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The Impact of US-driven Geo-Economic Fragmentation and Economic Nationalism

Adam S. Posen

ESRI International Conference 2024 "Major Future Economic Challenges"

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1750 Massachusetts Avenue, NW | Washington, DC 20036 | www.piie.com

Underlying global economic themes for 2024 thru 2028

1. **Long-term interest rates in the G7 will stay up** in coming years, even if short-term rates are cut by central banks and inflation stays around target.
2. The **trend productivity growth rate in the US has risen** and this faster rate will be supported by widespread adoption of AI over the next two-to-five years.

   The spread and speed of productivity acceleration in rest of the world remains to be determined.
3. **China will find various fiscal and monetary stimulus policies ineffective**, bearing out the Economic Long COVID analysis. Growth will remain slow, chiefly in the private sector.
4. There is **a lasting and widening gap between several larger EM and the rest of the low- and middle-income economies** with respect to growth, debt, and financial stability.
5. The **corrosion of globalization continues** in the critical areas of foreign direct investment, technological exchange, and business/research networks, though industrial trade is resilient.
6. **Green technology diffusion will be politically fraught and uncertain/**

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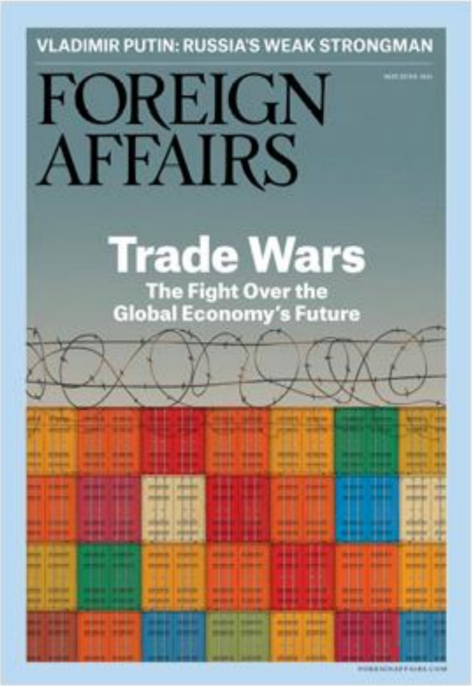
The US has been withdrawing from globalization since before 2002

The Price of Nostalgia



The Price of Nostalgia

America's Self-Defeating Economic Retreat

By [Adam S. Posen]

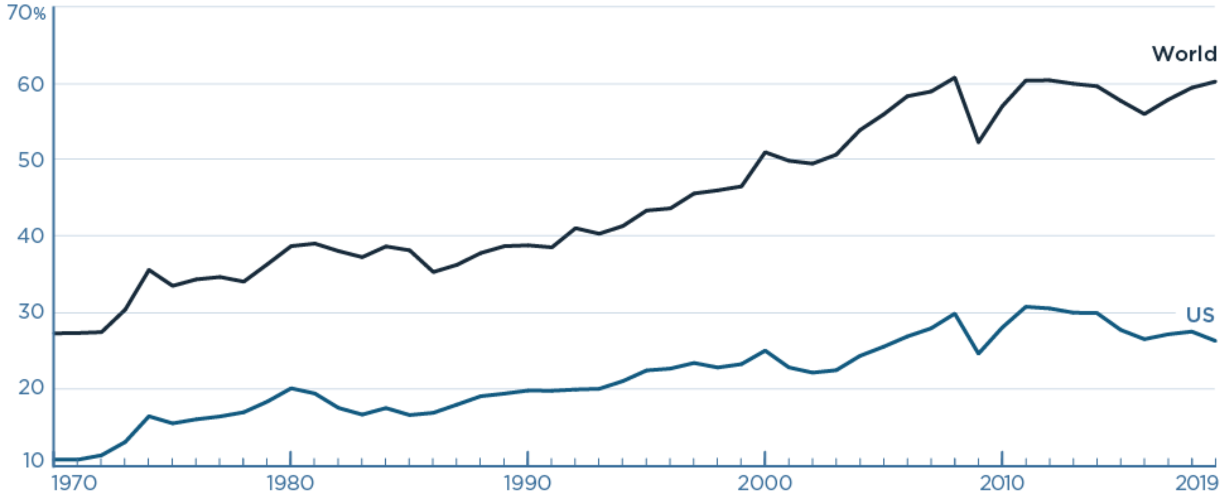
[May/June 2021]

https://www.foreignaffairs.com/articles/united-states/2021-04-20/america-price-nostalgia

