Reflections

Restoring Free Trade and Investment in a Global Trading System

William A. Owens and Barry W. Poulson

Unfortunately, the United States has taken the lead in a retreat from global economic integration. U.S. trade policy is now focused on "friend-shoring." Tariffs and other trade restrictions are designed to shift supply chains from China and its allies to benefit the U.S. and its allies. U.S. subsidies promote high-technology industries such as semiconductors and microprocessors. The U.S. has launched a subsidy war in its efforts to promote clean energy. The U.S. has also entered into regional agreements with its allies, e.g., the Indo-Pacific Economic Framework for Prosperity, that are fragmenting trade into regional trading blocs.

China has responded with its own countermeasures, boosting tariffs and trade restrictions on the U.S. and its allies. China pursues industrial policies to divert supply chains toward its own industries, imposing tight controls on exports from high-technology industries. China also pursues mercantilist policies through bilateral and regional trade agreements. BRICS members have all responded by boosting tariffs and trade restrictions on the U.S. and its allies.

William A. Owens is a former vice chairman of the Joint Chiefs of Staff. **Barry W. Poulson** is an emeritus professor at the University of Colorado Boulder. They are founding board members of the Federal Fiscal Sustainability Foundation Inc.

The Independent Review, v. 29, n. 1, Summer 2024, ISSN 1086–1653, Copyright © 2024, pp. 169–176.

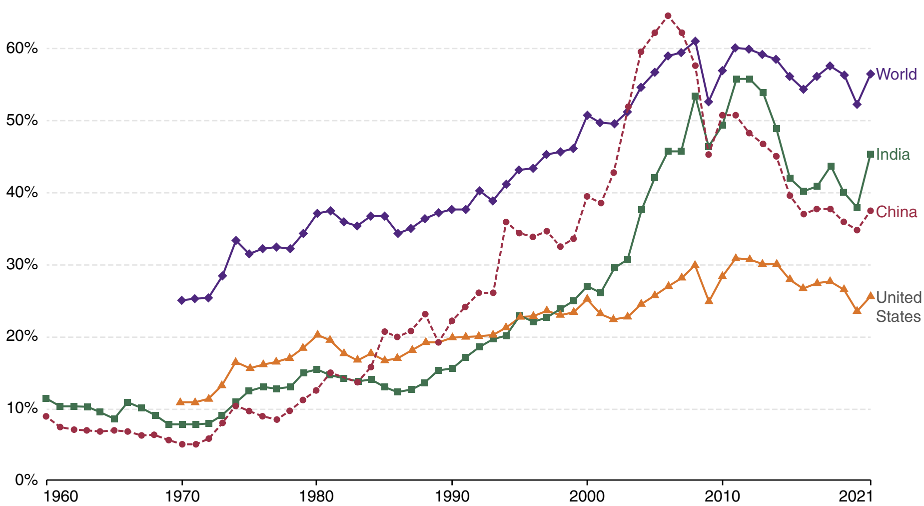
Figure 1 shows trends in trade as a share of gross domestic product in three economies: India, China, and the United States. Prior to the financial crisis in 2008, trade as a share of GDP was rising in all of these countries. The financial crisis in 2008 marked the end of this rapid growth in international trade; since then, trade as a share of GDP has fallen in most of the world, including the U.S. The decline in trade as a share of GDP is especially evident in China and India.

Since the financial crisis, trade as a share of GDP in the rest of the world has stagnated. It is not surprising that retardation in the growth of trade relative to GDP in the major economies has had a negative impact on trade in the rest of the world. The protectionist policies pursued in the U.S. and China have been accompanied by beggar-thy-neighbor policies throughout the global economy.

Perhaps the most controversial policies have been U.S. sanctions on the financial assets of foreign countries. When Russia invaded Ukraine, the U.S., along with other countries in the Western alliance, froze nearly half of Russia's reserves in foreign currencies and gold, and severely limited Russia's access to the SWIFT international payments system. In prior years, similar sanctions were imposed on smaller countries, including Afghanistan, Iran, and Venezuela.

Whatever impact these sanctions had on the target countries, they have had unintended consequences for the international financial system. The sanctions

Figure 1
Trade as a Share of GDP, 1960–2021



Source: Our World in Data. Accessed March 15, 2024. https://ourworldindata.org/grapher/trade-as-share-of-gdp?tab=chart.

