Welcome to De-globalization: A Short History of the End of Globalization (?)

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Abstract

The world economic crisis has the potential to reverse the process of globalization. The crises has weakened the “attraction among economies” and decreased the movement of goods and services, and factors of production (especially capital, and people). Furthermore, the defenders of globalization, especially exporters (and importers?) and governments, will be weakened in facing anti-globalization movements. It is probable (but not certain) that the anti-globalization forces will gain power in many countries that lead to protectionist policies and by other anti-globalization policies, including in Indonesia.

Keywords: Globalization, Financial Crises, Trade Integration, Trade Policy

JEL: F01, G01, F11, O24
1. HOW THE STORY BEGINS

It was wrong when it was predicted some years ago that globalization would ultimately lead to de-globalization. It seems that the real de-globalization is starting now (as reflected by a widespread decline in the flow of goods and services, and factors of production (especially capital), information, and people). The main source has been the recent Global Financial Crisis (GFC), which was followed by political developments. At least two influential magazines have noted this phenomenon: first, The Economist (February, 2009) with its cover: “The Return of Economic Nationalism” and second, Newsweek (February 2009), with its cover: “We Are All Socialists Now”.

The story has its roots in the US subprime crisis, which was followed by snowballing economic crises in most developed countries. The World Bank and the IMF (October, 2008) have estimated that the cost of this crisis in terms of losses in banks and other financial institutions will be the worst of any crisis since the Great Depression of the 1930s, outstripping losses during Japan’s ‘lost decade’, the banking crisis in 1990-2000 or the Asian financial and economic crisis in 1997-1998.

![Figure 1: Estimated Losses in Recent Crises](image-url)

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It is interesting to connect the economic crisis with international trade. From the economic explanation, it can be seen that the US economy as the world’s largest economy (at 20% - 25% of the global economy), has affected demand for global merchandise, goods and services. This is a natural economic phenomenon: that the “gravity or attraction” among countries to trade (flow of goods and services) is lowered by a fall in world demand as the largest economy experiences a contraction in economic growth.

The figure below shows that world economic growth in 2009 is expected to fall 1.3 percent. Global economic conditions will undoubtedly affect politics. The momentum for anti-globalization movements to gain political bargaining power and have a greater chance of garnering political support in many countries will increase sharply. In the coming years (during the world economic crisis) elected politicians in many countries will be supporters of anti-globalization efforts; their policies will tend to be more protectionists against foreign goods, foreign workers, or other so-called global influences. Politicians will urge a prioritization of domestic goods, services, workers, etc over their foreign counterparts. New campaigns to buy and use domestic products or domestic workers are evident across the world as “Buy Indonesian” or “Buy American” gains a foothold in each respective nation. How can this phenomenon be explained?

Figure 2
GDP Growth

Source: www.imf.org
There are at least two logical explanations for this: the mercantilist idea and the re-distribution of the “gains from trade”. First, the mercantilist idea simply implies that “export is good and import is bad”, as “export creates jobs and import destroys jobs”. However, this idea was buried by David Ricardo (The Principles of Political Economy and Taxation, 1817) who urged equal treatment of exports and imports and let the comparative advantage determine the pattern of trade among countries. Theoretically, the mercantilist idea has vanished from economic textbooks and classrooms; however, in practice, it is alive and well in the behavior of both politicians and bureaucrats. It could be concluded that protectionism has loyal supporters. In general, the anti-globalization movements that tend to oppose free trade are coming from a variety of groups such as environmentalists, human right activists, populists, and traditional lobbies. For example, In Free Trade Today (2002), Jagdish Bhagwati, one of the most prominent trade economists, revealed his experience in facing the anti-globalization activists both in debates and in demonstrations. In his book ‘The Audacity of Hope’ (2006), Barack Obama, elaborating on his ‘Thoughts of Reclaiming The American Dream’, discussed the debate over CAFTA (Central American Free Trade Area) and NAFTA (North American Free Trade Area) in which he advocated ‘fair trade’ rather than free trade, and for this reason voted against CAFTA. Obama’s position on free trade is described in Krugman (2007), in ‘The Conscience of A Liberal: Reclaiming America from the Right’, where the cover of his book showed a swing from the right into the left in US policy.