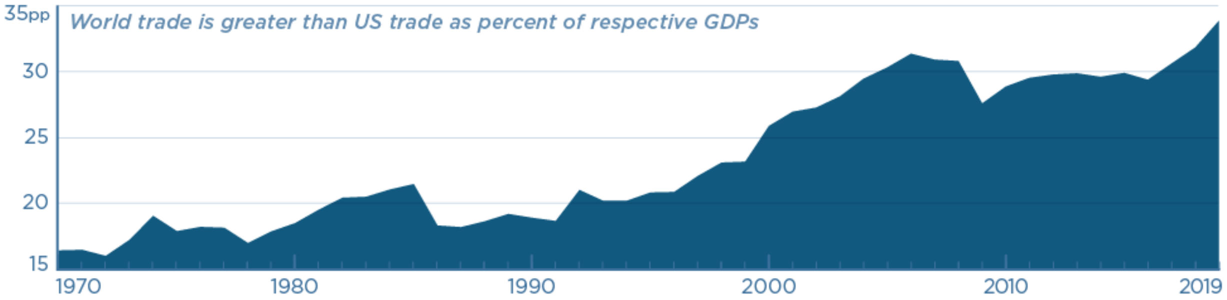
Figure 1

US trade openness has not kept up with the world

a. Trade in goods and services as percent of GDP, 1970–2019



b. Difference between world and US trade as percent of respective GDPs, 1970–2019



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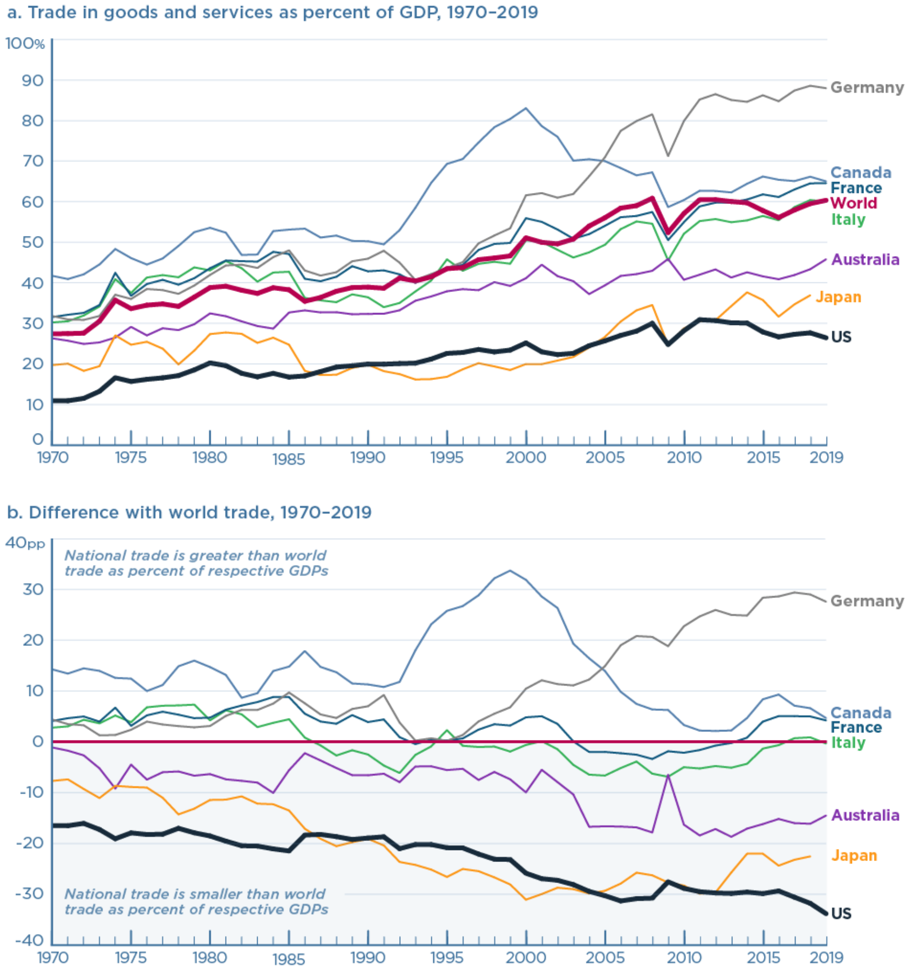
pp = percentage points

Source: World Bank, World Development Indicators database.

Figure 2

US trade openness has declined while that of other large advanced economies has increased