Note: This chart shows the sum of exports and imports of goods and services, divided by gross domestic product, expressed as a percentage. This is also known as the trade openness index.

imposed by the U.S. increase the risk in holding dollar reserves in all countries, especially when their foreign policies do not coincide with that of the United States. Sanctions have been imposed on countries with ties to BRICS members, so it is not surprising that these countries are now attracted to the new BRICS reserve currency arrangements and payments system.

As the U.S., China, and other countries pursue mercantilist policies, the world is fragmenting into competing trading blocs pursuing trade wars and currency competition. Mercantilist policies are diminishing international trade and investment flows, just as they did during the Great Depression. This has proved to be fertile ground for populist leaders of all stripes.

Prominent officials, such as Treasury secretary Janet Yellen and European Central Bank president Christine Lagarde, tell us that the global trading system is stagnating (Olson 2022a). The International Monetary Fund has even given a new name for the policy-driven reversal of global economic integration: geoeconomic fragmentation. It is important to put “geoeconomic fragmentation” into historical perspective.[1]

There have been two eras when globalization led to rapid growth in world trade and investment. In the early nineteenth century, the modern era of international trade and investment was created, with Great Britain as the dominant player. The classical economists challenged mercantilist policies, and Great Britain provided leadership in pursuing policies of free trade and investment. By the second half of the nineteenth century the benefits of a global system of trade and finance were clear, and other countries followed the lead of Great Britain in pursuing these policies. Rapid growth in international trade and investment launched the Industrial Revolution and modern economic growth.

This era of globalization was interrupted in the early twentieth century by two world wars and the Great Depression. Populist leaders of all stripes persuaded their citizens to pursue “beggar thy neighbor” policies. Unfortunately, the U.S. took the lead in this deglobalization, an era that proved to be fertile grounds for xenophobia and military conflict.

In the post–World War II era the U.S. took the lead in restoring a global economy. Multilateral negotiations through the General Agreement on Tariffs and Trade, and later the World Trade Organization, provided the framework for reducing restrictions on international trade and investment. The International Monetary Fund and the World Bank facilitated the creation of a global reserve and payments system based on the gold standard and a reliance on the dollar as a reserve currency. This new era of globalization was also accompanied by rapid economic growth.

1. Geoeconomic fragmentation has been the focus of a number of studies by international organizations. See, for example, International Monetary Fund (2023a, 2023b, 2023c, 2023d) and Goldberg and Reed (2023).

Over the past two decades, however, we have again experienced an era of deglobalization. Major turning points were the economic shocks of the financial crisis in 2008 and the COVID pandemic in 2020. Countries responded to these economic shocks by imposing new restrictions on international trade and finance; and countries are now fragmenting into regional trading blocs pursuing trade wars and currency competition. Financial regionalization is undermining the international reserve and payments system. Not surprisingly these policies have resulted in stagnation in international trade and investment, accompanied by retardation in economic growth.

This new era of deglobalization has also proved to be fertile ground for xenophobia and military conflict, pitting the United States against a united China, Russia, and Iran. A new cold war has emerged with military conflicts in Ukraine and the Middle East. This new era of deglobalization has much in common with that of the early twentieth century. As Elon Musk argues, "I think that we are sleepwalking our way into World War III" (*Wall Street Journal* 2023b).

When China joined the World Trade Organization in 2001, the expectation was that its entry would reaffirm China's commitments to an integrated global economy. But the WTO has hit major roadblocks in multilateral negotiations and has failed to address some of the new mercantilist policies.

A New Plurilateral Framework for Free Trade

The challenge now is to restore commitment to an integrated global trading system (Olson 2022b). If multilateral negotiations in the WTO have failed, new approaches must be pursued. We propose plurilateral negotiations within the framework of a "Free Trade and Investment Agreement."

A Free Trade and Investment Agreement could provide a framework for plurilateral negotiations focusing on distorting practices that have been roadblocks to reform in the WTO. The plurilateral negotiations must be open and nondiscriminatory. Membership must be open to any country willing to commit to the rules and conduct of a globalized trading system. Trade and investment policies pursued by member countries could not discriminate between different foreign countries.