Second, although we know that free trade will benefit all countries compared to autarky or protectionism, there is an unequal re-distribution of the benefits among citizens in these countries; in other words, there are winners and losers as the result of free trade policy. This explanation is based on the famous international trade “Heckscher-Ohlin Model” which is re-formulated into the “Specific Factor Model”. The losers or the citizens who benefit least from free trade are only a small fraction of society, but they are well organized and are able to persuade or promote their protectionist ideas. Economists suggest direct policy could be used to lessen unequal re-distribution.

Although the theoretical explanation points to potential winners and losers from free trade which means redistribution among owners or production factors tends to create winners and losers, most of the empirical evidence shows the positive impact of free trade on poverty reduction, as argued in Reimer (2002), Dollar and Kraay (2001), Evans (2001), Friedman (2000), and conceptually in Winters (2000).

Often protectionist policy cites the protection of the poor as a supporting reason for its implementation, yet the available empirical
evidence does not show this, as can be seen in the findings from LPEM’s study (2005) by applying an Interest Group Variant Model and a National Policy Model which showed that there is no connection between agricultural protection and pro-poor policies in Indonesia.

The story of the anti-globalization movement after the Second World War (especially anti-free trade movements) already begun in the 1980s and 1990s. It reached one big event in 1999. The issue in the 1980s was the threat of Japan from US perspectives and unfair competition from low wage countries from US and Europe perspectives during the 1990s. One of the big events of the anti-globalization movement was the WTO meeting that took place in Seattle, US, in 1999. However, world economic conditions at the time did not support the movement since there was no significant world economic crisis at that time.

2. THE POSSIBILITY OF DE-GLOBALIZATION

The accumulation of losers and supporters plus the political momentum fostered by protectionist politicians and bureaucrats will lead to support for protectionist policies; and the deeper the economic crisis, the greater the tendency for protectionist policies. A trade war or retaliation is waiting when each country applies protection against imported goods. But is policy the only explanation? The answer is no. As Mussa (2000) explained in “Factors Driving Global Economic Integration”, globalization has been driven by at least three forces: technological developments in (1) transportation and telecommunications that have dramatically decreased the average cost of each, (2) consumer preferences from the demand side and (3) pro-globalization public policy.

Over the last 20-30 years, most countries have liberalized their economies through bilateral, regional, and multilateral agreements. The largest impact has come from the multilateral agreement in the establishment of the WTO (World Trade Organization) in 1994 and especially when China joined the WTO in 2001. Other examples include the establishment of NAFTA (North American Free Trade Agreement) and the development of an integrated European economy through the EU (European Union). These large scale liberalizations not only covered trade in goods and services, but also the movement of factors, and the harmonization of fiscal and monetary policies. These policies protect globalization; however, the economic crisis plus the accumulation of losers with political momentum of protectionist politicians and bureaucrats will oppose it, by taking advantage of exceptions and loopholes in the agreements or probably in the extreme situation they will not obey the agreement. In the mean time, the supporters of globalization (such as exporters, transnational corporations (TNCs) and
other gainers) will be weakened at the time of crises, including the politicians who support the globalization process (especially free trade supporters).

What will happen when the volume of the movement of goods and services, production factors, and people decreases significantly? This will affect the cost of transportation and telecommunications. Technological advancements in transportation and telecommunications are not solely responsible for determining the cost of transportation, but also economies of scale, meaning the higher the volume of trade/transactions, the lower the average transportation and communication costs. If the movement of goods and services, production factors, information, and people were to significantly decrease, it would in turn increase the average cost of transportation and telecommunications, further impacting volume. Simply, this will lead to “de-globalization” where there will be a decrease in the movement of goods and services, then followed by the decrease of the movement of production factors, information, and people. The process could be seen in the figure below.

Figure 3
The Process of De-globalization

1. World economic recession: world demand on exported goods & services, factor of production, and travel are fall

2. Political impact: exporters will suffer; coordination among free trade supporters are weakened; anti-globalization forces will gain momentum (especially anti free trade, anti foreign capital, and anti foreign workers); most of selected politicians are taking advantage of the momentum by applying the anti-globalization policies

3. Further Economic impact (De-globalization?): volume of traded goods will decrease; volume of factor of production movement will decrease; volume of people movement will decrease; cost of transportation and telecommunications will increase due to diseconomies of scale problem
The figure illustrate the cycle of the process of de-globalization. The only way to stop the process is to improve the world economy which will increase "the attraction among economies" by increasing the world demand for the goods/services, factor of production, and tourism; otherwise, the cycle will deteriorate the globalization process or even worse such as could lead to political chaos, social unrest, or wars.

