

FOREIGN AFFAIRS

JANUARY/FEBRUARY 2023 • VOLUME 102 • NUMBER 1

The Gospel of Deglobalization

What's the Cost of a Fractured World Economy?

RAGHURAM G. RAJAN

The Gospel of Deglobalization

What's the Cost of a Fractured World Economy?

RAGHURAM G. RAJAN

Homecoming: The Path to Prosperity in a Post-Global World

BY RANA FOROOHAR. Crown, 2022, 400 pp.

The Globalization Myth: Why Regions Matter

BY SHANNON K. O'NEIL. Yale University Press, 2022, 240 pp.

The most recent era of globalization seems to have come to an end. The ratio of global exports of goods and services to world GDP peaked in 2008 and has trended down ever since. According to the World Bank, foreign direct investment peaked in 2007 at 5.3 percent of world GDP and drifted down to 1.3 percent by 2020. The world's two largest economies, China and the United States, have become increasingly hostile, trying to reduce their dependence on each other for goods and services. They are not the only ones. Since the global financial crisis of 2008, there have been five times as many protectionist measures enacted across the world as there have been liberalizing ones.

And, of course, immigration remains an important issue in many countries, with nationalist parties pledging to pull up the drawbridge and keep foreigners out. Deglobalization is well underway.

In a recent speech, Janet Yellen, the U.S. treasury secretary, advocated "friend shoring," that is, restricting U.S. trade and investment to countries that share U.S. values. Two books, largely written before Yellen's speech, help assess whether friend shoring is a goal worth pursuing. In *Homecoming*, Rana Foroohar, a business columnist and editor at the *Financial Times*, says yes: the United States should not trade with countries such as China that do not share its values, and it may even want to cut back on trade with others

RAGHURAM G. RAJAN is Katherine Dusak Miller Distinguished Service Professor of Finance at the University of Chicago Booth School of Business. He was Governor of the Reserve Bank of India from 2013 to 2016 and Chief Economist and Director of Research at the International Monetary Fund from 2003 to 2006.

that do. In *The Globalization Myth*, Shannon O'Neil, a vice president at the Council on Foreign Relations and a scholar of trade and Latin America, claims that there has never been such a thing as unfettered globalization; the United States has always traded more with friendly neighbors than with distant, possibly adversarial regimes. In other words, most U.S. trade is already friendshored. O'Neil insists on the importance of maintaining and strengthening regional trade and investment. Both authors foreclose the notion of a world entirely open and connected by trade: in their view, globalization is passé, and a fragmented future lies ahead. Their claims certainly reflect a growing consensus, but the costs of giving up on globalization are immense and will be borne disproportionately by those these books pay insufficient attention to: people who live outside the developed world, the young, and future generations.

TAKE BACK CONTROL

In *Homecoming*, Foroohar highlights the flaws of a globalized world increasingly dominated by profit-maximizing multinational corporations, global supply chains focused on efficient production, and large countries such as China that don't share the United States' values. Foroohar traverses familiar territory in documenting the decline of traditional manufacturing and the disappearance of middle-income jobs in the United States as a result of either automation or outsourcing. She worries about the consequent rise in income inequality in recent decades as many people without college degrees now have to juggle multiple jobs only to earn a precarious

living, while the highly skilled make stratospheric incomes. She blames globalization, financialization, and excessive corporate concentration for the United States' ailments. To counter these developments, Foroohar, who wears her progressive inclinations on her sleeve, wants the U.S. economy to prioritize the "local rather than global, Main Street rather than Wall Street, stakeholders rather than shareholders, and small rather than big."

A number of authors have emphasized the need for more local (and thus widely distributed) economic activity to revitalize the United States. Starting with a fascinating description of new technologies such as vertical farming and 3D printing, Foroohar argues that such advances, together with strengthened traditional service sectors such as health care and home care, can allow good jobs to move away from the big cities to more semiurban and disadvantaged communities. For instance, small but efficient local vertical farms could supply much of a community's food needs, creating skilled jobs and saving on costly and energy-intensive transportation and warehousing. Apart from giving the community the economic basis for survival, the localization of good jobs also has collateral benefits, such as providing a solid basis of support for institutions such as schools and community colleges. As Foroohar puts it, "More focus on the local is actually crucial to saving what is best about globalization."

