FINANCIAL TIMES
22-11-16

Donald Trump faces the reality of world trade

The US president-elect must decide what to do about China

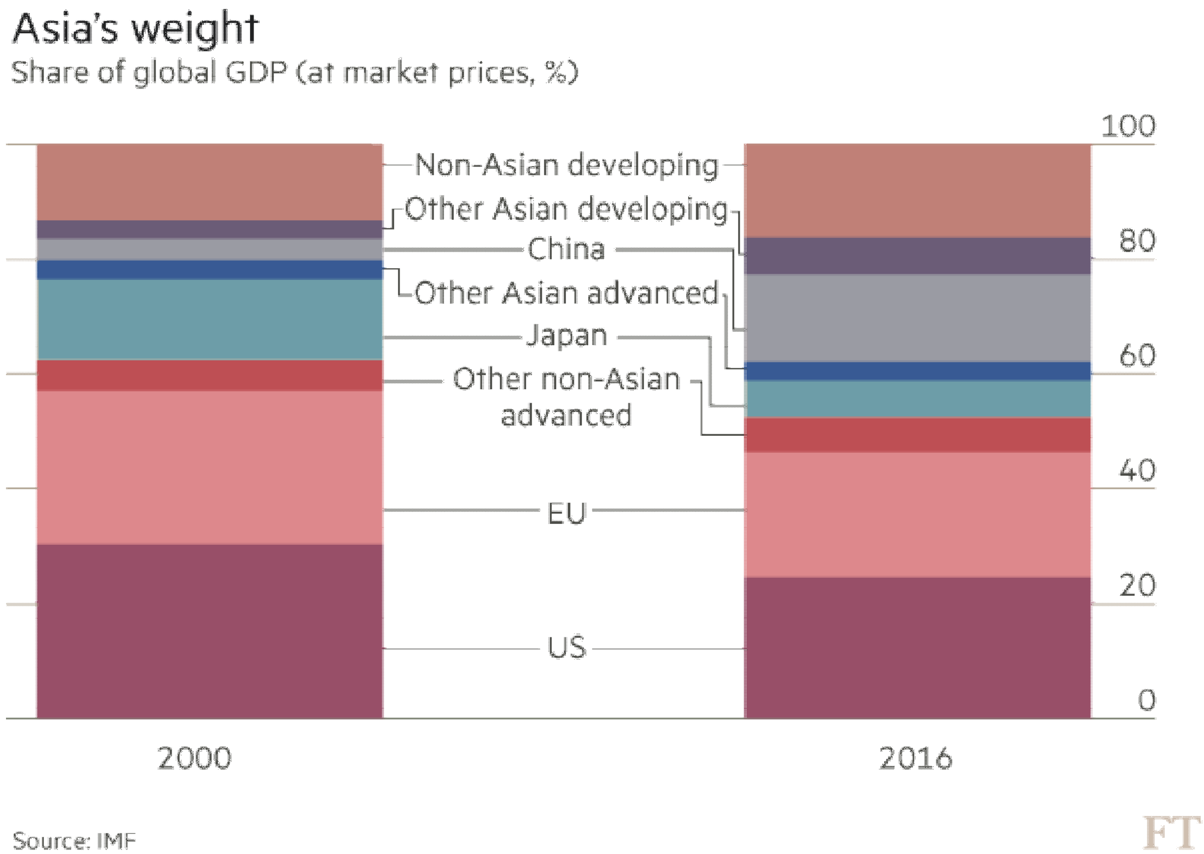
by: Martin Wolf

Might China rescue the globalisation of trade from its rejection by the US, under President Donald Trump? Could the threat of Chinese leadership, or pressure from US business, persuade Mr Trump to take another look at trade deals, even President Barack Obamaôs Trans-Pacific Partnership?

The answer to the first question is: only up to a point. China could not replace an engaged and outward-looking US, even if it wanted to ð but it could help. As to Mr Trumpôs intentions, are they fixed or negotiable?

President Xi Jinping this weekend promised a brave new Beijing-led order marked by openness to trade and investment. Mr Obamaôs TPP was designed to exclude China. Now Mr Trump has announced the US will pull out of the deal when he takes office. This leaves the way open for China to push ahead with its alternative: the Regional Comprehensive Economic Partnership. Seven of the 12 putative members of TPP are potential members of RCEP. Mr Xi also offers Latin American countries access to Chinaôs ñOne Belt One Roadò initiative.