3. WHAT DO THE DATA TELL US ABOUT DE-GLOBALIZATION?

The symptom of the de-globalization process could be seen from the early data such as in world trade, inflows of FDI, world tourist arrivals.

**World data shows a slowing growth of trade.** Weakening demand in developed countries, realignments in exchange rates and fluctuations in the prices of commodities, such as oil and gas, caused uncertainty in global markets in 2007. As a result, growth in world merchandise trade declined by 6 percent in real terms, down from 8.5 percent in 2006 (WTO, International Trade Statistics, November, 2008). From time series data, the decreasing trend of both world exports and imports has started since 2008Q3 as shown in the figure below.

![Quarterly World Export and Imports 2005-2008](image)

Source: WTO Secretariat, processed
However, trade remains strong for developing countries (especially China, India, South and Central America, and the Commonwealth of Independent States (CIS), while it has decreased sharply in developed countries (most apparent in the US, EU, and Japan) which dominate the world economy.

World data shows a slowing growth of Foreign Direct Investment (FDI). FDI flows are estimated to have declined by 15 per cent in 2008. A further decrease in FDI flows can be expected in 2009, as the full consequences of the crisis on transnational corporations' (TNCs) investment expenditures continue to unfold. The fall in global FDI in 2008–2009 is the result of two major factors affecting domestic as well as international investment (UNCTAD, 2009).

The figure below shows that based on the UNCTAD estimation in three scenarios: the optimistic scenario (V) will show a quick upturn by the end 2009; the base case (U) will begin to pick up in 2011; and the pessimistic (L) will not pick up before 2012.

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**Figure 5**

Worldwide FDI inflows with three different trajectories 1990-2012
(Billions of dollars)

![Graph showing three scenarios for FDI inflows](image)

**Source:** UNCTAD, based on FDI/TNC database (www.unctad.org/fdi statistics) and UNCTAD own estimates.

**Note:** The shapes of V, U and L scenarios are based on different assumptions regarding recovery for illustrative purposes only and not based on any statistical analysis.

**Source:** Assessing the impact of the current financial and economic crisis on global FDI flows April 2009, United Nations Conference on Trade and Development (UNCTAD), 2009.
World data shows a slowing growth of tourist arrivals. A UNWTO (United Nations World Tourism Organization, 2009) report showed that in 2008, international tourist arrivals reached 924 million, up by 16 million over 2007, representing a growth of 2%. It seems that tourism demand slowed significantly through the year under the influence of an extremely volatile world economy (financial crisis, commodity and oil price rises, sharp exchange rate fluctuations), undermining both consumer and business confidence and resulting in the current global economic recession. In the second half of 2008 growth in tourism came to a standstill with the number of international arrivals declining slightly—a trend which is expected to continue in 2009.

In addition, statistics also show an increase in the price of transportation as shown in WTO report (International Trade Statistics, November, 2008). Another example is the condition of shipping in Batam and Singapore which is influenced by crises conditions. There are many ships that have to wait longer to be loaded because the decrease of the volume of trade. If the de-globalization process proceeds, the communications also will suffer.

4. INDONESIA’S EXTERNAL ECONOMIC POLICIES

In Indonesia, the decline in the movement of goods is just starting. From November to December 2008, the growth of Indonesian exports declined by 9.6%. Nevertheless, the growth of exports from January-December increased by 17.2%, mainly to Japan, US, Singapore, and EU (Statistics Indonesia, February 2, 2009). As the main destination countries are facing economic recession, it can be concluded that Indonesian exports will decline in 2009.

The history of Indonesia’s external economic policies has fluctuated between outward looking policies (pro-free trade) and inward looking policies (anti-free trade or a preference for protectionism) were mostly affected by political and economic events that interacted with the rise and subsequent fall of the power of the anti-globalization supporters (especially protectionists). These can be divided into four eras, each of which affected the political-economic conditions of the time.

