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World Trade Amidst War, Inflation and Protectionism

The Case for Bretton Woods 2.0

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SYNOPSIS

Rising geopolitical rivalries after the 2008 global financial crisis has resulted in a new round of protectionism. This has led to Deglobalisation 2.0 and heightened the risk of geoeconomic fragmentation. Calls for Bretton Woods 2.0 have been made. Will they be realised?

COMMENTARY

At the United Nations' Monetary and Financial Conference held in 1944, known more popularly as the Bretton Woods conference, an agreement was reached to set up a rules-based global economic architecture (GEA) that would reduce rampant nationalism, protectionism, beggar-thy-neighbour policies, and economic instabilities of the interwar years (1918-1939).

The Bretton Woods GEA comprised the International Monetary Fund (IMF) for macroeconomic and monetary stability, the General Agreement on Tariffs and Trade (the predecessor of the World Trade Organization) to promote trade openness, and the World Bank to provide development finance for poverty reduction.

Although it had several critical faults, the Bretton GEA worked well for more than 60 years. It ushered in the golden age of globalization when the trade openness index – sum of world exports and imports as a percentage of world output – increased six-fold between 1950 and 2008. The GEA also brought about rapid economic growth and prosperity, and poverty reduction all over the world.

Global Financial Crisis and the Ensuing Protectionism

The 2008 global financial crisis marked a turning point in several ways. Rising geopolitical rivalries among countries since then, has led to a new round of protectionism based on national security grounds. In the immediate aftermath of the crisis, the will to cooperate among countries was strong. But this was soon followed by nationalist and protectionist sentiments as countries recovered from the crisis at different paces.

Under President Donald Trump, the US embraced the "America First" policy, pivoting away from the multilateralism of the past to unilateralism and bilateralism. His administration levied tariffs on steel, aluminum and solar panels from most countries, which accounted for about 20 per cent of the total imports of the US.

Separately, the Trump administration set and escalated tariffs on goods imported from China, which resulted in the US-China trade war. These tariffs angered trading partners, including those in Europe, who imposed retaliatory tariffs of their own.

At the height of the COVID-19 pandemic, many countries had also imposed export restrictions on medical goods, some of which remain.

More recently, the tide in the US has changed considerably from globalisation to protectionism. International trade is seen as a zero-sum game. Supply chains are being "reshored" and "friendshored" to cope with COVID-19 disruptions and national security concerns.

President Joe Biden has accelerated Trump's move towards protectionism and domestic job creation. In 2022, to maintain a technological edge over other countries, especially China, the US Congress enacted two bills in the name of national security. The CHIPS and Science Act provides US$52 billion of incentives for the semiconductor industry. Similarly, the Inflation Reduction Act seeks to spend nearly US$400 billion to boost clean energy and reduce dependence on China in important supply chains, such as batteries for electric vehicles. The US is also attempting, as much as possible, to bring in its allies to its side. These actions have set-off a "tech war" with China.

There is strong bipartisan support for protectionism based on national security concerns in the US. It is, therefore, unlikely that this protectionist policy will be reversed any time soon.

It is not just the US that is implementing protectionist measures to push domestic industry at the expense of foreign rivals. Data from the United Nations suggest that more than 100 countries accounting for over 90 per cent of world output, have adopted formal industrial policies. Spending on subsidies among the G7 countries has risen sharply in recent years, from 0.6 per cent of output on average to 2 per cent in 2020. Investments abroad are also being closely screened and scrutinised.

New Protectionism, Deglobalisation 2.0, and Bretton Woods 2.0

As a result of the new protectionism, the global economy is now experiencing a period of deglobalisation, which means a sluggish or declining trade openness index. This is

Deglobalisation 2.0, to differentiate it from Deglobalisation 1.0, which was experienced during the interwar years.

The globalisation of the 1990s and 2000s was underpinned by the belief that economic integration would cause China and the former Eastern Bloc (Soviet Bloc) countries to become strategic partners with the West. This led to widespread liberalisation of trade, capital flows and ideas.

But economic reality fell short of this optimistic vision set out by the leaders of the West. Rather than a strategic partner, China has now been identified as a strategic rival and competitor of the US. Sweeping sanctions have also been imposed on Russia and Belarus following the outbreak of the Ukraine War in February 2022.

Deglobalisation 2.0 will affect the global economy through the trade and finance channels. The IMF has estimated that the cost to global output from geoeconomic fragmentation could range from 0.2 per cent to 7 per cent of global GDP.

Until recently, the institutions established at the Bretton Woods conference had adapted well to the changing world and achieved successful outcomes. But many analysts now feel that they are no longer fit for purpose. Calls have, therefore, been made for a Bretton Woods 2.0 or “Big Bang” reforms like that of 1944, which set up the present GEA under the leadership of the US.

An example is Gallagher and Kozul-Wright who have noted that the last time, in 1944, when the world economy became defined by financial instability, recession, inequality, right wing populism, lack of leadership, and war, the leading nations of the world came together at Bretton Woods and established rules and institutions to foster stability. As elaborated above, they were successful in establishing a rules-based global economic architecture.

Eighty years later, that system and its core institutions are facing a world which bears a striking resemblance to the past that the Bretton Woods delegates had hoped would be gone forever. This situation is compounded by a climate change crisis that is posing as a new existential threat to Planet Earth and to humanity.

An important on-going study on Bretton Woods 2.0 is the one by The Atlantic Council which was launched in 2022. So far, this project has issued four papers, and detailed studies are forthcoming. We are now moving from a unipolar to a multipolar world, hence, in addition to Western views, these studies should incorporate the views and perspectives of the dynamic emerging markets, especially China and India.

Will We have Bretton Woods 2.0?

Rising geopolitical rivalries have dimmed the environment for global cooperation. The radical reforms that a Bretton Woods 2.0 may draw up may therefore not be feasible, at the present time.

Reforms should be prioritised into those that are modest in scope and readily implementable in the current institutions, and those that are more ambitious and structural in nature such as the need to establish new institutions. The immediate focus of reforms should be on the former, a Bretton Woods 1.5 as it were, while discussions and debates on the latter, a Bretton Woods 2.0, should be continued.

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