# The Economics of Trade and National Security

by David A. Anderson

In an increasingly globalized world, trade and economic displacement issues, geopolitics and national security concerns has become intertwined creating a multitude of possible friction points between state actors, international financial institutions and trade organizations. Left to their own devises these factors may slow trade and economic cooperation to a crawl. Vulnerability to such a litany of problematic probabilities does not bode well for global trade and economic harmony. Susceptibility is particularly true when global economic powerhouses such as, the U.S., China, Japan, and the European Union (EU) have domestic economic challenges and/or international trade issues with each other and among their neighbors. These countries account for 69 percent of global Gross Domestic Product (GDP).[1] Unfortunately, this is exactly the condition we find ourselves in today. This article sheds light on the amalgamated mess that has created this fragile environmental situation both economically and in the realm of national security. It closes with the possible ramifications of not resolving the discord and a statesman's approach to potential resolution.

## International Economic Institutions

Arguably, much of the present global economic turmoil is rooted in benefits originally derived from the Bretton Woods conference, held in New Hampshire in 1944. Foreseeing a victory over the Axis powers during World War II (WWII), this conference brought together 43 countries determined to ensure post-war economic cooperation among nations ravaged by war and the Great Depression of the 1930s.[2] Two empowering organizations emerged from the conference; the International Monetary Fund and the World Bank. Both institutions were established to facilitate economic growth within and between nations for the collective greater good.[3,4] These two organizations also set the stage for the founding of an international trade focused entity – the Generalized Agreement on Tariffs

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and Trade.

The Generalized Agreement on Tariffs and Trade, later known as the World Trade Organization (WTO) was created in 1947 to promote trade cooperation and to lower barriers to trade, such as tariffs.[5] Many tariffs, such as the U.S. Smoot-Hawley Act, were implemented in the 1930s and further worsened the Great Depression.[6]

Collectively, these three international organizations are designed to synergistically meet their respective mandates for the greater economic good of the global community. The United States leads and shapes all three institutions. Only one of them, the World Bank, is headquartered outside the U.S. The precursor to these organizations is the United Nations, which was established in 1945 to promote peace, security, political and economic development, and cooperation among member nations. It too is headquartered in the U.S.[7]

The influential role the U.S. plays within these institutions is a direct result of U.S. economic and political hegemonic stature dating back to the very birth of these organizations. By the end of WWII, the U.S. had accumulated 60-70 percent of the world's gold.[8] A global economic recovery outside the U.S.S.R. sphere of influence was largely dependent on U.S. financing, industrial capital and goods/services.

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### U.S. Trade Dominance to Decline

From 1945 to 1975, the U.S. dominated the global economy, running trade surpluses while maintaining a disproportionate share of global GDP. Between 1960 and 1970 the U.S. accounted for nearly 39 percent of global GDP.[9] Conversely, the U.S. habitually negotiated less than equitable terms of trade with its partners in order to win their diplomatic favor/support for U.S. national security and strategic policy interests around the world. It wasn't until 1974 that the State Department handed over trade policy to the newly created statutory position of the U.S. Trade Representative.[10] Unfortunately by then, poor U.S. trade policy and cost/quality complacency of its export products caught up with it and the era of U.S. trade surpluses ended in 1975.[11]

The U.S. eventually lost its competitive edge to emerging competitors such as Japan, Taiwan, South Korea, and those of Western Europe. Many of these same countries were rebuilt by the U.S. after WWII. By 1980 the U.S. share of global GDP shrank to approximately 26 percent. In 2018 this figure fell to around 24 percent.[12] These newly industrializing countries leveraged the aforementioned economic institutions, a U.S. espoused export-oriented approach to economic development, and U.S. Foreign Direct Investment to displace large segments of the U.S. manufacturing.

### The Rise of China

The economic emergence of China in the 1990s, supported by neo-mercantilist policy, cheap abundant labor, an abundance of Foreign Direct Investment and supercharged by membership into the WTO in 2001, further adversely affected balance of trade issues for not only the U.S. but for other countries as well. China displaced much of what remained of U.S. manufacturing and much of what other industrialized countries like Japan and those of Western Europe produced. Since building a globally dominant manufacturing base between the 1960s-1980s, Japan has struggled to maintain any semblance of its original manufacturing glory. It has lost out to cheaper producers—namely China—and has had to move much of its auto production closer to its foreign markets. Its aging population and extremely low-to-negative birth rate makes labor cost and supply even more problematic. It has since shifted its economic efforts toward higher, value-added, advanced technology products and services.