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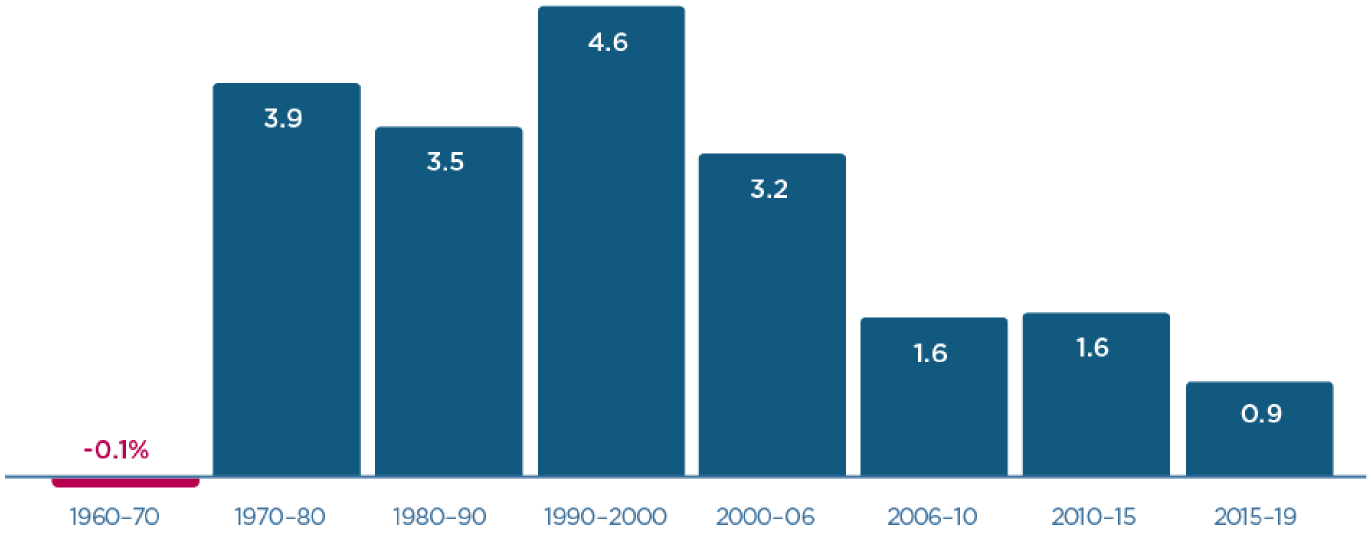
pp = percentage points

Source: World Bank, World Development Indicators database.

Figure 4

US immigrant population growth has been slowing for decades

Average annual growth in US immigrant population, percent, 1960–2019



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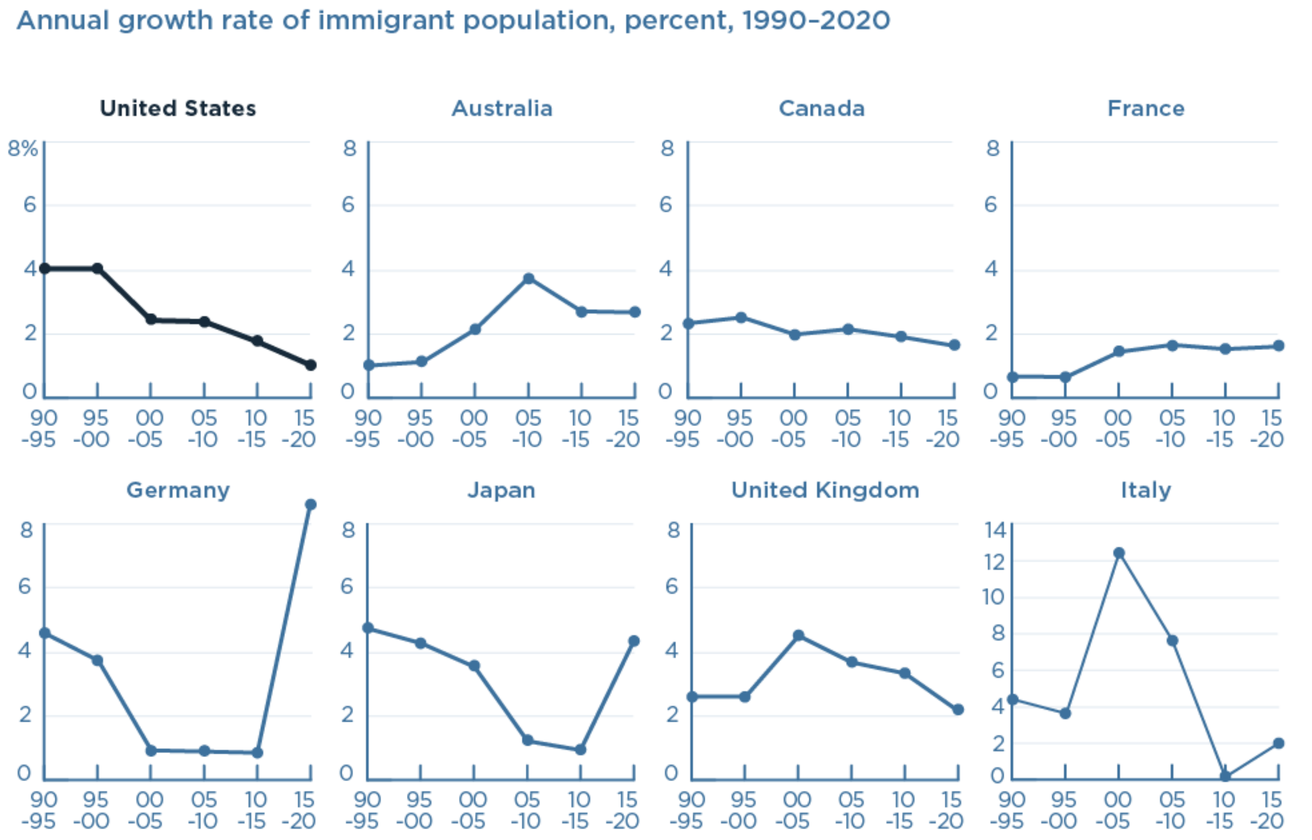
Note: Annual growth rates are geometric averages. Immigrants refer to people who are not US citizens at birth and include naturalized citizens, lawful permanent residents, temporary migrants (e.g., foreign students), humanitarian migrants (e.g., refugees and asylees), and unauthorized migrants. Data from 2006 exclude population born at sea. Average annual growth in US immigrant population was 2.5 percent in 2000–2010 and 1.3 percent in 2010–2019.

