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Beware Of Declarations Portending Russia's War Is The End Of Globalization

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Russia's President Vladimir Putin with his Defense Minister and Navy Commander in Chief.
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It is hard to miss the headlines proclaiming that Vladimir Putin's invasion of Ukraine and the subsequent imposition by the West of massive sanctions on Moscow mark the close of the era of economic globalization. Some go so far to posit this is the end of capitalism.

If only Russia, let alone all of its former Soviet satellites that currently constitute the Commonwealth of Independent States (CIS), were so economically important—although, of course, that may well be Mr. Putin's fantasy.

Nor will globalization's termination (when, or if, it does come) be that discrete or likely to be driven by a single event. More than two centuries ago, globalization's advent was anything but sudden, and it was engendered by a multitude of pulses.

Indeed, globalization is an *evolutionary* process: the structure of the world's markets as well as their economic participants—businesses, workers, consumers and governments—are constantly transforming, being driven by many factors, frequently interacting with each other, including demography, innovation, political movements, policies, climatic conditions, natural disasters and wars.

Since globalization is constantly changing, the proponents arguing that Mr. Putin's Ukrainian war is globalization's death knell must believe that the *shock* stemming from his actions is so deep and sweeping so as to fundamentally rupture a longstanding fixture of the global economy. This is quite a dubious proposition.

Arguably the COVID pandemic—which we all hope *is* a one-time shock—has brought to the fore market vulnerabilities and supply chain structural complexities that have had, and will still have for years to come, a more fundamental impact on changes in globalization.

Today's declarations about globalization's demise also stem from the belief that the West's responses to Russia will propel the establishment of a formidable alliance between Xi Jinping and Putin such that China and Russia, together, will counter the advanced democracies and form an integrated economic bloc of state-dominated socialist states.

I believe this is naive: at least that is my perspective, initially shaped from spending both 7 years on the ground in Russia (and other CIS countries) as the senior World Bank official at the start of the Yeltsin era into several years of the Putin regime overseeing the bank's financial operations and reform programs after Moscow's economic meltdown in 1998, and almost 4 years working in much the same capacity in China.

Indeed, such a presumption reveals a greatly misinformed, if not simplistic, view of Beijing's calculus of the risks and opportunities stemming from China's deep financial, supply chain, technological and educational (university) relationships with the West.

While there are certainly strains in these relationships, especially with respect to China's ability to capture the greatest value of pathbreaking *basic* R&D performed in the advanced democracies by Beijing honing in on carrying out *applied* R&D, decoupling such relationships will not be easy, costless nor accomplished quickly. China fully understands this dilemma.

The notion that such a Sino-Russo axis can be fashioned, let alone become durable and provide symmetrical benefits for both sides, also reflects naivete about Mr. Xi's enormous ambitions and trenchant cunning to further the advance of China *itself* in multiple realms across the globe.

It is not far-fetched to believe that Xi would actually relish the demise of Mr. Putin, potentially paving the way for Beijing to infiltrate Russia and the other CIS countries just south of China. Xi is well-known as someone who is masterful at playing both sides of the table.

There is also an assumption held by some of those forecasting that a China-Russia linkage will draw the curtain on globalization that Russia's Ukraine incursion has emboldened China to invade Taiwan.

That is certainly a valid issue to ponder. But the realization of such a scenario is by no means as clear-cut as some might believe.

In part this is because the genesis and duration of tensions and military conflict between Beijing and Taipei are arguably much more complex than that between Russia and Ukraine.

The Chinese-Taiwan relationship certainly has a much longer history, dating back 70 years. Moreover, the antagonism between the two has almost always occupied a prominent place on the agenda of *many nations* and in the operations and structure of numerous *global institutions*.

Suffice it to say, a China-Taiwan military confrontation would be a very high stakes enterprise for the two countries as well as the world community on many levels. One presumes both the Chinese and Taiwanese—and presumably the U.S. and others—recognize the analogies with Russia's war in Ukraine are limited. Still, it would be naïve to rule out that the odds of cross-strait military actions are now not more top of mind than before.

