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# AN IDEAS-BASED GLOBALIZATION

## Global Economic Governance is Collapsing but Globalization is Thriving


### Summary

Is globalization dying? There is good news and bad news. Let us start with the bad: the world and global politics are in a bad shape, and the post-war framework for international economic governance is no exception. The International Monetary Fund, the World Bank, the OECD and other bodies relating to economic development are all sliding into oblivion. Members of the World Trade Organization (WTO) no longer consider it a relevant arena for trade negotiation. The network of trade rules that the WTO maintains is under great pressure.

Behind this unfortunate development stands decaying political leadership from Western governments and widespread neglect by rising powers. Worryingly, the pandemic and its economic fallout will likely accelerate the pace of institutional corrosion. No political leader offers global leadership. No Western country seems to have a strategy for the world beyond "muddling through".

The good news is that real, on-the-ground globalization is increasing in pace. Merchandise trade has dropped during the period of COVID-19 lockdown but will recover in the years to come. For a few years now, however, there has been a shift in the pattern of globalization – with the real forces of growth in global commerce coming from digital services and "trade in ideas". They will remain the sources of globalization growth for years to come – and they are very difficult to stop for politicians with protectionist instincts. While it is a relatively straightforward exercise to put high tariffs on the imports of steel and chemicals, it is something completely different to stop exchange in ideas – for example, R&D collaboration; the sharing of new knowledge, technology and innovations – and the imitation through global organizations of business models and management practices.

This is no time to be sanguine about the risk for protectionism. Nor should we underestimate the power of modern globalization. Real economic exchange is likely to grow even if global economic governance is breaking down.



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## The world is unwell

Most parts of the world are fighting a pandemic that, so far, has exacerbated frictions and conflicts that have evolved over a long period of time. The United States is heading towards a crisis of order and governance – triggered in part by a reckless president who is at war with domestic institutions and political norms. President Trump sees no global dependency for the US that he does not want to upend. Meanwhile, China has ramped up political and social control, sharpening its authoritarianism even more. It believes the pandemic has given it a new opportunity to shine on the global stage – creating new loyalties to Beijing. Both China and the US continue to accelerate the strategic conflict between them.

Europe is fighting its own disorder. Most member states have become more introspective in the recent decade. During the pandemic, export curbs were slapped on internal trade in some medical goods, thus breaking with the norms of the single market as well as human empathy. Germany, for instance, banned the export of face masks to Italy. To add insult to injury, requests of medical assistance from one member state to others were initially met with silence. In April, Ursula von der Leyen, the Commission President, felt she had to go as far as issuing an apology to Italy on behalf of the EU. When the crisis hit Italy, Europe hadn't been on its side.

Now the European Commission is trying to make amends and in the process jockeying itself into a new position in the post-pandemic world. It has done so by reviving some old and familiar tunes – the evergreens of Europe's centralist version of federalism: a vastly expanded EU budget, "own resources" for the EU (meaning the right to take up taxes and fees directly), and a wholesale takeover of EU commercial policy by French-style mercantilism. While there are merits to the claim that other countries should help countries such as Italy with financial assistance, this is something else. Inevitably, all these propositions will lead to huge internal frictions in the years to come.

Other powers are not faring better. India's Prime Minister, Narenda Modi, is stoking a domestic culture war – one that he thinks will benefit his brand of Hindu nationalism. Throughout the pandemic, Brazil's Jair Bolsonaro has confirmed his reputation of being the less competent version of Donald Trump. The UK's Boris Johnson has been riding high in the polls, partly supported by public sympathy for his own COVID-19 experience, but his government is appearing increasingly shambolic. Its ambition for post-Brexit Britain is startling. Britain left Club Europe to make its own way in the world as an agile, innovative and free-trading economic power. It wanted no longer to be "shackled to the corpse" of the European economy, or so we were told. Now it is sprinkling cash on firms and wants to boost public spending, seemingly unbothered by the prospect of having tariffs put on trade with Europe again. Britain, it seems, left Europe to become more like France.