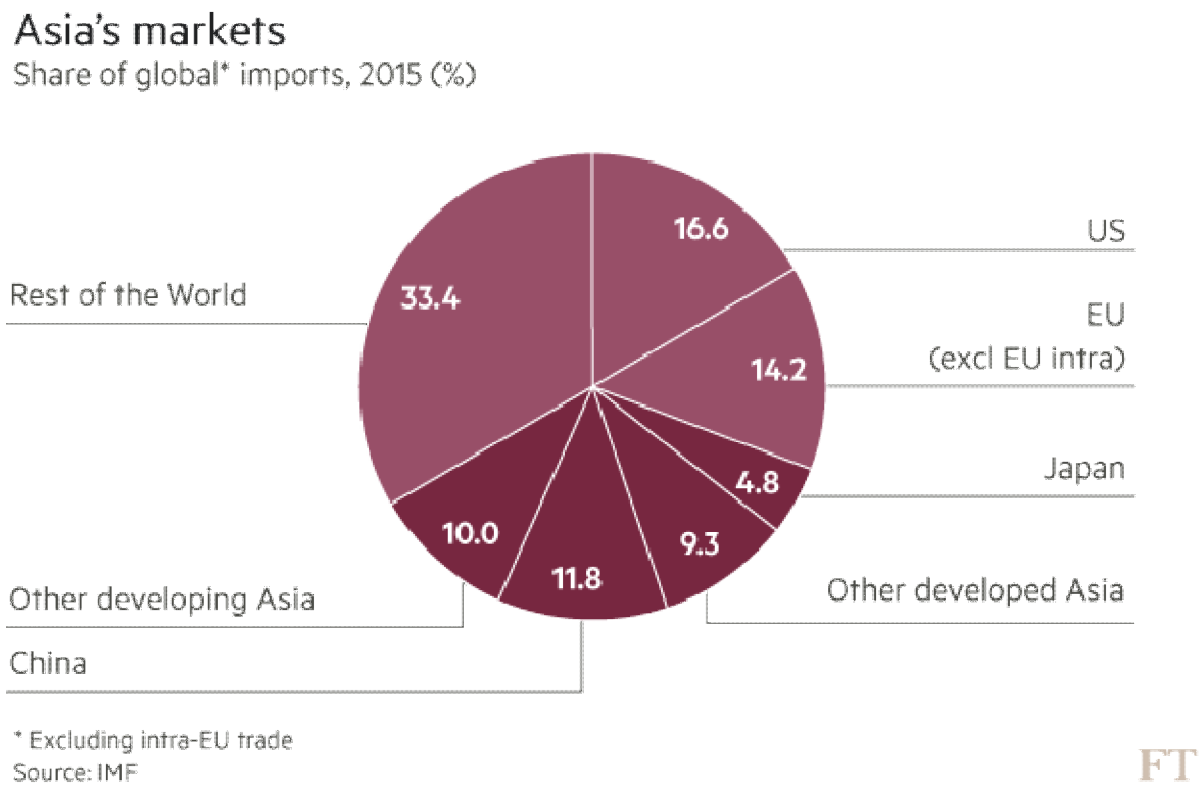
Yet there are limits to how far China might replace the US, let alone the west, in world trade. If we look at shares of global gross domestic product at market prices, a crude measure of actual purchasing power, Chinaôs share jumped from 4 per cent in 2000 to 15 per cent in 2016. The share of Asia (including Japan) is 31 per cent. Meanwhile, the US and the EU together account for 47 per cent of global GDP. Similarly, despite growing rapidly, Chinaôs share in global imports was only 12 per cent in 2015, while that of Asia was 36 per cent. The US and EU (excluding intra-EU trade) still accounted for 31 per cent of world imports.



Moreover, this understates the role of high-income economies in world trade, in two significant respects. First, much of the worldôs final demand still comes from these economies: at market prices, Chinese consumption was roughly a quarter of that of the US and EU combined in 2015. Second and far more important, the knowledge driving much of contemporary trade comes from companies of high-income economies. Chinese companies have still no comparable depth of know-how to offer.

In The Great Convergence, Richard Baldwin of the Graduate School in Geneva sheds a bright light on the nature of trade in todayôs era ð the ñsecond globalisationò since the industrial revolution.