Two points are important in this regard.

First, it is quite likely that somewhere in Washington's thinking, a calculation was made as to how Beijing would perceive the suddenness and sweeping nature of the application by the US and its allies of sanctions on Russia.

Second, Taiwan was one of the few non-Western nations to join in the imposition of sanctions on Ukraine. You can be sure this was not a decision that Taipei took lightly.

What Is Globalization?

Whether one is a supporter or detractor of globalization (and capitalism for that matter), the widely accepted understanding of the term "globalization" refers to the cross-border growth of *economic* activity. Of course "globalization" can also be viewed through political as well as technological lenses. But most practitioners argue that, at its core, globalization is an economic phenomenon, driven by commercial interests, which in turn drive political and technological dynamics.

At the most basic level, therefore, globalization is defined along a number of dimensions, such as:

(i) where *sales or purchases* ("consumption," as we economists are wont to say) of goods or services takes place (involving importation and/or exporting);

(ii) the location of *production* of goods and services, utilizing *invested capital* (such as machinery, computers, etc.) and employing *workers*; and

(iii) how, where and by what means do goods and services *reach their point of final usage or consumption* (such as by ship, air or the internet).

From this perspective, the current declarations that the "era of globalization has now ended" as a result Russia's military invasion of Ukraine appear rather over-extended.

Perhaps, however, the notion that Putin's intrusion into Ukraine and the West's subsequent sanctions reflect globalization's end because there is a belief that Russia is a significant enough player in the world economy such that its retrenchment from international markets (whether by its own or others' doing) would fundamentally halt (or alter) globalization. It is not.

In terms of nominal GDP, Russia ranks 11th among the globe's economies. However, that ranking belies more telling statistics revealing a long withering economy. The size of the country's population has been on a steady decline: as of January 2022, the number of births in Russia now stands at its lowest level in two decades; over the same period Russian mortality has increased by more than 15 percent. The demographic statistics are not the sign of a growing, healthy—and formidable—economic power.

How does the overall prosperity of the Russian populace stack up on a global basis? Russian GDP per capita in nominal terms in 2021 ranked 64th worldwide. In real terms, that is, accounting for inflation, 54 countries registered a higher level of GDP per capita than Russia in 2021.

With respect to the magnitude of Russia's economic prowess in international markets, its flows of merchandise trade with other nations in 2020 were 46 percent of GDP, which marked a significant *decrease* from 68 percent of GDP twenty years earlier.

What do the data show as to how attractive is Russia as an investment destination by foreign entities?

At the time of the break-up of the Soviet Union, inflows of foreign direct investment (FDI) to Russia measured just 0.5 percent of GDP. Following the first decade of economic reforms (just prior to Putin's ascendancy), that ratio increased by a factor 9—to 4.5 percent. Yet by 2020, after two decades of Putin's grip on the economy and his failure to diversify the country away from being a natural resources producer—the core challenge Russia (still) faces to realize sustained growth and attract investment—it decreased back to 0.6 percent.

Perhaps one of the more recent telling signs that Russia lacks global economic significance are press stories about the rapid "voluntary exit" or departure or mothballing of facilities in the Russian market by several hundred Western firms at the onset of the country's invasion of Ukraine *even before* sanctions were imposed.

To be sure, heightened reputational risk by these companies back in their home markets and the imminent application of sanctions on Russian banks would make conducting local business very difficult. However, it is not unheard of in such situations for businesses to attempt to press their home governments to seek carve-outs from sanctions. This would only occur if a market in question were intrinsically commercially important. That such arguments were not even advanced in Western capitals and would suggest—based on the spate of data published by various sources attracting lots of stories of firms' exit from Russia—that foreign investors do not place a premium on operating in Russia's economy.

