Economies around the world rattled

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Almost 90 years after the tit-for-tat (TFT) tariffs that defined trade restrictions during the Great Depression of the 1930s, the United States (US) and China have clamped selective reciprocal protective tariffs. It is a clash of the titans in the global economy and international trade. The clock is ticking as the March 01, 2019 deadline approaches. Negotiators from the two countries are back at the table in Washington DC with barely one week left. The best scenario for the world community would be if it is a soft deadline that can be deferred. China has been targeted for "unfair trade practices, technology theft, cyber attacks, illegal subsidies, undue import barriers, and currency manipulation" — a long package of serious complaints from the US administration.

United States, the largest economy in the world with US$20 trillion Gross Domestic Product (GDP), is the largest importer of goods in the world. China, the second largest economy with

$13.5 trillion GDP, is by far the largest exporter. At this point in time, we would desist from describing this as a trade war just yet. It is rather a trade spat. For all the hyperbole surrounding these developments the two sides are seriously engaged at the negotiating table for a mutually acceptable resolution. In the meantime, there is no question that the TFT tariffs have rattled economies around the world dampening the prospects of growth in global trade and output. Bangladesh today is far more integrated with the world economy than it was 25 years ago. It cannot therefore be immune to these developments. There could be positive as well as negative implications of this development for Bangladesh. No doubt a closer look is warranted.

Since the 1980s, the Chinese economy has averaged double-digit growth (approximating 10 per cent) for nearly three decades. In the process, the Chinese economy overtook two economic giants – Japan and Germany – while slowly catching up with the US. The Chinese economy has been booming since they adopted market-oriented reforms beginning in 1978. But it was China's accession into the World Trade Organisation (WTO) in 2001 that gave Chinese trade and exports the real boost catapulting China as the export powerhouse of the world, overtaking Japan and Germany in that category. In a world of rising consumer spending China became the world's largest supplier of consumer goods ranging from electronic appliances to apparel, footwear and toys. China has been accumulating trade surpluses ever since while depleting savings from the rest of the world, creating the imbalance that played a pivotal role in precipitating the global financial crisis of 2008-09.

While analysts continue to decipher the various implications of the evolving drama, the focus of the present paper is on the most critical aspect – US-China trade imbalance — leading to the current crisis. In 2018, the US ran an overall trade deficit of $600 billion of which some $375 billion came from its trade with China. It is fair to say that the geopolitics or the political economy of trade deficits often raise more red flags than the economics of it. Economists rightfully focus on trends and sustainability of overall trade deficits rather than the bilateral deficit between two countries. But bilateral trade deficits, when they are significant and persistent over time, do give rise to political or economic tensions between two economies, as is the case with US and China. In the case of Bangladesh, the two major sources of imports are China and India with whom it ran a combined trade deficit of about $20 billion in FY2018 but ran surpluses with most other countries including important trading partners like the US and EU. Inflow of remittances typically compensate for our trade deficit leaving the current

account in surplus for most years since 2001. The bilateral trade deficits with India and China are not of much concern as they turn out to be cost effective sources of inputs into the productive sectors of the economy.

The state of US trade has been high on the agenda of the Trump administration. The root cause of the problem lies in the massive and persistent trade deficits that the US economy has been running year over year, not just with China. Basically, this reflects the fact that Americans spend more than their income (largely debt driven), and invest more than their savings by borrowing from abroad (capital inflows). Nevertheless, the US economy appears to be strong, with the lowest unemployment in decades, and growing faster than most developed economies today. But Trumpian economics of trade deviates from the mainstream notion of the gains from trade and specialisation according to comparative advantage. And there is a narrow focus on 'trade deficits'. The long-discarded mercantilist argument that export is good, import is bad, seems to have gripped his policy advisers who are not known for their command over the workings of international trade. The rise of China as the most cost-competitive source of consumer goods is seen as an outcome of 'unfair trading practices' rather than of comparative advantage stemming from resource endowments. Part of the blame is levelled against the rules-based international trade body, WTO, for letting China enjoy developing country special and differential treatment (S&DT) despite being highly industrialised. Furthermore, US is unhappy with WTO for being unable to ensure compliance of trade agreements, such as the one in respect of intellectual property, Trade-related Aspects of Intellectual Property Rights (TRIPS). In the past two years, the Trump administration has done all it can to undermine this institution which, though not perfect, has played a seminal role in fostering global economic development through expansion of trade.

Considering dismantling of the WTO – a post-War institution whose principal architect is the USA no less – could take world trade back a century. To be fair, none can deny that the WTO needs reform, perhaps an overhaul, to cope with the transformative changes taking place in the world of trade and industry. It is also true that while China acquiesced with the necessary tariff reductions to join the WTO, its economy falls well short of commitments to embrace fundamentals of the market economic system. State ownership and intervention in the market still remains pervasive – a situation that raises serious questions about pricing and subsidy policies that contravene the basic tenets of competitive practices in international trade. Not surprisingly, the US calls for a level playing field, and justifiably so. But the US

threat to throw the baby out with the bath water is unconstructive to say the least.

That brings us to the geopolitics and political economy of international trade. China is no longer the puny poverty-stricken developing economy it was in the 1970s. It is now a major economic player on the world stage, with significant financial muscle that comes not merely from the fact that it holds over $3.0 trillion of foreign exchange reserves — the largest reserves for any country. It is also seen to be flexing its muscle to gain geopolitical advantage in Asia and Africa through strategies such as Belt and Road Initiative, Asian Infrastructure Investment Bank (AIIB), and the New Development Bank, to name a few. China has also become a major player offering stiff competition in the digital world with considerable advances achieved in the critical area of artificial intelligence (AI).

That said, putting all the focus on the containment of the US-China trade deficit through the archaic instrument of tariffs is a non-starter that is bound to cause more harm to the world economy than it would help the US. Reports suggest that 99 per cent of US economists disagree with the approach taken by the Trump administration. But Trump and his policy advisors remain unmoved. In addition to opening up the Chinese economy by removing artificial barriers to exports their ostensible strategy is to diminish if not cut off China's access to the vast US market that will reduce imports from China enough to substantially eliminate the bilateral trade deficit. The US has the leverage of being the largest export market in the world, and China so far has built a dynamic economy on the back of exports to USA and Europe, followed by emerging markets and others in East Asia and the Pacific. The problem is that even if this strategy were to yield the intended result – at significant costs to American consumers and producers — it would lead to widening trade deficits with other economies leaving the overall deficit largely unchanged, as long as the root cause of the problem is left unattended. Consumer spending makes up 67 per cent of total spending in USA and is the main driver of growth. Curbing consumer spending will have high political costs at home. Generating more savings out of a growing economy is the better option that Americans will have to learn to get used to. But that is easier said than done.