The loss of industrial jobs by developed countries to China and the ensuing trade deficit many now have with China, has exacerbated matters. In 2018, China ran a trade surplus of 323 billion dollars with the U.S.[13] and a trade surplus of 185 billion euros with the EU.[14] China has quickly risen to be the second largest economy in the world[15] and a geo-political power ably flexing its newly acquired clout when and where it wants (e.g., China's South China Sea claims).

Confounding trade matters associated with rapidly industrializing countries like China is the move by developed countries trying to hang on to legacy industry or even repatriate that which they have already lost. Likewise, less developing countries are trying to establish their own industry base while the newly industrializing countries of the world look to hang on to what they now have for as long as possible. These countries know at some point they will have to yield to even cheaper cost producers down the road. If industry is displaced too quickly to developing economies, then newly industrialized countries may be ill-equipped to move up the economic ladder into higher value-added production and technologically/innovation driven activities, leaving them unable to effectively compete with the likes of the U.S., Japan, and the EU. This economic phenomenon is currently playing out and adversely affecting trade relations around the world. Nations are seeking to control their own economic destiny while attempting to dictate terms of trade. In other words, they want to have their cake and eat it too.

China, the primary displacer of Japan's manufacturing base, is directly facing this very problem. Less than forty-one percent of China's GDP now derives from its industrial sector.[16] Furthermore, significantly less Foreign Direct Investment in China is now being invested in this sector. Those funds are now invested in the likes of Indonesia, Malaysia, and Vietnam. Even China is shifting some of its manufacturing focus to cheaper cost producing countries. China's one child policy has come back to haunt it. It left a notable gap of 20-40 year olds to fill the labor force and drove up the cost of labor in China. Furthermore, like Japan, China's population is aging. By 2030 China is forecasted to have 300 million people aged 60 and older.[17] This is a dynamic not lost on the Chinese government—anticipating a looming labor supply shortage while incurring the growing costs associated with an aging population.

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Since joining the WTO, China has done a less than stellar job complying with WTO rules. It has become obsessed with maintaining a favorable trade balance, controlling foreign businesses operating in China and acquiring their technology as a cost of doing business within its borders. This practice of achieving technology transfer through less-than-accepted conventional protocol highlights China's paranoia of not being able to successfully compete more directly with the likes of the U.S. and other advanced countries operating further up the economic ladder. China is openly accused of stealing highly sensitive intellectual property not only for commercial but military uses as well. Its telecommunications equipment company, Huawei, has been accused of spying on behalf of the Chinese government and economic espionage is a growing concern of China's major trading partners.[18] These issues have posed national security concerns for the U.S. and its allies.

In response to China's unfair trade practices the U.S. has imposed tariffs on many of China's exports to the U.S. This act has added notable costs to the sale of these items and disruption to the Chinese supply chain.[19] China's July 2019 Defense White Paper accuses the U.S. of being a destabilizing force for peace in the world, "destabilizing international harmony."[20] U.S. importers are now scrambling to find low cost producers in other countries to offset the increased costs posed by the tariffs. The silver lining, of sorts, is that more countries get to be a greater part of the global economy and the U.S. will be less reliant on Chinese suppliers.

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China is also accused of currency manipulation in order to make Chinese goods more cost appealing. On August 5, 2019 in response to the U.S. imposing a 10 percent tariff on Chinese goods exported to the U.S., China fostered the devaluation of its currency to offset U.S. imposed tariffs. China is increasingly branded as an untrustworthy trading partner by many nations around the world. China's practices have led to trade friction with notable trading partners such as the U.S., Japan, and the EU. This places China in an unenviable position. It wants the respect of others yet feels the necessity to secure its economic and political future at all costs. China knows that any trade/economic concessions made to the U.S. will come with expectations by other nations to have similar type arrangements. It would also indirectly lead to a greater expectation that China conform to WTO membership rules. Not surprising then is China's tough trade talk with the U.S.