In fact, it remains unclear how much bona fide "exit" has taken place from Russia. Some of the data behind these stories may not reflect this. It is not simply a question of "closing up shop" but of divesting assets/liabilities—the consummation of such transactions not just the agreement to do so—from Russia. This is a far weightier decision by a company. This is especially so for advanced country firms who have made direct investments in emerging markets, especially in countries like Russia or China—that is, investment in plant and equipment, in the training of personnel, in cultivating a "brand following," and so on. In this sense, real exit from Russia may be far lower than believed.

Why do I say this? My on-the-ground experience in emerging markets such as Russia is local stakeholder have longer memories about foreign investors than do advanced countries. Thus, assuming business executives in Western firms operating in such environments do their homework and are smart, their exit decisions (just like their entry decisions) are, or should be, done on a "present value" basis, figuring in the potential future "costs of re-entry" to (i) win back the hearts and minds of local customers, regulators, and governments and to (ii) make sure their (renewed) investments are potent enough to out-compete the businesses that stayed in the market and filled the void created by exit.

Could Globalization End?

The history of the world economy shows it is in a constant state of flux. As every high school or college student knows, for centuries the economic standing of nations has risen and fallen—akin to the kids' game of "king of the hill." Think the Han, Mauryan, Persian, Roman, and British empires, among others.

To this end, as many of us have written, globalization, itself, has gone through phases. (I've argued earlier in this space that we are in the midst of "Globalization 3.0", although some term this "Globalization 4.0".) How to term globalization is apparently in the eye of the beholder. If there comes a time when globalization does end, it is highly unlikely to occur in one fell swoop. If anything, as it has over time, its nature will continue to evolve.

Moreover, among today's advanced democracies, where globalization is most pronounced, there are different centers of gravity: Think the European Union and the UK versus North America. Within each, some nations are prone to continue a more rapid pace of globalized growth than others. In this regard, as has been the case in the past, the contours of globalization even within the West may well become more graduated.

In contrast, the trajectory of international growth achieved by China—the single largest country in the world, with 1.4 billion people—will be more consequential in terms of how the nature of globalization across the planet continues to evolve. After all, China is a single national unit—and one governed by a uniform set of political and policy objectives where there is no competition of ideas or authority at that.

My own view, about which I've written several times in this space, is China's path forward in terms of maintaining robust long-term economic growth is fundamentally problematic. This is due to the inherent contradictions in Beijing's economic strategy of a "socialist market economy" (which is, of course, an oxymoron by definition).

Another potential significant pole of globalization is India, which is the second largest country with a population of 1.3 billion people and a democracy. It is a nation blessed with enormous natural assets, including a prime location straddling two key oceans. In addition, a portion of India's population is, by world standards, extraordinarily highly educated in science and technology.

Yet India's economic record reflects a governance structure and policy regime that continue to hamstring consistently high levels of growth. In a word, for decades India's economy has punched significantly below its weight.

If these are indeed some of the key components of "the anchors" of the world's economic topography, it seems unlikely that globalization will, any time soon, whiter away, resulting in numerous economically atomistic self-sufficient units.

One scenario, therefore, for the future of globalization is not its end, but that the world economy will continue its trend toward further formation of two or more dominant economic blocs: one comprised of the advanced democracies, the core of which would be the G7, the EU, Australia, South Africa, and other like-minded advanced democracies; and the other being a Sino-dominated socialist economic cluster, which would include Russia and the CIS.

Global Decoupling: Technological and Supply Chain Sovereignty

If this were to become the future structure of the world economy, it would suggest an entry into the latest phase of globalization. Needless to say there are several key questions to understanding how markets might function differently internationally under such a regime.

· How will cross-border competition at the *nation-state* level *between* the blocs be mediated?

· Might one expect that members *within* each bloc would have stronger incentives than is *currently the case to integrate systematically* their markets and business operations, through free trade agreements, investment treaties, and R&D agreements?

· To what extent will there be porosity between the blocs for the remaining countries who occupy the "middle ground"? And, presumably, what would be their "price of admission" to a bloc?

· Will competition on an inter-bloc basis *end masse* be more or less intense than the *status quo ante*?