It is surprising, then, that Foroohar is much less supportive of the devolution of political power, apart from an engaging riff on how digitization can engage common people in governance.

Yes, competition from global and national markets has undermined the economic basis of local communities. But the disempowerment stemming from the centralization of regulations, standard setting, and dispute resolution that accompanies market integration has also undermined the political basis of communities. For instance, the Brexit battle cry “Take back control” reflected not only British resentment of EU immigration rules but also the United Kingdom’s inability to reject the myriad EU regulations the country had to accept in the interest of a “harmonized” market. The slogan even channeled the antipathy of local communities to obeying the dictates of a globalized London.

Of course, the world needs global agreements to deal with global problems, such as climate change. But sometimes such agreements go too far. Globalization does ride roughshod over the wishes of many people when large corporations push for a seamless uniformity across the countries they operate in. Big firms encourage governments to conclude intrusive global agreements that enforce homogeneity without the direct consent of those who will be governed by these arrangements. For example, many people in developing countries resent the 1994 Trade-Related Aspects of Intellectual Property Rights agreement because stronger patent protections raise the costs of essential medicines and pad the bottom lines of multinational pharmaceutical companies. Foroohar is therefore right when she argues that globalization is fundamentally antidemocratic, yet she wants to restrict the power of

global and even national corporations but not necessarily rein in global or national governance. Foroohar does not criticize international standard setting and rule-making. Indeed, she calls for more U.S. coordination with Europeans in setting global standards, in part to prevent China from having too much say in the standards of the future. But in the process, she underemphasizes some of the ways that globalization squashes local interests.

Similarly, within a country, the imperative of creating a seamless national market leads to national policies that disempower regional and local governments. Centralized one-size-fits-all programs and regulations are often inappropriate for local conditions. Once again, Foroohar does not question (and even favors) certain forms of centralized industrial policy in the United States, including the push toward friend shoring.

Foroohar understands that many consumers are better off because of globalization, but she wants U.S. producers, by which she typically means small firms and workers, to get a better deal. Yet even if cloaked in rhetoric about values, any protectionism that benefits small firms and workers will also simultaneously reduce foreign competition for large firms. Big companies will inevitably manipulate protectionist policies to their own advantage.

Foroohar dislikes a global trading system that helps China, which does not share U.S. values and plays by its own rules. The surest path to development in recent years, however, has been export-led growth. Such a strategy has helped not just China but also smaller economies such as those of Poland,

Singapore, South Korea, and Taiwan. As globalization fueled their growth, these countries were for the most part governed by authoritarian regimes. Any form of globalization today that insists on shared values would disrupt the growth prospects of poor developing countries, many of which have unstable, undemocratic governments. It may even prevent some of them from becoming more democratic.

The downsides of globalization highlighted in *Homecoming*, such as the disproportionate burden of adjustment that falls on people who have little capacity to bear it, are very real. But some countries have learned to live with international market forces. Scandinavian countries, for instance, have facilitated extraordinary cooperation among businesses, unions, and governments, ensuring that workers have the skills for new jobs when global competition or automation renders old ones unviable. Contrast such efforts with the feeble attempts in the United States to help workers who have lost their jobs because of trade. Maybe Americans can learn from the successes of others and find that, with globalization, they can actually have their cake and eat it, too.

LOWER FENCES MAKE GOOD NEIGHBORS

Compared with Foroohar, O'Neil is much more convinced of the virtues of trade across borders. But she insists that the notion of a world flattened by globalization is a myth. The world has never been one integrated market. Instead, regional trade and investment has always accounted for far more of a country's trade than flows to and from

distant lands. Indeed, the well-known "gravity model" of trade postulates that trade between two countries is inversely proportional to the distance between them. As the political and economic costs of trading at a distance rise, countries will rely on more regionalization, routing supply chains through neighboring countries. This, in O'Neil's view, offers the best of both worlds: it secures the benefits of globalization without the baggage, such as the headaches of trading with unreliable rivals.

O'Neil offers a defense of globalized free trade similar to the one that scores of liberal economists have been making for decades. For example, the departure of traditional manufacturing from the United States, she suggests, is not a bad thing. When U.S. companies build manufacturing facilities abroad, they make cheaper, higher-quality goods and open up foreign markets, both of which have the effect of expanding opportunities and creating jobs in the United States. Of course, these new jobs will not be the same as the jobs that were lost, and they may not be located in the same place. Workers must adjust constantly, a reality that is a source of volatility and anxiety. Unlike many liberal economists, however, O'Neil does not dismiss these costs as something that can be easily taken care of by reallocating the profits from trade—which rarely happens in reality. The benefits of globalization have been uneven, and many who have suffered the loss of their jobs or the hollowing out of their communities are justifiably angry.