## Challenging U.S. Power and International Institutional Norms

Over the past ten years, China has openly contested U.S. influence and voting power on decisions taken by the International Monetary Fund. It has further objected to U.S. policies and lending practices which seem to favor those countries of economic and geopolitical interests of western countries. In response, China created an alternative, multilateral, development lending institution, the Asian Infrastructure and Investment Bank. China has positioned itself in the leadership role, owning 27 percent of the institutions voting rights by far the largest percentage among member countries. India has the second largest number of votes with nine percent. China believes its bank is more appropriately focused and better positioned to address the lending needs of developing countries. Many of the principle members of the International Monetary Fund are now concurrently members of the Asian Infrastructure and Investment Bank.[21] This geopolitical extension emboldens China. It also creates political friction, pitting countries strongly opposed to the Asian Infrastructure and Investment Bank such as the U.S. and Japan, against many of their longstanding economic and political allies. For example, the U.S. and Japan see no need for the Asian Infrastructure and Investment Bank, believing it's a redundant institution serving little purpose other than to compete with the International Monetary Fund while empowering China at the same time.

An extension of the Asian Infrastructure and Investment Bank is China's Belt Road Initiative. Countries are beginning to see Belt Road Initiative in a new light, including those thought to directly benefit from it. China has advertised it as a means of building infrastructure among its East Asian neighbors and collectively connecting them the entire way to Eastern Europe all in an effort to expand trade and promote economic development. Many of the countries involved with China's initiative are now discovering that the true cost of doing business is too detrimental to their sovereignty, fiscal budget, terms of business/trade and employment of labor in working Belt Road Initiative projects within their countries.[22,23]

### WTO Ineffectiveness

Over the past twenty-five years criticism abounds of the WTO's ineffectiveness. The Doha round of trade talks which began in 2001, have yet to conclude. It is inherently difficult to gain consensus on trade initiatives among 164 member countries at different stages of development, presenting opposing/conflicting priorities, views, and outcome expectations. The WTO is accused of being too soft in governing and too slow in ruling over trade disputes (e.g., protecting intellectual property rights against violators, and developed countries subsidizing agriculture production), which undermines developing countries ability to cost compete for market share. The WTO is also accused by developing countries of letting developed countries shape the agenda and outcomes of trade talks at the expense of developing countries, as well as condoning protectionist policies that restrict access to developed countries' markets.

Bilateral and multilateral arrangements are trending among nations in response to the ineffectiveness of the WTO.[24] Over time even these have challenges. Countries are taking unilateral actions against each other on trade-related matters. The U.S. has forced renegotiated terms of trade within the North American Free Trade Agreement. The U.S. reneged on its original commitment to join what was then when known as the Trans Pacific Partnership believing membership would no longer be in its best interests. The EU has had budget, fiscal and monetary issues with member countries (e.g., Greece, Portugal, Spain, and Italy), that ultimately affected the value of the euro and the flow of trade between the EU and others. The United Kingdom is currently in the process of exiting the EU over economic, sovereignty and political issues. The U.S. is working towards new bilateral terms of trade with Japan and the EU that are seen as more equitable for the U.S. Japan and South Korea are tenuously working toward better trade arrangements. However, as of August 2019, Japan has removed South Korea from its trusted list of trading partners.[25] The U.S. and China appear locked in an uneasy trade stalemate. China and India's trade arrangement is increasingly problematic due to the disparity in the flow of goods between the two countries. China is selling far more to India than it is buying from India.[26] This makes the cold peace between the two more fragile when considering the long standing border disputes they have with each other. These illustrated examples are merely a representation of some the larger trade issues ongoing around the world.

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### Promoting Domestic Economic Growth and Trade

Trade is a key component and critical focal point among nations in facilitating domestic economic growth. Countries are looking to grow their economies, put more people to work, increase domestic consumption and trade their way out of debt. There is an underlying fundamental economic fragility among most of these. This is particularly true among most developed countries facing slow GDP growth, deficit spending, shrinking domestic consumption and negative trade balances. For example, the Organization for Economic Cooperation and Development with 34 developed country members, and the G20 with the EU and 19 member countries, have an average debt-to-GDP ratio of approximately 72 percent.[27,28] G20 countries represent 85 percent of global GDP and two-thirds of the global population.[29] Both organizations have promoted financial stability and economic sustainable growth as underpinnings of their organizations. However, their members habitually have domestic economic interests that frequently collide with other participate countries making the organizations ineffective to its associates, as well as non-member developing countries that are supposed to benefit from their policies. Many of these partner countries are referenced throughout this article.

