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The Fate of Globalization

| Dr. Alan Greenspan, Senior Economic Advisor | April 2022

In The Age of Turbulence, I opined that World War I was more devastating to civility and civilization than the physically far more destructive World War II: the earlier conflict destroyed an idea. I cannot erase the thought of those pre-World War I years when the future of mankind appeared unencumbered and without limit. I still have a book from my student days, Economics and the Public Welfare, in which retired economist Benjamin Anderson evoked the idealism and optimism of that lost era in a way I've never forgotten: *"Those who have an adult's recollection and an adult's understanding of the world which preceded the first World War look back upon it with a great nostalgia. There was a sense of security then which has never since existed. Progress was generally taken for granted … Decade after decade had seen increasing political freedom, the progressive spread of democratic institutions, the steady lifting of the standard of life for the masses of men."*

The end of WWII ushered in a period of progress similar to that which preceded WWI: *Individual economies grow and prosper as their inhabitants learn to specialize and engage in the division of labor. So it also is on a global scale. Globalization—the deepening of specialization and the extension of the division of labor beyond national borders - is patently a key to understanding much of our post-WWII economic history. A growing global capacity to conduct transactions and take risks throughout the world has created a truly global economy across finance, manufacturing, services, technology, institutions, and people. Production has become increasingly international. Much of what is assembled in final salable form in one country increasingly consists of components from many continents, often with assembly from others. The ability to seek the most competitive sources of labor and material inputs worldwide rather than only nationwide not only reduces costs and price inflation but also raises the ratio of the value of outputs to inputs - the broadest measure of productivity and a useful proxy for standards of living. On average, international standards of living have risen markedly. Hundreds of millions of people in developing countries have been elevated from subsistence poverty. Further hundreds of millions are experiencing a level of affluence that, scant decades earlier, only those born in developed nations could hope to achieve*.

Two threats to the present era of globalization have emerged – one that is fairly straightforward and one that is far more insidious. The first is the COVID-19 pandemic. As country after country locked down in an attempt to contain the virus, the fragility of our interconnected supply chains and "just in time" inventory management methods were exposed. The bottlenecks and backlogs

created by this exogenous shock are still being felt some two years after the initial outbreak in the form of record setting figures on inflation. New lockdowns in Shanghai show that while we have learned to cope with COVID to a certain degree, we have further adjustments to make. This threat will certainly slow the progress of globalization, for instance in greater deliberateness in the diversification of supply chains. However, whereas COVID led to questions regarding best practice in the execution of globalization, the fallout from the Russia-Ukraine conflict challenges the tenability of the very idea of globalization itself.

It is not the invasion per se – Russia invaded Ukraine in 2014 and has a history of "special operations" in neighboring countries – but rather the West's response to the atrocities committed in Ukraine that has changed the international landscape. The invasion of Ukraine has sparked unprecedented economic sanctions from the West that will be felt by both sides. Russia now has oil and gas that Western countries will seek to avoid, $140 billion in gold reserves that will be much more difficult to offload, and has simultaneously lost access to crucial foreign goods, services, and markets. Their foreign reserves have been frozen, causing an inability to pay their outstanding sovereign debt. Meanwhile, the rest of the world faces increasing challenges including shocks to the oil market and the frightening possibility of a global food shortage as Ukraine, the "breadbasket of the world" will be unable to deliver its usual crops worldwide due to the Russian invasion.

While the effects of the Russian sanctions will reverberate for some time, the true threat to globalization comes from the fact that China, the world's second largest economy, is surely watching and weighing its own relationship to the post-WWII world order. China also has an authoritarian government and has made no secret of its desire to eventually annex Taiwan back into the fold. While China has made no major moves to overtly assist Russia in dodging Western sanctions, its relative silence on the conflict speaks volumes. Russia believed it had sanction-proofed its economy, perhaps thinking the West would be unable or unwilling to band together and go so far as to sacrifice economic growth in the name of defending its ideals. Both China as well as Western companies that depend on its factories and covet its potential market have undoubtedly gleaned some lessons from Russia's ordeal. To mitigate future risks, companies on both sides are likely to favor counterparties that may ultimately be more expensive but are in ideologically aligned countries that present less risk for sanctions. This process may take time but the currents driving it do not appear easily reversible and could emerge as a true threat to the trend toward increasing globalization witnessed in the post-WWII era.

Alan Greenspan served five terms as chairman of the Board of Governors of the Federal Reserve System from August 11, 1987, when he was first appointed by President Ronald Reagan. His last term ended on January 31, 2006. He was appointed chairman by four different presidents.

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