According to O'Neil, these costs are much smaller when trade occurs at a more regional scale. In contrast to the



Precious cargo: unloading masks from China, Leipzig, Germany, April 2020

loss of two million or so manufacturing jobs the United States caused by importing goods from China in the first decade of this century, job losses and their adverse effects on community health were far more muted under NAFTA, the 1994 trade agreement between Canada, Mexico, and the United States. Regional supply chains increase work for everyone in the region since the supply chains snake in and out of all the countries involved, making use of each country's comparative advantage.

On average, 40 percent of U.S. imports from Mexico are made in the United States, and 25 percent of U.S. imports from Canada are made in the United States. By contrast, on average, only four percent of a product coming from China into the United States is made in the United States, which may explain why trade with China has produced more job losses for American

workers than has trade within North America. Of course, these numbers do not account for any jobs created in the United States over the last mile, in transportation, retail, and financing, for instance, to help Chinese-made goods reach U.S. consumers. They also do not account for any jobs created in connection with U.S. goods that China imports (think of Boeing airplanes). But they offer a neat representation of the difference between regional trade and trading at a distance.

O'Neil argues that the danger of the recent moves toward deglobalization is that countries may throw out the baby of regional trade with the bath water of globalization. She fears this will happen even though the United States is poised to benefit from the next wave of globalization, which will be driven by ideas and innovation and will favor the better-paid, better-educated, and relatively young U.S. workforce.

Foroohar and O'Neil reach the same place—regionalization—but differ on how to get there. Foroohar wants government to push companies to shrink their global footprint because she fears that profit-maximizing companies do not sufficiently value resilience and are all too willing to run vulnerable portions of their supply chains through strategic rivals such as China. O'Neil argues that companies have already been diversifying regionally to build more resilient supply chains. Further protectionism could end up hampering regionalization, she believes, and make the United States worse off.

GLOBAL WARMING IS GLOBAL

And yet these visions of a deglobalized world will offer cold comfort to many people. A future of friend shoring and regionalization will split the globe into blocs, including a North American bloc centered on the United States, an East Asian bloc centered on China, and a European bloc. Both books highlight the benefits of regionalization to those in the regional blocs. But what happens to the rest of the world?

Deglobalization has many costs, some of which are already evident. They include the higher cost of goods and services as production no longer takes place in the most efficient locations, the loss of scale economies as production becomes fragmented, the increase in the power of domestic oligopolies as global competition is restrained, the decline of learning by doing as multinational corporations no longer spread best practices, and the rise in inflationary pressures as local supply-demand imbalances are no longer tempered by a global market.

Rather than revisiting these, consider a cost that the world can no longer afford to ignore—the way deglobalization into isolated regions might hamper attempts to deal with climate change, the existential global challenge of the age.

Climate action falls into three categories: mitigating harm to the environment by reducing emissions, adapting to changes in the climate, and allowing migration to better climes. The sequence is important, as each category of action bears more of the burden if less is done in the previous ones. For instance, if countries do nothing at all on mitigation and adaptation, expect hundreds of millions of refugees to flee their unlivable tropical native lands for lands farther away from the equator.

All three kinds of action require continued globalization. Take emissions, for example. Any serious commitment to make cuts will be painful for all who undertake them. And geopolitical rivalry will make everything even more difficult. How can China and the United States agree to meaningful emission cuts without each sensing the other is securing an economic advantage?

Surely, ongoing trade and investment between the two countries facilitates such agreement by giving them more reasons and occasions to talk to and understand each other and more chips with which to barter: a technology transfer here in return for an emission commitment there, for instance. Both sides would also have something to lose if they did not cooperate. Mutual openness, including the free movement of businesspeople, tourists, and officials across countries, will also make

it easier to monitor climate action. Deglobalization and decoupling will only make it harder to know what others are doing or not doing.

