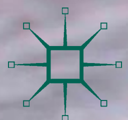
Developed Nations and the Economic Impact of Globalization

Ken Moak



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To my first granddaughter, Mila May Lai Dowe, hoping and praying that she and millions of babies and children will live in a world of compassion, humanity, peace and prosperity.

Preface

Globalization may not be popular during periods of economic slowdown and high unemployment, but it has benefited the world far more than it cost. Without free or free international trade and investment, improvements in transportation, communication, and information technologies might not have advanced as quickly as they have. It was the lure of higher profits that incentivized business enterprises or investors to seek new and more efficient methods to transport greater quantities of goods across the globe faster and cheaper. Without immigration, the developed economies, particularly the United States might not have earned its status as the world's leader in innovation. Its well-funded universities have attracted and will continue to attract some of the world's best and brightest minds to its shores. Without international cooperation, peace between major powers might not have lasted as long as it did. In short, there is every reason for globalization to be promoted and embraced.

Indeed, it could be argued that globalization, for all its flaws and contradictions, is needed more than ever before in human history. Increasing protectionism threatens to undo all the good things that globalization has given to the world. A return to the era of import restrictions would trigger trade wars from which no country benefits. Rising tensions between major powers could lead the world to a war from which hundreds of millions of people will perish and countless properties destroyed. It is these scary scenarios that prompted me to write this book, hoping to play a small role in triggering a rational debate on globalization in university classrooms, policy communities, and public

forums. Until another planet suitable for human habitation is discovered, the Earth is our only home. World governments must not only preserve it but make it more livable for all of humanity and other forms of life.

It is also the hope that universities and colleges would encourage undergraduate economic, political science, and other students to study globalization. Being future leaders of government, business, labor organizations, international institutions, and non-governmental organizations, they should have an understanding of globalization. Having taught the course for 15 years at Capilano University in Canada, students found the subject informative and relevant for their future endeavors. Indeed, my students and colleagues made valuable inputs in writing this book.

I hope the book is a suitable textbook for an undergraduate globalization issues-oriented course. The lack of a such a reference book impedes teaching effectiveness and learning. This book covers most if not all major and relevant topics of globalization, affording professors and students with the necessary information for teaching, learning, and debating this very important and timely topic.

Whether we support or oppose globalization, its impact on all of our lives cannot be understated. For this reason, we should understand it better so that we can determine for ourselves whether globalization should be promoted or ended. An understanding of the aspects of globalization would also afford us the knowledge to assess the information that is propagated by various vested groups objectively and rationally to avoid disastrous developments. For example, the public should be able to determine whether China, Russia, or any other country is really threatening our interests or security.

Burnaby, Canada | Ken Moak

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There are a large of number of people to whom I owe a debt of gratitude. First, I would like to thank Mr. Chen Ie Lie, retired investment banker from the Netherlands, for his insight on international financial and geopolitical affairs, particularly those relating to Europe and Southeast Asia. Mr. Ben Mok, retired executive of the Coca Cola-Swire Group-Cosco joint venture in China, for making me aware of the issues occurring in China. Mr. George Mok and Mr. Wai Hung, retired businessmen living in Canada, generously shared their views on Asian affairs, particularly those relating to Hong Kong and Taiwan. I thank my former colleagues and students for their valuable input on the course contents and how they should be delivered and discussed during the 15 years that I taught the course on globalization at Capilano University. I owe a debt of gratitude to the independent reviewers who commented on my book outline and on the sample chapters. Their advice and input are appreciated. Last but not least, I express my appreciation to Ms. Brigitte Schull,

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Contents

1 A Summary Analysis of the Globalization's Dynamism 1

2 Globalization: Drivers and Effects 19

3 History of Globalization: European Colonization and Bretton Woods 49

4 Bretton Woods International Trade and Financial Organizations 75

5 GATT, Rounds of Negotiations, and the World Trade Organization 97

6 Selected Bilateral and Regional Trade and Investment Agreements 121

7 The Group of Seven and Group of Twenty 147

8 The 2008 Global Financial Crisis: Effects on the Global Economy 167

9 The Washington Consensus Versus The Beijing Consensus 189

10 BRICS and China Initiated Global Trade Initiatives and Financial Institutions: Alternatives to the US-Dominated IMF and WBG and ADB 211

11 The Future of Globalization: Should It Be Promoted or Ended? 225

12 A Final Word on Globalization 247

Bibliography 253

Index 255

CHAPTER 1

A Summary Analysis of the Globalization's Dynamism

Globalization has become a hot topic of debate because its promoters did not deliver on the promises that they espoused. Manufacturing has been hollowed out and jobs are being lost in the West. However, economic growth is increasing in the developing countries, particularly China and India, causing a shift in the global economic order from West to East. The relative rise of the developing world seems to have upset many in the developed countries, culminating in a call for de-globalization.

Globalization, loosely defined as forging closer economic, technical, geopolitical relations and other human interactions between countries, was promoted by the Anglo-American-led Allied Powers toward the end of World War Two (WW II), when victory over the Axis Powers was imminent. In 1944, 44 Allied Powers gathered at the US resort town of Bretton Woods, Connecticut, to chart an economics architecture for the post-WW II era.[1] The main architects of the Bretton Woods system were the representatives of the United Kingdom (UK) and the United States (US), respectively, John Maynard Keynes and Harry Dexter White.[2] Central to the postwar global economic system was liberalized cross border trade and investment, deemed essential for achieving sustainable economic growth, because it was isolationism or trade protectionism that pushed the world into the "Great Depression" in the 1930s. Accessing external markets was therefore necessary to increase the Gross Domestic Product (GDP), the value of all goods and services produced in the economy in one year.

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The US and the UK created the International Monetary Fund (IMF), World Bank of Reconstruction and Development (WB), and the General Agreement on Tariff and Trade (GATT) frameworks after WW II (these organizations will be discussed in Chaps. 3 and 4). The functions of these institutions were to promote and facilitate efficient cross border financial transactions, rebuild infrastructures and capital assets destroyed by the war, reduce tariff barriers on international trade, and prevent the resurgence of the prewar chaotic trade and financial systems. However, the ways the three institutions were structured and their governance architecture had a geopolitical dimension in that they ensured that the US and the UK would dominate the post-WW II global geo-economic order.[3]

Until the 2008 financial crisis, the West, particularly the "Anglo-American Alliance," did dominate the world economic and geopolitical orders, writing rules and regulations in its favor.[4] For example, the West promoted free or freer trade only on the goods and services (i.e., information technology and financial services) in which it enjoyed a comparative advantage, but routinely blocked goods (i.e., garments and steel) in which it had a comparative disadvantage. The West did that by applying ambiguous and subjective nontariff barriers (NBTs) such as government procurement policies. However, the financial crisis "turned the table around," exposing the weaknesses and vulnerabilities of the Western, particularly the Anglo-American, neoliberalism and financial system. If the system's established rules and regulations did not serve its best interests, powerful interest groups could repeal them (i.e., the repeal of Glass Steagall). Glass Steagall banned commercial banks from carrying out investment businesses because they were responsible for wrecking the financial system in the 1930s.[5] Restricting commercial banks to take deposits and make loans, however, undermined their ability to earn huge profits, particularly when the US Federal Reserve was sticking to its low interest rate policies. However, allowing all banks (commercial and investment) to carry out investment businesses culminated in reckless behavior because of heightened competition in a tight market. With regard to the Western economies, they were not as sound as traditionally believed, but were literally a "house of cards" built on and supported by a growing pile of consumer, bank, and government debts. Consumers' and governments' heavy debt burden stifled domestic demand, explaining why the G7 and other developed economies continue to struggle to climb out of the economic hole created by the financial crisis. The consumer debt/income ratio was over 110 percent and public debt/GDP ratio was estimated at

over 100% in the G7 nations.[6] Real wages rose only marginally at less than 2% because most jobs created were in the low-pay service sectors.[7] Private and public consumption accounted for over 80% of these countries' GDP.[8] Further, huge liabilities prevented banks from making loans, culminating in a "credit crunch" that stifled consumption and investment.

On the other hand, major developing economies, particularly that of China, were growing at a spectacular rate. China's economy grew at an average annual rate of almost 10% from 1980 to 2007.[9] While it slowed down to 6.5% in 2008, the government's huge stimulus package of over US$580 billion or 14% of GDP reversed the downward trajectory, resulting in an annualized 9.2% growth rate in 2009.[10] However, the government's restructuring and rebalancing policies (moving to value-added manufacturing and making domestic demand as the engine of the economy) has slowed year-on-year the Chinese economic growth down to less than 7% in 2014.[11] But, the growth figure still outshines all other major economies with the exception of India, whose economy is registering an annual growth rate of over 7.5% in 2015.[12] China's spectacular economic growth not only propelled it to become the second largest economy in the world and accumulated a huge financial toolkit, but also pulled many developing economies on an upward trajectory. Economic growth in developing economies afforded them to contribute to over 50 and China to over 30% of world economic growth since 2008, causing a shift in the center of economic and geopolitical gravity from the North (developed economies) to the South (developing ones).[13] Without the major developing economies' participation, particularly that of China, few, if any, global issues could be addressed.

The influence of major developing economies—Brazil, Russia, India, China, and South Africa—is expected to rise because their established financial institutions could compete with the US-dominated International Monetary Fund (IMF) , World Bank Group (WBG), and the joint-controlled US/Japan Asian Development Bank (ADB).[14] The five developing nations' financial institutions—The New Development Bank (NDB), Emergency Currency Reserve Fund (ECRF), Asian Infrastructure Investment Bank (AIIB)—are alternative funding sources for developing economies to build infrastructure and address temporary currency issues. Unlike the IMF, WBG, and ADB, the emerging economies' development banks do not impose harsh conditionalities (i.e., austerity measures during economic stagnations, privatization of state-owned assets, etc.). In this regard, it would not be a surprise that

developing economies will be turning to the major developing economies, collectively known as BRICS (Brazil, Russia, India, China, and South Africa), for financial help. Indeed, China loaned more money to developing countries than the US-dominated international banks combined in 2015, because it neither imposed IMF-type loan conditionality nor interfered with the borrowers' internal affairs.[15]

China's "One Belt, One Road" (OBOR) or Belt and Road (BR) initiative along with the Silk Road Fund (SRF) should further raise the country's economic profile in the world. The OBOR, the revival of the ancient Silk Road, is to link China to Europe with a land route in the north and a maritime one in the south.[16] Located along the two routes are over 60 countries straddling between China and Europe. The SRF is a US$40 billion intended to assist countries participating in the initiative to invest in businesses. It is estimated that two-way trade between China and the countries on the OBOR corridor had reached over US$1 trillion, almost 25% in 2015.[17]

However, not everyone is "happy" with the developing economies, particularly China's economic rise. Some in the West and countries having territorial disputes with China are wary of its economic rise, viewing it as a "threat" to their national interests and security. China's currency inclusion in the IMF SDR basket, effectively making the Yuan a world reserve currency, is portrayed in the Anglo-American media as a challenge to its financial hegemony. The losing of manufacturing prowess to China is seen by some in the United States as "stealing" American jobs. The faster than expected closing of the technology gap (between the US and China) is seen as China committing industrial espionage against US firms. Chinese military buildup in the South China Sea is viewed as a threat to the freedom of navigation and overflight operations. Since it is in the interest of the United States to maintain the status quo, some in the US view China's military posture in the South China Sea as a threat to its national security. Close allies, Australia, New Zealand, Japan, and Singapore are joining the United States in calling China to abide by the July, 2016 Permanent Court of Arbitration ruling, albeit that they are not parties to the dispute.[18] The Australian government has blocked a Chinese state-owned enterprise in buying a huge track of land and an electricity-generating company in the name of national security. With regard to Japan, it is involved in a territorial dispute over the Diaoyu (Senkaku) Islands with its giant neighbor. The major source of friction between Asia's two biggest economies is the historical animosity resulted from the atrocities committed by the Japanese army during its

8-year occupation of China from 1937 to 1945. Whether these charges and concerns are true, the anti-China rhetoric appears to have public support. Cancelling the Australian land sale is the result of a public backlash against selling a large track of land to a Chinese state-owned enterprise.[19] The majority of the Australian public has a negative view on China, said to be shaped by decades of relentless anti-China rhetoric fanned by its media.

The media and pundits in the West, Japan, and countries having territorial disputes or ideological differences with China not only propagate the anti-China rhetoric, but are also pushing their governments to impose "tough" policies on the communist country.[20] The New York Times and other Anglo-American newspapers and pundits subjectively portray China as a repressive authoritarian state based on information from interviews with persons such as "pro-democracy activists," urging the government to disinvite China from participating in US-sponsored activities such as the biannual navy exercise.[21] These "balanced reporting" privately owned news outlets are accused of never, if ever, bother to interview people with a different opinion. For example, the British Broadcasting Corporation (BBC) only interviewed the student activists or those supporting the "Umbrella Movement" (supposedly mounted independently by students demanding democracy for the former British colony) in Hong Kong.[22] The British government neither granted the Hong Kong people democracy nor did the latter demand it before returning the territory to China in 1997. Indeed, the pan-democrats such as Martin Lee and Anson Chan were champions of British colonial rule; only after the last governor of Hong Kong, Christopher Patten, was appointed in the 1980s to oversee the transition period when the territory was to be returned to China in 1997 did they become the cheerleader of democracy in Hong Kong.[23]

The same Anglo-American media outlets and pundits never explain how China is posing a threat to their countries or to the world. For example, the Australian media did not explain clearly how selling its land to a Chinese commercial enterprise poses a national security risk to Australia. One would think that selling it to the company would make Australia more prosperous, because of the added investment and economic activities that the land would create. It could be argued the land purchase was a "win–win" transaction, improving China's food security and enhancing Australian economic growth.

The danger of feeding subjective information to a public (whose majority has never set foot on or knows anything about China) not only squanders economic opportunities, but cultivates public support for a war against the rising economic and military superpower. For example, the Vietnam War was sold to the American public that the Vietnamese military fired on a US warship. That turned out to be less than true since no US ships were hit or sunk. The dismal outcome of that war cannot be overstated, costing over 50,000 young American and millions of Vietnamese lives, incurring incalculable damage in properties, and costing Lyndon Bains Johnson a second term and legacy.[24] A war against China based on unsubstantiated information and perceived threats would likely be far more devastating and costly than the Vietnam war, given its achievements in military technology.

Those who are wary of China's rise ignore the fact that it is largely attributed to the government's pragmatic and effective economic policies (Chinese economic policies will be discussed in Chap. 8).[25] China's ability to leapfrog technological advances is largely attributed to: (1) the government's funding (i.e., over 2% of GDP) on research and development activities; (2) requiring foreign joint ventures to transfer technology as a condition of forming of joint ventures with Chinese enterprises; and (3) buying foreign firms and technologies.[26] On China "stealing" US jobs, they were already leaving for Mexico and Asia before China was granted the most favorable nation (MFN) status by President Bill Clinton in the 1990s.[27] It was the US, European, and Japanese firms' decision to earn higher profits that they relocated production to and source products from China and other developing countries that reduced manufacturing in the developed economies. Moreover, automation probably contributed more to manufacturing job cuts in Europe, US, and Japan than relocation of production overseas. As regards US trade deficit with China, it is misleading because the figures include re-export values. For example, the Apple iPad costs US$172 to produce from start to finish, to which China contributes less than US$11.[28] However, US customs includes the total value (US$172), and not China's part (US$11), when "importing" the electronic to the US (free on board). Moreover, the size of US trade deficit (at 3% of GDP) with the world has not changed since the 1980s, only its composition is (skewed toward China).[29] This suggests that China has become an increasingly important and profitable destination for US investment and outsourcing because over 60% of "Chinese imports" are produced by US or Sino-US joint venture enterprises.[30] With regard to

China posing a national security to the United States, there is no evidence to suggest that this is the case. China has not shown any evidence that it is pushing the US out of Asia. In fact, China may even welcome a US naval presence in the South China Sea because it would save the government a huge amount of money in keeping the sea route safe. Moreover, China has not built military bases surrounding the United States. It should also be pointed out that China's military is less powerful and less technologically advanced than the United States'. Finally, the Chinese government is burdened with insurmountable domestic problems (i.e., environmental degradation, ethnic tensions, poverty eradication, etc.) to engage in any overseas military adventurism, particularly against the world's biggest and strongest military. However, China is determined not to allow US or any other nation's naval forces to block its sea routes in the East and South China Seas and threaten the country's "core interests" in the event of a US-China military conflict. These "core interests" include economic development, territorial claims in the East and South China Seas, and national defense.

With regard to "threat" (to the West) from other major developing economies, Russia is accused of having annexed the Crimea, invaded the eastern part of the Ukraine, and threatened its neighbors. On this, Russian and some Western analysts disagree, arguing that the charges were to justify the continuing existence of the North Atlantic Treaty Organization (NATO).[31] The alliance was formed in the aftermath of WW II to deter Soviet Communist expansion into Europe. But after the collapse of the Soviet Union and the arrival of democracy or rejection of communism in Russia, incursion into Western Europe by "communist" forces no longer exists. According to some international relations analysts, NATO is determined to find an excuse to remain "relevant," prompting it to instigate a "Ukrainian problem" by blaming Russia for annexing the Crimea and sending troops into the eastern part of the country.[32] As regards India, it is seen as a close "ally" of the United States rather than as a competitor, concluding a defense agreement on military cooperation to counter China's "aggressive militarization" in the South China Sea.[33] Brazil and other developing economies have neither the desire nor the ability to pose any problem for the West. That said, neither India, Brazil, nor South Africa will dance to the tune of the US if it is not in their interests. For example, India has not committed to join the "diamond of democracies"—US, Australia, and Japan—to mount freedom of navigation operations in the South China Sea. On the contrary, it was showing signs of renewing relations with

Russia and forging closer economic ties with China at the 2016 BRICS meeting.[34]

Growing Western Protectionism

Unable to recover from the 2008 financial crisis and losing manufacturing competitiveness and jobs to developing economies, many in the West are blaming globalization and the political and business establishments for their economic and social problems. The business establishment is accused of focusing on increasing the profit line rather than the socioeconomic well-being of workers. The government's liberal trade and immigration policies are said to be "drafted" or influenced by vested business interests. These policies are blamed for hallowing out the manufacturing sector, taking jobs away from "locals," taxing the social net, and for the rising crime at home, climate change, widening of the rich–poor gap, and other socioeconomic ills.

Whether globalization is the culprit behind the socioeconomic woes of the world is debatable, but there is some true to the allegation that those in the West who promoted it did not do enough to address its adverse effects. International trade and investment necessarily produce "winners and losers." However, Western governments and multinational enterprises did not provide sufficient job retraining programs for workers who were displaced by production relocation. On environmental degradation or climate change, some scientists would argue that it was the Western and Japanese industrialization in the nineteenth and twentieth centuries that caused the problem.[35] These experts suggest that pollutants were trapped into the soil, gradually releasing into the atmosphere. Government policies on employment creation before pollution protection might also be a contributing factor. Former Canadian Prime Minister Stephen Harper, for example, implicitly said that no government would place environmental protection over economic growth.[36] While Western governments are generally receptive to immigration for economic and demographic reasons, they did not spend enough to meet the new arrivals' economic and social needs. Moreover, the West, the United States in particular, is said to be responsible for causing the huge refugee problem. Regime change policies are blamed for creating dysfunctional governments in the Middle East and North Africa, forcing millions of innocent people to escape their homes in search of a better life for them and their families.[37] In the UK, Brexit was largely attributed

to a liberal EU immigration policy, taking in many non- and Eastern Europeans.[38] After reaching the EU, these migrants travel to the UK in search of a better and peaceful life for themselves and their families.

Will There Be a Stop to or Slowdown of Globalization?

The general consensus is that globalization has benefited the world more than it cost, alleviating poverty in the developing world, improving world living standards in the West, bringing people of different races and cultures closer together, and reducing the prospect of another global military conflict between major powers.[39] China's export and investment-driven and other "going out" economic development strategies, for example, have lifted over 700 million people out of poverty and put over 400 million and 100 million, respectively, in the middle and upper middle or wealthy classes within a 30-year period.[40] China's manufacturing comparative advantage has increased real income in the West, enabling consumers to buy larger quantities and varieties of goods and services. For example, Chen Baizhu calculated that Chinese-made goods have saved the average American family over US$1000 per year.[41] Thus, even those who were displaced by globalization have gained because they too are able to access the low-priced Chinese imports. If true, globalization could be the source of world economic, political, and social stability. Karl Marx's hypothesis, "economic determinism," states that economic conditions dictate political and social behavior, implying a direct correlation between "happiness and economic prosperity."[42]

The global economy is also becoming increasingly interconnected and integrated with rising division of specialization between nations, outsourcing, and offshoring. For example, vying for business, Boeing (the US-based aircraft manufacturing conglomerate) offshores parts production to a number of countries, bringing them back to the United States for final assembly.[43] As indicated earlier, the design of the iPad is done in the United States, parts are produced throughout Asia, and final assembly is carried out in China. These are just two of the many examples of multinational enterprises offshoring and outsourcing production overseas.

While protectionism or de-globalization is on the rise in the West, the developing economies, led by China, are moving in the opposite direction. China's "One Belt, One Road" initiative is considered by the United Nations as an important posture in promoting global economic

growth and meeting its 2030 development goals.[44] As indicated earlier, the over 60 countries located along the trade route are already enjoying an over 10% increase in trade annually since OBOR's announcement in 2013. Moreover, at the 2016 G20 meeting in China, the host country proposed interconnected, innovated, inclusive, and invigorated growth as a way to sustain long-term global economic growth.[45] (The four "I" growth proposal will be discussed later in the book).

In the United States, de-globalization will only be a temporary stance because some powerful and influential multinational enterprises, academic institutions, other nongovernmental organizations, and the majority of Americans will oppose it. Conglomerates such as Boeing, General Motors, and Wal Mart would lose considerable business opportunities if they could not set up factories in or buying/outsourcing product from China and other developing economies. On education, not able to recruit the best and brightest minds could erode the quality and standard of scholarships at universities. Moreover, the United States needs an open immigration policy to maintain the country's "demographic balance." Most developed economies are recording an aging and declining population with an average fertility rate of 1.6, less than the replacement's 2.1.[46] Further, there are not many, if any, issues that the United States could resolve without international cooperation. For example, climate change and global security agreements could not be pursued, let alone reached, without collaboration with the world's major economies and powers such as China and Russia.

The Promoters of Globalization

Multinational enterprises (MNEs) were the first to embrace and promote globalization because they realized that accessing resources from and selling goods to other markets would bring huge profits. European monarchs were willing participants because they too wanted to increase wealth and power, creating an ideal condition for collaboration between the business and ruling elites.[47] European colonization, for example, was a "private–public" partnership in which companies such as the British East India Company funded governments or monarchs to expand empires and to enrich themselves.[48]

Today, business enterprises of all nations remain (and likely continue to be) the chief cheerleaders of globalization: investing or outsourcing production overseas; lobbying governments to improve economic and

geopolitical relations with other countries; and other factors or issues with respect to the process. For example, business enterprises pushed the US government to negotiate the Trans Pacific Partnership (TPP), comprising of 12 nations located on both sides of the Pacific Ocean, because it would enhance profits and protect intellectual property rights.[49] Japanese MNEs were said to be the major force behind their Prime Minister Shinzo Abe's half-hearted efforts to mend relations with China because the giant neighbor is a lucrative market for Japanese products and investments.[50] In Canada, it was the business community that "forced" the former Stephen Harper Administration (which was less enthusiastic than Liberal governments) to forge closer economic relations with China.[51] Chinese enterprises were the biggest merger and acquisition (M&A) player in the world in 2016, spending over US$88 billion in buying foreign firms in the first half of the year.[52]

Globalization: The United States and China

China and the United States are arguably modern globalization's biggest benefactors. China's "going out" strategy first introduced by Deng Xiaoping in the late 1970s and early 1980s is largely credited with the country's integration into the global economy.[53] China was the recipient of over US$100 billion in foreign investment, signed free trade agreements with Australia and South Korea, sent over 300,000 students overseas to study, and encouraged over 125 million Chinese tourists to visit other countries in 2015.[54] Additionally, China was the largest resources consumer (almost 50% of iron ore, cement, copper, and other commodities) and the largest manufacturer in the world in 2015.[55] Incorporating the "One Belt, One Road" initiative with the Russia-led Eurasian Economic Union (EEU) and the Shanghai Cooperation Organization (SCO), the block will be made up of over 30% of the world's GDP and population.[56]

With respect to the United States, it is the world's most open society relative to those of other nations, being a country of immigrants and founded by business interest groups. It takes in more immigrants than any country in the world, estimated at over 1 million each year and if undocumented ones are included, the figure could swell to millions, preventing a demographic problem facing most major economies.[57] Immigrants are in fact the country's strength and backbone, attracting the world's best and brightest to its shores, making the United States

what it is today. In its major post-secondary educational institutions, and scientific and innovative centers, over 30% is staffed by foreign-born nationals who stayed after they completed studies. American corporations are also more "color blind" than their European or Japanese counterparts in employing professional and senior management personnel, another reason for attracting talent. In China, for example, US enterprises hire Chinese nationals as senior executives because of their talent and understanding of local conditions. This stance explains at least in part why US firms are more successful in China relative to other foreign-owned firms. Last but not least, it could be argued that only in the United States can foreign-born nonwhites become chief executive officers (CEOs) of major enterprises. For example, the CEOs of Microsoft and PepsiCo are Indian-born nationals.[59]

Could Domestic Politics and Pursuit of National Interests Derail Globalization?

De-globalization stances are largely driven by domestic interest groups to promote and protect their and by extension national interests. Labor organizations and import-substitute manufacturers cry out against globalization because of the loss of union membership and business opportunities. Popular politicians in the West championed the anti-globalization voice to gain public support for their bid to be elected. On the geopolitical side, the US's "pivot" to Asia and NATO's expansion in Eastern Europe are said to be promoted for containing China and Russia. The pushback by China and Russia was construed as what they called Western "cold war mentality."