The World Trade Organization notes that there are two types of plurilateral trade agreements (PAs). In an exclusive PA the benefits are shared among participants only. Open PAs are implemented on a most-favored-nation basis that benefits nonsignatories as well. The WTO concludes that such agreements among a subgroup of countries are viewed, potentially at least, as an escape route from the stalemate in the Doha Round of negotiations, which is likely to persist for quite some time. The most important of these PAs are the Information Technology Agreement (1996) and the Agreement on Financial Services (1997). Because of the persistent stalemate of multilateral negotiations, the WTO has encouraged more discussion of plurilateral trade negotiations (World Trade Organization 2017).

There is also precedent for PA negotiations outside the framework of the WTO. One of the most important of these was the Summer Palace Dialogue. This organization was founded by one of the coauthors, Admiral Bill Owens, former vice chairman of the Joint Chiefs of Staff and chairman of AEA Investors, and Vice Minister Liu He of the Chinese Central Leading Group in financial and economic affairs (Columbia University Global Centers 2012). Owens was later the lead negotiator with Donald Trump and Wilbur Ross on trade negotiations in 2020 and 2021. The Summer Palace Dialogue was founded by Owens; Hank Greenberg, retired chairman of AIG; and Tung Chee-hwa, former governor of Hong Kong. The meetings included prominent economists from China and the U.S. They were held at the Summer Palace in Beijing, and in Washington, D.C., from 2009 to 2011. The outcome of this dialogue was recommendations that were used by both governments in higher-level negotiations. These were associated with more open trade, greater understanding of the international environment and of organizations such as the WTO, and the policing of illegal trafficking across borders (Columbia University Global Centers, 2012).

A new Summer Palace Dialogue could jump-start PA negotiations and break the roadblocks to reform in the WTO. The discussions could focus on issues that have emerged since the first Summer Palace Dialogue, including geoeconomic fragmentation, the weaponization of currencies, and other policies that have led to growing confrontation between China and the United States. Recommendations from a second Summer Palace Dialogue could be the basis for plurilateral agreements with a broader group of countries. The ultimate goal of these plurilateral agreements would be free trade and investment to restore the global trading system.

Plurilateral trade negotiations could focus on industries where negotiations within the WTO are at a standstill. For example, the pharmaceuticals industry is unusually knowledge based, and a major stumbling block in the WTO is negotiation over intellectual property rights. Such plurilateral negotiations would be especially important for China and the U.S. given the importance of this industry to their economies. Other countries with a major stake in the pharmaceutical industry, such as India, would also have an incentive to participate in plurilateral negotiations. Progress in such negotiations could be expected because of the externalities or social benefits of innovations in pharmaceuticals, and because this industry is far removed from national security concerns (Cockburn 2009).

Even if a Free Trade and Investment Agreement provides common ground for restoring a global trading system through plurilateral negotiation, not all countries will agree on some areas, such as legitimate national security issues. Plurilateral negotiations by the U.S., China, and the other major economies could provide a forum for discussing and resolving national security concerns. While members must have the flexibility to pursue unilateral policies on national security issues, there must be guardrails to limit the negative impact of unilateral policies on other countries.

Plurilateral negotiations within a Free Trade and Investment Agreement could be accompanied by renewed support for multilateral negotiations within the WTO. Some issues, such as tariffs, are best resolved through multilateral negotiation. Using a Free Trade and Investment Agreement to break the deadlock on distorting issues could set the stage for reaffirming the commitment to multilateral trade negotiations in the WTO.

We do not have a dominant player in the global economy, such as Great Britain in the nineteenth century, or the U.S. in the post–World War II era. But a Free Trade and Investment Agreement could give the major economies, as well as other countries, an opportunity to pursue plurilateral negotiations to restore a global trading system. A Free Trade and Investment Agreement could break the roadblocks to reform, and with leadership from the U.S. and China, other countries would have an incentive to join.

The U.S. and China are now trapped in the prisoner's dilemma. Although conflicts between the U.S. and China have not led to the Armageddon that Elon Musk fears, the risk is there and ever growing. Continuing along the present path of fragmenting into regional blocs with trade wars and currency competition increases that risk.

With multilateral negotiations in the World Trade Organization at a standstill, the best hope for reversing deglobalization is through plurilateral negotiation. The meeting between President Biden and President Xi at the Asia-Pacific economic summit in San Francisco provided an opportunity for the U.S. and China to take the lead in launching plurilateral negotiations to reverse "geoeconomic fragmentation" and the collapse of the global trading system (*Wall Street Journal* 2023c).