First, from independence in 1945 until 1966, inward looking policies gained political momentum from the anti-capitalist/colonialist movement. During the period 1945-late 1949 Indonesia had to wage a fierce armed struggle against the returning Dutch army. It was only after the Dutch recognition of Indonesia’s independence on 27 December 1949 that the Indonesian government exercised full sovereignty over the entire Indonesian territory, except for Dutch-occupied West New Guinea (now Papua province), and was able to formulate economic policies (Thee, 2009).
Second, from 1967-1973, outward looking policies were applied in many areas, particularly the liberalization in investment and trade. The New Order era was totally opposed to the economic and political policies of the Soekarno era. Third, inward looking policies again gained momentum from 1974-1982 as a result of high oil prices and domestic political tensions (such as the Malari incident of January 1974). Protectionist policies were applied to foster import substitution. Fourth, as oil prices fell steeply in 1982, the government struggled to fund its expenditures and develop new sources of export revenues. Hence, outward looking policies were pursued to boost non-oil exports and private investment, including foreign direct investment (FDI). These outward looking policies have been consistently applied until now with some ambiguities in 1991-1997, and also in the present post-New Order era.

It is projected that starting in 2009 and continuing for the next five years, Indonesia’s external economic policies will again be strongly shaped by the political economy. Supporters of protectionist policies will gain momentum from the Global Financial Crisis (GFC). The symptom of this condition can be seen in Box 1 below. If Indonesia’s economic performance worsens, the demand for protectionism will increase. Optimists expect that protectionism will not be as severe as in 1945-1966 and 1974-1985. However, if the world economic crisis worsens over the next four years, then strong protectionist pressures in Indonesia (and around the world) will occur and true de-globalization will arrive.
Box 1: Current Issues on Indonesia Presidential Election 2009: Issues on Against Globalization?

The symptom of the rising issues against globalization in Indonesia could be seen from the preliminary debates of the presidential election 2009 where two of the candidate teams, Jusuf Kalla-Wiranto (JK WIN) and Megawati-Prabowo (Mega Pro), use anti-neoliberalism issues against the team of Yudhoyono-Boediono (SBY-Boediono) and propose so-called “People-based economy”. However, Yudhoyono denied having implemented a neo-liberal economic policy by stating that his administration is not a neo-liberalist during a dialogue with members of the Indonesian Chamber of Commerce and Industry (Kadin) in Jakarta (The Jakarta Post, May 20th, 2009).

The debate on neoliberalism started since Yudhoyono choose as his running mate, Boediono, as the vice presidential candidate. The resistance was initiated by some political parties that support Yudhoyono, such as PKS (Partai Keadilan Sejahtera) and PAN (Partai Amanat Nasional). One of the strongest statements came from Amien Rais, one of the reformist leaders against Suharto (Indonesia Former President in New Order) in 1998 who totally rejected Boediono because he perceived Boediono as a neo-liberalist.

One of the other examples was the statement of Kalla when he was in Tanah Abang, a semi-traditional market for textiles, who said that “Tanah Abang is more important than Pasar Modal (Capital Market)”. This statement was reminiscent of one of the slogans in America during the US presidential campaign in 2008, that “Main Street should be supported rather than Wall Street”. In emphasizing the issue, on May 23rd, 2009, Kalla stated that in the presidential election, there will be the battle of ideas and we should choose whether we develop a self-reliant nation or just let free market forces run rampant (Kompas, May 23rd, 2009) while Megawati-Prabowo declared in Bantur Gebang (the place for waste processing in Jakarta, the capital city of Indonesia) to show their concern for the “wong cilik”, the ‘little people’ or very poor people) by having representatives of workers, labors, peasants, and fishermen pledge to support them and proclaiming their proposal on fostering a so-called “people-based economy”. From the location of their declaration and by announcing the concept of a ‘people’s-oriented economy’ (and by stating that they were anti-neoliberals, and especially anti-free trade and stating their objection to the removal import tariffs on milk), it appears that the Mega Pro team’s protectionist views are quite opposite to the views of the SBY-Boediono team.
The Neoliberalism Concept

One of the good article on neoliberalism is written by John Williamson (2004) "A Short History of the Washington Consensus" who defines neoliberalism by referring to the Mont Pelerin Society which promotes a free society. Some of the leading scholars in this society include Friedrich von Hayek, Milton Friedman, Karl Popper, and Ludwig von Mises. Williamson proposed his views on what became known as the so-called Washington Consensus in 1989, which were subsequently agreed by the OECD.