There is very little doubt that policymakers on both sides of the divide are aware of the incalculable costs to be incurred in any economic and/or military conflicts, prompting them to continue exploring all avenues to preempt "economic and strategic miscalculations." The United States and China established the Economics and Security Dialogue, meeting twice a year to iron out differences and promote mutual interests.[60] Russian President Vladimir Putin signals détente with the United States and NATO to fend off a potential war.[61] Newly elected Philippines President Rodrigo Duterte indicates a willingness to put the territorial disputes aside with China (and to be settled at a later date), because he is aware that following the footsteps of his predecessor, Aquino, is a

non-starter.[62] Some US European allies are hinting at an end to sanctions against Russia because they erode their economic interests. The German foreign minister said publicly that picking a fight with Russia is irrational and will bring disaster to both sides, revealing that the sanctions cost his country's firms to lose billions of dollars in businesses.[63]

Nations have neither friends nor foes, only national interests. But what are they, how are they being promoted and protected, and why do they necessarily cause conflict between nations? First, national interest means different things to different people, ranging from economic, political, and social stability to the accumulation of wealth and power at any cost. The first implies that policies should target "nation building" activities such as attaining a diversified industrial structure, ranging from resource exploitation, to resource refining, manufacturing, and services. Its realization requires protectionist policies, restricting imports to prevent unemployment and giving "infant industries" a chance to grow and prosper. Indeed, few if any country became industrialized by adopting unfettered trade and investment policies. The British garment industry prospered in the eighteenth and nineteenth centuries because the UK banned the Indian textile industry, forcing the former colony to buy British clothing.[64] However, neo-colonialism, exploiting a developing country's resources and banning the colonies from manufacturing, eventually harmed European interests because it condoned inefficiency at home and kept former colonies underdeveloped.

Neither did self-serving "beggar thy neighbor" policies such as currency manipulation to gain an export advantage, help the nations that implemented them. The policies brought chaos to the world trade and financial systems, culminating in currency and trade wars in which all parties suffered.

Pursuing national interests for the state, vested interest groups, and the nobility (i.e., wealth and power accumulation) was a major driver of empire building and conflicts between nations and peoples. The Roman Empire was formed by building a strong military whose main purpose was to conquer weaker peoples, occupying their land, enslaving the people, and taking their valuables. Colonization was all about European and Japanese imperialists' pursuit of wealth accumulation and territorial expansion.

However, all of these empires vanished because of excessiveness, incompetence, corruption, and greed. For China, it was arrogance, corruption, and self-imposed isolation. Past Chinese rulers considered China

the center of the universe, wanting nothing to do with the outside world. The Ming Dynasty emperors also banned innovation, burning scientific literature and punishing those who dared to be creative. For Britain, it over-extended its power projection, culminating in colonies declaring independence. The former colonies were sources of "free" natural resources and revenues. For example, the British took the Hong Kong people's land and leased it back to them for 99 years, giving the colonial government a huge source of revenue until the UK had to return it to China in 1997.[65] If history is a guide, the US dominance over the postwar era will not last forever, not because it is getting weaker or less wealthy but because other nations are getting stronger and wealthier. Like children growing up, mature nations would demand the right to chart an independent path or a say in their future. In any event, coercing other nations to forgo their national interests in forming an "alliance of convenience" against a "common foe" would not last because it is not in the coerced nations' interests to do so. With the exception of Singapore, the Association of Southeast Nations (ASEAN) are showing signs of abandoning the US pressure to raise tensions with China over territorial claims in the South China Sea.[66] In addition to the Philippines, Vietnam and Malaysia are sending reconciliation gestures to China because it has the capital and resources to invest in their economy and infrastructure. China is also a huge market for these countries' exports.

Summary

In light of rising tensions between great powers and economic slowdown in the developed world, globalization is needed more than ever in human history to defuse geopolitical conflicts and realize long-term sustainable economic development and growth. The G7 countries lack the financial resources to pull themselves out of the current economic malaise because they are highly indebted, lacking private and public consumption power. Moreover, employment prospects are dismal at best in the United States, EU, and Japan because the majority of jobs created were in the low-paying service sectors. To that end, it is difficult to see how consumers in the developed economies can spur economic growth. As pointed out earlier, consumption, after all, accounts for almost 70% of the G7's GDP. It should also be pointed that public spending, accounting for over 10% of the G7 GDP, is largely funded by increasing debt and/or quantitative easing. The 2016 Brexit exacerbates the UK and EU

economies, prompting Moody, the IMF, and other economic agencies to revise the UK economic growth downward.[67] The UK's future is said to be uncertain because Scotland is leaning toward holding another referendum on whether to stay or leave the country. Brexit is said to have an impact on France, Germany, the Netherlands, and Italy, in that they had planned to hold referenda on the EU had the far-right populist parties won the general elections.[68] Without access to external markets and international cooperation, the geo-economic plight of the EU, US, and Japan, would likely worsen, taking the world to a gloomier future. And as indicated earlier, growing tensions between the United States/NATO and China/Russia demand the continuation of engagement and dialogue to prevent them from turning into a nuclear war.

The West is unlikely to abandon globalization, suggesting that the politicians supporting anti-globalization sentiments are playing a political strategic game to gain support. As the US presidential elections have shown, once the "protectionist" politicians were elected to power, they quickly made a "U turn," albeit Donald Trump signing executive orders reflecting his campaign promises. Building a wall along the US-Mexico border and forcing his southern neighbor to pay for it may be easier said than done. What is Trump going to do now that Mexico has publicly stated it would not for the wall, go to war? Indeed, in a January 27, 2017 CNN news report, Trump said that he had a "friendly and constructive" telephonic conversation with his Mexican counterpart on the matter. What that means, however, is difficult to say because Trump has a record of saying one thing one day, and saying another thing the next day. Moreover, history will tell that once the economy recovers, anti-globalization voices recede as the pre-2008 financial crisis period had shown. These scenarios would also apply to Europe, in that xenophobic sentiments emerge when the economy is not doing well. History will tell that protectionism and populism will likely evaporate once the economy revives.

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CHAPTER 2

Globalization: Drivers and Effects

Globalization has changed and evolved since the days of traders from one region carrying goods to trade with counterparts in other regions. The ordeal proved extremely lucrative or profitable because the merchant-traders were able to fetch high prices for the goods that the political, economic, and social elites demanded. Attempting to gain more wealth, merchants began to find ways of how trade could be increased and made more efficient over the years, culminating in innovation and progress made in transportation, telecommunication, and information technology.

Interaction and integration of human activities expanded over the years to include noneconomic activities such as culture, changing values, and behaviors. Political beliefs, ideals, and practices were not far behind because self-interest is a natural human DNA, spilling globalization over to the geopolitical realm. The pursuit of self-interest-maximization led to conflicts between groups from different regions of the globe. For example, rising anti-globalization sentiments in the West is largely attributed to production relocation to developing economies, immigration, and other developments that contribute to loss of unemployment. When the West's economy picks up, however, that sentiment will likely change to pro-globalization because there will be less competition for jobs. The average person, regardless of where he/she is from, wants the same thing: a steady job to support his/her family.

Globalization is driven mainly but not exclusively by trade and investment. There are other drivers such as transportation and geopolitics.

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These will be discussed later in the chapter. For now, it may be appropriate to revisit the rationale behind international trade and investment: comparative advantage. Globalization and international relations students would have had studied the principles of economics, but may find a revisit beneficial. For those who have not been exposed to economics, it would shed light on why nations promote closer trade and investment relations with other countries.

Comparative Advantage: Revisited

Nations acquire a relative superior efficiency in producing one or more goods because of geographical location differences, endowing countries with resource(s) unique to their climate and terrain. The United States, for example, possesses a relative efficiency in the production of technologically advanced products due to its focus on investment in education, research, and development. Harvard and other top universities have become the world's most prestigious institutions of higher learning, attracting the best and brightest minds from every corner of the globe (to study and do research) because of well-funded state-of-the-art research facilities and world-class faculty.[1] Even better, a large number of bright foreign students chose to stay and apply their knowledge/skill in the United States after they completed research work or studies. Their willingness to stay was (and will continue to be) a big part of the United States being at the forefront or leader of innovation. Jerry Yang, the founder of Yahoo, was born in Taiwan but studied and applied his talent in the United States.[2] He is just one of the many foreign-born "geniuses" that came and will continue to come to study in the United States. Like Mr. Yang, they will work, teach, and open businesses. For this reason, the US was, is, and will likely continue to be the inventor of advanced technology, sustaining its cultural, technological, economic, and geopolitical leadership. China, with its huge population and skilled labor pool (thanks to the government's industrialization policies), has gained a comparative advantage in manufacturing.[3] With its comprehensive infrastructure (ranging from roads, power generation, railways, airports, cargo ships, domestic supply chain, value for education, procurement, and distribution), China would likely dominate the production and distribution of manufactured goods for a long period of time. In this regard, trade between the two countries should be a natural occurrence because the two economies are highly complementary, fitting in with the theory of comparative advantage.

Simplified Version of the Theory of Comparative Advantage

David Ricardo, an eighteenth-century English economist, postulated that a country exporting a good in which it has a relative superior efficiency (lower cost advantage) and importing that in which it incurs a relative inferior efficiency (higher cost disadvantage) would benefit not only itself, but the trading partner as well.[4] He reasoned that employing the resources to produce the good at which they are most productive brings economies of scale, expanding economic growth. The following simple example illustrates Ricardo's theory of comparative advantage

> Suppose a scenario in which a physician decides whether to install the bathroom in his house himself or hire a plumber to do the job. Further assume: i) the physician and plumber respectively earns $200 and $50 per hour; ii) the task takes the physician 10 hours (he was a plumber in his first life) and the plumber 20 hours; and iii) the physician hires the plumber to do the task and resume his medical practice. From this illustration, the gains to both should be clear: the doctor saves $1000 or reducing his opportunity cost by $1000. Had the doctor forgone 10 hours of medical practice, he would have loss $2000 in fees. The plumber receives $1000 that he might not be able to earn had the doctor decided to do the work himself. Since both of their income increased, the doctor and plumber would be able to buy more goods and services, expanding economic growth

Since then, a number of trade theoreticians have expanded Ricardo's theory of comparative advantage, giving policymakers more sophisticated tools to advance the trading process. The Swedish economists Eli Heckscher and Bertil Ohlin built a mathematical model based on the relative abundance or scarcity of a resource in quantifying the benefits and costs of free trade.[5] They pointed out that if a country has an abundance of labor and scarcity of capital, it should produce labor-intensive goods because the price of labor would be less than that of capital. They also suggested that the government should implement "proactive" policies (i.e., manpower retraining) to minimize the pains of workers who lost their jobs through trade.

Paul Samuelson and Wolfgang Stolper (US economists who developed the Samuelson–Stolper Theorem) expanded the Heckscher–Ohlin two-factor model to include the effects of trade on unskilled labor in high-income countries.[6] In their model, Samuelson and Stolper calculated that a high-income country should import labor-intensive manufacturing goods and export capital-intensive ones for similar reasons as those of Heckscher and Ohlin.

Both the Heckscher–Ohlin and Samuelson–Stolper models assumed "constant returns to scale" in that the opportunity cost of producing an additional unit would be the same no matter how many extra units are produced. They also assumed that production would be at the capacity output (minimum per unit cost). However, neither assumption is consistent with reality because of the law of diminishing returns or increasing cost, in that (holding other things constant) the additional productivity of inputs would fall from producing an extra unit of good. After all, workers do get tired from working long hours.

The above two models were "refined" by economists such as Paul Krugman, emphasizing the importance of increasing returns to scale and net effects.[7] They postulated that the law of diminishing returns prohibits complete specialization because the production process goes through different stages of efficiencies—increasing returns at the beginning, constant returns once the minimum efficiency scale (least-cost unit of production) is reached, (and from that point on) decreasing returns. The law of diminishing returns stipulates that holding other things constant, inputs (capital and labor) efficiency will fall in producing an extra unit of output at some point in the production process for reasons indicated earlier.

These economists also defended the eighteenth-century "infant industry protection" argument. Like newborn babies requiring parents' care and mentoring, infant industries must and should be protected and nourished before releasing them to compete with the already established and efficient foreign multinational enterprises. History seems to be on their side, in that trade protectionism was largely responsible for Western and Japanese industrialization. For example, Toyota might not have been able to become the world's biggest automobile producer had the Japanese government not erected barriers to protect its automobile industry from foreign competition.[8] Krugman and his "soulmates" seemed to agree with Heckscher and Ohlin in that free or freer trade would enhance economic growth only after a country has acquired efficient industries allowing them to compete effectively in the world market. They also suggested that governments and enterprises put in place adequate remedial programs (i.e., manpower retraining) to address displaced workers and industries.

(A definitive analysis of the aforementioned scholars' work is beyond the scope of this book. For readers interested in the scholars' research, please follow the links provided in the citations. Additionally, there is an abundance of literature on the works of these prominent economists on the Internet and in libraries.)

Drivers of Globalization

International trade and investment bring economies of scale or reducing costs through appropriate and efficient use of resources or inputs (as demonstrated in the simple comparative advantage illustration). Increases in supply reduce prices, resulting in real income and wealth rises, leading to higher levels of consumption and saving. However, trade and investment are not the only drivers of globalization. Others such as outsourcing, offshoring, transportation, information technology, telecommunication, and geopolitics also drive or accelerate globalization, although they might be derivatives of the trading system.

a. *International Trade*

International trade is the exchange of capital, goods, and services between nations. Its importance to a country's economy, polity, and society has accelerated since European colonization, in that it dramatically enhanced economic growth, expanded empires, and altered social behavior. Natural resources were being sourced from the "new found lands" to produce consumer and industrial goods at home to be sold in the domestic and foreign markets. The process increased wealth, improving people's living standards, which culminated in changes in consumption and social behaviors. For example, real income afforded people to buy discriminately, purchasing more desirable (i.e., automobile) and less inferior goods (i.e., bicycle).

International trade is largely in goods and services because they can be more easily moved across international borders than capital and labor. Goods refer to physical products such as clothing and automobiles. Services involve consulting, banking, and other intangible goods. The only barriers are tariffs (i.e., tax on imports) and nontariff measures (i.e., quota restrictions). Of course, there are nontradable goods (i.e., advanced jet fighters such as the US-F22 or Raptor) services (i.e., haircut). Labor, on the other hand, is less mobile because of immigration laws and other restrictions (i.e., lack of skill). That said, labor is indirectly traded because of the imports it produces. Capital refers to inputs and assets used to produce goods and services. Some (i.e., building) are more difficult if not impossible to transport across international borders because they are physically fixed and cannot be removed.

International trade is perhaps the biggest driver of globalization because of its huge rewards and impact on a country's economy,

polity, and society. The export-led growth model is credited with China's remarkable economic achievement. Export enterprises are largely foreign-owned or foreign–local joint ventures employing hundreds of millions of people, bringing in advanced technology, increasing people-to-people exchanges, and generating revenues for people, companies, and the state.[9] The accumulation of wealth and exposure to the outside world might be responsible for transforming the country's political architecture, from rigid Leninist-Marxist-Mao Zedong Thought to less ideological "socialism," giving people more freedom of expression, enterprise, and movement.

Trade is also responsible for the rise of other major developing economies such as Brazil and Russia. It was Brazil's selling huge quantities of agricultural products and iron ore that jump-started the country's economic growth. Russia's economy is largely built on the back of its energy exports. Intraregional trade is responsible for Asia being the fastest economic growth area in the world, estimated at over 5% in 2015.[10]

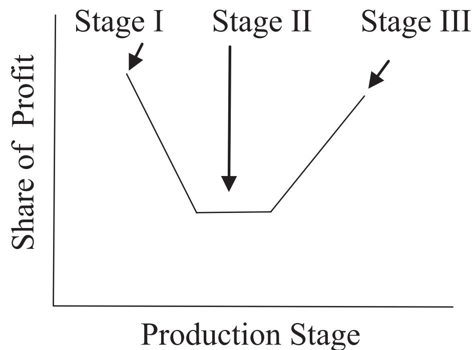
Although external demand is weakening due to uncertain world economic prospects, exports still account for almost 30% of global GDP, suggesting that developing and developed economies need to access markets outside their boundaries to grow.[11] Weak external demand, particularly from the West, is largely responsible for China's economic slowdown, which in turn causes the demand for world natural resources and prices to fall. Without increasing exports, China's economy would be stuck at the "new normal" growth rate of around 6.5%. In the absence of increasing demand for natural resources from China, resource-based economies could encounter strong headwinds going forward. In the developed economies, domestic demand has proven to be inadequate in spurring economic growth. Chinese President Xi Jinping is right when he suggests that globalization is the best vehicle in enhancing economic growth, stating at the 2017 World Economic Forum in Davos that "protectionism is like locking oneself in a dark room."

b. *Outsourcing*

Outsourcing is the process of contracting out production of some parts or the entire final product to countries in which labor costs are lower and environmental protection and labor laws less rigid or not vigorously enforced. It is different from foreign investment in that the outsourcing firm is subcontracting production

to other countries. Unlike trade, the outsourcing company owns the product, not buying it from a foreign firm. Outsourcing has many advantages over trade and investment. One advantage is the firm being spared from having to deal with labor- or environmental-related issues. Another is reaching an agreement on price before production avoids unexpected hidden costs and other issues.

As indicated in the diagram below, outsourcing can be extremely profitable for multinational firms. Apple, the US-based smart phone, computer, and iPad conglomerate is earning huge profits by outsourcing production to foreign-owned manufacturers. The company earns the biggest shares of profits in Stages I and III .



Stage I represents the design and development stage. Its share of total profit is estimated at over 40%. Stage II is manufacturing or assembling, earning between 15 and 20% of the total profit. Three is distribution, accounting for 35 and 40% of profit. The total production cost of an iPad is US$174 of which less than US$11 is earned by Chinese workers. Design and development are carried out by Apple's engineering or technical staff and facilities in the United States. Engineering and parts production are subcontracted to Japan, South Korea, Singapore, Taiwan, and Malaysia. Assembly of the iPad is contracted out to Foxconn, a Taiwan-based manufacturing conglomerate with factories in China. The iPad sells for over US$400, depending on the model, capacity, and screen size.[12]

c. *Offshoring*

Offshoring is the process of producing of semi-finished parts at a facility located in lower wage countries. The "rough" components

are then shipped back to the company's home factory for finishing. This process is a common practice for US manufacturing companies. General Motors, for example, produces the unfinished camshaft in other countries, such as Brazil, whose wage rates and labor standards are lower than those in the United States.[13] The semi-finished product is then shipped back to a GM-owned factory in the US for finishing. The process is extremely profitable considering the huge wage differences between the countries and the large quantity of camshafts required.

d. *International Investment*

International investment is the process of acquiring a production facility or financial asset from abroad. It comes in two forms, portfolio and direct investment. The first involves investors buying and selling of foreign currency-dominated financial assets such as sovereign and private company bonds (Canadian Treasury Bills, General Motors bonds). Foreign portfolio investment (FPI) is lending money to a sovereign state or large private enterprise for a guaranteed rate of return. Foreign governments issue securities to raise capital to spend on fiscal programs and building infrastructures as a way of sustaining social stability and enhancing competitiveness. The United States has sold over US$1.2 trillion worth of its Treasury Bills to China; most of the sales proceeds were spent on infrastructure projects, social programs, and even making weapons.[14] Private enterprises also sold bonds to build company assets. The Canadian Pacific Railway Limited, for example, sold bonds to the amount of CAD$900 million to improve efficiency and competitiveness.[15] Bond buying is usually for safe investment as well as speculative purposes. For example, investors normally buy a Treasury Bill (TB) when its yield increases because yields and price are inversely related. To that end, the buyer would gain higher returns on investment and pay a lower price for the TB. Bonds, particularly government bonds, are a riskless investment because their values and payments are guaranteed by sovereign states with the authority to print money and raise taxes.

The second form is asset or foreign direct investment (FDI), buying or building of facilities to produce goods in another country. FDI is influenced by the principle of comparative advantage, in that firms invest abroad because of lower production costs. A country's high tariff rates might also be an incentive for foreign firms to invest in it.

One of the national policy of economic development strategies of Sir John A. Macdonald, Canada's first prime minister, was to impose a 33% tariff policy to block US manufactured goods, which was responsible for the surge in American foreign investment in the latter part of the 1800s.[16] Rather than pay the tariff, US firms invested in the newly formed country, accessing the Canadian and British Empire markets through the "back door." Canada benefited in that Canadian industrialization might not have advanced so rapidly had US firms not invested in the country at its infant stage.

Today, Chinese enterprises are following their Western and Japanese counterparts, increasing overseas investment. For example, its 2015 outbound investment overtook that of inbound, respectively, estimated at US$125 billion and US$110 billion.[17] Avoiding import restriction measures, climbing the value chain, pursuing "brand name" status, and speeding up innovation are the drivers of Chinese enterprises investing abroad. Huawei buying brand name firms like General Electric's appliance production operations is to gain experience in and manufacturing of world-class products to compete in the increasingly competitive world market.[18] The upward trend in Chinese investment abroad is expected to surge in the coming years. The government, for example, announced the "Made in China" strategy, a policy designed to upgrade the manufacturing sector through innovation and producing value-added goods for the domestic and foreign markets.[19] Mergers and accusations (M&A) are a part and partial to that strategy because China is still behind the developed economies in science, technology, and management methods.

e. *Transportation*

Transportation is the process of moving goods and people from one place to another, thus essential for globalization. To increase the volume of goods and the number of people that can be moved and efficiency, humankind constantly innovates the process, turning it from an aid to a driver of globalization. The invention of the wheel allowed wagons to carry more goods over longer distances at higher speed. Bigger ships were built to transport large volumes of products from one country to another across the oceans. The system of offloading cargos from ships directly onto railway cars (roll-on–roll off) to be transported across vast landmasses saved time and money. High-speed passenger and freight trains can carry

thousands of people and millions of tons of goods from China to Germany in less than 24 days, compared with taking over a month by sea. If the cliché "time is money" is true, it is not surprising that transportation has become a driver for globalization. China seems to think the cliché is true, explaining the reason why it has built almost 20,000 km of railway tracks as of 2015.[20] It in fact completed building a railway track between Xi'an and Hamburg in that year, taking 15 instead of 35 days to ship goods from China to Germany.[21]

There are different modes or ways in which goods and people can be moved: roads, water, rail, air, and pipelines, collectively referred to as the transportation infrastructure. Roads were the first mode of transportation, using human and animal power, to be followed by cars and trucks from the nineteenth century on. The invention of the steam engine in the eighteenth century made railway transportation possible, carrying large quantities of goods across massive landmasses. Ship building and navigation paved the way for ocean transportation. The twentieth century brought air and space transportation.

Each mode of transportation requires its own unique infrastructure or fixed facilities. Airplanes require the construction of airports, cars need roads, ships need docks, and so on. The building of infrastructures spurs economic growth, in that it triggers construction, attracts investment, incubates tertiary industries, and builds new cities. Infrastructure is capable of creating huge multiplier effects as shown in the both the United States and China.

The Chinese cliché, "to create wealth, the country must first build roads and other infrastructures" makes economic sense, prompting developing economies such as India, Russia, and Brazil to invest heavily in infrastructures.[22] One reason why India lacks behind China in attracting foreign investment is its inadequate infrastructure system of uncertain power availability and not enough roads and railways to transport goods from manufacturing facilities to seaports or markets.

f. *Telecommunication*

Telecommunication is defined as the "transmission of signs, signals, messages, writings, images, sounds and intelligence by wire, radio, optical or other electromagnetic systems."[23] Its innovation drives globalization because of quick and efficient transmission of

messages and information. Texting, for example, can relay a message of development from one person to another in seconds. This quick and efficient way of sending messages has sped up globalization because decisions on trade, investment, refugee problems, and other issues can be made immediately after the information is received.

Telecommunication technology has made remarkable advancements, particularly in the past two centuries starting with the discovery of the telegraph to today's Internet. Although sending messages were cumbersome and required the installation of posts and wires, telegraph messages were quickly sent and received. Today, the Internet allows people, companies, and governments to send questions and replies to answers on matters relating to trade, investment, and other globalization issues in a matter of seconds.

g. *Information Technology*

Information technology refers to the use of computers and the Internet to bank, retrieve, send, process, and disseminate information, a process closely related to telecommunication technology. This process is readily available to billions of people around the world who own an iPhone or iPad. They can literally access and send information on anything and anywhere in the world with a touch on their electronic gadget. For example, stock market values respond immediately after an announcement on the decline of the price of oil, leading to a frenzy of buying and selling of the commodity or the stock of oil-producing enterprises.

h. *Geopolitics*

As mentioned earlier, globalization has a geopolitical dimension because it changes a nation state's political architecture. After WW II, the United Nations was established to prevent future wars and improve relations between nations. To do so, member countries ceded some of their sovereignty to the supranational institution. For example, declaring war against a country requires a UN Security Council (UNSC) resolution as was the case in the Korean War (1950–1953), although the way it gained "unanimous" support was debatable.[24] UNSC resolutions require the unanimous approval of all permanent members holding a veto power. The United States pushed the Korean War resolution through when the Soviet Union representative was absent at the moment. However, needing the unanimous support of all 5 permanent members (United States, Russia, China, United Kingdom, and France) and at least 9

of the 15 nonpermanent ones to pass resolutions, can be broken. The United States, for example, attacked Iraq even though three of the five permanent members, Russia, China, and France, vetoed it.[25]

The rise of China and other major developing economies has spilled over to the geopolitical realm in that it is viewed by the West, particularly the United States, as a challenge to its global dominance. China's ability and willingness to invest hundreds of billions of dollars in Africa, Latin America, and Eurasia has replaced the West and the US in particular as the main sphere of influence in these regions, prompting a revisit on relations with these developing regions. After years of not paying attention to the continent, the EU set up a China–Africa style forum to explore economic cooperation between the two continents as way to check or counter China's geoeconomic influence.[26] Losing influence to China is probably the reason why the former US Secretary of State and 2016 presidential candidate denounced the Asian country as a "neocolonialist," out to exploit Africa's resources in the first term of the Obama presidency.[27] It is also during that period that the United States established a new military theater, Africa Command, to insert its economic and geopolitical influence on the continent.