Sources: Migration Policy Institute (https://www.migrationpolicy.org/programs/data-hub/charts/immigrants-countries-birth-over-time?width=1000&height=850&iframe=true). Data for 1960 to 2000 are from Campbell Gibson and Kay Jung, "Historical Census Statistics on the Foreign-born Population of the United States: 1850 to 2000," Working Paper No. 81, February 2006, Washington, DC: US Census Bureau, Population Division.

Figure 5

The immigrant population in the US is now growing more slowly than in most other advanced economies



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Note: Annual growth rates are estimated exponential annual rates of change of the international migrant stock.

Source: United Nations Department of Economic and Social Affairs, Population Division, International Migrant Stock 2020.

Why will long-rates stay up? Fragmentation in multiple ways

- Most things that kept r* down from 2007-2019 remain in place, notably:
  - Demographics, risk aversion, and Asian savings glut
  - Forecasts also previously assumed low productivity growth

- A number of things have shifted due to geopolitics and COVID, however
  - G7 and China will increase fiscal spending on defense, green, and industrial policy
    - Reversing the Cold War Peace Dividend, worth ~0.7% increase
  - Fragmentation of global financial markets will trap savings in China and reduce available savings in the West – net is higher rates in US transmitting elsewhere
  - Risk aversion has been reduced in US in response to YOLO and safety net
  - Productivity growth trend has arguably increased – the last 4 quarters are not a blip

⇨ US 10-year Treasury average real rate will *increase* over the next few years

The political landscape for US anti-globalization

- Neither China nor trade are first-tier concerns for most Americans. Migration, however, is a first-tier concern for many American voters.
- These concerns drive politics via symbolism rather than economic outcomes
  - The same voters who are suspicious of US engagement abroad dislike trade/migrants
  - Political advisors confuse lower income voters in swing states with popular views
  - Congress is addicted to demonizing China for performative reasons
- The result is that the proposed policies are largely untethered from economics, especially Trump's. But business is frightened to fight back or sees the gains.
- Congress is almost certain to be split whoever wins: R Senate, D House
  - This raises the likelihood of budget breakdown and little oversight
  - This creates more room for Trump Executive Orders, less room for Harris
- Trump would be more about executive discretion and deal-making (corruption and uncertainty); Harris would be more about legislation and rule of law

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Limited differences on trade/FDI/migration

- Biden retained essentially all tariffs and migration restrictions imposed by Trump
  - FDI screening and restrictions were expanded by Congress during Trump, but still have not been fully implemented. The treatment of Nippon Steel, however, is worrisome.
- Trump will deliver 10 or 15% tariffs “across the board” and 50-60% on China
  - This will translate in practice to raising of all tariffs in the areas deemed ‘national security’ or eligible for Super 301 protection during Trump’s first term – with individual exceptions
- The imposition of 50%+ tariffs on eVs from China – and from Mexico made by Chinese producers – is likely to be implemented soon by either administration
- Harris would prefer to put in place standards and other NTBs and subsidies for domestic production than to raise tariffs in order to achieve the same result
- Similarly, Trump will demand WTO revert to the GATT or the US withdraws, while Harris would not withdraw but would seek the same outcome
- Whatever Trump promises during the campaign, Harris is likely to match

Very different on export controls/sanctions

- The one claim Biden made about trade/China during the SOTU was that his administration has been tougher on tech restrictions, which is true.
  - Trump would de facto suspend Russian sanctions, as well as Ukraine aid
  - Trump would loosen all attempts at financial sanctions except on Iran and Venezuela
  - As seen with TikTok this week, Trump would case by case erode China restrictions
  - He would retain the appearance of China restrictions, but Russia will provide access
- Congress (Senate R's) might stand up to Trump on this set of issues re China, but Trump will retain discretionary implementation so no real teeth will remain
- Both the Harris and Trump Administrations would declare that pharmaceuticals supply is a national security measure and try to end dependence on PRC
- Both the Harris and Trump Administrations will impose unilateral restrictions, but Trump to extract concessions (and reverse them), Harris to pursue security

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Little *international* difference on climate