Chinese president Xi Jinping has vowed to open the Chinese economy to easier market access. In a letter to the China International Import Expo (CIIE) Xi pledged that China "will firmly advance high-standard opening up" and continue to make economic globalization "more open, inclusive, balanced, and beneficial" (PRC Ministry of Foreign Affairs 2023).

Secretary of State Antony Blinken has also asked for China's help in preventing a wider war in the Middle East. Plurilateral negotiations could not only facilitate a peaceful settlement in Ukraine and the Middle East, but could also lay the groundwork for a restart in negotiating a nuclear disarmament agreement (*Wall Street Journal* 2023a).

We do not need to repeat the mistakes of the Great Depression. The U.S. must restore its commitment to debt sustainability and stable prices. With debt over $34 trillion, such a commitment will be more difficult than it was during the "Great Moderation" of the 1990s. But with sustainable debt and stable prices the U.S. could shore up the value of the dollar as a reserve currency. This would help stabilize international trade and financial flows and promote peace.

Free trade and investment should again be the centerpiece of U.S. foreign policy. The proposed plurilateral negotiations would be an opportunity and a challenge for both the U.S. and China to reaffirm their commitment to free trade and investment. Plurilateral negotiations focused on specific industries such as pharmaceuticals would allow them to take concrete steps toward free trade and investment. With U.S. and Chinese leadership these policies could expand the global economy, creating opportunities for all countries to improve the income and wealth of their citizens. The U.S. must also reform policies that sanction the financial assets of foreign countries. The unintended consequences of these sanctions are undermining the international financial system. If, as many economists predict, we soon experience another recession, the fragility of the international financial system will be tested.

As Milton Friedman argued, we have underestimated the potential for authoritarian regimes to impose repressive measures on their citizens and others. But this should not prevent the U.S. and China from creating a Free Trade and Investment Agreement and reaffirming their commitment to a global trading system. The U.S. and China have the most to lose if deglobalization results in Armageddon, but we don't need to repeat the mistakes of two world wars and a Great Depression.

References

Cockburn, Iain M. 2009. Intellectual Property Rights and Pharmaceuticals: Challenges and Opportunities for Economic Research, in *The Economics of Intellectual Property*, 150–79. Geneva: World Intellectual Property Organization.

Columbia University Global Centers. 2012. What Is the SPD? March 25, 2012. https://web.archive.org/web/20120325022645/http://globalcenters.columbia.edu/eastasia/what-spd.

Goldberg, Pinelopi K., and Tristan Reed. 2023. *Is the Global Economy Deglobalizing? And If So, Why? And What Is Next?* NBER Working Paper 31115. Cambridge, Mass.: National Bureau of Economic Research, April 2023. DOI: 10.3386/w31115.

International Monetary Fund. 2023a. Geoeconomic Fragmentation and the Future of Multilateralism, *Staff Discussion Notes*. Washington: IMF, January 2023.

———. 2023b. The Rise of Discriminatory Regionalism. *Finance and Development*. Washington: IMF, June 2023.

———. 2023c. Long Live Globalization: Geopolitical Shocks and International Trade. IMF Working Paper WP/23/225. Washington: IMF, October 2023.

———. 2023d. Navigating Global Divergence. *World Economic Outlook*. Washington: IMF, October 2023.

Olson, Stephen. 2022a. Yellen, Lagarde, and the Death of the Global Trade System. Hinrich Foundation, May 4, 2022. https://www.hinrichfoundation.com/research/article/trade-and-geopolitics/yellen-lagarde-global-trade-system/.

———. 2022b. In Search of Trust and Security in Global Trade. Hinrich Foundation, November 15, 2022. https://www.hinrichfoundation.com/research/article/trade-and-geopolitics/trust-and-security-in-global-trade/.

PRC (People's Republic of China) Ministry of Foreign Affairs. 2023. Xi Jinping Sends Letter to the Sixth China International Import Expo. News release. November 5, 2023. https://www.mfa.gov.cn/eng/zxxx_662805/202311/t20231110_11178041.html.

Wall Street Journal. 2023a. Can China Help in the Middle East? October 26, 2023: A17.

———. 2023b. Musk's Views on Future Turn Dour, October 30, 2023: B3.

———. 2023c. Beijing, U.S. to Hold Arms-Control Talks, November 2, 2023: A18.

World Trade Organization. 2017. Plurilateral Trade Agreements: An Escape Route for the WTO. WTO Working Paper ERSD-ERSD-2017-03. Geneva: WTO, January 2017.