This Washington Consensus included 10 principles on economic policies, as shown in the following list (see: Williamson (2004):

1. Fiscal Discipline. This was emphasized because many Latin-American countries had run large deficits that led to balance of payments crises and high inflation that hit mainly the poor because the rich could park their money abroad;

2. Reordering Public Expenditure Priorities. This suggested switching public expenditures in a pro-growth and pro-poor way, for instance switching expensive subsidies to expenditures on basic health and education and infrastructure;

3. Tax Reform. The aim was to set up a tax system that would combine a broad tax base with a moderate marginal tax rate;

4. Liberalizing Interest Rates;

5. Maintaining a Competitive Exchange Rate;

6. Trade Liberalization;

7. Liberalization of Inward Foreign Direct Investment;

8. Privatization;

9. Deregulation. This focused specifically on easing barriers to entry and exit, not on abolishing regulations designed for safety or environmental reasons, or to govern prices in a non-competitive industry; and


Most of the points from the 10 principles of the Washington Consensus, especially about trade liberalization and foreign direct investment, are advocated by supporters of globalization, since these policies will guarantee the free flow of goods and services, and factors of production, including people. As is commonly known, public policy is one of the strong factors that drive globalization (see: Mussa, 2000).
In challenging the SBY-Boediono team, the other contending teams (JK WIN and Mega Pro) are propagating the concept of a people-based economy to refute neo-liberalist ideas. However, there is no specific explanation on what the people-based economy actually involves. From some comments and interviews by both the JK WIN and Mega Pro teams, the people-based economy concept probably refers to an economy that is focused on the economic advancement of poor people. Some of their comments also tend to refute trade liberalization and foreign investment. At a time of economic crisis (which tends to weaken the supporters of free trade) these populist ideas are powerful enough to persuade voters. However, fortunately for SBY-Boediono, the present economic crisis in Indonesia is still well managed and positive economic growth compared to some of the neighboring countries at least until this paper is written in early June 2009.

For further analysis of political economy of protection, especially manufacturing protection in Indonesia, the table below adapted from Basri (2001) to demonstrate the role of the technocrat, economic nationalist, rent seekers, and foreign institution in influence the trade policy outcome since 1945.
The table above shows the trade policy orientation and the role of the groups in influencing Indonesia’s trade policy outcomes. As shown in the table, economic nationalists and rent seekers have a strong influence at the time of political and economic crises such as during 1945-1965 (when Indonesian political conditions were in turmoil), 1973-1982 (the oil boom era and domestic political tensions at the time of the Malari riots in January 1974). What the trade policy in 2009-2014 will be is still uncertain.
5. LESSONS LEARNED FROM PROTECTIONISM AND ISOLATIONIST POLICY

There are at least two lessons from history that can be used as examples of how protectionist policy affects the global economy: the US's Smoot-Hawley Act in 1929 and the more extreme case of the Chinese isolationist policy in the 14th century.

The Smoot-Hawley Act in 1929 increased tariff duties on thousands of trade commodities. Some economists cite this law as the main source of the Great Depression. When the policy was imposed, unemployment increased, which was the opposite result of the policy makers' expectations. Other consequences included retaliation from trading partners. Overall, world trade decreased sharply from 1929-1934.

The isolationist policy of China, after the legendary journey of Zheng He (in the Zhung Di Emperor era) demonstrated that protectionism in the largest economy at the time weakened its economic and political power. As noted by Menzies (2003) in 1421: The Year China Discovered The World: "...by the time the fleet returned, China was beginning its long, self-imposed isolation from the world it had so recently embraced. And so the great ships were left to rot, and the records of their journey destroyed. And with them, the knowledge that the Chinese had circumnavigated the globe a century before Magellan, reached America seventy years before Columbus, and Australia three hundred and fifty years before Cook". Even though there is no record of the trade effect of this isolationist policy, it is clear that China's isolationist policy occurred, as the role of China in the world's economy declined.

6. CONCLUSION

The global economic crisis in both developed and developing countries has the potential to reverse globalization. The crisis will allow anti-globalization forces to gain power in countries, leading to protectionist policies. If the world cannot face these challenges, true de-globalization will take place, starting by a decline in the volume of trade (goods and services) followed by a decline in the movement of production factors, information, and people.

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