- Harris would like to be very different than Trump on climate, and will do so via regulation and by encouraging state governments to advance restrictions
  - He will not however be able to pass new legislation nor do anything to credibly restrict continued gas/oil extraction, ICE production, pipelines, etc., as he has not so far.
- As with WTO, Harris would not withdraw from Climate Accords, while Trump would, but Harris would de facto block progress by insisting on America-only rules
- Harris would continue to insist that US green tech subsidies are equivalent to EU Carbon Price, and put in place a CBAM versus many LMIEs
  - Conflict with the EU over US grabbing energy intensive industries either way
- Trump would explicitly back the ongoing production of ICE, while Harris would set targets for its replacement, but protectionism on eV/batteries would stall progress

Geopolitical change will affect Third Nations' global access

- Both U.S. and E.U. brands/companies are likely to go into secular decline in rest of the world
  - Combination of self-dealing, barriers to imports/migration, and unpopular stances will reduce demand
  - Genuine question of how much can Japan, Inc., grow in non-China in competition with China?
  - Likely substantial increase in tied lending, infrastructure investment, FDI with green offset, in LDCs
  - U.S. and E.U. likely to be miserly, PRC too bullying – a real opportunity for Japanese-financed growth?

- The US+2 strategy will be less protected from low-cost competition outside of Japan and U.S.
  - Military use and adjacent emergency use markets may be a growing exception
  - Middle East and SE Asia also could prefer a non-US but non-China dependent set of standards
  - Do not put large bets, though, into Central America, South Asia, Sub-Saharan Africa

- Safe to assume that geopolitics will drive down gas and petrol prices medium-term
  - U.S. and others will want to get what is in the ground sold before they can no longer do so
  - Genuine uncertainty how much green network gets built in ROW given climate – is there a role for EU or Japanese infrastructure diplomacy?

Best current guesses about US Foreign Economic Policy Impact

A. Will 2024 be a political realignment election, meaning the wiping out of either the current Democratic or Republican Party as a player, empowering the President even more?

   Wipeout more likely if Harris/Dems win than if Trump/Reps win. Could swing left(er) on climate

B. How much could Chinese and EU problems – or exogenous productivity gains in US – mask the costs of these policies and minimize the relative pressure on the US?

   Relative performance could hide a lot of US costs from ill-advised policies by either party

C. Would Trump's weakening of NATO commitment encourage Russian/Chinese adventurism?

   Main impact would be China using Russia to evade restrictions instead of vice versa

   Fissures within EU would likely grow, leading to migration and FDI problems

D. Does EU vs US vs China divergence on climate policy create new conflicts?

   Yes. China's role in EM and ROW will rise, and EU and US role will decline, as a result

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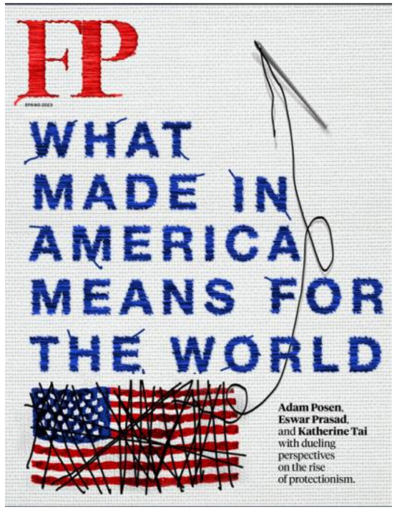
The global pushback on Bidenomics



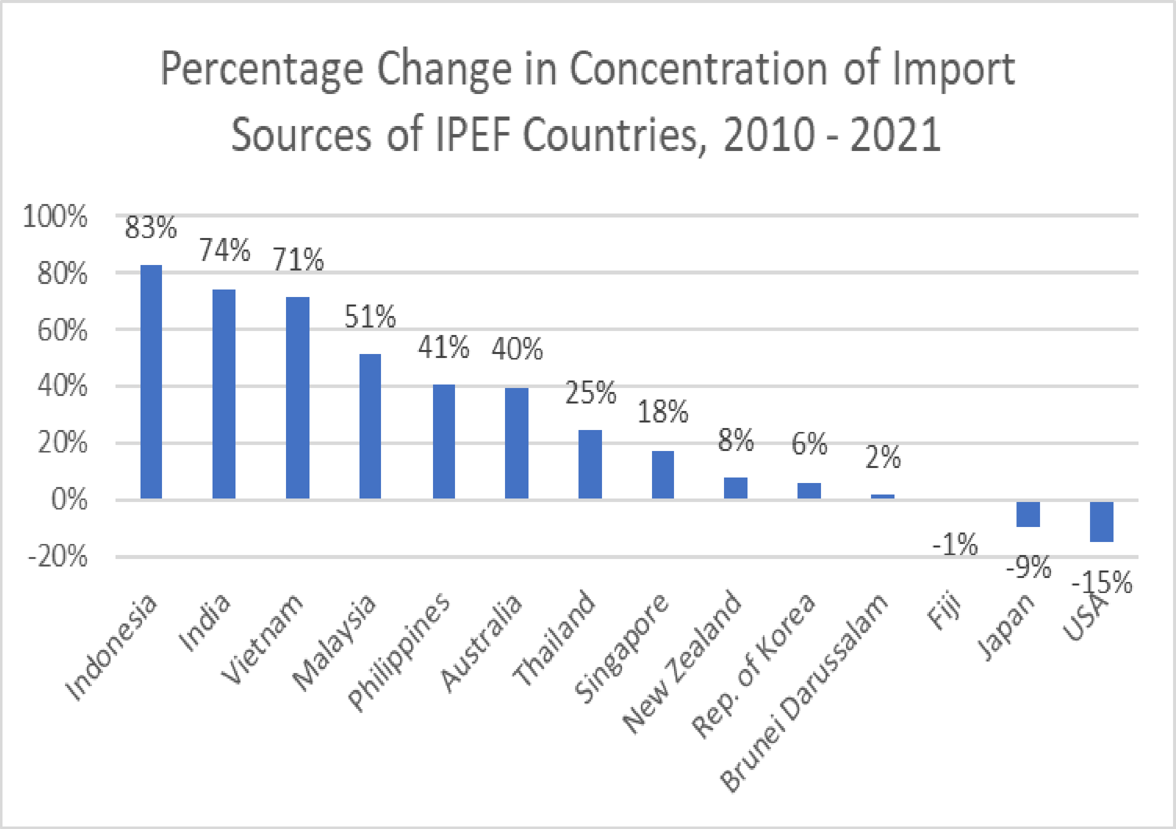
America’s Zero-Sum Economics Doesn’t Add Up