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If there was ever a moment for decisive reforms of global economic institutions, this is not it. All the Bretton Woods institutions have been conspicuously absent in this crisis, despite a tanking world economy and risks of proliferating economic nationalism. The World Trade Organization maintains its network of trade rules, but the integrity and relevance of this institution itself have been on a decline for 15 years or more. The International Monetary Fund is missing in action – just like the World Bank and the OECD. Neither the G7 nor the G20 have convened to thrash out common responses to the economic fallout of the pandemic.

No country is offering global economic leadership. Trump is a disrupter who wants to move fast and break things, including the post-war economic architecture. China has not made up its mind whether it wants to erode post-war norms and institutions for international economic governance – especially with their reliance on free-market principles – or if it would be a benefit for making them relevant again. Europe is occupied with itself. The EU is on a downward trajectory but no one has a realistic idea for how to break the negative trend. It is impossible for its leaders to have an adult conversation about the economic and political realities of Italy and Greece inside the euro: too much honesty would literally break the bank, or at least throw Italy to the wolves of the bond market. Germany is failing on most of its strategic objectives for Europe, including its ambition to bring fiscal rigueur to the Club Med. Britain is out. France, as usual, is everywhere and nowhere at the same time. Brussels is stuck in bureaucratic introspection. No one really seems to have a strategy about anything: we are just "muddling through".

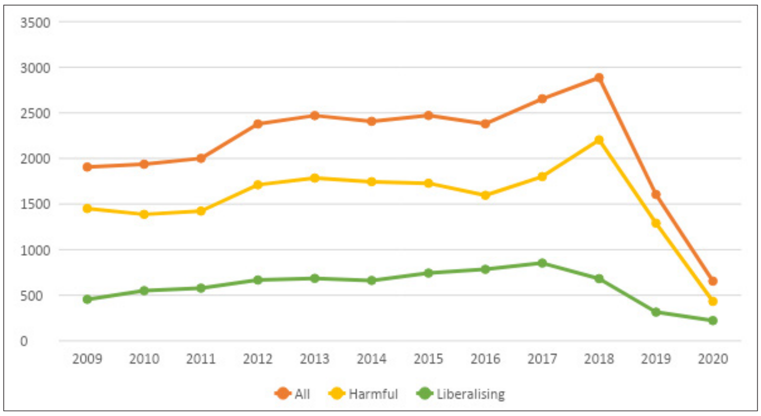
## The change in the nature of globalization

Now to the good news: trade policy may be in poor health, but cross-border commerce is not. The global economic architecture may be on an irreversible course to oblivion, but there is little suggesting that globalization is dying or that governments are about to fracture it to such a degree that we would lose its fundamental economic essence: that national market and factor prices reflect global prices. Yes, there are worrying trends, but the main point is this: globalization is changing and has been for quite some time.

Let us start with trade liberalization and protectionism. While it is true that trade negotiations have not delivered much consequential results for a long time – the last time that a multilateral round of trade negotiations finished successfully was in 1994 – but trade has remained a powerful engine for prosperity. Ever since the end of the financial crisis, global trade has been humming along. There was an immediate recovery in 2010 and 2011 that returned world trade to pre-crisis levels, but trade growth has continued in the post-recovery period and, helped by generally high levels of demand in the world economy, continued to support jobs and private-sector growth. Globally, merchandise exports and imports have been growing by 20 percent since 2012 – even if the pace of growth petered out in the two years prior to the pandemic. A similar pattern can be found for the EU. It's total trade (goods and services) is up by two thirds since the global financial crisis of 2009.