The answers to such questions will turn on the challenges arising from how bifurcated will these blocs be, and how would such bifurcation affect overall economic growth, innovation and prosperity of the world economy, especially if the cost savings and production efficiencies arising from extant economies of scale and scope are diminished by the creation of "duplication of facilities."

There are two critical dimensions to be concerned about it here: supply chains and investment in R&D.

If the structure and operations of extant *global supply chains* are largely bifurcated, there is likely little question that such a change would adversely impact efficiency and prices at the upstream end (factories) and at the downstream end (delivery to end-users and customers) both *within* each bloc and on a *global* basis.

Needless to say, dismantling/re-routing the various nodes along existing supply chains could be both very costly, especially if new production facilities, warehousing, and transport networks need to be built, and time intensive. Planning and executing how such transitions would take place smoothly will not be a trivial exercise.

Similar considerations arise if there is greater bifurcation of the *global R&D enterprise* that already exists. This cuts several ways.

First, while the fruits from collaboration in R&D among the advanced democracies at present is more robust than it is among states that are/or would be within the China-centric bloc, nonetheless significant structural, institutional and policy changes are sorely needed R&D investment in among the democracies.

That the objectives driving advanced democracies' pursuit of such collaboration is to promote "science diplomacy" in *basic* R&D rather that forging ways to capitalize on collectively harnessing *applied* R&D efforts, says it all. It is the *inverse* of China's approach. Indeed, China is a master of capturing the commercial value of the basic (and some applied) R&D performed by the advanced democracies.

On the other hand, in a *truly* decoupled R&D ecosystem, the China-centric bloc would face the significant challenge of having to perform *basic* R&D that rivals that of the advanced democracies. That is a tall order for two reasons: not only are Chinese scientists actually keen to spend time at *Western* rather than Chinese universities and labs since their institutions and related opportunities at *home* do not compare favorably, but also Russian scientists (with whom Chinese experts would collaborate) are no longer deemed world-class since, unfortunately, there has been dramatic underinvestment in such activities by Moscow and other CIS capitals over the last few decades.

Second, while there is certainly an appealing *political economy* argument for the decoupling of R&D activities between the two blocs, the deleterious "bottom-line" effects of doing so would likely be huge. In a nutshell, technological decoupling would surely mean sacrificing the sizeable commercial benefits otherwise obtained through the economies of scale and scope realized by the application of advances in technology on "the factory floor." The question for the political leaders, then, may become: is technological decoupling the price we should be willing to pay to have separate blocs?

In fact, if separate blocs are to successfully co-exist it may well call for bifurcated technology standards. The economic pressure for upholding different technology standards rather than a single global standard, however, can be intense. While there are literally many examples that illustrate the point, one only needs to recall the battle between Betamax and VHS.

Where Does This Leave Us? Will Russia's War Upend Globalization?

"Globalization" has almost always exclusively referred to *economic* — and thus, *technological* — relations. (Globalization as a *political* phenomenon is not a tenuous concept.) Seen this way, arguments advanced that Russia's war will be the agent of change in tearing apart globalization are a misdiagnosis. Russia is not only a comparatively modest-sized economic power, it is also, today, a modest-sized technological power.

It is only the conduct of China—in light of its global economic and technological significance today that, unfortunately and unwittingly, has been aided and abetted by the advanced democracies failing to step up to the plate over the past 3 decades in these domains—which *conceivably* could engender a real fissure in globalization. I emphasize "conceivably" because, as I note above, China's economy suffers from fundamental contradictions that have been significantly eroding its strength for years. Unless these are ameliorated, its prognosis is not nearly as healthy as popularly believed.

Of course, whether Beijing nonetheless will *overtly try* to cause a fundamental rupture in the globalization of the world economy is another matter, either doing so unilaterally or opportunistically to take advantage of Russia's incursion in Ukraine. But one thing is certain should China proceed in this manner: if it serves its own interest, it will not think twice about usurping Russia.

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