PGIM FIXED INCOME

PGIM India Mutual Fund

Global Macro Matters

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Globalization 2.0—A New Synthesis

As this century dawned, the forces driving globalization seemed inevitable, inexorable, and broadly desirable. An array of evolving technologies was making the world smaller and national borders more fuzzy. These included information and communication capacities, most notably the worldwide web. In addition, there was an expectation that increased global competition and access to international markets would enhance the underlying efficiency of national economies.

As a philosophical matter, policymakers were committed to continuing economic and financial integration. Free trade was viewed as a key driver of global growth, and openness to capital flows was thought to support the development and efficiency of the financial sector. Immigration, while the subject of much political debate, was generally seen as an established plank of economic policy. The ongoing integration of the European economies, including the introduction of the euro in 1999, was in many ways a manifestation of these forces. The European project was predicated on the "four freedoms"—free movement of goods, capital, services, and labor.

Summarizing such observations, Ben Bernanke noted in 2006:

> *By almost any economically relevant metric, distances have shrunk considerably in recent decades. As a consequence, economically speaking, Wausau [Wisconsin] and Wuhan [China] are today closer and more interdependent than ever before. Economic and technological changes are likely to shrink effective distances still further in coming years, creating the potential for continued improvements in productivity and living standards and for a reduction in global poverty.*[1]

Today, however, the prospects for globalization have shifted appreciably. The shrinking of "effective distances" has slowed and, in some dimensions, even reversed. Globalization is now criticized in many quarters as having failed to deliver on its promises—in terms of both the pace of growth and the distribution of gains across society. The economic expansion in the aftermath of the global financial crisis, although distinguished by its longevity, brought growth rates that were more muted than those following other downturns.

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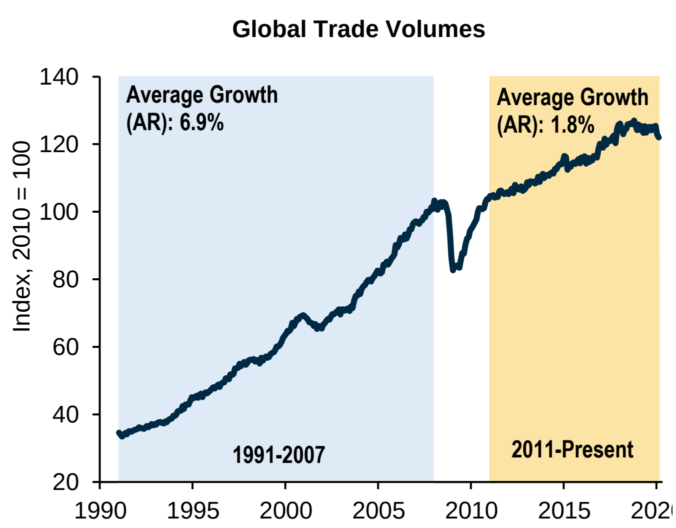
[1] *"Global Economic Integration: What's New and What's Not," August 2006.*

The Critique of Globalization

In many countries, there is today a sense that the gains from globalization have been disproportionately harvested by wealthy elites. In contrast, the working classes have faced increasingly stiff competition for employment from abroad, particularly from China, and there is a sense that too many jobs have been outsourced. Immigration has been criticized for squeezing job opportunities for the native-born population. For good measure, many policymakers in both advanced and emerging-market economies now view inflows of foreign capital more warily, with even the IMF accepting capital controls in some instances.

Moreover, in the years since the global financial crisis, international trade has been a less powerful engine of economic growth. As shown in the figure, from 1991-2007, global trade volumes expanded by 6.9% a year on average, but slowed to growth of just 1.8% a year following the crisis. Since 2018, when President Trump kicked off his trade war in earnest, global trade volumes have flattened further.

Figure 1: Global Trade Volumes Reflect the Pause in Globalization



Source: PGIM Fixed Income, Haver Analytics

There is little doubt that globalization has created distinct winners and losers. For example, PGIM Fixed Income research shows that, in the decade following the financial crisis, jobs created in the United States tended to be either in attractive high-paying jobs (management, computers, business and finance, and healthcare professions) or in low-paying fields (particularly food preparation and personal services). The center of the wage distribution, which included the lion's share of middle-class jobs, has largely been hollowed out.[2] Similarly, measures of U.S. income and wealth inequality in recent years have climbed to their highest levels of the post-war era. Although these dynamics have not been as acute in many other countries, similar underlying forces have been at work, with broad swaths of the population feeling left behind.