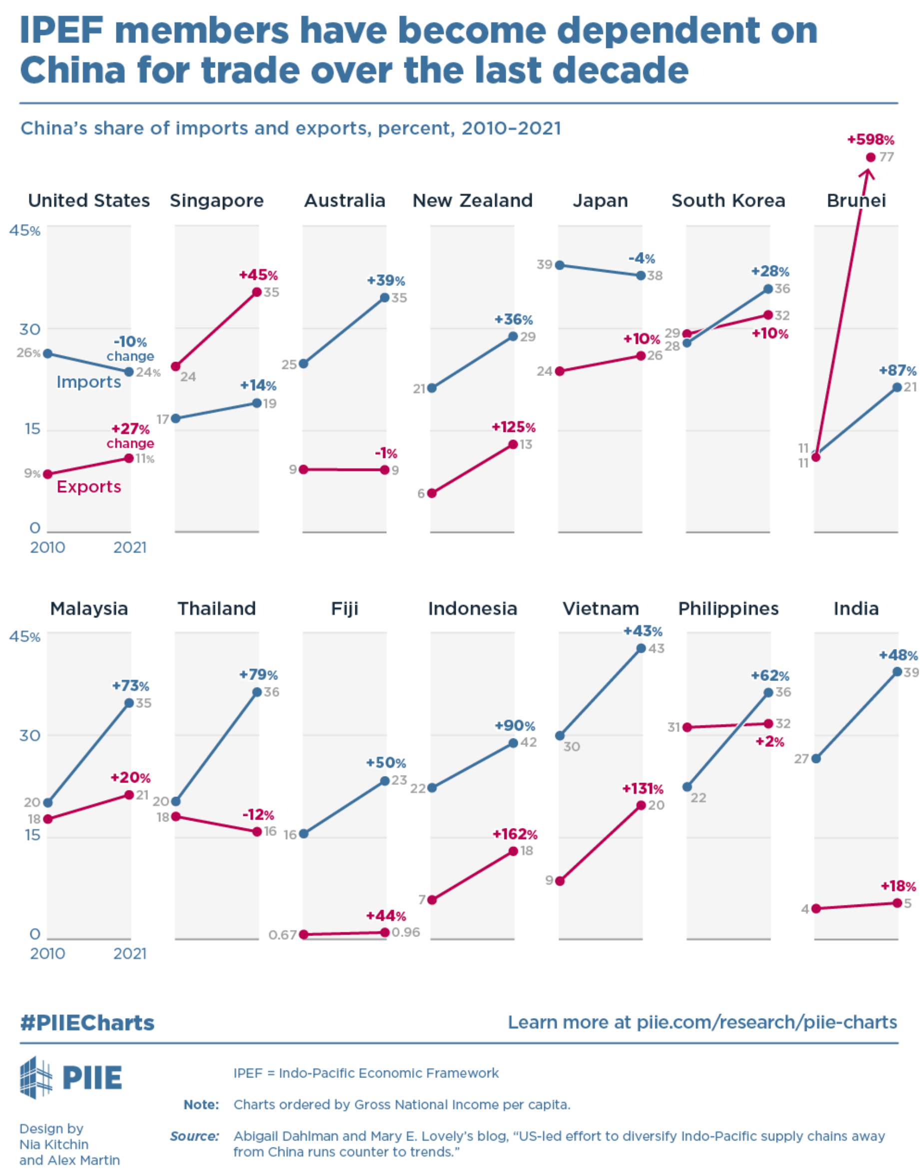
Adam S. Posen
Foreign Policy
March 2023

https://foreignpolicy.com/2023/03/24/economy-trade-united-states-china-industry-manufacturing-supply-chains-biden/