Both trade liberalism and protectionism have been on the rise. The Global Trade Alert tracks new trade-policy interventions. Figure 1 below shows the number of liberalizing and harmful measures introduced since the financial crisis. It shows a pretty stable development for both liberalizing and harmful measures, with the number of harmful measures consistently outweighing the number of liberalizing measures. Two significant observations are the rise in both liberalizing and harmful measures between 2016 and 2018, and the decline in both measures since 2018. On current trend, 2020 will be the year of the fewest harmful trade interventions since the financial crisis.

**Figure 1**: Liberalizing and Harmful Trade Policy Interventions in the World




*Source: Global Trade Alert database*

The bilateral nature of many new protectionist initiatives also reduces their potency. President Trump has disrupted trade relations – with Canada, China, Europe, Mexico and more. For most of the time, however, Trump's protectionist measures have attacked only one country. This is less worrying compared to measures that attack everyone: the trade that gets lost when bilateral measures are introduced is usually substituted by other trade. Obviously, this is not optimal: an effective exporter gets substituted by a less effective exporter. So far, most firms whose import sourcing have been attacked have managed the substitution without significant efficiency losses. Trump's protectionism has not had much of an impact on domestic prices.

What it has done, however, is to reduce US production. Trump's trade war with China is a good example of how protectionism usually backfires. Obviously, the trade war has had the effect of reducing trade between the two states. Between 2017 and 2019, US exports to China went down by 18 percent while China's exports to the US declined by 11 percent – leading to a growing bilateral trade deficit for th US. Moreover, it has caused America's share of total global trade to drop too.

So, globalization is not dying, but it is going through a period of structural change. Take a look at the data. Figure 2 below lays out the development over time for growth in global trade, divided up between different forms of trade. First, the growth of merchandise trade has slowed down markedly since 2014, reflecting macroeconomic rebalancing in the world economy and less appetite for continued globalization of supply chains. It is not the growth of trade in goods that has completely stalled, but rather that it is no longer powered by the factors that made merchandise trade to grow by 7-8 percent annually for several decades. China's entry into the world economy and the fragmentation of supply chains were the two main factors behind rapid trade growth in the 1990s and 2000s. But China's economy has now matured, and there is not another economy on the doorstep of the world economy that can boost new trade. Moreover, once the big change in patterns of production and outsourcing have happened, it cannot be done again: ”the soufflé cannot rise twice”. Companies continue to change the location of production and their pattern of sourcing, and that is part of a constant process to optimize production, get closer to end markets and utilize the benefits of trade. But they are not moving production out of the home market in the same way companies did before.

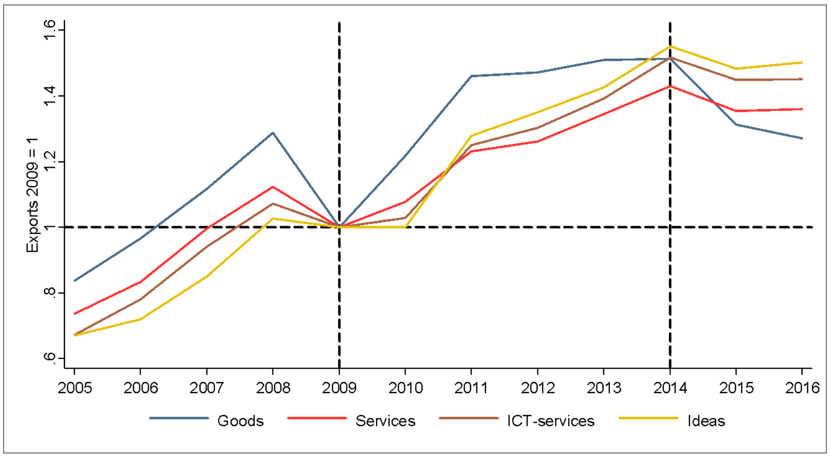



**Figure 2:** Growth patterns in trade and globalization 2005-2016 (2009=1)

*Source:* Erik van der Marel, *Estimating the Economic Impact of Restrictions on Data Flows: Productivity, Trade and Innovation*, ECIPE 2019