In an effort to stimulate economic growth in an otherwise anemic Eurozone, the European Central Bank has lowered its key interest rates to within a range from 0.25 percent down to as low as -0.40 percent.[30,31] What a negative rate means to bank deposits is that account holders must pay to keep their money in the bank. In countries such as Denmark (currency is the Danish Krone) where negative rates have persisted, home mortgage holders actually receive a check each month from their lending institution for having a loan with a negative rate.[32] Extremely low to negative interest rates are intended to encourage consumption and investment. The approach has been underwhelming in effectiveness, including in Japan whose economy has been stagnant for years.

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Countries employing this stimulus approach have left themselves with little room remaining to use monetary impetus to spur economic growth. When coupled with huge fiscal deficits, these countries are running out of viable options. They are already facing the consequences of ineffective monetary policy and burdensome government debt. The U.S. has amassed 22 trillion dollars of government debt.[33] China and Japan hold 2.2 trillion of it.[34] This could pose a national economic security risk if they were to sell their holdings. It would ultimately lead to the U.S. having to offer higher yields on future debt offerings to make the debt instruments appealing to buy. Whereas, paying down the debt takes money out of the economy causing slower growth—a catch-22.

Japan has accumulated a government debt balance equal to 253 percent of GDP[35] and a private debt balance of approximately 165 percent. China does not fare much better, with a combined private/public debt to GDP ratio of approximately 258 percent.[36] The higher interest payments would put the U.S. further in debt. That being said, it has led to lower valued currencies in relationship to other major currencies making their goods more cost appealing to foreign buyers. On the flip side, it has hurt U.S. exports further exacerbating the balance of trade problem the U.S. has with China, the EU, and Japan.[37]

### Protecting State Interests

National security related documents among nations are further focused on economic prosperity, fair and equitable trade and protecting national security by restricting the purchase of security sensitive products, technology, domestic businesses, infrastructure and resources. U.S. examples include, the 2017 National Security Strategy's, pillar #2 titled "Promote American Prosperity, preventing China from purchasing U.S. oil company, Unocal in 2005, and preventing Dubai Ports World 2006 attempt to manage numerous major U.S. east coast ports.

There is growing concern of state-owned enterprises purchasing private sector companies that pose economic and national security concerns. Countries like China have accumulated huge Sovereign Wealth Funds from years of positive trade balances. They are increasingly using their funds to make purchases of technology, natural resource companies, and other economically sensitive businesses around the world. China's Sovereign Wealth Funds is approximately $940 billion U.S. dollars.[38] There is a total 7.6 trillion U.S. dollars' worth of Sovereign Wealth Funds held by countries.[39]

## Conclusion

Generally speaking, globalization has nurtured warm economic peace among trading nations, whether bilateral or multilateral, overriding cold politics. However, trade spats over national security concerns, fairness in the terms of trade, the flow of trade, currency manipulation and subsidization and protectionism of trade etc. are undermining trade and threatening global economic growth. When coupled with a weak/ineffective WTO, a globally trending economic slowdown, hastily emerging political and economic polarization among nations and failing monetary and fiscal policies, economic conflict is likely to increase rather than decrease around the world.

This condition is an unfortunate and troubling sign of things to come. Everyone loses when trade is impeded. The world pays more for things which leaves less discretionary money available to buy other things—purchasing power is lost. It will contract economic growth around the world and may severely spiral downward through tit-for-tat polices that protect domestic markets at the expense of trade. Nations must recommit themselves to their liberalist cooperative roots that led them to create the international economic-focused institutions they joined. Liberalist principles are only as good as the willingness to adhere to them. Trade should not evolve into a divisive zero sum game of "I win, you lose." This undermines the spirit of global economic prosperity for the sole interests of the few. Warm economics can quickly turn into cold politics.

There is a fine line that separates securing domestic economic growth and ensuring national security from global peace and economic stability. Nations and the EU community need to do a more cooperative, thoughtful and purposeful job walking this fine line, beginning with the U.S., China, the EU, and Japan. The rest of the world will follow their example. If any country/union of countries fails to operate in a global collective spirit, then they must be held accountable by the international community and pay for their misguided approach. Only then will the mutually distractive "race to the bottom" path we are on be turned around. ***IAJ***

## NOTES

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