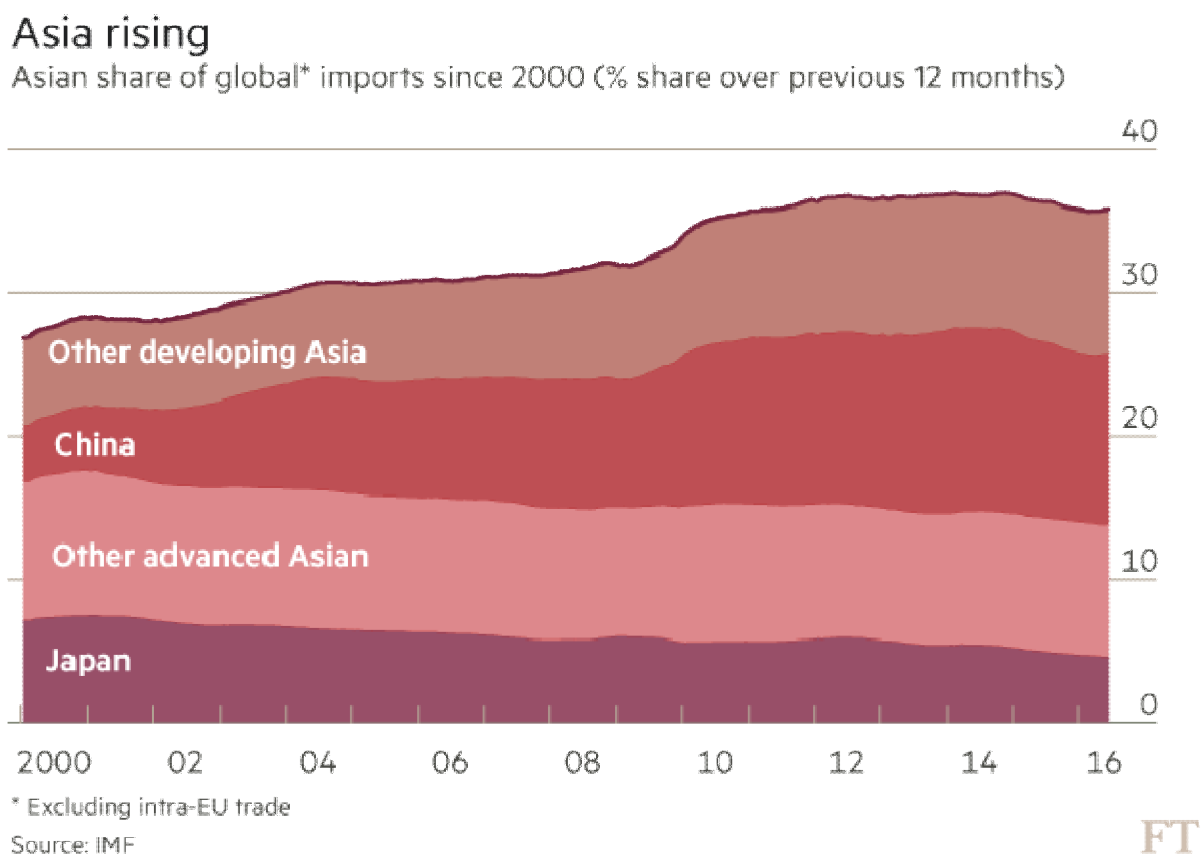
His core point is that trade is always limited by the costs of distance, the relevant costs being those of transportation, communication and face-to-face contact. In the first globalisation, in the late 19th century, the rapid growth of world trade was driven by the fall in the costs of transport of goods. This made it possible to create a global exchange of manufactures against the natural resources and agricultural products from mainly the Americas and Australasia.



In that era, however, it was impossible to unbundle the manufacturing process. To compete in industry, a country had to master all the necessary skills. As a result manufacturing, and with it the gains from economies of scale and learning-by-doing, were concentrated in high-income economies.

Furthermore, modestly skilled workers in these countries shared much of these gains ð achieving, as a result, unprecedented incomes and political influence. This happened because they had privileged access to the fruits of the knowledge developed within their economies.

Until about a quarter of a century ago, the only way to break into this charmed circle was to develop competitive industries of oneĝs own. This was difficult: few countries managed it. But, in the second globalisation, costs of communication fell so far that it became possible to unbundle (or fragment) the production process, with the production of components and final assembly scattered across the world, under the control of manufacturers or buyers with the relevant knowledge. As Mr Baldwin puts it, workers in South Carolina ñare not competing with Mexican labour, Mexican capital and Mexican technology as they did in the 1970s. They are competing with a nearly unbeatable combination of US know-how and Mexican wages.ò



National capitalism became global. This also applied to some service activities. Most developing economies failed to take advantage of these opportunities. But some did ð notably China.

Trade of manufactures for raw materials continues too, notably between China and its suppliers. But it is the new dynamic of trade that drove the protectionism that brought Mr Trump to power. The political struggle is now over who benefits from the know-how developed by the companies of high-income countries. That struggle raises an important normative question: who ought to win? It also raises a positive one: who will win? Will Mr Trump favour US workers over the owners and managers of US companies?

Or will he merely pretend he does so, offering token gestures ð rejecting TPP, renegotiating the North American Free Trade Agreement or threatening China with tariffs while leaving most world trade much as it is? Might he not conclude, in fact, that giving China a chance to organise world trade is against US interests? Might he not fear that, by limiting the US role in the global unbundling of production, his countryôs companies would be at a disadvantage and might move even more of their activities to more welcoming regions?

It is not possible for Asia as a whole, let alone China, to maintain the dynamism of world trade on its own. The west matters far too much, not least for China.

Fortunately, the forces in favour of global trade remain quite strong. Even Mr Trump might lack the ability or the will to thwart them altogether.