Geopolitics thus drives globalization in that political and military influence could and has changed between nations. Indian pressure, for example, caused Sri Lanka's new government to re-examine Chinese investment in the country in 2015.[28] However, India does not have the financial resources that China has, prompting Sri Lanka re-revisiting the latter's (China) investment projects. The United States is said to have pressured Australia to persuade China to accept the ruling of the 2016 Permanent Court of Arbitration on the South China Sea territorial dispute. In succumbing to US pressure, however, the Australian economy could be put in a state of persistent slow growth because China is its biggest trade partner, buying over 30% of Australian products.[29] The country probably has found that finding an alternative market able and willing to buy that volume could be difficult.

Effects of Globalization

The effects of globalization, both benefits and costs, will likely be debated for years to come. Below is a sample list of the benefits and costs presented by the supporters and detractors of globalization. The reader

is cautioned to examine the empirical evidence and logic behind the opposing sides' claims before deciding on who is right or wrong.

Socioeconomic woes are the causes of rising protectionism in the West and the success of Brexit in the United Kingdom. The question is whether globalization is responsible for the problems that are plaguing the West. The answer has profound ramifications because if globalization is not the source of the West's economic, geopolitical, and social problems, ending globalization would be like pulling the wrong tooth. In this regard, the toothache would only worsen.

1. *Benefits of Globalization*
   a. *Increase in GDP*

In the 1960s, the countries that embraced globalization are said to have recorded an annual average economic growth rate of 4.7%, favorably compared with those that did not participate in the process at 1.4%.[30] The economies of the "four Asian tigers," South Korea, Taiwan, Hong Kong, and Singapore, owed their "developed" economy status by integrating into the global economy, growing at an average annual rate of over 7% from 1962 to the late 1990s, because exports accounted for over 150% of their GDP.[31] History repeated itself in the 1990s, in that the developing economies that were integrated into the global economy enjoyed an annual economic growth rate of more than 5%.[32] The common denominator was that the mentioned economies were (and still are) export-driven. China is arguably one of if not the most successful globalized nations in recent history, owing its averaging an annual growth rate of almost 10% from 1980 to 2013 largely to exports (30% of GDP) and (domestic and foreign) investments (over 40% of GDP).[33] It was the world's biggest trading nation, biggest trade partner with over 100 countries, and the second largest recipient of direct foreign investment after the United States in 2015.[34]

Export-led economic growth is given credit for increased income and wealth in East Asia, allowing consumers in the relatively rich Asian countries to enjoy a standard of living compatible to if not higher than that of the West and Japan. In 2015, real per capita GDP (PPP) in Singapore exceeded US$86,000, favorably compared with that of the US at US$57,000 and higher than Japan's US$38,000.[35] Hong Kong and South Korea registered a

real per capita GDP of US$58,000 and US$37,000, respectively.[36] Status-conscious Asian consumers might be the biggest buyers of Louis Vuitton bags, Sony television sets, and Apple computers. Chinese consumers are following those of the Asian Tigers' footstep, buying expensive Rolls Royce or Mercedes Benz cars, and other luxury Western and Japanese goods. As indicated earlier, China's huge and growing middle class, estimated at over 400 million in 2015, exploding to over 600 million by 2020, was the biggest source of tourists with over 120 million in 2015.[37] The Asian countries' (excluding Japan) strong consumption power has prompted the IMF to project an average economic growth rate of over 5% in the region, favorably compared with that of the EU, US, and Japan at less than 2%.[38]

b. *Enhancing Global Economic and Geopolitical Relationships*
Increasing economic interdependency between the major powers in the post-WW II order is said to be an important factor in preventing them from taking up arms against each other. The increasingly intertwined economies owed no small part to the US and Chinese multinational enterprises that played a pivotal role in establishing the Economic and Strategic Review Dialogue (ESRD). The forum is co-chaired by each side's top diplomatic and foreign affairs officials, meeting twice a year to address conflicts and promote trust and good relations. The regular meetings have been instrumental in keeping the Sino-US relationship "stable," preventing economic (currency manipulation charges) and geopolitical (South China Sea freedom of navigation) issues from escalating to a shooting or trade war.

c. *Acceleration of Technological Advancement*
The most effective way to increase competition and profits is by bringing advanced technology and management methods to the recipient countries. American companies' capital and technology are said to be responsible for Canada's rapid industrialization in the nineteenth and twentieth centuries. That might also be true in the case of the "four Asian tigers," South Korea, Hong Kong, Taiwan, and Singapore in that imported US and British technologies were instrumental in spurring fast economic growth and narrowing the technological gap with the two countries. Equally important to note is returning engineers, technologists,

and scientists who had studied and worked in the United States played an important role in accelerating the tigers' technological advancement. As indicated earlier, the Chinese government requiring foreign enterprises wanting to invest or form joint ventures in China to bring advanced technology and management techniques is one of the major reasons for its remarkable economic growth and fast closing of the technological gap between the two countries.

d. *Enhancement of Mutual Understanding and Promoting Geoeconomic Relations*
Globalization has accelerated transportation technology, making traveling affordable to increasingly huge numbers of people in all countries to visit, work, and study abroad. People with firsthand observation of each other's landscape, environment, culture, language, music, polity, society, and the arts have a better understanding of the countries they visit. The increasing number of Chinese nationals visiting, studying, and working in the United States and other Western countries is in part responsible for the Chinese government's continual economic and political reforms. The Americans, Canadians, and Europeans who have traveled to China view the communist country more positively than those who have never set foot in China. According to a 2015 Pew International Opinion Poll, 55% of America's younger generation has a positive view of China because they have had traveled to the country or are more aware of global economic and geopolitical affairs.[39] Of the Americans who are older and never set foot on the country, less than 30% of this population view China positively.[40] Similar findings are also found in China. The majority of Chinese who had traveled to, studied, and worked in the United States have a positive view of the country but over 50% of those who did not, view the United States negatively.[41]

As opinion polls on other countries revealed similar conclusions, there is hope for sustainable economic development and geopolitical stability. The young will be tomorrow's leaders. Their understanding of other people's culture, economy, polity, and society can only help in cementing international geoeconomic relations, lessening the prospects of big powers falling into the Thucydides Trap.

History will tell that whenever a rising power is viewed by the existing power as a threat to the latter's hegemony, war between the two will likely take place. This insight was first brought to the world's attention by the Greek historian, Thucydides.[42] He concluded that the Peloponnesian War fought between Athens and Sparta over 2400 years ago was sparked by Athens' (the rising power) demand for a bigger role in the Peloponnese peninsula but Sparta (the established power) was determined to defend the status quo.[43] Historians such as John Mearsheimear, a prominent scholar with the University of Chicago, saw a parallel scenario between China and the United States.[44] They argue that China is demanding a larger role in shaping global affairs and the United States is equally forceful in defending the status quo. These historians claim that a China–US war is unavoidable because 12 out of 15 wars since the 1600s were caused by either a rising power challenging an established one, or vice versa.[45]

However, Mearsheimer and his supporters could be wrong in assuming the China–US case to be similar to those of the past. Past powers did not possess nuclear arms, precluding total destruction or at least killing over half of each other's population. Nor were past powers' economies as intertwined as those of the United States and China. Indeed, even the Cold War between the United States and the former Soviet Union did not lead to war for fear of mutual assured destruction (MAD). Another important difference is that China has not shown any indication that it is attempting to unseat the United States as the global hegemony. As Moak and Lee indicated in their book, *China's Economic Rise and Its Global Impact*, China would gladly let the United States be the "world's big brother."[46] Indeed, there is no reason for China and the United States to go to war with each other.

e. *Other Benefits*

Other benefits of globalization are said to be: a wider selection of affordable consumer goods and services, more opportunities to study and work in foreign countries, and others. Had Dell or other US computer firms not outsourced production to China, many Canadians or Americans may not have been able to buy a laptop or an iPad. As indicated earlier, it is the lower priced Chinese-made goods that increased real wages in the West and in other parts of the world. Foreign students coming from China, India, and

elsewhere have subsidized American, Australian, Canadian, British, and other Western European post-secondary educational institutions for local students (having to pay three times more).[47] The total number of foreign students in the Anglo-American countries—the US, UK, Australia, Canada and New Zealand—topping over 1 million—is also a sizable demander for these countries' goods and services.

An Assessment of the Benefits Claims

Although the logic and evidence behind the benefit claims appear reasonable and probably true, some of them would have occurred without globalization. For example, rapid economic growth in the United States between the 1950s and 1960s was largely attributed to the government's massive road construction program.[48] It was responsible for stimulating manufacturing, particularly the automobile manufacturing sector. The US dot.com revolution in the 1990s was the result of US information technology advancement.

The Chinese economy actually enjoyed high rates of economic growth before Deng Xiaoping opened its doors to the world, albeit from a low base. Between 1953 and 1980, the Chinese economy grew at an average annual rate of over 6%.[49] However, embracing globalization has accelerated the country's economic growth rate.

Losses or Costs of Globalization

However, critics of globalization are not as praiseworthy: relocating production overseas, worsening environmental degradation, widening the rich–poor gap, exporting of "good-paying" Western manufacturing jobs, losing the middle class in the West, and a host of other adverse effects.

1. *Environmental Degradation*
   According to the critics, globalization's biggest damage is environmental degradation. They claim that China's monumental pollution problem was the result of both foreign and domestic owned factories dumping toxic chemicals or wastes into the environment, causing climate change and being responsible for inflicting over 400,000 deaths and costing almost 6% of GDP annually.[50] The

environmental damages are said to be the result of the Chinese government's decision to create employment, attract foreign investment, and promote exports before improving the environment.

China was not the only country placing economic growth over environmental protection. The United States, Japan, and Canada, for example, refused to rectify the Kyoto Protocol on Climate Change for fear that agreeing to its targets on greenhouse gas (GHG) emissions would impede production and employment.[51] The toxic wastes freely traveled around the world through the atmosphere and oceans, causing climate change, which created El Nino (warming of ocean waters) or El Nina (cooling of ocean waters). Both of these phenomena brought unprecedented climate change, depleting fish populations and causing forest fires and other unprecedented natural disasters around the world. California is still immersed in a 5-year drought.

2. *Widening of Rich–Poor Gap*

Globalization is blamed for widening of the rich–poor gap. Increasing wage costs, and high-standard industrial and labor policies in the developed economies made manufacturing increasingly uncompetitive at home, causing firms to relocate their production to low wage countries. At the same time investors in the West, the owners (stockholders) of publicly listed enterprises, are demanding higher return to capital, forcing enterprise executives to relocate or outsource production overseas.

By investing in and outsourcing production to other countries, the West and Japan are said to be exporting high-paying manufactured jobs to low-wage countries, while most of the "replacement jobs" in the developed economies are largely created in the lower paying services sectors. According to the US Department of Labor, almost 85% of new jobs created are "Mac" ones.[52] On the flip side, those with wealth to invest in stock markets enjoy a surge in their income, increasing the Genie Coefficient from less than 0.40 to over 0.48 in the United States, China, and elsewhere over a 15-year period.[53]

In China, income inequality is regional as well as personal, the result of its government action to develop the coastal east first (primarily to attract foreign investment) and allow private enterprise. Developing the coastal regions before those of the hinterland culminated in regional income disparity by a factor of 5–1

in favor of the former.[54] Allowing free enterprise unleashed some people's entrepreneurial spirit and hard work ethics. They got rich. However, those who clung on to the "iron rice bowl" (a stance referred to workers who cannot be fired or laid off for any reason) felt off the crack and remained poor. The result was an increase in China's Genie coefficient from 0.33 to 0.47 within a decade.[55]

3. *Hollowing Out Manufacturing in the Developed World*
As indicated earlier, it was the high costs of production (attributed to high wages, land costs, high labor standard, and environmental protection legislations) that prompted Western and Japanese labor-intensive industries to relocate abroad. For example, Canada's Bombardier asked the government for a CDN$1 billion bailout and at the same time relocate production overseas to remain competitive.[56] Further, consumers are literally drowning "in a sea of debt" after the 2008 financial crisis, disenabling them to pay for the higher prices that domestic producers will charge. It is estimated that a pair of Nike shoes produced in the West would cost US$675, compared to less than US$100 for a pair that is made in Indonesia.[57]

An Assessment of the Cost of Globalization

The view that globalization is the culprit behind the ills of the world is not universally shared. Climate change is said to have begun in the eighteenth century when Europe, particularly the UK, started the Industrial Revolution.[58] Industrialization was followed by the United States and Japan in the nineteenth century. Factories burned coal to generate power. The toxic chemicals produced by coal were said to be trapped in the ground, slowly releasing greenhouse gases (GHG) into the atmosphere. Another cause of climate change, which has nothing to do with globalization, is that coal, oil, and wood are the main sources of fuel for cooking, heating, and manufacturing in developing economies. Finally, the "car culture" is blamed for spilling GHG into the atmosphere. Rising incomes in the developing economies, particularly China, prompt many to buy cars. Beijing is jokingly referred to as the largest parking lot in the world, thousands of cars sit idling with the motors on. Supporters of globalization also question the allegation that it caused income disparity. In a market economy, whether or not it is tied to trade, some take chances and work hard, whereas others do not. It is therefore natural that those who

gamble and work hard become wealthier. As regards developing countries stealing jobs from developed ones, automation might be the bigger offender.

Brexit

The term, Brexit, derived from British and exit, is a movement to take the UK out of the European Union. Disengaging from Europe is not new, the movement in fact began when the UK joined the European Economic Community (EEC), the EU's predecessor, in 1975.[59] Although over two-thirds (67%) voted to join the EEC, opposition to integration with Europe remained strong.[60] In the aftermath of joining the EEC, a number of advocacy groups (comprising of a variety of interest, lobby, and campaign organizations) and political parties sharing a common desire to remain "British" were formed. Groups such as "Leave.EU" (founded in 2015), "Grassroots Out" (established in January, 2016), and "Get Britain Out" (formed in 2007) campaigned to take the UK out of the EU. Their common message was to make Britain independent of external influences. Indeed, some analysts suggest that these groups did not consider themselves Europeans. Political parties also called an exit from the EU. The Labor Party campaigned on a leave EEC platform in the 1983 election, but was defeated by the pro-EEC Conservative Party under Margaret Thatcher. The United Kingdom Independence Party (UKIP) and the Referendum Party (RP) were, respectively, formed in 1993 and 1994 to demand for holding a referendum on leaving or staying in the EU. Some in the Conservative Party and Labor Party were major players in the pro-Brexit campaign.

Brexit succeeded in a 2016 referendum (51.9% of Britons voting to leave the EU) because of the UK's economic woes and the EU's immigration and rights of abode policies.[61] Unemployment and poverty were rising in the UK, prompting many to oppose the current immigration policy and the EU stance of allowing residents of the EU the right of abode in the country. The EU opponents claimed that migrants from Eastern Europe, the Middle East, South Asia, and Africa were not only taxing the UK's social programs, but also increasing crime.

The leave EU side was mainly from England and the northeastern part of Northern Ireland, while Scotland and the non-northeastern part of Northern Ireland voted overwhelmingly to stay in the EU.[62] Within England, in London and other cities, the majority of the people voted

to remain in, while those living in rural or small cities elected to leave the EU. The regional voting differences could pose a problem for UK unity.

The Scottish Parliament appeared to view leaving the EU was not in Scotland's economic interests, fearing that Brexit could discourage foreign investment in the UK. To that end, Scotland's First Minister Nicola Sturgeon did not rule out a second referendum on whether to leave or remain in the UK. She also took steps to promote Scotland in the EU with "Scotland is open to business" slogan.[63] If Scotland were to vote for leaving the UK, the country could fall apart, causing further economic and political chaos in the country.

Brexit could also have implications for the EU. Immediately after its victory, nationalist political parties in the Netherlands, Germany, France, and Italy campaigned to hold a similar referendum on the EU in their countries.[64] Although the majority of people in the four EU countries were supporting to stay, anti-immigration parties were gaining support. Indeed, an anti-immigration party was voted to power in German Chancellor Angela Merkel's home state, an indication of rejecting her pro-immigration policy.[65] Unless the EU's economy recovers, anti-globalization forces will only grow stronger in Germany and other countries, putting the existence of the EU in jeopardy.

In view of Prime Minister Theresa May's overtone to China, the United States, and other countries on economic relations, Brexit does not mean trade and investment isolationism albeit preferring bilateral relations. May renewed Cameron's "golden era" relationship with China in that her government welcomed Chinese investment in the Hinckley Point nuclear power and other infrastructure projects. She also envisaged a free trade agreement with the United States.

The Trump Effect

In the United States, the forces against globalization and its promoters (i.e., political and business elites) are similarly on the rise. After the 2008 financial crisis (to be discussed in Chap. 7), the country is in a relative decline economically and geopolitically. Growing at an average annual rate of less than 2% since 2008, the United States is struggling to regain its economic eminence.[66] Falling economic fortunes have an impact on the country's geopolitical influence on the world, in that rising economies like China are forging their own foreign and trade policies.

Americans who were displaced by globalization blamed the business and political establishments that promoted and supported it. They accused the establishments for "selling out" the country and people to countries such as China and Mexico for personal gains. Donald Trump and his "Make America Great Again" campaign slogan resonated with this group of Americans, enabling him to beat out 16 well-qualified and established politicians to become the Republican nominee for the presidency. His calling Mexicans "drug dealers" and "rapists" and building a wall along the US–Mexican border on Mexico's dime have been cheered and supported by many. His relentless China-bashing rhetoric of labeling the country a currency manipulator and threat of imposing a 45% tariff on Chinese-made goods are popular among the US public. Trump's vow to tear up the TPP, renegotiate NAFTA, and stop immigration also played a role in him getting the nomination as the Republican candidate for and won the US presidency. It did not matter that Trump was wrong on his claims that Mexicans are criminals and China is "raping" America, but his message is what his supporters wanted to hear. Whether Trump can "Make America Great Again" is unclear, but his message offered the working and lower middle classes a glimpse of hope, whereas the political establishment in both mainstream political parties had lost credibility with them, particularly among white people with only a high-school education or less.

Trump won the 2016 presidential election, although he lost the popular vote to Hillary Clinton by almost 3 million votes. His strategy of playing to the emotions of the displaced and focusing on the around 10 swing states was what probably landed him the presidency. Voters in so-called rust belt states such as Ohio, Michigan, Florida, and Pennsylvania gave him a slight victory over Clinton. Under the US presidential election system, the winner takes all the states' Electoral College votes, the combined number of Congressional and Senate seats.

Trump's first two weeks as President of the United States has sent ambiguous and troubling messages on domestic and foreign policies. Using "executive order" privileges, Trump ordered the building of a US$12–15 billion wall along the US–Mexican border, prompting the Mexican president to cancel a meeting with him. A day later, Trump and Nieto talked over the telephone, agreeing to keep the issue private and hinting that the result would be mutually acceptable.[67] Trump's China-bashing stance also seems to have taken a U-turn, sending a letter and following up with a phone call to the Chinese President Xi Jinping

to build a great relationship between the two countries and honor the one-China policy, whereas he was threatening a 45% tariff on Chinese imports, denying Chinese troops to enter the islands they built, and revisiting the one-China policy only days ago.[68] He then signed an executive order barring refugees and immigrants from seven Middle East and Africans nations into the United States (the ban was overturned in a lower court in Washington State and later by the 9th Circuit Court of Appeal in San Francisco). Another executive order was issued to path the way for repealing Obamacare. Other executive orders included the termination of the TPP and renegotiation of the NAFTA. Mr. Trump was a busy man and followed through on his campaign rhetoric.

Trump has picked and nominated a "mixed bag" of neoconservatives, businesspersons, pro-and anti-globalization supporters, and China hawks for senior positions in his administration, adding more anxiety around the world, particularly the Asia-Pacific region. His appointment of Peter Navarro, a fierce anti-China critic, as chair of the newly established National Trade Council (NTC) has raised eyebrows in the Asia Pacific, including the United States. It is Navarro who blamed China for closing down 25,000 US factories, leading to the loss of 57 million jobs.[69] However, Trump has also picked the governor of Iowa, Terry Branstad, a personal acquaintance of Chinese President Xi Jinping and promoter of US–China trade relations, as the US Ambassador to China.[70] Trump antagonized China by taking a telephone call from Taiwan's leader Tsai Ing-wen that no other president has done since the two countries normalized diplomatic relations in 1979.[71]

The next 4 years will be problematic for both the United States and the world if Trump continues to sign executive orders or push policies to please his support base rather than for the interests of the nation. Imposing a 45% tariff on Chinese-made products would not enhance economic growth in the United States because China will retaliate, US consumers will pay higher prices, and the cost of production will increase. Banning refugees or immigrants from the seven Muslim countries may not reduce terrorism because resentment against Americans would only grow. Threatening corporations with high tariffs if they do not produce in the United States would not necessarily bring back jobs in the long run because they will retool and increase the pace of automation in order to be competitive. In the end, "Make America Great Again" could be more effectively attained by embracing globalization and working together with other nations.

Rising Populism and Protectionism in Europe

Like in the United States, trade protectionism and anti-immigration sentiments are on the rise in Europe. The European countries are encountering high rates of unemployment and crimes, prompting frequent protests against immigrants from non-European countries. German and other EU members are opposing the Trans-Atlantic Trade and Investment Partnership (TTIP), an agreement its critics claim would benefit only the United States.

Persistent high unemployment coupled with increasing numbers of "terrorist" attacks on the continent has sparked a rise in populist politics. Perhaps with the exception of Austria, far-right or right-of-center political parties, promising to take their countries out of the EU and stop non-European immigration, did gain ground in the 2017 general elections in France and the Netherlands albeit that they lost to pro-globalization parties. Like in the United States and United Kingdom, EU countries wanting to disconnect from globalization may prove to be easier said than done.

The Unexpected Consequences of Globalization: China's Economic Rise and Its Global Impact

Perhaps the biggest surprise of post-WW II globalization was the rise of developing economies, particularly China. In the aftermath of the Cultural Revolution, Deng Xiaoping, the then Chinese leader was determined to reform China's economy from central planning to market-drive.[72] A major reform policy was forging closer relations with former enemies (i.e., United States and Japan), sending students overseas to study modern management methods and advanced technology, establishing special economic zones (SEZs) to attract foreign investment, and making export one of the engines (the other being investment) of economic growth. As indicated earlier, his reform policies succeeded beyond expectation, transforming the Chinese economy into the world's biggest (PPP) and an increasingly innovative one in less than 30 years. The Chinese economy was estimated at nearly US$20 trillion compared with that of the United States at US$18 trillion in 2016.[73] Within this period, China was able to come from a technically backward economy to one of the most innovative, becoming the leader in high-speed railway, space, bridge, and information technology.

China's rise has impacted the world hugely, causing a shift in the global geoeconomic power. As indicated earlier, there are no issues, from climate change to global security, that can be addressed without its participation. Financial system reform would not succeed without including China in the conversation, given that it is the biggest holder of foreign reserves at around US$3 trillion and America's biggest creditor, buying over US$1.2 trillion in Treasury Bills.[74] As a veto holding permanent member of the United Nations Security Council (UNSC), China is in a powerful position to influence international decisions. For example, it blocked the UN resolution of allowing India into the exclusive nuclear club in 2016.[75] Its relatively high annual economic growth rates might have cushioned the world economy from falling into a recession. In fact, most countries are looking to China, not the United States, to pull their economies out of slow growth or stagnation. (How China is able to grow so big so quickly will be discussed in Chap. 8.)

However, there are dissenting voices on China's economic sustainability. Gordon Chang and other American pundits wrote that its economic rise is not sustainable and will collapse. His 2001 book, *The Coming Collapse of China*, predicted that the day of reckoning for its economy was 2011.[76] When 2011 arrived and China was growing at 10% annually, Chang said that he was only 1 year late. The *New York Times, Financial Times, and Economist* have also been telling the world that the Chinese economy will be drowned in a sea of debts and will collapse over the last 30 years.[77]

Critics warned that China's rise not only threatened the country's neighbors, but also posed a "national security threat" to the United States. Peter Navarro, University of California, Irving economics professor, and others propagated that China was threatening its neighbors in the South and East China Seas.[78] Moak and Lee, however, stated that there was no credible evidence to suggest that China was threatening its neighbors. China has neither deployed its navy to stop freedom of navigation nor established military bases around the world, except in Djibouti (which it said is for supporting antipiracy activities). Its territorial claims in the South China Sea and East China Sea are inherited from past governments in that the "Nine Dash Line," based on historical records, was drawn by the Nationalist government in 1947.[79] China said it built the islands and installed military hardware within that line to prevent outside forces from occupying the territories. Moreover, the Cairo Declaration (1945) and the Potsdam Proclamation (1947) demanded

that Japan return all the territories it annexed from China before WW II.[80] The United States was a signatory to and the major author of the two documents.

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CHAPTER 3

History of Globalization: European Colonization and Bretton Woods

The accumulation of wealth and empire expansion were the main drivers of globalization in the ancient world. The Roman aristocracy and wealthy classes found Chinese silk entreating, prompting entrepreneurial and risk-taking merchants to establish the Silk Route extending from China to Rome in 200 BC (200 years before the birth of Christ, giving birth to globalization).[1] The ludicrous silk and spice trade lasted over a thousand years until the Ottoman Empire blocked it in 1453.[2] However, the pursuit of profits spurred powerful and wealthy Western European maritime powers (having had made advancements in ocean-capable ship building, navigation, and military sciences during the Renaissance period) to find a sea route to China. The timing could not have had been better for Western European seafaring expeditions and colonization.

Trade was interrupted by the WW I and again from the 1930s to the end of WW II. At the end of WW II, the Allied Powers, particularly the United States and United Kingdom, began to build a new world economic and financial order based on liberalized trade and investment. The framework was established at the Bretton Woods Conference in 1944.

The Chinese Factor

China has over 5000 years of history, before the founding of the People's Republic of China, but it was not a nation state like the United States. Rather, it is a civilized state glued together by a common written language and culture but separated by lack of transportation modes and

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distance. Over the millennia, each region literally became a state in itself, developing its own values, ideals, and customs with very little loyalty to the central government. Moreover, bloodline dynasties produced incompetent and self-indulging emperors after the second and latter generations, leaving the affairs of the state to be attended by officials and cronies.