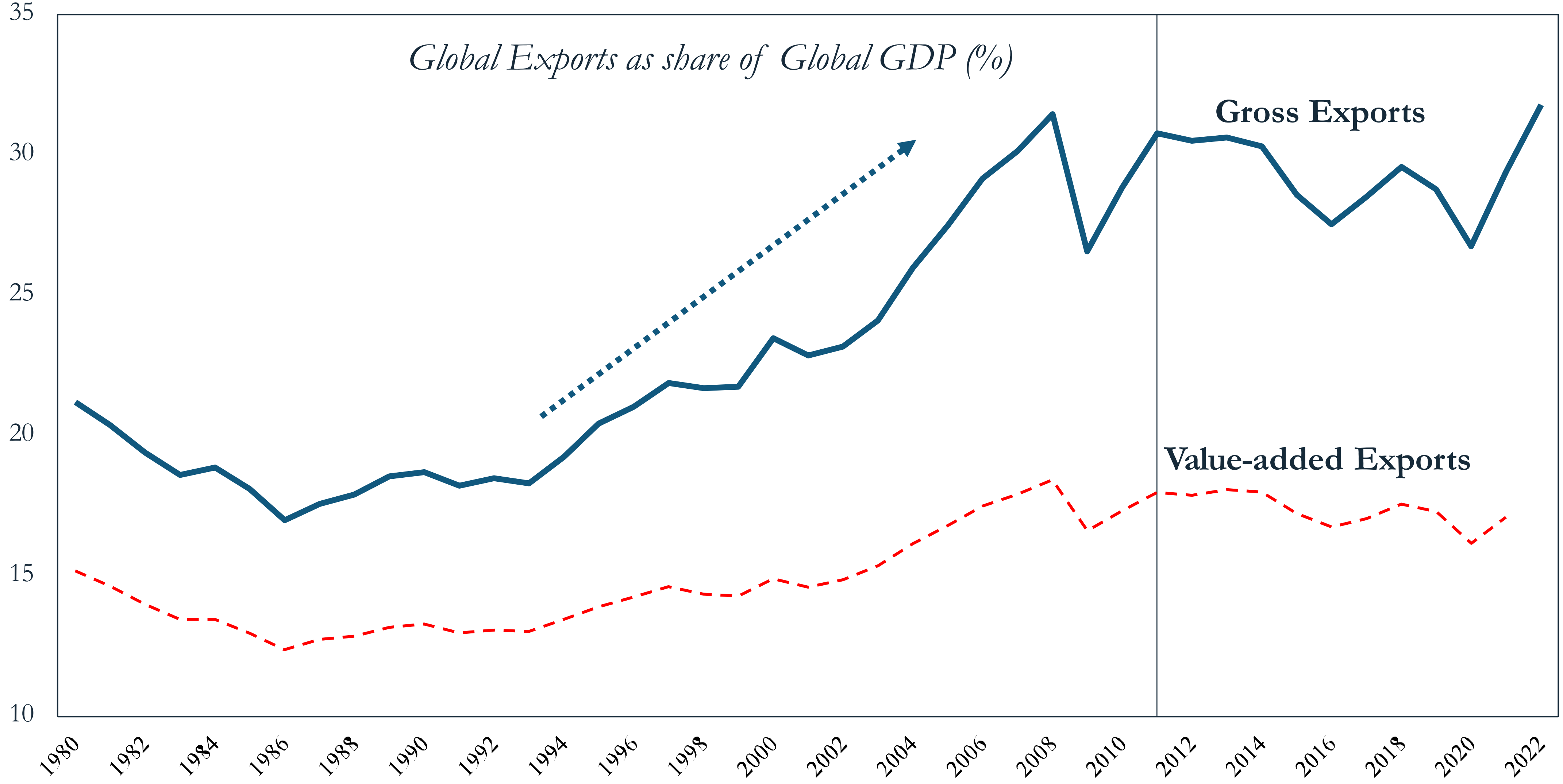
- Biden IP ignored global impact
- National champions arise from producer subsidies and trade protections -> Corruption
- Rapid subsidies arms race
- Exclusion of LMIE from tech future and politicization of trade/FDI
- Slower diffusion of green tech
- Limited recognition now by Biden-Harris Administration

Imports of most IPEF countries have concentrated on China (Lovely, 2024)





Hyperglobalization is Dead (Subramanian, 2023)