This economic critique has been accompanied by a social critique, which has arisen from segments of the population emphasizing the importance of preserving national identity, culture, and the prerogatives of sovereignty. The concern is that globalization's centripetal forces are moving too quickly—too much is changing too rapidly. At root is a deep question of what it means to be a "nation" in a world of global technologies, communication, and transportation.[3] The advisability of immigration, and if so at what pace, is at the core of many of these debates.

This skepticism toward globalization has manifested itself in the politics of many countries. These themes have been front and center in Britain's Brexit debate. They have also been espoused by the populist movements in continental Europe and been debated there in domestic elections. Packaged in various ways, such themes have been championed in the United States by both Donald Trump and Bernie Sanders. Arguably, these themes have even echoed into the politics of emerging-market economies, including AMLO's left-wing populism in Mexico and Jair Bolsonaro's right-wing populism in Brazil.

Two Recent Challenges

Over the past couple of years, the headwinds impeding globalization have been amplified by two new challenges—President Trump's trade war and the onslaught of the coronavirus.

[2] *For more details see, N. Sheets and G. Jiranek, "[The Great 'Hollowing Out' of the U.S. Job Market](),"* June 2019.

[3] *For a further discussion of these issues see, PGIM, "The End of Sovereignty?", Spring 2018.*

The trade war strikes us as rooted in many of the factors outlined above. The virus, in contrast, seems largely new and exogenous.

Our sense is that the trade war has thrown some key elements of globalization into retreat. First, it has disrupted trade flows between the United States and China, the world's two largest economies. This has contributed importantly to the recent flattening in global trade noted above. Second, the resulting tensions have strained the U.S.-China relationship more broadly and reduced the capacity of the two countries to work together on other issues. Third, the trade war has introduced tariffs as a tool of economic policy in a new and qualitatively different way. To date, China and other countries facing U.S. tariffs have limited their response to retaliatory tariffs, and they have not used tariffs in President Trump's proactive and aggressive manner. But there is a risk that this might yet happen.

More generally, the trade war highlights the U.S. Administration's ambivalence about U.S. leadership in the international economy. The President has voiced concern that in the past the United States unnecessarily compromised its best interests to advance the global order. Whether or not this critique is accurate, the Administration's reluctance to provide global leadership has left key groups like the G-7 and G-20 rudderless during challenging episodes. More deeply, the unilateral nature of the trade war—and its marked divergence from the established international consensus—may have undercut the perceived legitimacy of the United States and its capacity to lead internationally.

Similarly, the coronavirus has prompted countries to close their borders and look inward to protect the health of their citizens. This has shut down a wide range of global inflows, including travel, tourism, and services trade, and reinforced the role and responsibility of individual nations to defend the welfare of their citizens. If globalization was tending to make national borders more fuzzy, the virus is hardening those borders again. Loosening border restrictions is likely to be among the last actions that countries take as they eventually heal from the virus' disruptions.

In addition, both the trade war and the coronavirus have highlighted unexpected risks embedded in global supply chains, especially those concentrated in China. In response, as economic activity rebounds, we expect that firms will seek to diversify the global dimensions of their production to avoid inordinate dependence on any single country. Further, for some companies, the prospect of consolidating their supply chains domestically may be increasingly attractive; this could be particularly true for U.S. firms. Whether economic realities permit such action will vary widely across industries, firms, and countries. Separately, in the name of essential security, governments may now require the domestic production of some goods, including pharmaceuticals and other medical products. The extent to which any re-profiling of supply chains represents an efficiency loss for the global economy—versus a prudent risk-management measure—remains an open issue.

Achieving a New Synthesis

So, given these wide-ranging considerations, where is globalization headed? Our sense is that the jury is still out, but two competing dynamics appear to be at work. On the one hand, the consensus that prevailed as the century dawned still holds more than a grain of truth. Technology, the availability of information, and the desire to expand the scale of production and the size of markets are powerful forces that will tend to bring the world closer together. On the other hand, globalization no longer has an aura of inevitability. It has not delivered all that was previously promised and, as a related matter, sovereign states are again flexing their muscles. In addition, the experience with coronavirus highlights that countries have responsibilities to their citizens, including to protect their health and welfare, and these might, at least at times, blunt global integration.

We expect that these competing forces will, over time, lead to a new synthesis and, likely, to a reframing of globalization. We expect that globalization 2.0 will be a notch less ambitious or, some might say, a notch more pragmatic. It is likely to be more thoughtful about possible social disruptions and the pace of change, and it will show more sensitivity to distributional consequences. Even so, the specifics of this synthesis will require years of debate and, probably, accumulated experience to hammer out. There is much work to be done. In the interim, globalization is likely to continue to face a tough uphill slog.

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