The Ming Dynasty Yongle Emperor (1360–1424) had imperial ambitions, commissioning Zheng He (a Chinese Muslim navigator who was once a eunuch in the Ming Court) to explore and trade with the outside world around 1402.[3] Zheng He was given 117, ships some of which were 400 feet in length. The large fleet carried nearly 27,000 crew members, many of whom were soldiers. Zheng made seven expeditions, sailing into the South China Sea, Malacca Strait and the Indian Ocean, the Horn of Africa, and the Red Sea between 1405 and 1433.[4] While he preferred diplomacy to deal with the indigenous populations, Zheng was prepared to use the military to suppress those who opposed his incursions or those who preyed on others. For example, he ruthlessly crashed the pirates who were plunging the settlements and killing the people on the South China Sea islands.[5]

However, Yongle's descendants suddenly banned further expeditions to Southeast Asia and beyond for no other reason than believing that the "barbaric outside world" had nothing to offer the Middle Kingdom. This policy blunder was the beginning of China's long history of self-imposed isolationism, slowly turning a culturally and technologically advanced country into a backward, impoverished, divided, corrupt, and weak nation by the 1800s.[6] The rulers not only banned innovation by burning blueprints and literature on the subject, but harshly punished those who pursued it.

It could be argued that policy blunders of incompetent rulers and corruption were the major causes of China being invaded, occupied, and humiliated from the early 1800s to the end of WW II.[7] While the dynastic founders were benevolent dictators, their descendants lived decaying lives, spending lavishly on self-indulgence activities, leaving state matters to officials. Their behavior prompted corruption to the level of treason, officials selling out the country for their own gains beginning with the Song Dynasty. The Mongols were able to bribe Song military officials to allow them into the country without any resistance The Manchus' bribing of Ming civilian and military made the establishment of the Qing Dynasty from the mid-1600s to 1912 possible.[8] The treachery

was repeated at the end of the Qing Dynasty and in the brief period that the Nationalists governed the country. In the early 1800s, corrupt Qing officials and Chinese opium smugglers helped European imperialists who invaded and occupied China.[9] Nearing the end of the Qing Dynasty, the Dowager Empress, Cixi, was alleged to have said, "I would rather give China to the foreigners than return it to the Chinese minions."[10] Her army in fact helped the European, American, and Japanese imperialists to crush movements (known as the Boxer Rebellion" in the West) to rid China of foreigners. Ironically, her reward was the burning and looting of her Summer Palace by the imperialists she helped to suppress and brutalize whom the Chinese referred to as patriots.[11] Between 1912 and 1949, China was in total chaos: conquered, divided, and embroiled in a civil war, forcing people to survive in any way they could.[12] Some became collaborators and spies, helping European and Japanese invaders to rule the imperialists' concessions. From 1937 to 1945, for example, over 2 million Chinese troops belonging to various warlords and the Nationalists helped the Japanese to control and suppress the people.[13]

European Colonization

Sailing from Europe to China, the Europeans "discovered" virgin lands inhabited by "uncivilized and divided peoples" fighting and killing each other. The Europeans took advantage of the internal strife and division among the local populations through "divide and conquer" tactics. Militarily and diplomatically, too, the indigenous populations were no match for the Europeans, who possessed superior weapons and military training compared to the natives' unorganized war fighting methods and primitive "bow and arrow" weaponry. The combination of superior military technology and effective "divide and conquer" tactics enabled the European imperialists to conquer the vast majority of lands and peoples in Africa, Asia, Oceania, and the Americas.

The Portuguese were the first to lay claims on other lands, conquering Ceuta in southern Spain in 1415.[14] The conquest paved the way for Portuguese expansions into northern Africa, particularly Morocco, where there was an abundance of agricultural and marine products, including cattle, grain, sugar, fish, textiles and honey.[15] Portuguese colonization might have emboldened and encouraged other European nations to expand their empires, wanting a share of the lucrative rewards that Portugal captured from conquering and colonizing other lands and peoples.

The Portuguese were also the first to undertake seafaring adventures in finding a route to China or Cathy. After many failed attempts, the Portuguese seafarer, Vasco de Gama, finally reached India in 1498, sailing south along the African coast, around the southern tip and the Indian Ocean.[16] His "trail blazing" expedition opened the gate for Portugal's future colonization of Asia. Alfonso de Albuquerque established Goa, located on the west coast of India, in the early 1500s, as a colony and trading hub.[17] He made Goa the administrative center for Portugal's empire building and trading ambitions. From there the Portuguese captured Malacca and Hormuz and reached China and Japan in the 1550s.[18] They managed to bribe the local chief to allow Portugal to set up a trading post in Macau, southern China. However, Portugal was unable to establish a colony or trading post in Japan because the Japanese were united, enabling them to drive out the Portuguese imperialists.[19]

While Portugal lacked the military power to protect their colonies and trading hubs in Asia, it succeeded in claiming Brazil and some African territories (Azores and Mozambique).[20] It was able to hold on to Macau until 1999 only because the Chinese government did not want it back before the lease expired in that year, a symbolic gesture of commitment in honoring past treaties however unfair they might be.[21]

Christopher Columbus, an Italian navigator, convinced the king and queen of Spain to finance a risky sea venture exploration of crossing the Atlantic in 1492.[22] His search ended up in the Caribbean Sea, where he "founded" some islands which he thought was India, naming them the Indies and the local population "Indians." Columbus claimed the islands for Spain in the same year, but did not establish permanent settlements or trading posts there.[23]

Columbus did pave the way for later Spanish conquistadors to colonize the Americas. Hernan Cortes arrived in Mexico in 1519 in search of gold.[24] He conquered the land first by befriending but later betraying the local chief, Montezuma, in 1521.[25] Cortes' successful conquest led him to extend the Spanish empire from Mexico to present-day Columbia. Francisco Pizarro conquered the Incan empire and took much of its gold in the late 1520s.[26] Spain continued to plunder South America for gold and silver, extending its land claims from California (then a part of Mexico) to the tip of South America.

The Spanish established permanent agricultural settlements, from large farms to plantations (known as haciendas) from which they gained

the vast majority of their wealth.[27] Rich soil allowed them to grow highly demanded fruits and vegetables that could not be grown in Europe. Enslaving the local population, the Spanish farmers and plantation owners became even more powerful and wealthy. Civil society was in the form of a rigid hierarchical system in which white Europeans were on top and the blacks/indigenous peoples at the bottom rungs of the economy, polity, and society.[28] In examining Latin American economic, political, and social structures, these architectures remain intact to this day. Those descended from African slaves and the indigenous population remain impoverished and that of the European-descended occupy the upper ranks of government, business, and society.

The Pope's decree that divided the non-European world between the Portuguese and Spanish was challenged by the northern neighbors, particularly England, France, and the Netherlands. The King of France, Francis I, demanded to know where in Adam's will (in the Book of Genesis, Adam was the first human, representing mankind) it excludes him from claiming land in the New World.[29] Being a "descendent" of Adam, Francis I challenged Portugal and Spain in colonizing the non-European world. He was soon joined by Britain and the Netherlands.

The northern European challenge to Iberian hegemony was in the forms of profiteering and military conquest. Neither Spain nor Portugal was a match for the English naval power. Francis Drake, acting on behalf of Queen Elizabeth I of England, carried out raids on Spanish galleons, carrying gold and silver from South America home.[30] The Spanish were also helpless or unable to stop the French, English, and Dutch from establishing colonies in the Americas, known as the New World at the time.

The English and French colonists were no more compassionate toward the indigenous populations than those from the Iberian Peninsula. The former, too, committed genocide, claimed the land, and exploited the resources for themselves. British colonists murdered tens of millions of indigenous people in North America, Australia, and Africa.[31] The British treated the Asians as less than second-class citizens, barring the local population from entering public places frequented by the European imperialists.[32] The French were just as, if not more, merciless in their treatment of Southeast Asians, Africans, and Amerindians (Native Americans or Canadians), killing them and exploiting their resources. Many Indochinese were killed and their bodies displayed in the open as a warning to those who dared to challenge French supremacy.[33]

The Netherlands drove out the Portuguese from Asia and Africa and competed with Spain in Asia and the Americas in search of wealth and power. Not only did the Dutch rob the Portuguese possessions in Asia and Africa, they also added the Asian territories of Batavia, Sumatra, Cochin, and Taiwan to their empire and set up a colony at the Cape of Good Hope in Africa.[34] From these colonies, the Dutch gained tremendous wealth—gold from Africa and rubber from Southeast Asia. However, the Dutch were less successful in the Americas, losing their possessions in North America (i.e., selling New York and ceding their Caribbean island possessions to the English).

France, too, was looking for a northwest passage to China but "discovered" North America instead. The King of France commissioned Jacques Cartier to sail west across the Atlantic Ocean in 1534.[35] His search for the Northwest Passage was unsuccessful, running into what is today the Gulf of St. Lawrence. From there he sailed westward along the St. Lawrence River to reach present-day Quebec City and Montreal during his three voyages across the Atlantic. It was not until the 1600s that France carved out colonies in New France and Louisiana.

The feud between the European countries, Britain and France in particular, spilt over to the colonies. The British knew that in order to capture North America, they had to defeat the French in Quebec. They did, in that the British forces under General James Wolfe defeated the French forces under General Montcalm in 1759 on the Plains of Abraham.[36]

The British emerged as the greatest and most successful colonizers of all European imperialists, conquering over 25% of the world's landmass at the height of its power, attributed to a combination of military strength and brilliant diplomacy.[37] The British had the world's biggest and strongest navy up until the twentieth century. British diplomats refined the art of "divide and conquer" stance to perfection. Their successes in defeating the French in North America, for example, were partially attributed to first allying with the Amerindians. After the French were defeated, the British turned on their indigenous allies (one by one). In China, the British took advantage of a divided and weak country, bribing corrupt government officials and employing collaborators, respectively, to establish and rule concessions.

Colonization was a "public–private" partnership between the state and wealthy businesspeople. The Dutch government, in partnership with businesses, formed the Dutch East India Company in 1602 to exploit the resource-rich Southeast Asian colonies, particularly present-day

Indonesia.[38] The wealthy British business elite, with the blessing and protection of the government, established the East India Company in 1600 to trade with nations in Asia.[39] It was the East India Company that instigated and funded the Opium Wars against China in the 1800s.[40] The Hudson's Bay Company, also known as The Governor and Company of Adventurers of England trading in the Hudson Bay, was incorporated under a royal charter in 1670.[41] The King of England gave the company a huge tract of land in the area of the Hudson Bay watershed known as Rupert's Land, comprising of over 15% of the North American continent.

The British and Dutch East India Companies were "joint stock" companies, raising money for "business" (colonization) operations by making the public that bought their stocks as "owner" of the enterprises. This was (still is) a brilliant financial architecture, enabling the "founders" of the enterprise to raise huge sums of money and earning big profits with little risk to themselves. It was largely the stockholders' money that were used to finance business transactions. However, the joint stock companies were successful, affording them to pay dividends to the shareholders.

However, colonization was as brutal in the treatment of non-Europeans as it was profitable. The colonists turned to slave traders in Africa to replenish a serious shortage of labor created by incurable diseases such as smallpox and mass killings of the conquered population. The slave trade became a "business" and mushroomed when the Catholic Church "sanctioned" slavery, declaring that non-Christians or non-believers (labeled as heathens and pagans) could be enslaved. In 1452, Pope Nicholas V issued the "papal bull Dum Diversas," granting Afonso of Portugal permission to enslave pagans or heathens.[42] With the "blessing" of the Church, the European colonists expanded the slave trade, providing European farmers and miners with an "inexhaustible" source of "unpaid" labor. Of the 12.5 million African slaves that crossed the Atlantic Ocean from 1526 to 1867, 10.7 million were sold in the Americas.[43]

In the nineteenth and the beginning of the twentieth centuries, new imperialist powers emerged, who were also determined to expand their empire and economic interests. The German ruler, Kaiser II, wanted a "place in the sun," which resulted in Germany colonizing parts of China and Africa.[44] The United States declared the Caribbean island of Puerto Rico and the Philippines as "protectorates."[45] Russia annexed a large part of Manchuria in northeast China.[46] Japan invaded and colonized the Korean Peninsula and parts of northeast China.[47]

However, colonization (for all its injustices and cruelties) was globalization in the true sense of the word, in that trade, investment, migration, and cultural transformation were extended to all corners of the globe for the first time in human history. Western maritime science and technology heightened global economic development and integration. The less developed world had access to "refined" European manufactured goods. European industries gained additional sources of natural resources. To enhance their commercial interests, European financiers invested in the colonies. It was British investment that made Canada's development possible. Investing in industries such as food processing allowed harvested fish to be sold to European markets. Harold Innes, the Canadian historian coined the "Stable Thesis" as the blueprint for Canada's economic development.[48] British investors financed ship building to harvest fish, food processing facilities, and tertiary industries to export and distribute the products in Canada and abroad. Innes labeled ship building, processing, and exporting/distributing, respectively, as backward, own demand, and forward linkages.[49]

The major difference between British colonization and that of other European imperialists was economic development. The British colonies were to become permanent homes to those who were persecuted (i.e., the Scots and Pilgrims), convicts who had a choice between settling in Australia and death or long-term jail terms, and others to escape poverty for a better life.[50] By necessity or choice, the British settlers developed the economies of the colonies, particularly those in North America and Australasia. Non-British European colonizers, on the other hand, were less interested in permanent settlement, using the conquered territories as trading hubs, exchanging European goods for natural resources. Unlike British colonists, those from the European continent did not establish manufacturing, in that farming, mining, and foresting were the main industries.

The colonial economic, political, and social packing orders between Britain and those of continental Europe were similar when the colonies gained independence, occupying the top ranks in businesses, government and civil society. The native populations were treated with contempt and forcibly took lands that were desired or wanted by the Europeans.[51] In Canada and the United States, they were treated as "wards of the state," creating a "trans generational welfare" syndrome.[52] Forcing First Nations peoples to live in designated areas (known as reserves in Canada and reservations in the United States) with monthly welfare

payments dis-incentivized the population to pursue higher education and employment opportunities, earning the insulting label, "lazy." The Canadian government even attempted to commit "cultural genocide" by taking away First Nations children from their parents and forcing them into residential schools to study the English culture and language.[53]

"Apartheid" is not completely eradicated in North America today, in that the majority of First Nations (Native Americans, Aborigines) populations are the most impoverished and live in reserves (reservations), apart from mainstream communities. The pledges to improve aboriginal socioeconomic well-being are for the most part political posturing. This author conducted a fishery management study for British Columbia's Aboriginal Fisheries Commission in the early 2000s and recommended that the First Nations pooled their fishery resources to form a cooperative in which the native communities would harvest, process, and market the fish. However, when it came to asking for government assistance in making the proposal a reality, the government of the day responded by saying First Nations did not have the 3-year business experience requirement to qualify for government financial help. However, to be fair to the government, the First Nations themselves showed little enthusiasm for pooling resources to form a fishery business, largely because of the "trans generational welfare" syndrome and the lack of cooperative spirit among the communities.

Finally, it should also be pointed out that European colonization has transformed the colonies' economy, polity, and civil society, bringing Western governance architecture, culture, and language.[54] The United States, Canada, Australia, and New Zealand might not have developed to the extent that they did without British investments and colonists working hard to attain a better life for themselves and their families. North America's democratic institutions are distinctively British and French, in that the parliamentary and legal systems of Canada and the United States mirror those of the ancestral countries. The folklores, arts, and languages of the Americas and the Caribbean are transplants from the UK, France, Spain, and Portugal.

The Road to Bretton Woods

In the late and early nineteenth and twentieth centuries, the world economy was encountering difficulties attributed to a combination of isolationism and "beggar thy neighbor" trade and financial policies. The

United Kingdom and France were unable to repay loans and Germany could not afford to meet the harsh reparations the Entente powers had imposed.[55] Among the chaotic and unsustainable policies were included the following:

i. In the 1920s, the UK instituted the "Sterling area," giving imperial preferential treatments to members of the Commonwealth and colonies.
ii. Nations were undervaluing their currencies to gain an export advantage.
iii. In the 1903s, nations on both sides of the Atlantic adopted protectionist and neo-mercantilist policies.

The "Sterling area" architecture was to give Commonwealth nations and colonies preferential treatment.[56] Since it had "de-industrialized," Britain was importing more than it exported, creating balance of payments deficits. To prevent that from occurring, the UK required colonies to deposit their trade surpluses at London banks. This arrangement, however, prevented the Pound Sterling from devaluing because in doing so, colonies would repatriate the surpluses, making British goods less competitive and putting the UK in a financial "bind."

The lack of a coordinated financial system allowed non-Anglo nations to manipulate their currencies. In order to fix the balance of payments difficulties, for example, non-Anglo nations devalued their currencies to gain an export advantage. Since every country was doing it, the stance effectively derailed the foreign exchange rate system, creating chaos in international trade. Uncoordinated foreign exchange rates might also be the cause for increases in the trans-border flow of speculative capital, exacerbating capital account issues.

Paradoxically, the 1920s were also a period of unprecedented wealth and optimism on both sides of the Atlantic, a decade known as the "Roaring Twenties."[57] Wealth was accumulated through stock market speculation and advancements made in automobile, motion picture and radio, and chemical industries. Mass production of automobiles (making automobiles affordable to the rising middle class) had the greatest impact on the economy, accelerating the growth of new industries: road construction, steel production, motels, roadside diners, service stations, house building, and other economic activities directly or indirectly associated with the

industry. The motion picture and radio industries with new ways of making movies further increased economic growth with construction of movie theaters and an expanded variety of radio programs.[58] Mass production made movies and radio programs affordable to a massive number of people. The revolution in the entertainment industry gave birth to a new industry: radio marketing. Economic expansion created optimism in the market, fueling stock market speculation.

Like all good things, however, the "Roaring Twenties" were unsustainable. Overcapacity production resulted in high levels of undesirable inventory, culminating in massive layoffs and huge decreases in stock values. Wealth was lost and the unemployment line grew, creating "bread lines" in which people literally had to rely on governments and charitable organizations to survive. A recession was looming. The Dow Jones index went into a "free fall," collapsing stock prices and the stock market crash on October 29, 1929 was popularly known as "Black Tuesday."[59] Farms abandoned by significant rural migration created food shortages and soil erosion, turning the Midwest into a "dust bowl."[60]

In the 1930s, nations were resorting to all sorts of policies that could reverse the recession, financial breakdown, and trade disequilibria. Protectionist policies such as the US' Smoot Hartley Act designed to keep out imports were introduced on both sides of the Atlantic to protect and promote domestic industries.[61] Imposing high tariff rates was to make imports more expensive, thus less competitive with domestically produced products. Mercantilist policies such as currency manipulation and export subsidies to increase exports and decrease imports were also implemented. Germany even forced its trading partners to use their surpluses to buy only German goods.

Mercantilist and protectionist policies were also purported to increase foreign reserves and fiscal and monetary policy effectiveness. An increase in foreign reserves by increasing exports and reducing imports was to increase the domestic money supply, allowing central banks to keep interest rates low. Restricting imports was to boost domestic production, raising employment thereby increased tax revenues and reduced government transfer payments. However, when everyone was doing it, the hopes were dashed, culminating in a complete breakdown of the international financial and trade systems in the early 1930s, stopping cross border trade and investment altogether. The "double whammy" of falling external and domestic demands increased unemployment and falling tax revenues.

In an era of the balanced budget philosophy, falling tax revenues forced governments to cut funding for education, healthcare, infrastructure construction, and other public goods and services. However, the government spending cuts turned John Maynard Keynes' hypothesis, the "paradox of thrift" under which governments were required to cut spending or increase taxes or both, into a reality. Government spending cuts reduced the aggregate demand (comprising of private consumption, investment, government, and net export). The economy went deeper south, increasing unemployment to over 25% in the mid-1930s from 15% in the early years of the decade.[62] Instead of balancing the budget, moreover, the national debt of most economies actually rose, pushing the economies on both sides of the Atlantic into a dilemma. For example, increasing government spending would exacerbate the national debt and cutting spending would sink the economies into a deeper hole. Protectionism coupled with "policy gridlock" culminated in the Great Depression.

It was at the peak of the Great Depression that led British economist, John Maynard Keynes, to write his famous book, *The General Theory of Employment, Interest and Money*, in 1935.[63] He argued that non-inflationary full employment is not automatic, contradicting classical economic theory. The Classicists opined that the macro economy is an extension of the micro economy in which the forces of demand and supply will bring the market into a state of equilibrium automatically in the long run. Keynes had two problems with the theory. One, he insisted that full employment and price stability are not automatic in that industries within the economy do not enjoy similar prospects. During a recession, for example, car manufacturers would encounter headwinds for lack of demand but bankruptcy firms could enjoy a boom in business. Unemployment in the car industry would increase while the price of cars would fall. The opposite would be true for the bankruptcy sector. In that scenario, the general price level might not fall, albeit unemployment would rise. Keynes in fact accused the Classicist theory to be guilty of "fallacy of composition" for hypothesizing the macro economy as an extension of the micro economy or that all businesses possess the same economic prospects and problems. His second problem with Classical economics was the distinction between short and long runs. For Keynes, there is no long run, perhaps sarcastically saying that "In the long run, we'll all be dead," disagreeing with the Classicists that spending out of the recession would harm long-term economic interests. For example, the Classicists insisted that deficit financing in a recession would erode

future recovery prospects because raising the national debt would increase current interest rates and future taxes, crowding out private consumption and investment in both the short and long runs. Keynes, however, argued that if the government was not “jump starting” the economy with borrowed funds during a recession, the recession would worsen because of weak private and public spending. He further argued that the savings in the banks would be left idle, suggesting that government deficit financing would not crowd out private consumption and investment.

Keynes’ hypothesis that non-inflationary full employment is not automatic is based on a number of assumptions.[64] First, price and wage are downwardly rigid in the macro economy because neither industry nor labor organizations would reduce wages and prices in a recession because of their monopoly power. Labor organizations represent a large number if not all of the workers in key industries. They would rather withhold service rather than take a wage cut to avoid setting a precedent for future wage negotiations. Moreover, businesses have no choice but to lay off workers because of the wage negotiated in collective bargaining is legally binding. Further, rational business people hesitate to reduce wages because the incentive to work is directly related to wage compensation, paying less would lead to lower productivity. Second, price-wage downward flexibility is undesirable in that it would reduce consumption and investment. Reducing price amounts to a fall in profits. Cutting wage would erode consumption power. The deflationary measures would reduce investment and increase unemployment. Third, the economy might not respond to a change in the money supply, in that investors and consumers have the same expectation in an inflationary or recessionary period. That is, they expect business and employment prospects to be poor in a recession, prompting investors and workers to hold on to their cash, falling into what Keynes called the “liquidity trap,” implying that the interest rate is not the main determinant of saving and consumption, but consumer expectation is.

Keynes proposed that the government stimulates the aggregate demand during a recession because investment (and by extension the economy) is demand driven. That is, government spending on public goods and services would incentivize investors to increase investment spending and hire workers, creating a multiplier effect. For example, investors would respond to increased government spending by buying facilities and machinery, stimulating the construction, service, and

manufacturing industries. The newly employed workers would increase spending on consumer goods and services, reversing the economy's downward trajectory.

The United States applied Keynes' theory in the form of "pump priming" in the mid-1930s, creating "make-work" job creating projects in the worst economically depressed regions.[65] Government employment of unemployed workers to clear forests and other "make-work" projects did rejuvenate the local economies, albeit in a small way. The workers were able to buy food and clothing, creating a mini multiplier effect. Prime priming, however, was unable to pull the economy out of the Depression, because the amount of government spending was too small and it was only a temporary measure.

The Great Depression persisted for almost a decade, from the early 1930s to the beginning of WW II in 1939.[66] European and British Commonwealth governments spent massively on the war effort, recruiting young men and women to fight the enemies overseas and hiring women and older men to make weapons and consumer goods at home. The United States, albeit not yet entered the war, was building armaments as well as consumer durables such as trucks massively.

The United States entered WW II after Japanese forces attacked Pearl Harbor on December 7, 1941, known as the "day of infamy," injecting even more capital to build planes, ships, tanks, and other weapons.[67] The surprise attack rallied the country together "to defeat the Axis Powers (Japan, Germany, and Italy), at any cost. Why Japan bombed US territory was not clear, but some historians attribute the invasion to neutralizing the US, allowing it "on easy pickings in the Pacific."[68] Whatever the reasons, Japan's attack on Pearl Harbor raised American patriotism and energized the US economy, allowing its manufacturing facilities to expand and increase production. Unlike Europe and Asia, the war was not fought on American soil, but at the naval base at Pearl Harbor. The absence of destructive forces coupled with huge endowments of natural resources and human capital not only sustained production, but expanded US industrial and military might during and after WW II.

Keynes' economic theory appeared economically sound and politically attractive. Applying counter-cyclical policies would spur economic growth, triggering a resurgence in private consumption and investment. Since both consumers and investors are said to be influenced by self-interest (respectively, value and profit maximization), the market forces of supply and demand will dictate resource allocation, goods production,

and distribution. Sustained economic growth would generate tax revenues and keep government spending down, creating a budgetary surplus (which would be applied to reduce or pay off the public debt). Politically, creating employment is a sure way for politicians to get re-elected. In contrast, unable to revive the economy could and did unseat a popular president as the US presidential elections have demonstrated. Bill Clinton won the US presidency on the slogan, "it's the economy, stupid." President George W.H. Bush was widely popular after winning the First Gulf War against Iraq, but the US economy was in disarray. Rightly or wrongly, he was perceived to be unable to turn the economy around. Donald Trump has won the country's highest office was his promise of "bringing manufacturing back to the United States." The Communist Party has remained popular among Chinese citizens because its policies have brought high rates of economic growth and improved people's living standards.