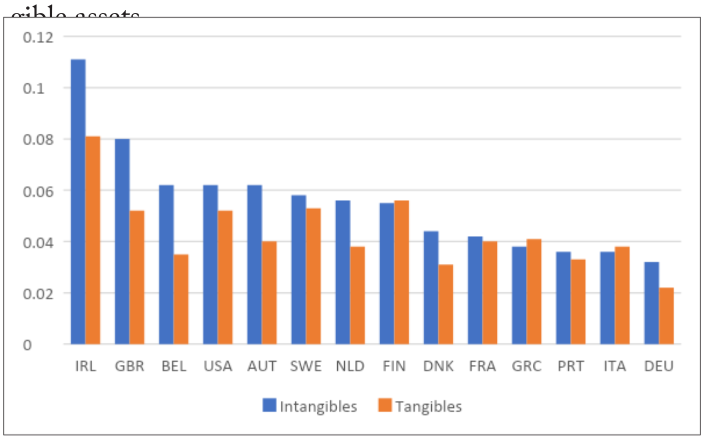
## Towards an ideas-based globalization

What is more interesting, however, is that non-goods forms of trade have been growing faster since 2014. If anything, cross-border economic exchange has increased its influence on the global economy by relying far more on growth in ideas exchange: exchange involving R&D, innovation, technology and knowledge transfers, management imitation and new patterns of digital commercial interaction.

The pandemic has ushered in a new degree of intensity in ideas-based exchange. Take the pharmaceutical sector, for example, where various global networks of firms, universities, governments and foundations are now involved in developing coronavirus vaccines and treatments. There is a lot more cross-border exchange of ideas now and most governments are keen to learn from others – from best practices – in how to control the reproduction of the virus in society. Some of these exchanges are monetized, while others are not. Most of them will never get recorded as trade, but they are a central part of what constitute modern globalization.

Figure 2 shows that trade has grown faster in ICT services and ideas than in goods since 2014. Obviously, trade in ICT services have been boosted by the whole wave of digitalization. What is less obvious is that trade in ideas also has started to grow faster. Flows of ideas are an ambiguous phenomenon. Most workers experience it constantly, but it is difficult to give it a precise definition. Moreover, given poor data availability, it is nigh on impossible to quantify. Figure 3 above is no exception: it builds only on recorded transactions in the balance of payments, such as royalties. Everything suggests it has grown faster than the data indicates. The US Congressional Research Service has estimated that US exports to the EU in ICT and potentially ICT enabled services amount to 190 billion US dollars, which is almost 15 percent of total trade between the two partners. Total US exports of ICT enabled services was estimated at 439 billion US dollars, hitting almost 18 percent of total US exports.[1]

To get a better understanding of trade in ideas, we have to start by looking at the growth of the intangible economy and digitalization. Both these factors are leading to changing patterns of cross-border exchange and workplace interaction. Intangible assets include a variety of assets like the stock of patents, brands, R&D, software and distribution networks – all these actors are increasingly important to economic development. These assets – and investments in them – nowadays define much of the productivity growth in modern economies, partly because they represent new knowledge, innovation capacities and the ability to push the technological frontier. As Figure 3 shows, the growth rate for intangible assets is higher than the growth in tangible assets.




Source: OECD

Intangibles get powered by digitalization because new technologies for interaction across borders have opened up for greater utilization in intangible assets. People can interact by e-mail or use professional platforms to have a constant flow of ideas, both between organizations or within an organization. Large companies especially work with cross-border teams for purposes of R&D, product development, market offerings, marketing strategies and more. These new ways of working are commonplace, but most of the time there are no records that track the economic and commercial significance of these interactions. It is just standard operating procedure.

What is clear, however, is that these interactions are increasingly generating value. These flows transfer as much knowledge as standard forms of trade when a formal exchange takes place. Trade economists have always put a

1 https://fas.org/sgp/crs/misc/R44565.pdf

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great value on the role that trade and investment have for “technology transfer”. Trade can improve the static allocation of resources in an economy, but what is far more important is that trade and investment allow firms and economies to access technology and knowledge that they otherwise would not have access to. They would be saddled with whatever offering incumbent firms would have.