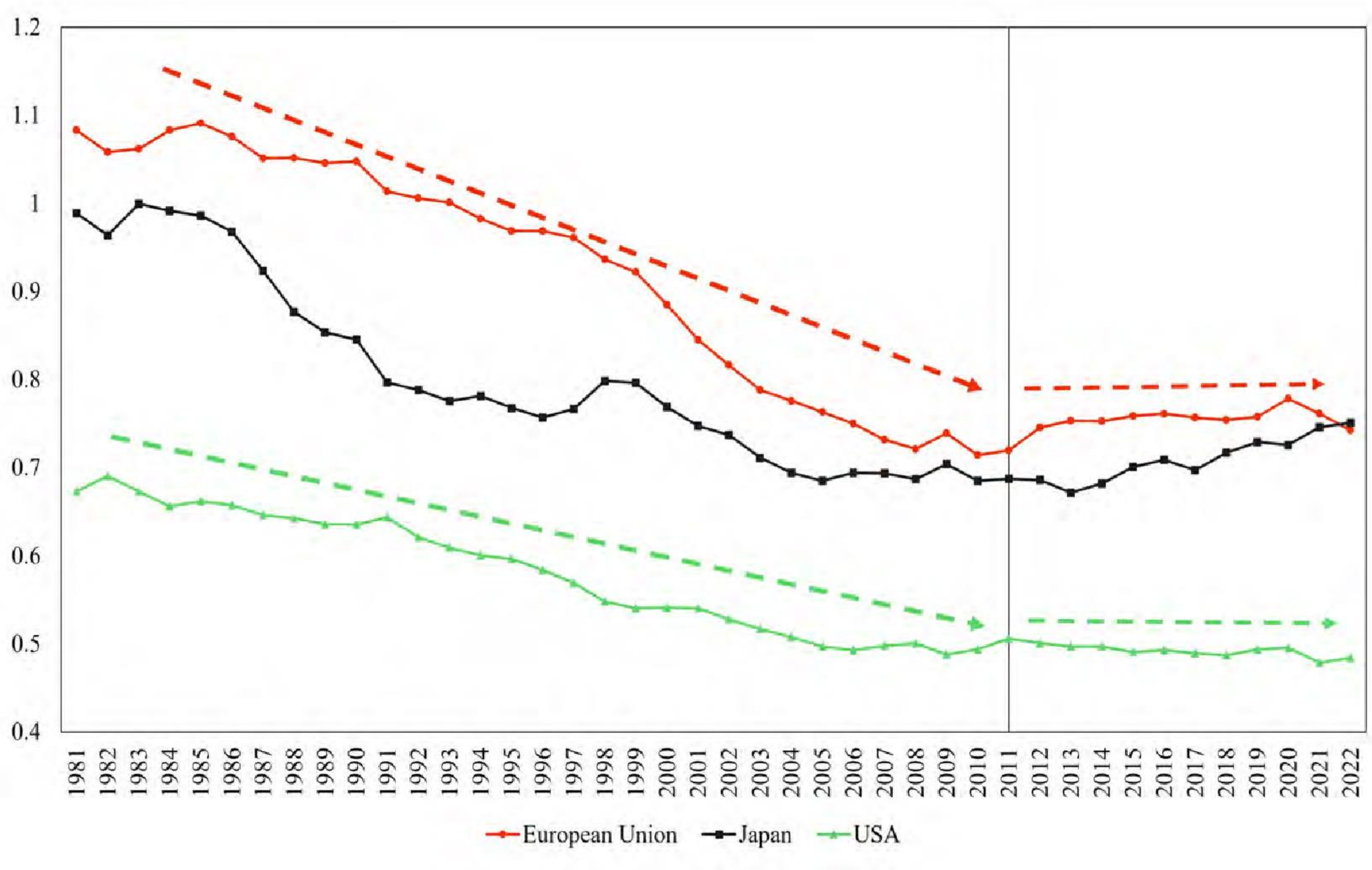


Possible End of Disruptive North-South Trade

(Subramanian, 2023)

Post-global financial crisis, imports from South into North have exerted less "pressure"

Average income level of manufacturing imports



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The corrosion – not the end – of globalization


FOREIGN AFFAIRS The End of Globalization?

The End of Globalization?

What Russia's War in Ukraine Means for the World Economy

By Adam S. Posen March 17, 2022

Adam S. Posen
Foreign Affairs, March 2022
https://www.foreignaffairs.com/articles/world/2022-03-17/end-globalization

- Trade is the most resilient part
- Multi-layered fabric of global interdependence
  - Some parts fraying, some parts expanding, some holes
- Foreign ownership and business networks are more vulnerable
- These hold up prospect of diverging technical standards and slower innovation spread

The changed macro and geopolitical landscape

- Long-term real rates will remain 0.5-1.0% higher than they were before 2020
- Average growth will be weaker in almost all economies, G20 and LMIEs
  - Likely positive exceptions: India, Indonesia, Brazil, Southern Europe
  - Rest of the BRICS and poorer countries will be in persistent difficulty
  - Lack of SIFI financial exposure means less response by G20 to the problems
- Decoupling of China/US and to lesser degree EU on investment, technology, business networks, and capital flows will be far greater than in trade
- Diversification of state-run/regulated portfolios will decrease
- Instability in developing world and military build-ups will reinforce each other
- Rising fiscal sustainability risks will be partially offset by economic nationalism