Bretton Woods Conference, 1944

The Allied Powers were determined to make post-WW II economic and geopolitical orders better than those of the years between the two world wars. Sensing that victory over the Axis Powers was a foregone conclusion, the 44 allied nations gathered at the Connecticut, USA resort town of Bretton Woods to chart a roadmap for global economic recovery in 1944. The conference, officially referred to as the United Nations Monetary and Financial Conference, was to set an agenda to "regulate the international monetary and financial order" in the post-war era.[69] However, the conference was dominated by the United States and Great Britain, in that they wrote the rules and regulations for the post-WW II trade and financial orders. Indeed, then British Prime Minister Winston Churchill publicly declared that the post-WW II global order is to be led by the United States and Britain.[70]

An agreement was reached to ensure an orderly monetary and financial post-war world to prevent the nations from implementing pre-WW II mercantilist policies. Nations agreed to consult each other on changes in its monetary and financial policies to avoid harm on the global economy and to assist each other in addressing short-term balance of payments or exchange rate problems. The Bretton Woods Conference established the following institutions and policies:[71]

a. The establishment of an International Monetary Fund (IMF), whose purpose was to act as a clearing house for international financial transactions.
b. The formation of the International Bank for Recovery and Development (IBRD), whose function was to provide loans for postwar reconstruction and economic development.
c. The institution of a fixed exchange rate regime, but a member nation was allowed to depreciate or appreciate its currency within a defined range.
d. All member nations must subscribe to the IMF capital, providing the organization with sufficient funds to assist nations with balance of payment problems.
e. Member countries' currencies must be fully convertible.

The conference, however, failed to establish John Maynard Keynes' proposed International Trade Organization (ITO) and the International Currency Union (ICU) because of US opposition.[72] The ITO was to provide mechanisms by which international trade could be facilitated and promoted. Its charter was agreed on at the United Nations Conference on Trade and Employment held in Havana in 1948.[73] It came to be known as the Havana Charter, a 126-page document detailing the long list of rules and regulations of international trade for the purpose of enhancing economic and employment growth. The removal of trade barriers and the establishment of cooperative measures in promoting trade were deemed necessary in the promotion and creation of employment. However, the United States Congress refused to ratify it, perhaps because it wanted to have the flexibility to erect protective barriers when needed, or that it was strongly lobbied by interested groups opposing globalization. Moreover, isolationist or protectionist sentiments remained strong in the US Congress and Senate.

The United States rejected the ICU (the purpose of which was to address a nation's trade deficits) because the British-proposed institution could harm US interests. Trade deficits were viewed harmful to global economic growth in that nations encountering current account deficits might be burdened by interest rate payments that could erode global economic growth. To avoid this from occurring, Keynes and E.F. Schumacher proposed an international currency known as the "bancor" in 1940, a "line of credit" to which a nation can access up to 50% of its trade value over 5 years.[74] For nations requiring loans over the

line of credit to cover their deficits, they would be charged an interest rate of 5%. The nations whose surplus was over 50% of trade value over 5 years would be required to pay a 10% penalty. Nations could also exchange their currencies for the "bancor" at a fixed exchange rate, a proposal that effectively called for a fixed exchange rate regime. Lastly, all members' currencies must be fully convertible. However, the United States representative, Harry Dexter White, opposed Keynes' ICU proposal because it could dilute US influence on the global economy.[75]

White presented two counterproposals, the International Stabilization Fund (ISF) and the International Bank for Recovery and Development (IBRD).[76] The ISF architecture put the burden of addressing balance of payment problems on the current account deficit nations and imposed no limit on the amount of surplus a country could hold. The ISF later became the IMF. The IBRD, incorporated into the World Bank Group, was to provide loans for economic recovery and reconstruction.

The United States "proposed" (some said demanded) the US dollar along with gold as the world's reserve currency. At the time, the US was the world's largest economy, the biggest creditor, and the holder of over two-thirds of the world's gold. Using the US dollar as the reserve currency brought enormous benefits to the United States, elevating the US as the bank of last resort, since the "greenback" is the world's "medium of exchange," "unit of account," and "storage of value." These monetary functions gave the United States literally an "unlimited supply of money."

Bretton Woods in the Post War World II Era—Need a Rethink?

The rules the Allied Powers set for a post-WW II global economic architecture created opportunities as well as problems. Establishing the IMF and World Bank to facilitate global economic growth and fund infrastructure construction and postwar reconstruction has unquestionably hastened world economic development and growth. The two international organizations' governance structure, the imposition of the fixed exchange rate regime, and conceding the US to set the price of gold at US$35 per ounce, however, proved unsustainable and problematic in the postwar trade and financial environment.[77] The fixed exchange rate, pegging the value of a currency against another at a fixed rate, conflicted with domestic monetary policies. If a country incurred a current account deficit and its

economy was on a downward trajectory, its currency value would fall. To defend the fixed exchange rate system, its central bank would have to raise the interest rate, effectively curbing economic recovery. Pegging gold at US$35 per ounce undermined the forces of demand and supply and put the US dollar at a disadvantage, because that stance allowed other currencies to devaluate against the greenback but not the other way around, which could put the US in a chronic current-account deficit. In recognition of this disadvantage to the United States, President Richard Nixon allowed the value of gold to be determined by the market in 1971.[78]

The Nixon Shock

The unshackling of the price of gold from US$35 per ounce in 1971 was referred to as the "Nixon Shock" because the decision effectively ended the fixed rate regime or Bretton Woods itself, creating turbulence in the international financial market. For all its faults, the fixed rate exchange regime brought trade and financial stability because it prevented export/import exchange rate volatility risk. Terminating the direct convertibility of the US dollar to gold in fact was the beginning of the floating exchange rate regime, allowing the market to determine the value of a country's currency. If the demand for a currency is greater than its supply, the currency will appreciate. Conversely, if the supply of a currency is less than demand, it will depreciate. Further, the absence of "automatic convertibility" between the US dollar and gold put the international system in turmoil, raising interest rates because the global community no longer viewed the greenback "as good as gold." Coupled with the "oil shock" that increased the price of the fossil fuel from US$1.72 to US$34 per barrel from 1972 to 1979, the global economy suffered a new phenomenon called stagflation of rising inflation and unemployment at the same time between the mid-1970s and 1980s.[79]

Some analysts, however, held a more positive view on the merit of the "Nixon Shock."[80] According to them, unshackling gold from the US dollar allowed the US Federal Reserve (Fed) to print as much as it wanted because the quantity of greenback was no longer restricted by the amount of gold it held. And it did just that, preventing the 1987 stock market crush from pushing the US economy into the "dump." The additional liquidity injected into the economy buffered the economy from falling into a recession or a slump because it increased public and private spending. Another advantage of the freely floating exchange

rate system was that it could complement monetary policies. If a country is incurring a current account deficit and is operating at less than full employment, market forces will cause that country's currency to depreciate, complementing instead of conflicting with its expansionary monetary policies. The logic is straightforward: currency devaluation would increase exports and reduce imports. Moreover, the lower currency value would more likely sustain the lower interest rate policy. Increases in net exports and lower interest rates would raise the aggregate demand, culminating in economic recovery.

The flip side of the floating exchange rate regime is the exchange rate risk exposure. Not knowing the value of a currency could have an adverse effect on international trade and investment, because the price of a tradable good is determined by the production, transportation, and exchange rate costs. Not knowing the value of the currency may prompt the traders to hedge or buy insurance against future volatility, fueling speculation, which could lead to inflation. Currency volatility may also undermine investment because it heightens interest rate risk exposure, eroding consumer and investor confidence.

The debate over the "pros and cons" of the "Nixon Shock" continues to the present day. However, one scenario is not in doubt: neither a fixed exchange rate nor a floating exchange rate regime is the answer to a country's economic woes. David Frum, the conservative commentator and former speech writer for President George W. Bush, observed that a fixed exchange rate regime might be deflationary while a flexible one could be inflationary.[81]

Bretton Woods—Need a Rethink?

In spite of committing to allow the market to determine exchange rates, countries are consistently applying the "managed floating exchange" rate regime to determine the value of the currency vis-à-vis the others. This practice is referred to as the "dirty float" because it manipulates currency values to maximize (countries) economic interests. The United States, EU, and Japan, for example, have carried out quantitative easing (QE), increasing the money supply to devalue their currencies.[82] However, they rejected that QE is used for currency manipulation, merely a monetary policy to stimulate economic growth. Although Trump accuses China as a currency manipulator, not too many analysts and international economics organizations agree with him.[83]

It seems that Bretton Woods might be in need of a rethink in that it is becoming increasingly irrelevant in today's global order. The fixed exchange rate regime comes in direct conflict with monetary policies for reasons cited earlier. Equally important to note is that the rise of the major developing economies is posing a real challenge to Anglo-American dominated postwar economic and geopolitical orders. China has replaced the United States as the world's largest trading and manufacturing nation, giving the former a powerful voice in shaping global trade and financial rules. With its huge financial resources accumulated over prolonged periods of economic growth and trade surpluses, increasing numbers of developing countries are borrowing money from China than from the IMF and WBG, largely because of the latter two institutions' harsh and counterproductive loan conditionalities.[84] Moreover, the BRICS nations have established their own infrastructure and development banks and currency emergency fund as an alternative to the IMF and WBG.

Summary

The ever-changing dynamics of globalization precludes any power(s) from dominating the global order indefinitely. Egypt, Ancient Greece, the Persian Empire, the Ottoman Empire, and the Roman Empire lost their glory and power after centuries at the helm of global hierarchy. Until the mid-fifteenth century, China was arguably the greatest naval power on earth, making overseas expeditions to as far as the Red Sea. However, later emperors decided to ban future overseas expeditions, disallowed building of ships requiring more than two masts, and persecuted anyone who dared to be innovative. Self-isolationism and corruption caused China's long-term descent into backwardness and poverty, culminating in its demise from the mid-nineteenth century to the end of WW II. Without Chinese competition, Western European maritime powers were able to colonize almost all four corners of the world from the late fifteenth to the early twentieth centuries. In the late nineteenth and early twentieth centuries, Russia, Germany, and Japan became imperial powers, carving out colonies in Asia, Africa, the Americas, and Australasia. However, power overreach and wars took their toll, ending European and Japanese empires. After WW II, the United States emerged as the world's indisputable dominant global power because of its immense industrial, financial, and military power.

No country, including China and Russia, has the ability and/or desire to challenge US hegemony in that neither has the economic, cultural, technological, and military clouts comparable to those of the United States. China is still at the "primary stages of socialist development," implying that it requires time and a prolonged period of peace and stability to develop the economy and address many of its insurmountable problems. Russia's military prowess might be comparable to that of the United States, but it does not have the economic and financial muscle to "take on the United States." Other major developing economies, including India and Brazil, are even less powerful than China and Russia. India is indeed attempting to strengthen relations with the United States to counter China's rise. That said, they are determined to forge their own independent foreign policy and developmental path.

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CHAPTER 4

Bretton Woods International Trade and Financial Organizations

The Bretton Woods Conference established the International Monetary Fund (IMF) and International Bank for Reconstruction and Development (IBRD) (became part of the World Bank Group (WBG) to improve the postwar global trade and financial order. The British delegation proposed an international trade organization modeled after the IMF and WBG, but was rejected by the United States. In addition, the United States instituted the Marshall Plan (MP), providing loans/aids for European reconstruction (later extended to other regions of the world) and contain Soviet expansion into Western Europe. The economic rise of Japan and the Asian Pacific region prompted the establishment of a regional "World Bank," the Asian Development Bank (ADB) in the 1960s, focusing on funding development and infrastructure construction projects in that part of the world.

The International Monetary Fund

The IMF was essentially a compromise between the United States and Britain after the former rejected the latter's recommendation to establish the International Clearing Union (ICU).[1] Established in 1944, it became operational in December 1945 with 29 members (mushroomed to almost 190 today). The IMF's mission statement is long and comprehensive, agreeing to "promote global monetary cooperation, financial stability, international trade, high employment, sustainable economic growth, and eradicate poverty."[2]

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John Maynard Keynes visualized the IMF as an organization from which members could seek financial relief to address monetary issues, similar to the three "Rs" that the United States instituted in the "New Deal" of the 1930s.[3] The three "Rs"—monetary *relief* for nations encountering balance of payment deficits or other financial problems, *recovery* programs to promote economic growth, and *reform* the international monetary system—were meant to prevent the pre-WW II financial system breakdown from happening again. US chief representative, Harry Dexter White, however, had a different view, insisting the IMF should function like a bank, and nations requiring loans should make payments before spending on economic development programs.[4] Because the US was the biggest creditor and the most powerful nation on earth, White's stance prevailed.

IMF Governance Architecture

The governance architecture of the IMF has only marginally changed since its founding. The United States, with over 17% of shares and holding a veto power, is the IMF's biggest shareholder and policy "decider" because a super majority of 85% is required for any reforms to be approved and implemented.[5] US control of the IMF is further entrenched because together with its allies—France, Germany, the UK, and Japan—they hold close to 70% of IMF shares.[6] In addition, although its managing director (president) has always been a European, the United States holds a veto power over IMF decisions. It should also be pointed out that the IMF's board of directors, the effective policy-making body, is overwhelmingly represented by Western and Japanese nationals. While it recently appointed non-Europeans (i.e., a Chinese national has been appointed Deputy Managing Director) to the top ranks of the organization's executive branch and China's currency is included in the Special Drawing Rights (SDR) basket, the United States and its allies are still controlling the international financial institution.[7]

The Western-centric governance architecture has frustrated not only the developing economies, but it may also violate the "letter and spirit" of IMF bylaws. Under its rules and regulations, shares were to be assigned in accordance with the size of the economy. China is the world's second largest economy in nominal exchange rate measurement, but it is the third largest shareholder behind Japan. China has 6.41% of IMF shares and 6.09% of voting rights, albeit the Chinese economy is more

than twice that of Japan.[8] The lack of power in influencing IMF policies forces developing nations to accept whatever decisions its executives and board of governors make. And the decisions such as the loan conditionality do not necessarily benefit the borrowing nations as pointed out by Columbia University Professor Joseph E. Stiglitz in his bestseller, *Globalization and Its Discountents.*[9]

Most nations, including some in Europe, blame the United States for turning the IMF into an increasingly "irrelevant" international financial institution because developing economies are turning away from it for funds, indicating that its loan conditionality is not only harsh, but damaging to their economic development. To that end, the IMF executive and board of governors did recommend that shares and voting rights be given to reflect the economic standing. However, the US Congress put the recommendations at the "bottom" of its policy agenda, did not approve the reforms until 2015, and gave major developing countries greater quotas and voting rights until October 2016.[10]

Effects of IMF Loan Conditionality and Governance

Operating the IMF as a bank, repaying loans over rational economic practices, takes away the borrowing nations' fiscal and monetary policy effectiveness. Disallowing the right to implement expansionary fiscal or monetary policies, for example, worsens the borrowing countries' woes as shown by the effects of IMF loan conditionality on Argentina and Thailand.

Case Study One: The Argentina Case

Between 1989 and 2001, Argentina was touted as a "model" economy because it complied with the Washington Consensus stance (the Washington Consensus will be discussed in detail in Chap. 7).[11] Carlos Menem privatized almost all state-owned enterprises (SOE) because of mismanagement, inefficient use of resources, and public outcry of poor services (i.e., it took years to install a telephone) in 1989.[12] His privatization decision worked (at least for a short period of time), because once the SOEs were privatized, efficiency improvement literally exploded. The new privately owned telephone company was able to install a telephone line within a week from the date of application. Productivity rose significantly because of investments in modernizing agriculture, industry,

and seaports. Another Washington Consensus stance to which Argentina adhered was unfettered trade in 1991.[13] The reform worked because Argentina's comparative advantage in agriculture and abundance of natural resources reversed the economy's downward trajectory. Monetary reform was a third policy undertaken by the Argentine government, introducing the currency board that changed the currency unit from the austral to the peso and adopting the fixed exchange rate regime of pegging the peso at par with the US dollar.[14] The new monetary rules also restricted the domestic money supply to the amount of foreign reserves the country holds, effectively stabilizing prices. Smaller troubled banks were allowed to be taken over by foreign banks from the West, particularly those of the United States, improving banking management and efficiency. Monetary policy reform attracted foreign investment, culminating in significant economic growth averaging over 5% annually, at least until the end of 1993.[15]

The "model economy," however, turned sour in the early 1990s for a number of reasons.[16] One, industrial restructuring was not in the way in which it was intended, resulting in rise of unemployment and riofts in the streets. The once SOE monopolies were sold to political cronies and the well-connected for pittances. Without competition, the privately owned companies became inefficient and price gouging created additional economic woes. One, the economy slowed down, raising unemployment to double-digit figures of over 12%.[17] Two, currency devaluation in Mexico worsened the Argentine economy, sending it downward by 4%, increasing unemployment by another 6% points within 6 months, and collapsing many banks because it (Mexican peso devaluation) made Argentine agricultural exports less competitive. Although the government took measures (i.e., tighten bank regulations, etc.) to increase economic growth and reduce unemployment from 1996 to 1998, Brazil depreciated its currency in 1999, exacerbating the Argentinian economy further.[18]

The fixed exchange rate regime and Brazil's depreciation tanked the Argentine economy because its industries could not compete with those of Brazil. The fixed exchange rate regime disallowed the peso to devalue, forcing industries to reduce prices. The loss of profits from price reduction, however, brought deflation in which wages were falling and unemployment rising. The strong export gains from 1991 to 2001 plunged, resulting in a current-account deficit of US$22 billion because of falling agricultural and commodity prices.[19] The 1997 "Asian Contagion" also

played a role in Argentina's economic decline because it raised interest rates and the cost of borrowing in the international capital market. Additionally, Russia's "1998 financial crisis" added "salt to injury" to the Argentine economy, hammering its exports. Financial system difficulties, uncompetitive industries, falling exports led to near-economic collapse, prompting the government to seek IMF financial help in 1999.[20]

The IMF agreed to loan Argentina US$7.2 billion on condition that the government would adhere to fiscal austerity and attain a 3.5% growth.[21] Austerity measures, however, made the growth target unattainable, the economy only grew by 0.5% in 2000 because the two goals were not compatible. As pointed out by John Maynard Keynes' hypothesis of the "paradox of thrift," cuts in public spending during periods of weak private demand eroded aggregate demand, bankrupting many firms and increasing the number of nonperforming loans substantially. The banking sector was in a financial crisis. What was once the world's economic "bright spot" or the Singapore of South America, Argentina became an economic basket case. It had no alternative but turn to the IMF another loan of US$40 billion.

According to most economists, the US$40 billion IMF loan conditionality worsened rather than helped Argentina to recover from an economic malaise caused by the first US$7.2 billion loan.[22] First, austerity measures slowed economic growth which in turn reduced tax revenues. Second, forcing the country to abandon the fixed exchange rate regime caused huge peso depreciation, increasing the amount and cost of loans (because they were in US dollars and other foreign currencies) and capital flight. The government had to default payment, prompting the IMF to negate on giving a US$1.3 installment because it did not reduce the deficit far enough.[23] The IMF also demanded further government spending cuts by as much as 10% in order to avoid a loan recall. To meet the demand, the government cut the civil service and pension benefits by 13%, culminating in unemployment increase from 14% to over 20% by the end of 2001.

Case Study Two: The Thai Case

The collapse of the Thai baht was largely attributed to IMF loan conditionality, albeit its domestic fiscal and monetary policies also played a role.[24] Financial deregulation allowing banks to make questionable and highly risky real estate loans initiated a financial crisis in Thailand, resulting

in an increase in the number of nonperforming loans and causing the baht to devaluate. Thailand was also under the fixed exchange rate regime, forcing its central bank to raise the interest rate and selling foreign reserves to defend the peg. The draining of foreign reserves curbed Thai borrowers to repay foreign currency-dominated loans. With the economy teetering on the brink, the higher interest rate became the “last nail” on the “coffin” because it raised the cost of consumption and investment. Thailand had no choice but to apply for an IMF bailout. The loan was granted but on the Washington Consensus loan conditionality. Forcing the country to adopt the flexible exchange rate regime caused the baht to devalue further because it was overvalued under the fixed exchange rate. Foreign hedge funds took advantage of the devaluation by “attacking” the currency, culminating in the collapse of the baht.

How was the baht “attacked”? Aware that the IMF would impose the flexible exchange regime, foreign hedge funds takes out a loan at a Thai bank at the prevailing exchange rate of let’s say US$1.00 for 25 Thai baht. Assume the speculator borrows 50 baht and converts the amount into US$2.00. Once the flexible exchange rate regime is in effect, the 50-baht loan devalues to US$1.00, reducing the loan amount by 50%. Instead of repaying the loan with US$2.00, the “attacker” only pays US$1.00, earning US$1.00 from the “attack.”

Again, it was the IMF loan conditionality that helped the collapse of the baht and Thai economy. Currency depreciation increased Thailand’s debt burden because the loans were in US dollars or other foreign currencies. Foreign investors’ confidence in the baht and economy caused capital flight, exacerbating the financial problems. Unable to repay mostly foreign currency-dominated loans forced payment defaults to outside creditors. The austerity measures imposed culminated in a lack of expansionary fiscal policies, worsening Thailand’s economic malaise.

Questions on IMF Washington Consensus Loan Conditionality

The experiences of nations borrowing from the IMF raise an important question: Does forcing the borrower to adopt a flexible exchange rate regime allow monetary policy effectiveness or give foreign (Western and Japanese) currency speculators an effective weapon to attack the former’s currency? History will tell us that the flexible exchange rate system is flawed because it could create chronic inflation and economic uncertainty (due to persistent currency value fluctuation), particularly in

developing countries with a weak financial system architecture. Uncertain of future currency values prompts demanders for and suppliers of foreign currencies to hedge against exchange risk, thereby raising the price of imports or exports. Since interest rates are partially influenced by inflation (expectations), frequent price changes could have an adverse effect on private consumption and investment.

Inhibiting borrowing nations to implement expansionary fiscal policies has proven to be counterproductive. Unable to apply expansionary fiscal policies was in fact largely responsible for Argentina's, Thailand's, and now Greece's economic disasters. Cutting transfer payments and laying off public sector workers reduced consumption further in these economies, culminating in decreases in GDP and tax revenues. As indicated earlier, falling tax revenues not only reduced funding to hospitals, educational institutions, and other publicly funded organizations that produce social goods and services, but might also increase payment defaults. These predictable outcomes were perhaps the reasons why developed nations never shied away from deficit financing to spur economic recovery. The burning question is: Why does the IMF demand borrowing countries to repay loans before spending on economic enhancement projects when it is or should be aware of the dire consequences?

Forcing borrowing nations to privatize SOE without first attaining an infrastructure and knowledge of managing private companies ended up in disaster as in Argentina, Chad, and Russia.[25] The SOEs were sold mainly to political cronies who had no experience in managing and operating profit-oriented businesses. In Russia, for example, the oligarchs ran their newly acquired enterprises as if they were state-owned, ignoring or misunderstanding the rules of the market. Not securing an efficient procurement system created production bottlenecks. Not having an adequate distribution network resulted in high levels of undesirable inventories.

Will the IMF Reform to Better Serve Developing Nations?

Although the IMF loan conditionality may not change in the foreseeable future, the rise of developing economies, particularly China, has forced the IMF to reform its flawed and contradictory governance, share, and voting rights architectures. As indicated earlier, the number of non-Western and Japanese nationals appointed to senior management positions is

rising. IMF share and voting rights assigning or distribution postures have reformed, giving developing economies larger shares in both. The Yuan was included in the IMF SDR basket in October 2016.

Inclusion of the Yuan into the Special Drawing Rights Basket

It was inevitable that the Yuan was included the IMF SDR basket along with the US dollar, British pound, Euro, and Japanese yen.[26] Increasing numbers of countries are creating Yuan or Renminbi hubs or swap centers in which the currency is to be used in settling financial transactions. Russia has added the Yuan as part of its foreign reserves. More countries will likely follow suit since China is the world's largest trading nation and trade partner to 125 countries.

On December 1, 2015, IMF announced the inclusion of the Yuan into its SDR basket, paving the way for Chinese currency to become a reserve currency. While the decision was symbolic, it is nevertheless a "milestone" shift because the world officially recognizes China's economic rise and importance on the global stage. The United States has no choice but to (reluctantly) approve the inclusion of the Yuan into the SDR basket, because increasingly a number of nations are using the Yuan as a medium of exchange in trade transactions. However, as seen in Table 4.1, the IMF decision did not change the US dollar's weight in the SDR basket. Indeed, neither the United States nor Japan has given up much of their currency's share in the basket, raising questions of how the IMF calculated the new SDR share since it is supposed to be assigned in accordance with the relative economic size. In 2015, China's GDP was a little over 60% of that of the US, but the former's SDR basket weight was only 25% of that of the latter.[27]

Table 4.1 IMF SDR basket weight: 2017

Currency	*Pre-review*	*Post-review*
US Dollar	41.9	41.73
Euro	37.93	30.93
Yuan	0.0	10.92
Yen	9.4	8.33
Pound	11.3	8.09

Source International Monetary Fund

IMF Share Structure and Voting Rights

The United States holds 17.68 and 16.74% of IMF shares and voting rights, respectively, for reasons cited earlier. The IMF share structure and voting rights are listed in Table 4.2.

It is interesting to note that with the exception of China, the shares and voting rights of the selected countries reflect (more or less) the size of their economy as a percent of the global GDP. To that end, China can be forgiven for feeling "discriminated" against because its economy accounts for over 15% of world GDP.[28] However, to be fair to the IMF, it recognized the discrepancy between the direct relationship between quota/voting rights and economic size, resulting in 95.329% of stakeholders in favor of the Resolution on Quota and Reform of the Executive Board, culminating in approving the reforms on December 15, 2010.[29] The IMF reforms included:

a. SDR quota to be doubled from SDR 238.5 to SDR 476.5;
b. Shift of 6% quota shares from over-represented economies to under-represented "dynamic" emerging economies (Table 4.3).

Although the shares and voting rights proposed for China are still less than what it should be getting, the IMF gesture is at least moving in the right direction and is reflective of financial contribution. The United States, Japan, the United Kingdom, Germany, and France were (still are) the biggest capital contributors to the IMF.