Thus, the broader picture shows that cross-border interactions help workers and firms to imitate productive and successful economic behaviour from other countries and units; and imitation is a critical part of the ideas-based economy. It is a learning process in which all parts of a firm get exposed to other forms of production and market behaviour. Management and managing teams in all firms spend a great part of their time to channel information that is necessary for positive imitation. Firms that operate on multiple markets are ever more dependent on coordination between markets. Modern factory-floor teams spend a growing part of their working time interacting with peers in other factories to learn from them or to share positive experiences with them. Consequently, the ideas-based economy – and trade in ideas – is a phenomenon that affects all sectors.

As innovation and product development become more central for the competitiveness of a firm, the ideas-based economy gets a boost. The economic power of innovation lies not only in the creation of the new idea itself, but in its use and how it forces other organizations to learn from the innovating firm. Innovations these days tend to foster many more cross-border interactions than they did in the past. With fragmented production structures, there are more units than before that have to learn from and adjust to new innovations. With presence in more markets, there has been a growth in the efforts that firms must make in order to ensure that a new innovation can be marketed – and that is just developments inside a firm. What is perhaps even more demanding is that firms need to keep track of the development in many different sectors – not just among their immediate competitors – and be prepared to quickly take onboard key innovations outside their own market territory. If they do not, the risk is that another competitor will.

Trade in ideas has not just grown faster than what is recorded in Figure 2; it will continue to accelerate, regardless of the pandemic. President Trump or President Macron cannot stop it. A growing part of the welfare that an economy generates will crucially depend on firms’ and organizations’ abilities to develop on the basis of current trends of diffusion in technology, innovation, knowledge and organizational behaviour. Obviously, this presents new challenges for policymakers. Trade liberalism and protectionism are traditionally part of a silo-structured world concept where policymakers deal with issues in goods, services and rules. Many of the formulas of trade policy simply do not capture the types of commercial interaction that are now growing fast, and in a world where politicians are warming to the ideas of economic nationalism, this is comforting.

## Moving forward

The point with all this is not to be sanguine about global trade or to dismiss fears about growing protectionism. Trump would not be Trump if he did not attempt new disruption of free trade; and France would not be France if it did not use the current opportunity to mold European commercial policy in its image. "There is a great deal of ruin in a nation", wrote Adam Smith, and one can imagine scenarios of rapidly rising protectionism in China, Europe and the US.

But there are counter forces to protectionism, and they are powerful. One is the basic principle of "an eye for an eye": if you hurt my exports, I hurt yours. More constructively, as digitalization will continue to increase its economic power, it will also prompt a lot more cross-border economic integration. Ideas-based forms of globalization are accelerating, and it is very hard to stop it. It is still harder to stop it without inflicting a lot of damage on your own economy, and that is the key point: stopping the forces that are powering modern globalization is extremely costly.

It is unfortunate that institutions of global economic governance have lost their relevance. But that process started a long while ago and only a small part of the blame could be laid at the doorstep of the White House. A far greater challenge for international trade policy is that the real economy runs past it and makes some of its habits and practices obsolete. Far too many got used to thinking about global economic exchange in a top-down manner, as if new trade were only caused by the results of trade negotiations. The reality is that trade policy lost its capacity to effect real and positive outcomes a long time ago. Trade liberalization most often happens autonomously – through domestic economic reforms pursued in the interest of making your economy more prosperous. New bilateral and sectoral trade deals make positive contributions to trade freedoms and growth – and a strong case can be made for reviving multilateral trade liberalization. However, the more that real globalization has moved away from goods trade and tariffs, the less the impact of trade agreements on actual trade flows. Globalization will not stop just because past models of trade governance are breaking down.

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