decided to increase trade finance significantly in April 2009. Secondly, considerable hysteresis exists with respect to the priors, in particular if a well-established theoretical framework and a coherent policy recipe existed before the event or if these priors are formulated strongly by intellectual and political leaders or leading institutions. A clear example is the assessment by the World Trade Organization (WTO, 2009, p. 2) that an increase in protectionism could contribute to trade contraction. The leading publication on the 2008/9 trade collapse (Baldwin, 2009, p. 12) lists protectionism as one of the three supply shocks 'commonly broached as a cause of the great trade collapse'. These assessments have been echoed rather uncritically in many papers as if the rise in protectionism was a matter of fact.[9] Protectionism has, however, been the 'dog that did not bark' (see Wolfe, 2012; Pryke, 2012 and Bems et al., 2013). Thirdly, the full empirical cycle often cannot be run (repeatedly) and typically prediction (frequently a key element of an empirical cycle) is impossible. This implies a high risk that errors and impressions of initial assessments may not be corrected. Fourthly, scientific advice and policy actions exert impact on the socio-economic system and this creates a channel by which errors in science and policy are no longer independent (Stiglitz, 2017). (Unfortunately standard techniques to solve this problem have only been validated in iterative processes and are not of much value here.) Finally, timelines may be fundamentally different in the sense that policy makers and academics during the Great Recession could tap into the experiences of the Great Depression (it is, incidentally, not clear beforehand if this has been a benefit).

The mainstream literature appears to have sought a solution for the problems posed by the Black Swan-related imperfections of the empirical and policy cycles by relying on the use of a disaggregated approach. Indeed, performing an analysis that is in principle based on individual country experiences could offer much needed detail, prevent distortions of aggregation (such as emerging from country classifications by the international organizations that may not be helpful analytically) and, last but not least, allow for the analysis of differences in national policies.

In as far as national experiences inform and inspire theoretical analyses this can help to explain why differences of opinion develop and persist. Typically, one expects that perspectives on the crisis (on characteristics, causes and consequences) depend on the actual geographical, political and socio-economic 'location' of the observer (this is predominantly the United States) and this may be a reason for the apparent heterogeneity of the interpretations of stylized facts. So while the disaggregated approach clearly has merit, an important logical problem with this approach should be recognized: it may be vulnerable to the fallacy of composition. This book attempts to provide an alternative by keeping the focus on deglobalization as the global phenomenon that it ultimately is.

What did I learn?

Writing is thinking and learning. So what are my lessons? The major lesson is that globalization and deglobalization are recurring phases driven both by endogenous forces and by design.

We are currently experiencing a period in which increasing trade uncertainty, diminishing returns of further globalization and increasing costs of redistribution of those that gained from globalization to the discontents lead to reallocation and reduced specialization. Our own deglobalization period started with the Financial Crisis. Deglobalization occurs in international trade, foreign investment and other global financial flows, including bank lending and remittances. Deglobalization can be recognized along many dimensions (with an exception for social globalization that continues on its original growth path) and for most countries and at the global level.

On top of this wave, that is driven by purely economic forces, significant changes occur in world leadership. Handing over the role of hegemon is a painful political process for countries that lose economic power. It is therefore no accident that the strongest breaches of the move towards international integration and cooperation have first occurred in the United Kingdom and the United States, where nostalgia and a cultural clash between conservative have-nots and liberal haves provides a fertile breeding ground for economic nationalism. The politics of deglobalization are important especially since presently the backlash against globalization in contrast to the 1930s is driven by western democracies.

The current political movers of these global processes are not innocent, but deglobalization started well before they came to power. They are symptoms, because the opportunities for their election platforms arose from fragmentation and a market for populism that resulted from the Financial Crisis and its world trade collapse. As yet their power is significant, but not sufficient to enforce deglobalization towards a level encountered in the early 1950s. This would, however, change if increasingly more countries were to follow beggar-thy-neighbour policies and profit shifting strategies. A repositioning of the extent of internationalization is still manageable, but then concerted action is necessary to make the required changes in the rules and regulations of the world economic system. Those rules and regulations should allow for changes in the composition of the group of countries involved in global governance.

And they should be redesigned to meet the requirements of globalization and, as recent experiences have made crystal clear, also meet the challenges posed by a wave of deglobalization.

ENDNOTES

1 James (2017, p. 6) makes the same point for all major episodes of deglobalization that 'have occurred in the wake of a major capital market crisis'.

2 See also Sapir (2009) and Berger (2009). In the past the end of US dollar convertibility against gold has also be seen as a form of deglobalization (see, e.g., Ruggie, 1982).

3 The often followed policy to reduce the adjustment costs by means of inflation (Ruggie, 1982) is not available in the economic context of the 1930s and 2000s with actual deflation and strong deflationary pressures, respectively.

4 Alternatively imagine a ruler that arranges a change in the party and state constitutions that ensures that he or she will be in power for a long period. Now the marginal benefits curve shifts up and the optimal level of globalization increases.

5 See, e.g., Mallaby, 2016, Cerutti and Zhou, 2017, and McCauley et al., 2017.

6 See the discussion by Livesey (2018). Went (2002) provides an overview of the history of economic ideas on globalization.

7 A key question for empirical researchers is of course whether anything can be said at all. It may be the case that structural change presently is so far-reaching that econometric analysis (based as it is on past experiences) cannot be used to analyse and/or predict the impact of key economic events. This is especially true for the significant changes in economic relationships and policies (including the sudden revival of old-fashioned but appropriate Keynesian demand stabilization) as witnessed in 2008 and 2009.

8 See, e.g., Amiti and Weinstein (2011), Auboin and DiCaprio (2017), Behrens et al. (2013), Korinek et al. (2010), Levchenko et al. (2011) and Paravisini et al. (2014).

9 A recent example is Görg and Spaliara (2018, p. 150) who write: 'There have been various explanations for this trade collapse during the crisis, attributing it to strong fall in demand, a rise in protectionism, a domino effect because of global value chains, or restrictions in the access to finance for exporters'. Goldstein (1986, p. 163) points to the common over-prediction of protectionism by the economic profession, especially in the context of generally speaking liberal trade policies.