Table 4.2 Shares and voting rights of selected countries: 2017

Country	*Percent of total share*	*Percent of voting rights*
U.S.	17.68	16.74
Japan	6.56	6.23
China	6.41	6.09
Germany	6.12	5.81
U.K.	4.51	4.29
France	4.51	4.29
India	2.44	2.34

Source International Monetary Fund

Table 4.3 Resolution on Quota and Reform Executive Board: 2010

Country	*Percent of share*	*Percent of voting rights*
United States	17.4	16.47
Japan	6.464	6.07
China	6.394	6.07
Germany	6.110	5.308
United Kingdom	4.227	4.024
France	4.227	4.024
India	2.751	2.029

Source International Monetary Fund

The World Bank Group

The World Bank Group (WBG) is part of the United Nations Development Group and is based in Washington D.C. The WBG is made up of five organizations: International Bank for Reconstruction and Development (IBRD); International Development Association (IDA); International Finance Corporation (IFC); International Center for Settlement of Investment Disputes (ICSID); and Multilateral Investment Guarantee Agency (MIGA). Each organization is assigned specialized functions.[30]

a. *International Bank for Reconstruction and Development*
   The IBRD is the oldest of the five organizations, having been conceived at the Bretton
   Woods Conference in 1944. It became operational in 1945 with a US$10 billion capitalization to help Europe recover from WW II.[31] Today, the IBRD's focus is on economic development and poverty reduction in "middle income" developing and "credit worthy" less developing countries. In addition to providing financial resources, the IBRD also provides technical services to assist borrowers in meeting economic growth and human development targets. Specifically, IBRD loans are for the following:

   1. Long-term human and social development that is unable to get private loans.
   2. Provide financial help to borrowers in times of crisis that adversely affect the poor.
   3. Promote policy reforms to reduce or eradicate institutional issues such as corruption.
   4. The creation of a favorable climate for private investment.

5. Provide borrowers to access capital markets with more favorable terms.

Source: World Bank.

The development goals are to be met through a combination of loans, (loan) guarantees, risk management instruments, and expertise on development-related measures. The bank loaned US$23.5 billion for over 110 projects in 2015, significantly higher than the annual average of US$13.5 billion between 2005 and 2008.[32] On project lending, Financial and Private Sector Development, Urban Development and Social Protection and Risk Management, respectively, received 26, 15, and 14%.[33] It should also be pointed out that IBRD loans are sovereign guaranteed and conditional on the Washington Consensus stance.

The IBRD and the IDA are grouped as the World Bank, both of whom are part of the World Bank Group, the governance architecture and share/voting rights are similar to those of the IMF. Like those of the IMF, Japan has more shares/voting rights than those of China. The US government, being the biggest shareholder, appoints the bank's president and can veto any decisions or reforms the bank makes (Table 4.4).

b. *International Development Association*

The IDA was established in 1960 to provide loans or grants to the poorest and "credit unworthy" nations, taking over the IBRD's responsibility for the poorest countries.[33] It is the "lender of last

Table 4.4 Share/voting rights and GDP: 2016

Country	*Percent of share*	*Percent of voting rights*	*Value of GDP (Trillion US$)*
United States	17.01	16.1	18.5
China	5.07	4.82	11.4
Japan	7.87	7.46	4.4
Germany	4.59	4.37	3.5
United Kingdom	4.12	3.92	2.8
France	4.12	3.92	2.5
India	3.19	3.04	2.3

Source IMF World Economic Outlook, April 2016

resort" because borrowers are in such a dire state that they are ineligible to borrow from private banks or IBRD programs. Like the IBRD, IDA loans or grants are for promoting economic growth and reducing poverty.

Since its conception, the IDA has given almost US$240 billion in loans and grants to over thirty-five countries and is the world's biggest lender or supporter of human development projects in the world's poorest countries.[34] Between 2000 and 2010, the IDA funded the following:

1. Trained 3 million teachers;
2. Immunized 310 million children;
3. Disbursed US$792 million in loans to 120,000 small- and medium-sized businesses;
4. Built or restored 118,000 km of roads and 1,600 bridges;
5. Improved water for 113 million and sanitation facilities for almost 6 million people.

Source: The International Development Association

In 2015, the IDA issued loans, guarantees, and grants totaling US$19 billion, of which the biggest recipient was Africa with US$10.4 billion.[34] The money was used to fund infrastructure, public administration, human development, rural development, social protection, and risk management.

c. *International Finance Corporation*

The IFC was established in 1956 to provide investment, advisory, and asset management services to promote and facilitate private sector development and reduce poverty in developing countries.[35] The IFC is the private arm of the World Bank Group, providing investment advice to and investing only in developing countries' "for profits" enterprises that could quicken economic growth and poverty reduction. Investment and consultancy services emphasis is on agriculture development, healthcare, and education improvement, increasing access to microfinance, infrastructure improvement, helping business accumulate revenues and climate health. The IFC's total investment and consultancy services totaled over US$100 billion helped developing countries reduce poverty by 2015.[36]

The governance architecture of the IFC is slightly different from that of the World Bank (IBRD and IDA) in that the executive branch is given more autonomy. The president of the WBG is also

the president of the IFC, but the latter's executive vice-president is the latter's chief executive officer (CEO), responsible for overall direction and operations. The board of directors that governs the IFC is made up of one governor from each country; it meets once a year to discuss and decide on policies.

d. *International Center for Settlement of Investment Disputes*
The ICSID was established in 1966 as an independent arm of the WBG whose goal is to facilitate dispute resolution and conciliation between international investors after many failed attempts by the Organization for European Economic Cooperation (renamed the Organization for Economic Cooperation and Development) in the 1950s and 1960s.[37] The ICSID does not conduct arbitration or conciliation cases, but those that go through it are binding for all parties. The ICISD does provide institutional and procedural support to the committees that hold them. Cases conducted under its auspices must satisfy two sets of rules: ICSID's Convention, Rules and Regulations, or ICISD's Additional Facility Rules.[38] The ICSID Convention requires a legal investment dispute between an investor of one member and that of another state. An investment dispute between a party of a non-member state and that of a member nation can proceed under ICSID Additional Facility Rules. It (ICSID) also offers technical support and other services to international commissions or tribunals that arbitrate investment dispute cases between member states. The United Nations Commission on International Trade Law (UNICTARL), (the) Hague Permanent Court of Arbitration, the London Court of International Arbitration, and the Paris-based International Chamber of Commerce use ICSID facilities and services. Approximately 400 disputes, from tourism to natural resources, have been conducted under the ICSID since its founding of which 62% was resolved and 38% settled or dropped.[39]
The ICSID is governed by its Administrative Council chaired by the WBG president. It meets once a year to approve rules and regulations and selects the Secretary-General and Deputy Secretary-General. The daily operation is the responsibility of the ICSID's Secretariat.

e. *Multilateral Investment Guarantee Agency*
The MIGA was established in 1988, offering political risk insurance and credit enhancement guarantees to investors interested in investing in developing countries.[40] Risk protection is supposed

to offer foreign investors an "insurance policy" in funding the host countries to enhance economic growth, reduce poverty, and improve the people's livelihood. In 2015, MIGA issued over US$2 billion in investment guarantees and political risk insurance of over US$64 billion to a host of projects in the developing world.[41]
While the MIGA is governed by its Council of Governors whose members come from the member countries, it delegates the responsibility to the board of governors. The chief executive officer is the MIGA's executive vice-president.

Criticisms of the World Bank Group

The IBRD, like the IMF, is criticized for ignoring the realities of the economic, political, and social institutions of developing economies. As indicated earlier, the loan conditionality effectively takes away the borrowers' ability to manage their economy. Imposing Western values of "democracy" and "human rights" (which, for the most part, are inconsistent with the borrowers' history and institutions) has hindered economic growth. Holding debates to gain a consensus among interest-conflicting groups is time-consuming, rendering a project such as poverty reduction ineffective and untimely. Literally taking years before a loan is approved does not solve short-term issues, in that the poor and hungry must be fed and housed today, not in the distant future. Other criticisms include the complaint that IBRD funds were used to fund projects that are environmentally harmful, and forced relocation of the local population, just to name two.

The Marshall Plan

The Marshall Plan, officially introduced as the European Recovery Program (ERP), was conceptualized in 1947 and became operational in 1948.[42] Although the US aid program focused largely on Western European reconstruction and economic development, it was offered to the Soviet Union's Eastern European allies perhaps in an attempt to wean them away from Soviet influence. President Harry Truman of the United States labeled the Soviet Union a "potential threat" to the post-war global order.[43] Winston Churchill made a similar observation in a speech in which he coined the phrase "Iron Curtain."[44] To that end, it could be argued that the offer to the Soviet Block was more politically

than economically motivated. In order to receive US aid, for example, countries must be more "like" the United States.

Ideology prevented the Soviet Union and its Eastern European "satellites" from accepting financial help from the United States. In order to receive US aids or loans, the market must be the main if the not sole participant in determining resource allocation, goods production, and distribution. The Soviet bloc, however, instituted central planning, completely different from liberal capitalism, as its development path. The Soviet leadership also feared that US aid might be a "Trojan Horse," conquering its empire with money because the benefactor would be forever indebted to the United States like the UK, France, Japan, and its other "allies and friends." To that end, the Soviet Union not only perceived the Marshall Plan as a way to contain its expansion or rise, but in fact complained at the United Nations that the United States was deploying money (and military power) to "shape" the world in its (US) image.

To counter the US Marshall Plan, the Soviet Union offered its allies the Molotov Plan in which countries would receive fuel and other goods and services in 1948.[45] The Soviet Union, however, was in economic "ruins" and the terms of aid were just as "harsh" if not more than those of the Marshall Plan. In order to receive aids or loans, the recipient country must adhere to the "dictates" of the Soviet Union, explaining why Mao Zedong refused Khrushchev's reinstatement of aid in the early 1960s, saying "…no thanks, we saw the results of your aid and conditionality in Eastern Europe."[46] The Soviet Union, moreover, did not have the resources to help itself, let alone aiding a third of Europe and other countries around the world. Because of inefficient central planning, the Soviet Union bloc was far less advanced (economically at least) than that of nations receiving US help. Worse, it demanded repayments even though the recipient nations were in dire need of those resources. China, for example, had to ship much needed grain, other agricultural and non-agricultural products to the Soviet Union to pay the "aids" it received during and in the post-Korean War period, exacerbating its economic woes and causing massive starvation.

The United States allocated US$13 billion (over 5% of the US248 billion economy) to aids and loans to help Europe and other countries, but conditional on buying US-made goods and services for post-war reconstruction and economic recovery.[47] Of the total sum, 55% went to the UK, France, and Germany.[48] The UK, albeit it incurred the least damage, was the biggest benefactor, receiving 26% of the money

perhaps because of the "kith and kin" relationship. British politicians like Winston Churchill dreamed that the postwar world would be dominated by "Anglo-Americans," two peoples whom he and his cohorts probably believed were natural global leaders. France got 18% because of the extent of the damage it received from the war.[49] Germany was the recipient of 11% because it was deemed the "heart" of the European economy, without it being recovered that of the continent may not improve.[50] When the Marshall Plan was officially renamed the Mutual Security Plan in 1951, countries in Asia also received US financial assistance. Japan and Taiwan received the bulk of the funds.[51]

Indeed, US investment, loans, and aids played an important role in developing the East Asian economies. US foreign investment and loans were the main reasons why the Japanese economy surged between the 1950s and the 1990s, growing at more than 7% annually for over two decades.[52] US capital helped the country to revive and reconstruct its industrial base. Having been blessed with a pre-WWII Japanese funded industrial base, US capital was probably responsible for Taiwan's average annual growth rate of more than 6% for decades. Singapore, too, had a history of US investment, explaining in part why it has become Asia's richest city-state with a per capita real GDP of over US$57,000 in 2015.[53] After the Korean War (1950–1953), the United States helped South Korea (ROK) to recover and rebuild its industrial base.[54]

Whether the Marshall Plan was responsible for Western Europe's quick recovery was debated among scholars. Some observed that Europe was already recovering but conceded that the US aid program accelerated it. From 1948 to 1952, European industrial production increased by 35%, poverty and starvation had been eradicated, and the western part of the continent enjoyed unprecedented growth for over two decades.[55]

Criticism of the Marshall Plan

Yet, the Marshall Plan did not escape criticism. The Austrian economist, Ludwig Mises, accused the US of violating the principles of liberal capitalism.[56] According to him, rebuilding the economy should be left to the market, implying that the forces of demand and supply would be more efficient in resource allocation, goods production, and distribution. An unfettered market would produce only those goods and services that benefit the buyer and producer, minimizing the waste of scarce

resources. Others complained that requiring the recipient nations to use the funds to buy US goods was in fact enriching the American manufacturers at the expense of their own. Moreover, critics of the Marshall Plan accused it of distorting the recipient's market.

Market Distortion

Some prominent European scholars and American politicians criticized the Marshall Plan for distorting the market. Wilhelm Ropke, adviser for the German economy minister, viewed the Marshall Plan as central planning because the money went to the state, giving the government direct control over economic development.[57] Ropke complained that the state used the money to subsidize an inefficient or failing system. Ludwig von Mises seemed to agree with Ropke in that he, too, suggested that the Marshall Plan was partially responsible for sustaining many of Europe's "socialist" policies such as pension payments. In the United States, some criticized the Marshall Plan as overly generous because it already "gave" Europe over US$9 billion in aid, and "spending" another US$13 billion was considered "outrageous.[58] According to these critics, the money could be better spent on America's infrastructure construction and employment creation.

Upheld Western Imperialism or Global Dominance

While the Marshall Plan revived Europe, it benefited the United States more. One, the funds were used for buying US-made goods and services, increasing or at least sustaining domestic production and employment. To that end, the "aid/loan" program was in fact enhancing US economic growth at the expense of the recipient economies. Two, the conditionality was to conform to US values and interests (i.e., upholding human rights, democracy, etc.). The conditions were favorable to the "donor" because countries that had a different development path had to align it with that of the United States in order to receive the aid/loan. Three, the recipient nations were required to allow unconditional foreign investments from the United States, particularly those related to banking and energy resources in which it had (still has) a comparative advantage.

The United States was also accused of helping European countries (France, the Netherlands, and Belgium) to finance military actions in the colonies. The French government had sufficient capital to stimulate

domestic growth, but accepted and spent US aids/loans to maintain its North African and Southeast Asian colonies. The Marshall Plan allowed the Netherlands to ensure Indonesia remained a colony. Had it not been for US aids/loans, the Netherlands, France, and Belgium might not have had the resources to maintain their colonies and rebuild their industries and infrastructures at the same time.

The Asian Development Bank

The ADB was established in 1966 to promote economic and social development in Asia.[59] Japan and the United States were (still are) the bank's largest shareholders, respectively, at 15.7% and 15.6%.[60] China and India, on the other hand, were allocated 6.5 and 6.4% of the bank's shares, respectively, although the Chinese economy is, respectively, more than twice and five times that of Japan and India. The President of the ADB was (and still is) Japanese.[61]

Summary

Increasing numbers of developing countries are turning to China and its initiated financial institutions and other funding vehicles for loans. As indicated earlier, the rising Asian economic juggernaut loaned more money to the less developed countries than the IMF and WGB combined. One reason is China's foreign policy stance, not interfering in other countries' internal affairs and not attaching any loan conditionality. Chinese loans are a part of its "soft power" policy in winning support from the world community and enhancing its own economic interests. The loans helped borrowing nations to develop and afforded Chinese firms to access external markets.

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CHAPTER 5

GATT, Rounds of Negotiations, and the World Trade Organization

The General Agreement on Tariff and Trade (GATT) was established in 1947 after the United States Congress refused to sign on the Havana Charter, an agreement reached by the Bretton Woods participants to form the International Trade Organization (ITO). It was formed to negotiate tariff reductions on tradable goods only through a series of "rounds of negotiations" in an attempt to revive international trade that plummeted by 65% during the protectionist Depression era.[1] Up until the Tokyo Rounds of Negotiations (1973–1979), the developed economies, particularly those of the G7, dominated the GATT, writing the rules on the global trading system and setting the tariff rates on a list of predetermined list of goods to be cut. The developed economies' dominance over global trade policies was beginning to wane when the developing economies refused to sign on the agreements reached at the Tokyo Rounds. Growing importance of the developing economies coupled with adding trade in services and investment items into the world trade system required a new governance architecture and framework to meet the needs of an expanded world trade system, leading to the Uruguay Rounds (1986–1994).[2] The Uruguay Rounds created the World Trade Organization (WTO) and GATT became one of the four agreements, albeit the biggest and most important.

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The General Agreement on Tariff and Trade

As indicated earlier, the GATT was formed to negotiate tariff issues of tradable goods only. The list of goods and the tariff rates to be negotiated was predetermined by the West or, more precisely, between the UK, France, Italy, Germany, and the United States since trade was largely among themselves. The developing economies were largely sources of raw materials and destinations of Western manufacturing goods. Japan joined the ranks of developed economies after it recovered from WW II in the 1960s with the help of US loans, aids, and investments. Their combined share of the world GDP was over 80%, taking it for granted that they should write the rules and regulations of the world's trade system.[3] As indicated earlier, the emerging economies were only invited to participate after the Tokyo Rounds failed to agree on trade policies favoring the developed countries. The developing nations' "united we stand" stance worked, diminishing the influence of developed countries in the post-WW II global trade system.

A Brief History of Rounds of Negotiations Under the GATT Framework

The first round of tariff reduction under the GATT framework was the Geneva Rounds (1947) in which US$10 billion of tradable goods were involved and the last was the Uruguay Rounds of Negotiations (1986–1994).[4] Of the seven rounds of negotiations, the last three were the most significant in shaping the global trade system. For this reason, this chapter discusses only the Kennedy, Tokyo, and Uruguay rounds. The earlier ones, Geneva I (1947), Annecy (1949), Torquay (1951), Geneva II (1955–1959), and Dillon (1960–1962), were simply on tariff reduction negotiations, favoring a small number—between 13 and 36—of participating Western nations.[5]

Kennedy Rounds of Negotiations: (1962–1967)

The United States feared that the formation of the European Economic Community (EEC) in 1958 under the auspices of the Treaty of Rome (1957) might block US imports into the newly formed custom union (the EEC will be discussed in detail in Chap. 5).[6] This concern prompted US President John F. Kennedy to urge the Congress to pass

the Trade Expansion Act in 1962, empowering him to reduce tariffs of up to 50% on imports from the EEC and provide financial and technical assistance to domestic firms and workers who might be harmed by trade.[7] The US position formed the basis of negotiations for the Kennedy Round of Negotiations in 1964, expanding the number of areas to be negotiated, including the following[8]:

a. Nontariff barriers (NTB) such as anti-dumping measures, government procurement rules and regulations, and quotas. Anti-dumping measures prohibited imports whose prices were below those sold in the domestic market. Another NTB was government procurement rules that barred the importation of goods for use in government-funded projects. Quota was imposing a fixed quantity of the good allowed into the domestic market.

   However, the reason for the application of NTBs was mostly subjective, a convenient way of blocking imports that were deemed harmful to domestic producers. Imposing anti-dumping measures was meant to prevent foreign exporters to sell products at "below costs," but the term was ambiguous because a third country's cost of production (usually higher than that of the country of origin) was used, ignoring the exporting nation's comparative advantage. For example, US anti-dumping measures against Chinese-made goods were based on the costs of producing the products in Singapore whose wages, rents, and other input prices were much higher than those of China.
b. Application of a "linear" model or "across-the-board" percentage cut on all tariffs was deemed more efficient or expedient because negotiators were spared from the tedious and time-consuming task of "item-by-item" tariff reduction ("nonlinear model"). The proponents of the nonlinear posture, however, complained that the linear model discriminated against them because the latter could bypass goods that developed countries (supporters of linear model) incur at a cost disadvantage. For example, labor-intensive goods such as clothing were not included in the "across-the-board" basket for tariff cuts because developing nations such as Indonesia retained their comparative advantage even at a 100% tariff rate.
c. The emphasizing of trans-Atlantic trade and economic integration as a way to strengthen the relationship between the EEC and the United States. The vision of forming an economic community

between the two sides was intended to promote and sustain Western economic growth. At the time, there was little trade between the West and the other parts of the world with the exception of Japan. Critics complained that not promoting trade with non-Western economies was meant to leave the developing economies underdeveloped, in that restricting their manufactured products' access to the European and US markets would slow or even stifle their economic growth.

However, the dream of a trans-Atlantic economic community was shattered by Europe's division and irrational farm policy. The EEC countries, while keen on increasing economic growth and prosperity, were not so enthusiastic in surrendering national sovereign power to the larger community. France, for example, vetoed the UK's entry into the club because that latter objected to the costly French farm subsidy program, the European Union's (EU) Common Agricultural Policy (CAP). Uncompromising policies coupled with jealously guarded sovereign power prompted two unintended agreements under the Kennedy Rounds[9]:

a. Expanding trade with developing countries was to access markets for Western goods, sources of raw materials, and destinations for Western foreign investment.
b. Thirty-five (35) percent tariff reduction on chemicals, steel, and other sensitive products in which the West has a comparative advantage. Between 15 and 18% tariff reduction on agriculture products was also instituted. Tariff reduction excluded products that the developed economies incurred a comparative such as textiles. In total, US$40 billion of tariffs and NTBs were cut.

A Comment on the Kennedy Rounds of Negotiations

While there were gains from the Kennedy Rounds, most of them were benefiting the developed countries, particularly those of the West. During the negotiating period, the developed economies highlighted Section VI of the GATT on NTBS as a deliberate attempt to block textiles as items for tariff cuts.[10] It was during this period that the Long-Term Arrangement Regarding International Trade in Cottons Textile was adopted to regulate the importation of clothing into the West. The main NTB was quota imposition. It was largely put in place to protect the US textile industry, ranging from cotton production to garment

manufacturing. The arrangement was incorporated into the Multi-Fiber Arrangement (MFA) in 1974 during the Tokyo Rounds of Negotiations. The MFA was said to be responsible for costing the developing countries over 27 million jobs and US$40 billion of exports per year over a 10-year period.[11] The EU, however, did not impose quota restrictions on textiles made in selected least developed economies such as Bangladesh, explaining why its garment industry expanded whereas that of others faltered.[12]

The Tokyo Rounds of Negotiations: 1973–1979

The Tokyo Rounds began where the Kennedy Rounds ended, focusing on tariff and plurilateral nontariff barrier agreements such as government procurement, technical barriers, anti-dumping measures, and countervailing duties. These measures were meant to protect the domestic interests of the developed economies. Tariff reductions on goods that developing countries could not make or compete (with the developed economies) continued and expanded. However, tariff reduction on textiles was again excluded. To further impede low-priced foreign-made garments and other goods entering the European and United States markets, a number of codes were established in the NTB negotiations (Section VI of the GATT). They included the following[13]:

a. *Technical Barriers*
   An ambiguous barrier was injected into the negotiation process, allowing the US government to bar the export of an item that it deemed posing a "national security" threat. One such item was a product that could have duel civilian-military use. A knife, for example, might be banned because it could be used to kill a person in combat even though the foreign importer had intended to use it to cut meat. There were many other export opportunities such as stealth technology being barred by the United States and its allies, particularly selling to countries like China and Russia, whom the Americans considered potential "enemies" or "competitors."
b. *Government Procurement*
   Government procurement is a plurilateral nontariff barrier restricting imports to protect domestic industries from foreign competition. For example, the US government blocked a US company from buying Canadian steel to expand and repair a dock it owns

at Prince Rupert, a Canadian city near the British Columbia-Alaska border.[14] Invoking the government procurement stance has proven economically and politically attractive, giving the impression that the government cared about the domestic industries and workers.

c. *Countervailing Duties*

The countervailing duties stance was injected into the Tokyo Rounds agenda to discourage unfair subsidies. The United States, for example, imposed a 29.5% duty on Canadian soft wood lumber because of British Columbia's stumpage fee formula and the absence of a competitive bidding process.[15] US producers complained that the fee was too low, giving Canadian softwood lumber producers an export advantage. Another US complaint was the traditional practice of issuing logging licenses on the basis of submitting an application to log in a specified region. However, the US producers complained that the Canadian bidding process was not made transparent. Additionally, the biggest logging companies were subsidiaries of the province's small number of lumber mills that bought the logs, fueling allegations that the oligopoly firms were price-fixing.

However, the US charges were dismissed by both the NAFTA and WTO.[16] The Canadian government won the case, but it took years for the US government to return the tariff revenues it collected from the Canadian industry.

d. *Anti-dumping Measures*

As indicated earlier, the most widely used NTB is anti-dumping in which a country is accused of exporting a product at a price below what it charges at home or the price is below the cost of producing the product in a surrogate or "third" country. China has been the "favorite" target of anti-dumping charges originated from the EU and US, accounting for the bulk of all complaints.[17] However, China is hitting back, taking the EU and US to the WTO for refusing to grant it "market economy status (MES)," a condition for escaping anti-dumping measures.[18] Under the WTO framework, China would be given automatic MES after being a member for 15 years. The EU, US, and now Japan refuse to follow through the WTO policy because they allege that China's "reforms have fallen short of expectations."[19] The real reason might be that the Chinese manufacturers are more efficient in producing steel, solar panels, and other goods, pushing these industries in developed economies into bankruptcy.

Summary Analysis of Nontariff Barriers

The definition of an NTB code is ambiguous, giving the protectionist country an easy or convenient barrier to block foreign imports. For example, there is no clear indication of an appropriate surrogate country on production cost, explaining why the United States arbitrarily uses that of Singapore to impose anti-dumping measures against Chinese-made goods. Being labeled as a developing economy, it would be more appropriate and fair to use other developing economies' production costs as a reference.

The NTB's ambiguous definition and subjective application could be construed as a way of hindering developing economies' economic growth. For example, NTBs are routinely applied to restrict textiles from Vietnam or other developing countries. However, garments and other labor-intensive products are the only products that these economies can compete with in the international market. Unable to export the goods has in fact been a major obstacle in blocking the developing economies' development. It might be the reason why the Tokyo Rounds failed to reach an agreement on the negotiated NTB codes, leaving the issues to the Uruguay Rounds to address.