Regionalization will hinder the production, investment, and innovation necessary to replace carbon-intensive production processes with climate-friendly ones. Take, for instance, battery production, which is necessary to store the power from sustainable energy sources. Lithium, nickel, and cobalt are the key metals used to make batteries, and the last two are projected to be in short supply within the decade, as are the rare earths used for the motors of electric vehicles. Global battery production would suffer if manufacturers sourced these commodities only from within their regions or from countries that share the values of their own. Much of the existing mining for these commodities is in conflict-ridden countries such as the Democratic Republic of the Congo, and much of the existing refining is done in China. Although each region will want to reduce interdependence, isolation would incur enormous costs. Regionalization would severely limit production capacity and increase production costs over the foreseeable future, a period when delays will reduce the chance of keeping global average temperatures below the critical threshold of 1.5 degrees Celsius above pre-industrial temperatures.

Adaptation to climate change will also be harder in a deglobalized, regionalized world. Planet heating will make it harder to grow traditional crops in the tropics using traditional methods—as demonstrated by the floods that devastated Pakistan last year. New crops and new technolo-

gies will help but will require investment and financing. Many developing countries outside the major regional blocs, however, will find it hard to secure such funding.

Even if farmers do their best to adapt, agriculture will become unprofitable for many in the tropics. They will have to look for new livelihoods outside of agriculture, which will require an acceleration in economic development. The surest way for countries to develop is to export their way to growth, benefiting from dependable demand in the more developed, and less heat-affected, world. Rising protectionist barriers in more developed regions will impede growth in Africa and South Asia, thereby limiting the ability of their people to adapt.

Reshoring supply chains entirely within a country or even a region would also increase its exposure to climate catastrophes and other risks. Greater resilience will be possible through geographic diversification. Ideally, every segment of the supply chain would draw on multiple suppliers across different regions and continents, giving them the ability to shift quickly from a supplier hit by a climate disaster to a supplier elsewhere.

Interestingly, surgical mask production during the pandemic, something both authors touch on, exemplifies the value of geographic diversification and flexibility. O'Neil points out that China contained the early strains of the COVID-19 virus relatively quickly. As a result, while the rest of the world was closing down, it was able to ramp up production of masks. In the spring of 2020, it exported more than three times the number of masks that were

made in the entire world in 2019. Foroohar writes about how a group of U.S. clothing factories organized to produce masks. With the help of machinery imported from Taiwan and Europe, existing textile production chains were flexibly repurposed to make masks. The examples are powerful, but they support continued globalization, not fragmentation into regions. Production capacities in both China and the United States, when capable of being repurposed and scaled up to supply a global market, offer the world more resilience than any single regional market could.

Similarly, in the case of commodities, especially critical ones such as food and energy, the best form of insurance against disruption is the existence of a well-connected, freely accessible global market where shortages can be smoothed over and no producer has undue leverage. The more local or regional the market, the harder it will be hit by severe weather, a malevolent rival, or other disruptions.

When mitigation and adaptation fail, people in badly affected areas will be forced to migrate. If countries do little on mitigation and adaptation, the scale of migration will be unprecedented. It would be myopic for mildly affected regions to assume they will live comfortably behind border walls. They will find it hard to ignore the humanitarian tragedy occurring outside. No matter how deglobalized, decoupled, localized, or regionalized such places wish to remain, desperate climate refugees will climb or break down any wall. Instead, governments should reach global agreements about how to place

climate refugees in countries that can absorb them best and how to provide them with job training and language instruction so they can be productive when they do eventually migrate. Once again, such tasks will be better advanced by continued globalization than by regional fragmentation.

A DISASTROUS RETREAT

Foroohar and O'Neil offer different views of friend shoring and reshoring. Foroohar wants more of it for the United States, whereas O'Neil believes the country has already been pushed by economics toward regionalization. She fears political trends will lead to further harmful isolation. That Yellen, a confirmed internationalist, has counseled friend shoring suggests how strong the political tides are in favor of this turn away from globalization.

Both books are valuable contributions to the understanding of the trends toward regionalization. They do not, however, adequately address how these trends will affect the existential challenge of our time—climate change—or about what regionalization would mean for the developing world. From the perspective of those living in the major regional blocs, regionalization is a problem because it hampers climate action. For those outside the major regional blocs, regionalization will be a calamity; once protectionism gets rolling, it can spread in leaps and bounds, and the disastrous retreat into walled regions will proceed apace. Faced with an existential threat, humanity will eventually realize it needs improved globalization, not less globalization—and the sooner, the better. 🌐