

Inquiring Minds Topic- 20 December 2019

Adair Heath, Moderator

Trade Wars and Its Losers

The G-Minus-2 Threat

[Arvind Subramanian](#) Jul 26, 2019 Project Syndicate

The US-dominated G1 world (G1 is a term the author uses to denote the time period of the post Bretton Woods international economic system) is long gone, and the G2 in which America and China shared hegemonic responsibilities is now fading into memory (G2 is time period of the international economic system after G1 with US and China sharing leadership of the trade globalization in the late 1980's until the late 2000's). In today's G-minus-2 world (time period of the current US-China trade war), US and Chinese policies threaten to have devastating consequences for the global economy.

CAMBRIDGE – For an all-too-brief period between the late 1980s and the late 2000s, the world was characterized by convergence, both ideological and economic. The West and the Rest agreed that an open liberal order was the best way to increase prosperity. Now, however, this ideological convergence is fading.

The two-decade-long “golden age” was one of [trade hyper-globalization](#), reflected in an unprecedented increase in the ratio of world exports to GDP. It was also an era of [economic convergence](#): for the first time in centuries, living standards in a broad cross-section of developing countries started catching up with advanced-economy indicators. Moreover, globalization and convergence were handmaidens: open markets enabled developing countries to prosper by building up modern, efficient, export-based industries. And no country benefited more from hyper-globalization than China. The liberal order underpinning this era was largely created by the United States. Exactly 75 years ago, when both the economic turmoil of the 1930s and World War II were fresh in the collective consciousness, the US was able and willing to supply three vital global public goods through the postwar institutions created at Bretton Woods. Emergency finance would come from the International

Monetary Fund, and long-term lending from the World Bank. Above all, open markets would flourish under the General Agreement on Tariffs and Trade (and its successor, the World Trade Organization). It was a G1 world, and America was the unchallenged hegemon. Today, we have neither a G1 world nor ideological convergence. Because of its spectacular growth since 1978, China has become the second dominant economic power alongside the US (Europe is still too decentralized and beset with internal problems to wield strategic influence). And the consensus about what constitutes good economics has broken down. In the West, and especially the US, a series of negative economic trends – including slower growth, rising inequality, declining mobility, and greater concentration of economic power – have called into question the benefits of globalization. In addition, the 2008 global financial crisis and its aftermath have undermined faith in American-style capitalism. China’s rise, and the perceived consequences for America, has also stoked US skepticism about globalization. A broad swath of US elite and public opinion believes that China has abused America’s largesse, via currency manipulation, intellectual-property theft and espionage, and forced technology transfer. Furthermore, China’s recent tilt toward statism and political repression adds to a broader US sense of betrayal, and of an investment in shared prosperity that has gone badly wrong.

This discordant G2 world and the end of ideological convergence now threaten *economic* convergence, and thus developing countries’ prospects. The “golden age” of convergence had, in any case, already started to face [headwinds](#). First, climate change poses risks to developing countries’ agriculture. Problems in this sector will reverberate throughout these economies, because high and rising agricultural productivity has been the key to successful structural transformations from farming to manufacturing. In addition, the spread of technology-enabled automation is replacing unskilled labor with machines, directly threatening the ability of poorer countries to lift incomes through labor-intensive manufacturing.

But the biggest threat comes from an ideological decoupling between the West and the Rest. The G2 of China and the US, instead of supplying the key global public good of open markets that the economic historian Charles Kindleberger saw as the responsibility of hegemons, is now providing global public “bads.” As the US and China impose tariffs and trade restrictions on each other’s goods, and as the US undermines multilateral trade rules and

institutions, world trade is [slowing markedly](#), threatening developing countries' export sectors and the viability of their overall development strategies. At the same time, the US and other Western governments are clamping down on migration. As a result, developing countries are boxed in, and will find it increasingly difficult to export their products or their excess labor. American repudiation of the Paris climate agreement does not bode well for the poorer countries who will bear the brunt of the consequences of global warming. That situation is dire enough. But perhaps the most critical "bads" provided by the US and China are the most subtle. America's unilateral measures, which flout the global rules that it helped to devise, have begun to damage the Bretton Woods institutions and the associated system of international cooperation. China, meanwhile, is a [hobbled hegemon](#), having become dominant without acquiring genuine international appeal. Undemocratic and repressive, the country lacks the "soft power" that would give it the additional legitimacy to assert its dominance: effective leadership, after all, requires willing followership. Moreover, hegemons need to provide open markets. Yet China is not offering enough export opportunities for poorer countries, even though it previously benefited greatly from deeper trade links with more advanced economies. The Chinese government's recent turn toward self-sufficiency and promoting domestic champions is contributing to the [rapid decline](#) in the country's imports. To be clear, China is entitled to pursue a development strategy that has aided its extraordinary rise. But the country cannot be a benevolent hegemon if it insists on maintaining a protectionist stance that deprives the global system – and other developing countries – of key public goods. The US-dominated G1 world is long gone, and the G2 system in which the US and China shared hegemonic responsibilities is now fading into memory. Instead, we live in a *G-Minus-2* world in which the two hegemons, instead of providing the Kindleberger global public goods of cooperation, are doing exactly the opposite. Understandably, developing countries have begun to ask some pointed questions. What will happen to the global economic system? Will the current system last long enough to enable us to prosper? How will we weather the next round of global turbulence? And does it even make sense to talk about cooperation when the two leading global protagonists are undermining multilateralism and the institutions that sustain it? Consumed by their quarrel, the US and China have so far provided no answers to these questions. There is

an old African proverb that says “when the elephants fight, it is the grass that suffers.” Right now, the rest of the world is very afraid.

* Former chief economic adviser to the government of India, is a senior fellow at the Peterson Institute for International Economics and a visiting lecturer at Harvard’s Kennedy School of Government

The author puts the current trade war into a larger and historical context. He also widens our perspective to the repercussions of the US-China trade war on the developing world’s economy. Here are a few questions to start our discussion:

- President Trump says he started the trade war with China to stop their unfair trade practices that a trade war was easy to win and would fulfill his campaign promise to bring jobs back to his constituents. Were China’s trade practices so egregious that other approaches would not work/ Use of World Trade Organization court? Pressure from a coalition of our Allies informally or through the Trans-Pacific Partnership which he withdrew from on his 4th day of office?
- Has his trade war worked as planned?
- The rise of inequality in the US was coincident with trade globalization in which big US multinational companies reaped most of trade globalization’s gains. Is there some other way than a trade war to make globalization’s economic gains more inclusive of all Americans?
- Is the author correct in saying that the China and US economic domination and cooperation era where the US and China provide world leadership and bring ‘the global public goods of cooperation’ over? Is it possible for Trump and China to repair their relationships? Could even a change in US administration be able to repair the damage?
- Is the author correct to say that the developing countries will be collateral damage in the trade war? If correct, what are the worldwide repercussions to this collateral damage?