The Uruguay Rounds of Negotiations: 1986–1994

There was a 7-year gap between the Tokyo and Uruguay Rounds of Negotiations, giving nations considerable time to rethink the rules and regulations of globalization on trade, investment, intellectual property rights, and other issues. The Uruguay Rounds was the eighth and last round under the GATT framework to negotiate previously excluded "difficult or complex" items such as textiles and agriculture.[20] It was perhaps the most comprehensive in terms of the large numbers of items to be negotiated, including: the reduction in agricultural subsidies; lifting of restrictions on foreign investment; inclusion of banking and other services; redefinition of nontariff barriers; tariff reduction; the establishing of intellectual property rights codes; and the drafting and reaching of an agreement in forming the WTO.

One of the most "difficult" trade issues to be resolved were (and continue to be) farm subsidies. The European Economic Community was adamant in keeping its Common Agricultural Policy (CAP) of heavily subsidizing its members' farmers, particularly French farmers. Unlike

farms in the US, Canada, Australia, Brazil, and other agrarian nations, European farms are small, and unable to accommodate modern machinery and technology that bring economies of scale. Heavy subsidy was therefore needed to compete with efficient agriculture production countries like the United States and the Cairns' Group of 19 countries, including Australia and Canada.[21] Because the CAP effectively shut out their agricultural products, the United States and the Cairns Group also demanded a reduction of European farm subsidies. As a result, the Agreement on Agriculture was reached, preventing the farm subsidy issue to derail the Uruguay Rounds of negotiations.[22] Under the agreement, domestic farm subsidies and duties on food imports were to be cut. However, strong resistance from farmers in the EU, Japan, South Korea, and even the United States precluded any meaningful cuts and remained a sore point in trade negotiations.

The other thorny issue was textile trade. As indicated earlier, the United States could not compete with the developing economies even if the tariff was raised by a 100%. To that end, it introduced the quota system as a way to protect its own garment industry, the backbone of some southern states' economy.

The Uruguay Rounds, at the urging or insistence of the developed economies, added new items to the trading system to include services: banking and consultancy, intellectual property rights, and trade-related investments.[23] Having a clear comparative advantage in consultancy and financial services, it made perfect economic sense for the United States and the United Kingdom to promote these industries to other countries. However, agreements on how services could be added to the trading system were not resolved because of disagreements on the length of time the original holders could own the rights. The developed countries from which most intellectual property was created wanted perpetual rights, the developing countries wanted a limited time period. With regard to trade-related investments, the developed countries' demands for conditions such as the right to bar foreign investments deemed a threat to national security. The developing nations, on the other hand, wanted no restrictions on foreign investments. Not surprisingly, no agreements on these items were reached at the end of the Uruguay Rounds.

A fourth reform was the revisions of rules governing trade disputes. One revision was disputes were to be settled multilaterally instead of bilaterally between the disputants. In this way, rulings are said to be more equitable, quick, effective, and mutually acceptable because the

third party would be impartial since it does not have an economic or financial interest in the dispute. A second revision was that under a multilaterally dispute settlement, no single party could block a ruling (as was the case in a bilaterally one). The new system also put a time limit of 1 year in cases without appeal, and 1 year 3 months for cases with appeal. The problem with the new reforms, however, was that the ruling was not necessarily binding.

It became increasingly clear that the GATT framework was unable to cope with the expanding global trade system that included agriculture, textile, banking, telecommunications, government purchases, technology transfers, migration, industrial standards and safety, intellectual property, and a host of other interactions. To that end, an overall agreement on returning to the Havana Charter in forming an ITO that could accommodate the enlarged trade system was reached, culminating in the formation of the World Trade Organization (WTO) in 1995.

The World Trade Organization: 1995

The WTO was officially formed on January 1, 1995. It was a formal, legally constituted organization modeled after that of the WBG and IMF, the exceptions being that the head could be a citizen of any member country and that each country had one vote. The WTO was to set up a multilateral trade system under which every nation would be involved in writing the rules and regulations on trade and investment, culminating in the establishment of the "principles of the trading system." They include the following[24]:

a. *Trade Without Discrimination*

Under WTO rules, the most favored nation (MFN) status was considered "non-discriminatory" because "friendly" trading partners can be given tariff preferential treatment. The MFN provision was written in the GATT, the newly formed General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Intellectual Property Rights (TRIPS). Under special circumstances, however, a country was allowed to either discriminate against others or give another nation preferential treatment. For example, South Korean automobiles were granted low import duties when it first entered the North American market because it was considered a developing economy (at the time). At the same time, countries

can form free trade agreements to block imports from nontreaty nations. For example, the EU blocked agricultural imports from the United States and other non-EU countries/regions that could have an adverse effect on the bloc's farmers.

Another aspect of equal treatment applies to "national treatment" under which an import would be treated as domestically produced once it entered the market. Imposing duties on imports before they entered the market, however, was not considered a violation of the stance.

b. *Freer Trade Through Negotiations*

Gradual reduction of trade barriers was considered a practical approach to promote trade and economic development. Tariff reduction lowered the price of imports, enhancing an exporting country's competitiveness. The lower price also increased domestic real income, leading to higher levels of aggregate demand and eventually higher economic growth rates. Gradual tariff reduction was also practical because it gave domestic firms time to adjust production methods to improve efficiency.

Freer trade through negotiations makes sense because of the expanded number of countries and goods and services entering the trading system. The less developed economies need time to acquire the necessary knowledge and resources to industrialize and compete. With regard to developed economies, not all industries are efficient, requiring time to adjust to a more efficient production process or reallocate resources to produce other goods.

c. *Stability and Predictability*

Investors might not invest in an environment that is unstable or unpredictable because both increase risks, prompting the WTO to encourage nations to make advance announcements on tariff increases or decreases. Announced duty cuts or increases were to be "binding" commitments in that they cannot exceed the agreed ceiling. Knowing the price of imports and exports could thus "stabilize" the economic environment, an essential driver of investment.

The multilateral trade system also discouraged the use of quota because the NTB requires considerable bureaucratic "red tape," creating instability and unpredictability unnecessarily. Quota was also discriminatory because it varies from one country to another. Making trade policies clear and nondiscriminatory allowed trading partners to know exactly what they need to do to accommodate the other countries' trade policies and practices.

d. *Fair Competition*
Fair competition policies under WTO rules included MFN, national treatment, and NTBs. MFN applied to countries requiring financial relief to boost their economic development and competitiveness. China and South Korea, for example, were given MFN status because they were considered developing economies needing lower import duties to compete with those of the more established Japanese, EU, and US.

e. *Economic Development and Reform*
A sound and sustainable world trading system required that all countries reform their economic development architecture. During the Uruguay Rounds, many of the participating developing economies indeed took measures to reform development policies. The countries that chose a development path that was consistent with their history, economic, political, and social institutions made substantial improvements. China, for example, chose the "socialism with Chinese characteristics" or state capitalism as its economic development path. Its success in transforming the Chinese economy cannot be overstated. India and other developing economies chose the liberal democracy market system. Their development has been slow because in a democracy, a consensus is required to enable a policy to become law. However, gaining that consensus proved to be difficult and time consuming because of the large number of entrenched conflicting interests, explaining in part why Prime Minister Narendra Modi's reforms are encountering strong headwinds in transforming the Indian economy.[25]

The Four Agreements of the World Trade Organization

Four agreements were established to deal with the expansion of tradable goods and services and the increasing complexity of addressing the divergent concerns of different nations.

a. *General Agreement on Trade in Services*
The GATS was instituted as an Agreement of the WTO on January 1, 1995, the result of the Uruguay Rounds to expand the multilateral trade system to include services similar to the GATT on trade in goods. Trade in services is defined as buying and selling of "intangible assets." It is not a physical product like an automobile whose

value is derived from the costs of the inputs—labor, capital, and raw materials—used to produce it. But the "value" of a service is difficult to put a price on because it relies largely on the reputation or skill of the person who provided it. The "value" of a lawyer, for example, is based on the subjective assessment on the part of his/her clients and is not market driven. Moreover, lawyer fees vary from one country to the next. It would be safe to assume that an Indian lawyer earns far less than his/her counterpart in the West, raising the question of which fee should be used when negotiating an acceptable value for trade purposes. However, using the value (total price including lawyer fee, and administrative and overhead costs) of an Indian legal document could trigger anti-dumping complaints. Then, there is the accounting valuation issue. Should the service be valued at cost or at market prices? The difficulty of service evaluation applies to all "intangible assets," explaining why financial assets are excluded from trade in services negotiations. For example, a financial asset can have "multiple" values—the value of the asset itself, or the value of its derivative. Its inclusion would make an already difficult position impossible for negotiators to come up with an acceptable financial services valuation formula.

The agriculture subsidies problem could be the most difficult to attain a consensus agreement on, because it is a political as well as an economics issue in the West. Being the first permanent settlers of a geographical region, farmers naturally saw themselves as its most important stakeholders. To promote and protect their interests, farmers formed powerful lobbies such as the Farm Lobby in the United States.[26] Their political influence grew over time, albeit the percentage of the population engaging in farming decreased. Settling the farm subsidy issue is made more difficult because it accounts for a large percentage of income, particularly in France where farm subsidy accounted for over 80% of an average farmer's income in 2014.[27]

Politicians in the developed economies are therefore put in a very difficult position. The American, European, Japanese, and South Korean politicians approving substantial agricultural subsidy reduction or dismantlement policies would be committing political "suicide." However, not reducing farm subsidy substantially would derail any progress on reaching an agreement on nonagricultural market access between the developed and developing economies.

b. *Agreement on Trade-Related Intellectual Property Rights*

The TRIPS agreement was negotiated at the completion of the Uruguay Rounds under the GATT framework in 1994 and was meant to acquire a standard and length of time that intellectual property rights could be upheld. Members of the WTO were required to provide "copyright" rights, defined as an exclusive right for the creator of an original work to use and sell for a period of time and in some cases (authors of books) in perpetuity. Any party using the work without the creator's permission would be held legally liable. Copyrights were also "territorial rights" in that the original creator's works are extended beyond the country in which he/she resides. To protect the copyrights of the original creator's work, the WTO set up a list of intellectual property protection rules and regulations that included the following[28]:

1. Content producers which cover performers, producers, of sound recordings, and broadcasting organizations. For example, a person cannot legally install the Microsoft Office program without a license or permission from the company.
2. Geographical indication is defined as the original product unique to and originated from a specific region. For example, tequila is a unique alcoholic beverage originated from Mexico. The Mexican government can "certify" it to bar other nations' brewers from producing the alcoholic beverage.
3. Industrial designs protect the visual appearance or shape of a product. For example, a foreign car producer cannot make an automobile in the shape of a Rolls Royce without permission from the British car manufacturer.
4. Integrated circuit (IC), defined as a product in its finished form whose elements (at least one) are interconnected, is classified as a copyright, protecting the designer of transistors used for radios or televisions. Layout design is a physical topographical product such as a computer's "motherboard." Protecting the "copyright" of a circuit board designer, however, is difficult and will fiercely be opposed by developing nations because in doing so could inhibit them from building it. Circuit designers, regardless of where they are from, usually use the same architecture and parts to make one.
5. A patent is a government granting the creator exclusive rights in the production of a good for a specific time period. For example,

the developer of a prescription drug is given the exclusive right to produce and sell it, barring others from doing so.

6. New plant varieties are meant to protect the rights of the creator to produce and sell the new varieties of plants. For example, a new breed of strawberry in the shape of a finger and in blue color can be patented or copyrighted.
7. Trademarks are recognizable signs or expressions. The Rolls Royce logo is a registered trademark.
8. Trade dress is considered intellectual property because it expresses the appearance of a product. Clothing design such as DKNY is an example of trade dress.
9. Confidential information covers regulations barring or limits access to a ruling. "Attorney client privileges," for example, are an example of this provision.

c. *Agreement on Trade-Related Investment Measures*

TRIMS are a set of rules and regulations that a country enacts to promote and protect domestic industries and workers from foreign investment.[29] Its establishment was probably driven by a surge in direct foreign investment around the world in the 1980s, creating concerns of industrial decline and foreign reserve outflows in the host countries. The host country would impose "local content" rules, restricting the foreign investors to buy some components of the final product in the host countries. Toyota, for example, has to agree to buy Canadian made parts (i.e., windshield wipers) for its cars to be made in Canada. TRIMS rules also apply to profit repatriation, restricting the amount that the foreign investors could remit back to the home countries because earnings are part of the host countries' foreign reserves or acceptable international monies, comprising of gold and currencies that are included in the IMF SDR basket.

The outstanding and new issues pertinent to the global trading system were to be addressed through ministerial-level meetings under the WTO Rounds of Negotiations. The first trade ministers of the WTO met in Singapore in 1996 and a second meeting was held in Seattle, Washington, in 1998.[30] However, neither meeting made any progress in addressing the trade issues because of major policy differences (i.e., perpetual versus fixed time period on intellectual property rights and conditional versus nonconditional foreign investment, just to name two) between the developed and developing economies, preventing them from reaching agreements.

The unresolved issues were deferred to the Doha Development Rounds.

d. *The General Agreement on Tariff and Trade*
The GATT was (and still is) the WTO's biggest and most important agreement, in that trade in goods remain the largest part of the world trade system. Issues concerning trade in goods were to be negotiated through the rounds of negotiations. The first of which under the GATT within the WTO framework was the Doha Development Rounds, also known as the Doha Development Agenda.

The Doha Development Rounds or Doha Development Agenda: 2001

The DDR or DDA was the only round of the WTO negotiations on trade barrier reduction for the purpose of increasing trade and enhancing economic growth. It was launched on November 1, 2001 at a ministerial-level meeting and completed in 2005.[31] The issues, however, were too complicated and neither the developed nor the developing economies were able or willing to compromise on delicate issues such as farm subsidies. Negotiations broke down completely in 2008 over industrial tariff, nontariff barriers, services, and trade dispute measures. Who was to blame depends on whose side one was on, but there was plenty of finger pointing. The developing economies accused the developed ones of not willing to abandon or dilute the status quote trading system that stacked against them (i.e., not having to substantially reduce farm subsidies to gain NAMA). The developed nations complained that the developing ones were not willing to compromise (i.e., standing firm on NAMA conditionality). Unwilling to compromise effectively killed the negotiations.

a. *The Cancun Ministerial Meeting: 2003*
The 2003 Cancun ministerial meeting was to make the four Singapore issues clear and open: government procurement; trade facilitation, trade and investment; and trade and competition.[32]
   1. Government procurement was (probably still is) an important part of the trading system because government purchases made up between 10 and 20% of the world economy, making it a subject of the Agreement on Government Procurement (GPA), a WTO plurilateral international treaty first realized in 1994 and revised in 2012.[33] The ministerial talks were to minimize the

effect of this protectionist stance on global trade. As indicated earlier, government spending was (still is) politically motivated as much as it was economic driven, particularly during elections and in periods of economic stagnation.

2. Trade facilitation refers to government regulatory regimes on administering the movement of goods and services traveling across borders. Customs clearance, for example, could be used to slow or block imports. In an attempt to slow down the rate and quantity of Japanese cars entering the Canadian market in the 1970s, customs officers checked each automobile's serial numbers.

   In enhancing efficient movement of goods across international borders, the WTO attempted to improve government facilitation procedures governing the trade. Again, reaching an agreement on this issue was difficult because the WTO allows the use of "legitimate" regulatory regimes, an ambiguous term that could be anything (i.e., typo documentation error), to block imports. Moreover, the definition of trade facilitation expanded beyond procedures for movements of goods to promote economic growth (i.e., corruption removal), making the acquisition of an agreement even more difficult.
3. The promotion of measures that would make trade and investment more efficient was a third item on the Cancun agenda. Gradual removal of protectionist barriers was to allow the industries that incur a comparative disadvantage to adjust or reallocate resources away from import competing goods, bringing production stability or minimizing the "harm" to trade. Reduction or elimination of tariff and NTB could reduce the price of an import, forcing domestic import-substitute manufacturers to improve innovation and efficiency so that they could compete in both the domestic and foreign markets. And if domestic production costs were competitive with those of foreign countries, firms might not need to relocate production overseas. In any event, reduction or removal of trade and investment barriers could keep prices and interest rates low, leading to increases in aggregate demand at home and meeting the development goals of the DDA.
4. The fourth area for negotiations at the Cancun ministerial meeting was to improve competition through trade. Allowing foreign firms to sell their products in domestic markets meant adding the number of producers or increasing the level of competition.

However, lack of progress made on the farm subsidy issue blocked negotiators from reaching an agreement on the item.

b. *Geneva Ministerial Meeting: 2004*
The Geneva meeting was held in response to US Trade Representative Robert Zoellick's, proposals of dropping subsidy for agricultural exports, continuation of trade facilitation, and changes in government procurement.[34] His proposals seemed to add impetus to market access in part because the EU agreed to eliminate agricultural export subsidies, giving countries an incentive to resume negotiating the outstanding issues from the Cancun meeting. For the first time, developed and developing nations negotiated in "good faith," resulting in the signing of the WTO Framework Agreement for conducting future Doha Rounds of Negotiations on July 31, 2004.[35] The agreement was made up of the Agriculture Framework Agreement, Non-Agriculture Market Access, Services, and Trade Facilitation. The agriculture framework was to address the "three pillars" of the 2001 Doha Ministerial Declaration on liberalization of agriculture trade, namely, significant reduction in domestic support that distorts trade, elimination of subsidies to agriculture exports, and nonagricultural market access. Domestic support trade distortions would include farm income subsidy, subsidy for feed in the US, and supply management measures in Canada. These items were to be negotiated in the Hong Kong Ministerial Meeting.

c. *Paris Ministerial Meeting, 2005*
The Paris meeting was to improve the negotiating process to be held in Hong Kong on January 1, 2005, giving negotiators "meat" to secure an agreement on the areas agreed to in the Geneva meeting. However, a number of issues surfaced in the meeting, France opposed farm subsidy cuts, the US, India and Australia, the EU, and Brazil failed to agree on issues regarding chicken, beef, and rice.[36] Again, developing economies would not entertain NAMA from the West and Japan without substantial reduction in agriculture subsidies. The outstanding issues were deferred to the Hong Kong meeting.

d. *Hong Kong Ministerial Meeting 2005*
The fourth ministerial meeting in Hong Kong was labeled "Development Rounds," recognizing that the world trading system is stacked against the developing world.[37] Farm subsidies prevented the least developing economies to compete with very low agricultural

product prices from the developed countries, literally bankrupting many farmers in the developing world, particularly those in sub Saharan Africa and India. The "dumping of food" in fact was one of the major causes of starvation or hunger in these regions. The developed nations also pressured the developing economies to allow market access not only for their goods but also investment, particularly in the service sectors in which the former have a clear comparative advantage. Though the developing nations pushed back, the lack of strong unity weakened their demand, giving away many benefiting trade concessions to the rich nations without receiving any meaningful benefits in return. The results of the meeting are listed below.

1. The rich countries agreed to eliminate agriculture export subsidies by 2013. However, this promise was not only unfulfilled but was actually meaningless. Agriculture export subsidy accounted for less than 5% of the total farm income subsidies in the EU, estimated at a respective 1 billion and 58 billion euros in 2011.[38] In this regard, even a complete elimination of agriculture export subsidy could not enhance economic development in the poorer nations. Moreover, the rich countries would only eliminate agriculture export subsidy if poor nations agree to give them more "concessions," a loophole for them to negate on the promise because the term was not clearly defined. Indeed, the rich nations did back off on their promise, largely because protecting domestic interests was more important than helping developing nations to improve their economic well-being. The little concession that the rich countries offered implied that they had no intention of giving up subsidies to farmers. Since the 2005 Hong Kong meeting, rich countries in fact continue to (heavily) subsidize their farmers.

   A US promise to eliminate cotton export subsidies by 2006 was equally meaningless, having very little effect on promoting economic growth in the developing countries. Export subsidy made up less than 10% of the total farm subsidies of US$25 billion in 2015.[39] However, the trade distorting domestic subsidies was "killing" cotton farmers in Africa and India, prompting cotton-growing African countries to demand the US for up to an 80% cut in cotton subsidies by 2006 and the remainder within a few years.[40] The two sides were so far apart that the Hong Kong agreement only indicated that cotton subsidies *should* be eliminated.

2. On NAMA, all members agreed in the 2001 Doha meeting that all nonagriculture goods were to be covered by WTO rules.[41] The EU trade commissioner, Peter Mandelson, told developing countries that the EU would withhold any concession on farm export subsidies unless they allowed NAMA. His concessions were not only disingenuous (for reasons cited earlier) but threatening as well. However, his threat worked due to lack of cohesion among the developing nations. The rich countries successfully managed to "divide and conquer," dividing developing countries into different groups (the G20, Least Developed Countries, etc.) and negotiating with each separately. At the end, developed countries conceded very little to the major components of the DDA development basket: substantial gains in cotton, market access for least developed countries, and "aid for trade." The developed economies "succeeded" because the developing economies were divided and did not really have a choice.[42] To that end, the developing economies "accepted" the declaration, but under protest.

   The Hong Kong Declaration stipulated that the "Swiss Formula" formed the basis of tariff reductions.[43] The following mathematical formula was proposed by Switzerland during the Tokyo Rounds:

   $Z = AX/(A + X)$, where Z = final tariff rate; A = agreed coefficient; and X = the initial tariff rate. Agreeing to a coefficient was the key because that would determine the final tariff rate. For example, if the agreed coefficient is 50 and the initial tariff is 80%, the final tariff rate would be 26.66%. The significant reduction from the original 80% clearly benefited the rich nations, but "de-industrialized" developing countries.

   On "aid for trade," the rich countries were supposed to allow "duty free" access for least developed countries into their markets. However, in reality, this seemingly "generous" offer was no more than a ploy to block imports from the LDCs because the duty-free imports are products that the rich economies do not produce. Moreover, the rich countries deliberately prohibited the imports of the 3%—textiles, fishery products, leather, rice, sugar, etc.—of the products that the LDC could access rich country markets. The United States even prevented the import of all textiles (from the LDCs) from entering its market.

The Hong Kong Declaration ignored the protests of the developing economies. The president of the meeting, Hong Kong's commerce secretary, did not even bother to acknowledge speakers from the developing economies when he declared the ministerial meeting closed and successful. To get his attention, trade ministers from the developing nations literally had to climb up to the stage to make their displeasure known over the agreement.

The Doha Development Rounds dragged on without any conclusive results. Subsequent ministerial meetings in Geneva (2006) and Potsdam (2007) also ended in a stalemate.[44] The developed economies refused to make significant concessions on issues that matter to the development goals of DDA. The developing nations, led by China and India, were equally adamant in having the developed countries to substantially reduce farm studies as a condition for NAMA. The situation today is that the DDA negotiations are at a standstill, turning the WTO into an inept organization, incapable of promoting trade rules and regulations that could enhance global economic development and employment. Negotiations broke down completely at the Geneva Ministerial Meeting (2008).[45]

It was not until the latter part of December 2015 that in a ministerial meeting held in Nairobi, Kenya, the WTO attempted to revive the world trading system. At the end of the 10th Ministerial Meeting, the over 160 attendee nations drafted the Nairobi Declaration, agreeing to the following[46]:

1. Rich nations were to eliminate all agriculture export subsidies immediately, whereas the developing nations would do so by 2018.
2. The elimination of all cotton export subsidies in the rich countries.
3. Four African cotton farming nations and 35 least developed countries (LDCs) would be able to export cotton tariff free to rich countries by 2016.
4. The expansion of information and technology products for tariff reduction.
5. The admission of Afghanistan and Liberia into the WTO.

The Director-General of the WTO, Roberto Azevedo, and Kenyan Foreign Minister Amina Mohammed hailed the Nairobi meeting as a renewed impetus to improve and strengthen the global trading system.[47] They both seemed to suggest that the agreements reached in the meeting would meet the development goals of the DDA. However, cynics

could be forgiven for being less optimistic, since agriculture export subsidies were promised before. And even if they were eliminated, developing nation farmers, particularly cotton farmers, would still encounter difficulties competing against agriculture imports from rich countries for reasons cited earlier. Whether the 35 LDCs plus the four African countries (Burkina Faso, Benin, Chad, and Mali) cotton would have unfettered access to rich countries also remained unclear because that "movie" had been played in previous ministerial meetings. The developing countries thus remained skeptical about the "sincerity" of rich nations helping them develop because past promises (on giving developing nations a "helping hand" in their economic development) proved to be just that, empty promises. Declaring that the Nairobi Declaration signals a "new era" in which the DDA was on track to reach the development goals might be premature.

Summary

It would appear that domestic politics overtakes economic sense in negotiating a workable world trade system, preventing nations from realizing the potential benefits of globalization. Under the GATT and WTO frameworks, the agriculture sectors in the most powerful developed countries have blocked every attempt to make meaningful reductions in farm income subsidies, culminating in resource misallocation, trade distortion, decreasing competitiveness, and increasing the cost of living. As indicated earlier, unable or unwilling to dismantle farm subsidies remains the main reason why major developing nations refused to grant developed countries NAMA. Unable or limited access to large and increasingly affluent major developing economies undermines economic recovery in the developed nations. These and other major outstanding issues (i.e., the ambiguous language on imposing NTBs by developed economies to block imports that threaten their domestic industries) clearly undermine the WTO's effectiveness in framing a practical multilateral world trade system that could enhance global economic growth and the livelihood of its inhabitants.

The difficulties in reaching a multilateral trade agreement has forced nations to focus on building trade and/or geopolitical relations with each other or forge bilateral or regional free or liberalized trade areas. For example, the EU was established to enhance trade and investment among 27 European countries and give them a vehicle to "speak with

one voice" on global affairs. The largest and richest developed economies established the Group of Seven (7) for the purpose of strengthening their dominance on the global economy, financial system, and geopolity. Donald Trump, withdrawing from the TPP and Paris Accord and renegotiating NAFTA, signaled that America would "go it alone" in pursuing policies or agreements that would "make America Great Again".

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CHAPTER 6

Selected Bilateral and Regional Trade and Investment Agreements

The WTO has not been able to establish a workable multilateral trade and investment system (that meets the development goals of the emerging markets) because of the vast differences in the stages of development between the developed and developing economies and domestic politics. The WTO is made up of over 180 members from less developed, developing, and developed nations, precluding it from reaching a trade or investment agreement that would suit or benefit all countries. Each of the three main groups are at different stages of economic development. Less developed countries (LDC) are at the "infant" stage, requiring full protection from efficient firms of the developing and developed economies. Though full protection is contrary to the letter and spirit of an unfettered trade system, the developed economies could not waive all trade barriers on goods from the LDC because of strong opposition from import-substituting industries and related labor organizations.

Opting for Bilateral Trade Agreements

Donald Trump made good on his campaign promise to terminate the TPP and renegotiate the NAFTA in his first week in office as the President of the United States. He opted for bilateral trade agreements that would make "America come first." Brexit was meant to disallow the EU from negotiating trade and investment agreements and immigration policies on behalf of the UK. The Trump effect raised the popularity of European far-right political parties favoring the US president's trade and

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immigration policies, most notably in France, Germany, Italy, and the Netherlands. To that end, the developed economies appeared to prefer bilateral or regional trade and investment agreements.

The developing economies, particularly China, remain committed to a multilateral trade system. They seemed to view that an architecture that is interconnected, inclusive, invigorated, and innovative would best serve the interests of all countries.

There is a large number of existing and pending trade agreements, including the European Union (EU), United States-Canada Automotive Products Agreement (US-Canada Auto Pact), North American Free Trade Agreement (NAFTA), ASEAN-China Free Trade Agreement (ACFTA), Asia-Pacific Economic Cooperation (APEC), Mercado Comun del Sur (Mercosur), and African Union (AU). In addition, other free trade agreements are coming onstream: Regional Comprehensive Economic Partnership (RCEP), Free Trade Area of the Asia-Pacific (FTAAP), and Transatlantic Trade and Investment Partnership (TTIP). This book examines a selected number of agreements, giving the reader an insight into the problems and prospects of free trade agreements.

The European Union

The European Union (EU) is a politico-economic union of 27 countries with over 500 million people and is the second largest economy in the world with an estimated GDP of approximately US$16 trillion (in nominal exchange rate measurement) in 2016.[1] The EU's formation was to secure a single strong voice on the world stage, promote economic growth, and ensure everlasting peace on the continent. The goals were to be realized through a system of seven supranational institutions: the European Parliament, European Council, Council of the European Union, European Commission, Court of Justice of the European Union, European Central Bank, and Court of Auditors.[2]

Road to the Formation of the European Union

WW II incurred huge geopolitical and economic costs to the European imperial powers. In an attempt to regain a prominent voice on the world stage, these powers set the stage for unifying the continent into a single United States of Europe (USE). That path began with the 1951 Treaty of Paris, establishing the European Coal and Steel Community (ECSC).[3]

The six members that signed the Treaty—France, Belgium, Italy, the Netherlands, West Germany, and Luxembourg—opined that integrating the production of coal and steel within the six countries would increase and strengthen their economies. In 1957, the six ECSC members signed the Treaty of Rome to establish the European Economic Community (EEC), bringing together the ECSC and the newly formed European Atomic Energy Community (EURATOM).[4] The Treaty of Brussels (officially known as the Merger Treaty) of 1967 dropped the "economic" part to form the European Community (EC).[5] The signing of the Maastricht Treaty in 1992 created the "internal or single market," allowing free movement of capital, goods, people, and services within the EC, introducing the Euro as a single currency, and establishing the European Union .[6] The 2007 Treaty of Lisbon incorporated the "three pillars"—EC, ECSC, and EURATOM—into supranational institutions.[7]

a. *Treaty of Paris: 1951*

The Treaty of Paris formally established the ECSC as the first international organization based on the concept of "supranationalism," with member states ceding power to the institution that they set up in making policies on its area of responsibilities. The principle, first put forth by Robert Schuman, was to prevent future wars by pooling the coal and steel industries of France and Germany.[8] It formed the foundation of the two countries' industrialization, since they were essential for making machinery, including weapons. Between 1952 and 1953, the ECSC pooled the production of coal, iron oil, scrap, and steel in an attempt to make the sector more efficient.[9] Integrating their production brought economies of scale, but it also created an oligopoly in which competition among the few led to price-fixing through supply restriction.

1. *Gains of ECSC*

Trade in coal and steel increased more than tenfold, attributing (largely) to a combination of abolishing tariff and the High Authority (ECSC Executive Branch) issuance of 280 loans to modernize production.[10] The absence of import duties among member countries on coal and steel effectively reduced their importation from the United States. The loans offered by the High Authority accelerated plant modernization, culminating in reducing production costs, and increasing economies of scale and competitiveness.

The ECSC also increased spending on social programs. Providing grants of US$1770 per unit helped the building of over 112,000 housing units, enabling the majority of workers to buy a home.[11] The additional home purchases created a multiplier effect in that the production and sales of appliances, furniture, and other household goods similarly rose. Funding 50% of retraining costs helped to create over 150,000 jobs, fueling consumer income and spending, and spurring economic growth in the member countries.[12]

2. *Economic Costs of the ECSC*

The ECSC might not have foreseen or ignored the possibility that the coal and steel industries could turn oligopolistic, but they became just that. Three largest firms accounted for over 90% of coal production in four countries: Germany, France, Italy, and Netherlands.[13] Industrial concentration (industry controlled by a few large firms) created two negative effects: price-fixing and undermining innovation and competition, particularly in West Germany whose three largest firms' coal production decreased by 20%.[14] Moreover, French President Charles De Gaulle, perhaps determined to maintain the country's coal dominance, stifled EURATOM and lobbied the ECSC to articulate an energy policy. However, the EURATOM's absence adversely affected efficient production and distribution of energy and delayed the plan to replace coal with nuclear power as the main source of energy. The continuous reliance on coal and oil to generate electricity worsened environmental degradation in the continent.

b. *Treaty of Rome: 1957*

The six-member ECSC signed the Treaty of Rome, officially named as the Treaty Establishing the European Economic Community (TEEC), as a way to deepen economic integration. The treaty gave birth to the European Economic Community (EEC) and European Atomic Energy Community (EURATOM), paving the road for the free movement of goods, capital, labor, and people within the union.[15]

The Treaty of Rome was the result of a number of events leading to its signing, the most important of which was perhaps the dream of creating a federal Europe, reviving the former imperialist powers' influence on the world stage. The United Kingdom and France were humiliated

by Egypt during the 1954 Suez Canal crisis, forcing them to ask the United States for military aid.[16] Instead of receiving US aid, the UK and France were told by the then US President Dwight Eisenhower to return the Suez Canal to Egypt. The humiliation and the desire to recapture Western Europe's past glory prompted the West German chancellor to propose a political union among the continent's sovereign states. The French government was very receptive to the formation of a "United States of Europe" (USE).

France put forward two proposals that could lead to the establishment of the USE: European Defense Community (EDC) which would include West Germany.[17] The former was to establish a continental or "Pan-European military force" to block "Soviet geopolitical expansionism and militarism." The military force was to become national components: the military force comprising of France, the Netherlands, Belgium, Italy, Germany, and Luxembourg was to be under the command of the respective governments. A centralized command structure and procurement architecture were to be set up, giving the EDC a common budget for arms and other related expenditures. The plan to form the EDC, however, failed to gain ratification in the French Parliament over fears of sovereignty loss, resurgence of German militarism, and French Communists' distaste of tying the country to US capitalism. The failure to establish the EDC caused the six countries to nix the EPC plan, prompting European politicians to focus on an economic union, culminating in the formation of the European Economic Community (EEC), also known as the Common Market. It became operational on January 1, 1958.[18]

The EEC was essentially a customs union, focusing on the integration of member states' economies into a supranational institution. The members agreed to abolish tariff barriers over a 12-year period. Freer or free trade accelerated transborder movement of goods and services between the member countries, culminating in economic growth within the EEC to outpace that of the UK and US. Moreover, the success of tariff dismantlement shortened the protection period from 12 to 10 years, ending it in 1968. At the same time, the EEC imposed a common tariff policy on goods and services from nonmember nations, expanding economic activities within the organization further. However, the oil crisis and the "Nixon Shock" brought global stagflation, ending the EEC "economic miracle" in 1973.

Stagflation, simultaneously raising inflation and unemployment, was a global phenomenon, an indication that global integration might be the

"new normal." However, that brought mixed results in that the US decision to "free" the price of gold had an adverse effect on the global financial system, raising the interest rate and dampening economic growth, including that of the EEC. Falling economic prospects forced the EEC to put up trade protectionist and reform measures.

One was the Common Agricultural Policy (CAP), protecting farmers through heavy subsidies. The CAP guaranteed farmers of member states that prices on the goods they produced would sustain a "reasonable" standard of living. Because farms were inefficient (due of their small sizes) and costs of living in the EEC were high relative to the United States and other parts of world, farm subsidies became a political as well as an economics burden. This problem remains "unsolvable" today in that farm subsidies account for almost 40% of the EU (EEC successor) budget.[19] Dismantling subsidies could lead to the end of European farming or a way of life, or at best impoverish many farmers.

By 1973, economic integration within the EEC framework was firmly entrenched and the desire to expand its membership was looming with the emergence of some unmistakable developments pointing to that direction. The European Council was designated the forum for heads of governments to hold meetings and make decisions on policies pertaining to the EEC in 1975.[20] It was the heads of states meetings that led to the establishment of "Eurocentric" institutions. The European Monetary System (EMS) and the European Currency Unit (ECU), for example, were instituted in 1979. In the same year, the first election of members to the European Parliament by direct universal suffrage was held. The club membership was enlarged with the accession of Greece (1981), Portugal, and Spain (both in 1986). Their joining the EEC was a result of the governments' desire to enhance economic growth in the aftermath of the dissolution of military dictatorship in the first half of the 1970s. A group of European parliamentarians, led by Italy's Altiero Spinelli, proposed a European Union Treaty to replace the Treaty of Rome.[21] While the proposed treaty did not gain support in the members' parliaments, its (at least some) proposals became law in the 1990s. Among them were common citizenship and foreign policies. Half of the EEC members signed the Schengen Agreement in 1985, allowing the free movement of people within the Schengen Area.[22] In 1990, the Schengen Convention was adopted to establish a common visa area.

With EEC membership expanded to 12 countries at the end of the 1980s, European integration was set to expand, culminating in the signing of the Maastricht Treaty and Lisbon Treaty.

c. *Maastricht Treaty: 1992*

The Maastricht Treaty (the Treaty on European Union) was signed on February 7, 1992 by the 12-member EEC to establish the EU. The structure of the EU was based on "three pillars": (i) the European Community comprising of the ECSC, EAEC, and EEC; (ii) the Common Foreign and security Policy (CFSP); and (iii) the Justice and Home Affairs (JHA).[23] The first pillar was perhaps the most meaningful in that it gave three supranational organizations effective power and influence: the European Commission, European Parliament, and European Court of Justice. The Commission, the EU's executive branch, was empowered to initiate legislation, implement policies, uphold treaties, and oversee the organizations daily operations. The other two pillars were intergovernmental-agencies committees set up by the governments of member states. The distinction was that some member nations, particularly the UK, were unwilling to cede military and foreign affairs to the EU for fear of losing sovereignty. To avoid potential division among members, a compromise was reached, forming a legally separated EU, comprising of the EEC and the intergovernmental agencies dealing with foreign policy, military affairs, criminal justice, and judicial cooperation. The compromise governance architecture, however, did not provide the EU with any more influence on the issues, thus diluting its power to develop policies on the matters and bringing into question the supranational institution's "speaking with one voice" stance.

The Maastricht Treaty also introduced the euro to replace the ECU as the EU's common currency.[24] In order for a member nation to adopt the euro, it must comply with the five criteria listed in Article 109 of the Maastricht Treaty. The number was listed as Article 121.1 of the Amsterdam Treaty (1997) and Article 140 of the Treaty on the Functioning of the European Union (2007).[25] The criteria, known as the Maastricht criteria, were defined in the Protocol on the Convergence Criteria and Protocol on the Excessive Deficit Procedure, both of which were Maastricht Treaty attachments. The criteria are listed below.[26]

1. Member states are required to maintain price stability, defined as an inflation rate of 2% or less year-on-year. The rate, calculated by the Harmonized Index of Consumer Prices (HICP), was the 12-monthly weighted average of price changes in all states adopting the euro in 1 year.

2. Government budgetary deficit to the GDP ratio must not exceed 3% at the end of the preceding fiscal year, albeit a marginally higher government deficit/GDP ratio of between 3 and 3.5% was acceptable. A state incurring persistently higher than the government deficit/GDP ratio after a number of warnings could face economic sanctions under the European Deficit Procedure (EDP). The EDP was a "stability and growth pact" of maintaining sustainable stable economic growth within the European Monetary Union (EMU).
3. Government debt/GDP ratio must not exceed 60% at the end of a fiscal year. GDP is the total market value of all final goods and services produced in the economy in 1 year. A higher government debt/GDP ratio would inhibit policy effectiveness, in that an excessive government debt increased interest rates and taxes, both of which could crowd out private consumption and investment.
4. Member countries must (or make efforts to) join the European Exchange Rate Mechanism (ERM), introduced in 1979 as a part of the EMS. The ERM was to reduce exchange rate fluctuation and enhance monetary stability.
5. Nominal long-term interest rate must not exceed 2% points greater than the lowest inflation rate recorded by members of the EU. The rationale for the criteria was to sustain price stability within the Euro Zone.

Effects of a Single Currency

Some scholarly studies pointed out that the introduction of the euro would increase trade within the Euro Zone, albeit at varying rates (from 0 to 200%) for a number of reasons.[27] One, it was believed that having one currency would remove transaction costs and exchange rate volatility. The price of an export item is dependent on three factors: cost of production; transportation; and exchange rate (which is determined by demand/supply). If the demand for a currency rises relative to its supply, the value of that currency will likewise increase, raising the price of exports. Two, a single currency would avoid currency arbitrage or speculation between member countries. Currency arbitrage is the process of buying and selling a currency simultaneously in different markets to gain a profit from the exchange rate differential between the two markets

(made possible by time differences). For example, assume the Canadian dollar appreciates against the US dollar from CAD$1 = US$1.01 to par value in New York. However, the exchange rate quote may still be CAD$1.00 = US$1.01 in Vancouver. Because of the three-hour time difference, a person would earn a profit of 1% by buying the US dollar in New York and selling it in Vancouver at the same time. Three, adhering to the Maastricht criteria would attain price stability, strengthening long-term sustainable economic growth. Central banks, for example, did not need to worry about inflation when formulating and implementing interest rate policies. Stable interest rate policies would encourage consumption and investment.

The introduction of the euro was said to be responsible for a 5% rise in foreign direct investment (FDI) within the Euro Zone.[28] One reason was loans were easier to obtain because member states must adopt the five criteria listed earlier. A second reason was that countries that had weak currencies before the euro's introduction were able to attract investment from nations that had stronger currencies. The introduction of the euro, for example, appreciated the weak currencies (i.e., Greek diner and Italian lire) and depreciated the strong ones (i.e., German deutschmark and French franc). To illustrate, assume one deutschmark is valued at two Greek dinars. When both countries convert their respective currencies to the euro, the deutschmark will get two euro but the dinar would only receive one euro. To that end, German investors would gain an advantage by investing in Greece. The economic gains of further economic and financial integration prompted the member states to pursue more reforms and closer relations.

d. *The Lisbon Treaty: 2009*

The Lisbon Treaty (initially the Reform Treaty) was signed in 2007 but did not come into effect until December 1, 2009. The Lisbon Treaty makes revisions on some parts of the Maastricht Treaty and Treaty of Rome, renaming the latter as the Treaty on the Functioning of the European Union. The amendment of the Maastricht Treaty (Treaty on European Union) linking it to the EU's Charter of Fundamental Rights was in fact a legal document giving EU citizens and residents certain economic, political, and social rights. Other revisions that bind the members closer and strengthen the EU economically and politically include the following[29]:

1. The European Central Bank (ECB) became the EU's official central bank with the authority and power to develop, implement, and administer monetary policies for the Euro Zone. For example, the ECB conducted a series of quantitative easing (QE), injecting cash into the Euro Zone to spur economic growth in the aftermath of the 2008 global financial crisis. To that end, the ECB functions much like the US Federal Reserve, printing money to buy sovereign assets such as Treasury Bills (TB). Another similarity between the ECB and the US Federal Reserve is that both are shareholder-owned. The former is owned by member states' central banks whereas the latter by US commercial banks. The ECB issues euro banknotes (euro coins are minted by individual member states) and is responsible for conducting the Euro Zone's foreign exchange operations. The primary responsibility of the ECB, however, is to maintain price stability, capping the inflation rate at under 2% increases year-on-year. And as indicated earlier, the euro is one of the five world reserve currencies—US dollar, Euro, Chinese Yuan, Japanese Yen, and British Pound—in the IMF SDR basket.
2. Putting the Court of Justice (COJ), General Court (GC), and Civil Service Tribunal (CST) the Court of Justice of the European Union (CJEU) was to expand and strengthen the judiciary system. Perhaps the new CJEU was also to make the administration of justice easier or more expedient. Specifically, the functions of the CJEU are to: (i) review whether the actions taken by institutions are within the confines of EU law; (ii) ensure that member states comply with the obligations under the treaties that they signed and agreed to; and (iii) interpret a set of legislations, rules, and regulations known as the EU law. Perhaps the most important function of the CJEU was the protection of the rights of EU citizens and institutions.
3. The voting procedure of the Council of Ministers (Council of the European Union) was changed from unanimity to qualified majority voting (QMV). A QMV is realized when 55% of member states with 65% of the population voted in favor of a proposal. The amendment was to improve efficiency in getting proposals approved. In a supranational institution that has divergent interest groups, gaining a consensus is extremely difficult and time-consuming. Having the majority of members and by

extension the population supporting a proposed policy is perhaps the best any institution can do.

4. The European Council (EC) officially separated from the Council of Ministers, giving the former the status of an EU institution like any other. The EC remains the forum for heads of state or government, having the authority to formulate EU strategic priorities such as imposing sanctions against a nonmember state or making senior appointments to the ECB and other institutions. The President of the European Commission is automatically the EC's president with a 2.5-year term. The difference between the European Council and the European Commission is that the latter is the executive branch of the EU, responsible for operations of the various institutions under its jurisdiction, whereas the former is more like a corporation's board of directors, empowered to set policies.
5. The European Parliament (EP) has more legislative power in that it shares legislation making decisions with the European Council and European Commission. The EP co-controls the EU budget with the European Council, but the Commission reports to the EP. The 760 members of the European Parliament (MEP) are directly elected by universal suffrage for a five-year term. However, the EP has no authority to initiate legislation, that role remains the domain of members' national parliaments.
6. National parliaments of member states are the final "decider" of which legislations become EU policies. Legislative proposals put forward by the EP or European Council must be scrutinized and passed by the national parliaments. However, national parliaments must submit "reasonable" reasons why they reject an EP legislative proposal.
7. The Commission of the European Communities was renamed the European Commission. Each member state was to appoint one commissioner. As indicated earlier, the European Commission is the executive branch of the EU.

Summary Analysis of the European Union

The EU, while successfully integrating the economies of 27 countries, appears to be in danger of disintegrating. One reason is that the hope of becoming a political union remains elusive because individual states

have no appetite for giving up sovereignty. A second reason for the EU's breakup is that Brexit might culminate in a domino effect in that other EU members (i.e., the Netherlands and France) might not rule out on holding a similar referendum if economic woes persisted. A third reason is that the implementation of the Euro as a single currency may have done more harm than good. Martin Feldstein, Harvard University economics professor, wrote an article in Foreign Affairs that the Euro has failed the EU because its introduction was politically motivated.[30] According to Feldstein, a common currency requires a common monetary policy. Within the EU, there are 27 central banks plus the ECB, and each has its own monetary policy architecture. Moreover, the Euro has made the southern EU states (i.e., Greece) less competitive because of currency appreciation.

A common currency makes sense only if all members have the same fiscal and monetary policies, but within the EU, there are 27 different economies each of which has different policies. The PIGS nations, hammered by high levels of unemployment and negative economic growth, require expansionary fiscal and monetary policies. On the other hand, the lending countries (Germany in particular) demand austerity policies to minimize or prevent payment default and inflation.

Without a "single voice" that could cement relations with nonmember countries, it undermines the EU's ability to forge geo-economic agreements. For example, Wallonia, a region of Belgium, was able to force revisions in the Canada-EU Trade Agreement (CETA) before approving it in October 2016.[31] Similarly, there are opposing views on the US-initiated Trans-Atlantic Trade and Investment Partnership (TTIP), Italy is for while Germany is against.[32] Not able to forge free or freer trade agreements with nonmember states could undermine the EU's ability to recover from the 2008 financial crisis, leading to discontent among the EU members.

Finally, the EU's survival is further in doubt because of the Trump effect and Brexit. Indeed, increasing numbers of prominent scholars (i.e., Stiglitz) are predicting its demise.

Canada–United States Automotive Products Agreement (Auto Pact): 1965–2001

The United States and Canada signed the Canada-US Automotive Products Agreement, popularly known as the Auto Pact in 1965, to increase automobile production efficiency.[33] This was to be achieved

through tariff reduction on cars, trucks, buses, tires, and automatic parts and the construction of large specialized production facilities. Prior to the signing of the pact, the North American automotive market was "unspecialized" (i.e., plants making multiple products) and "truncated" (research and development and management decisions were the domain of US parent plants) with tariff barriers. High tariff rates on cars, ranging from 17.5 to 40% attributed to only 3% of cars produced in the United States sold in Canada and 7% Canadian-made cars headed south.[34] Growing automotive imports from Europe exacerbated the industry even more because European cars were more fuel efficient, with superior engineering technology and design, giving North American producers a "run for their money."

The signing of the Auto Pact by Canadian Prime Minister Lester Pearson and US President Lyndon Johnson in 1965 changed the North American automotive industry. Larger plants specializing in producing one single model were built and tariffs on cars, trucks, buses, tires, and automotive parts within North America were dismantled. The results were dramatic in that[35]:

a. Made-in-Canada cars exported to the south of the border increased from 7% in 1964 to over 60% in 1968.
b. US-made cars accounted for 40% of the Canadian automobile market.
c. The automobile industry surpassed that of pulp and paper, becoming the largest sector in the Canadian economy.
d. Over 140,000 new "blue collar" but relatively high paying jobs were created in Ontario. But that number was reduced to 95,000. White collar jobs, administrative and professional, were added in the United States.

The success of the US-Canada Auto Pact might have prompted Canada to seek and reach an overall free trade agreement, the Canada-US Free Trade Agreement and its successor, the North American Free Trade Agreement (NAFTA). The new NAFTA turned out to be a timely replacement of the Auto Pact when the WTO ruled it illegal in 2001.[36] The automotive industry serving the entire North American market, embodying Canada, the United States, and Mexico, was firmly entrenched. Moreover, the enhanced market size encouraged Asian and European automobile manufacturers—Toyota, BMW, Honda, Hyundai, and others—to invest in North America.

The Canada–US Free Trade Agreement: 1989

Hailed as the most comprehensive free trade agreement in the world, because it included trade in goods and services, the NAFTA is deeply rooted in two Canadian initiatives. Struggling to recover from the global stagflation, then Prime Minister Pierre Elliot Trudeau appointed Donald Macdonald, his finance minister, to head the *Royal Commission on the Economic Union and Prospects for Canada* in 1982 on ways to improve Canada's economic and social prospects.[37] Upon its completion in 1984, the Commission made three key recommendations, namely: (i) let the market play a bigger role in the economy and negotiate a free trade agreement with the United States; (ii) make social reform, improving social justice and economic efficiency; and (iii) reform the senate, electing its members instead of appointing them. Having a small population and being a "branch" of the US economy, negotiating a free trade agreement was on top of the recommendation list. The United States, with a population ten times that of Canada and the richest market in the world, forming a customs union with the southern neighbor was considered key to revive and sustain Canada's economic growth and prospects. The US-Canada Auto Pact became the template because of the benefits it generated for the Canadian automobile industry and by extension the economy. Indeed, a free trade area between the United States and Canada was deemed a natural union because over 50% of Canada's corporate assets were owned by American multinational enterprises (MES).[38] Canada's major industries, from natural resources to manufacturing, were in fact branches of US MES. Finally, over 75% of tradable goods between the two countries were already duty-free.[39] To that end, it did not take the new Progressive Conservative government long to begin negotiating a free trade agreement with the United States.

Negotiating the CUFTA, however, was not without controversy.[40] Opposition to a Canada-US free trade agreement came from multiple corners of Canadian society, from political parties to nongovernmental organizations (NGOs). Labor unions argued that an FTA would take away Canada's social programs such as the Medical Services Plan and negotiated extended healthcare benefit plans. Opposition political parties feared an erosion if not the end of Canadian sovereignty. Indeed, the Liberal Party under John Turner vowed to tear up the agreement if he were elected prime minister. The New Democratic Party leader, Ed Broadbent, promised to do the same. Others were concerned, fearing

the depletion of freshwater, other natural resources, and Canadian culture.

However, the Progressive Conservatives had a majority in the House of Commons, making it easy for the prime minister to ratify the CUFTA. In Canada, unlike the United States, members of parliament were (still are) expected if not required to vote along party lines. Besides, there was a general feeling that Canada's economic well-being would be tied to technological advancement and globalization. The CUFTA was signed by Prime Minister Brian Mulroney and US President Ronald Reagan in 1988 and it became effective on January 1, 1989.[41] The major provision of the Agreement included: (i) tariffs and nontariff barriers were to be removed completely over a 10-year period; (ii) free movement of specified occupations (i.e., educators, engineers, etc.); and a dispute mechanism to settle trade conflicts.

Though the CUFTA was hailed as an example of liberalized trade agreement that would expand the economic prospects of the two countries, it did not "live long" enough to come to any definitive conclusion. The CUFTA ended in 1994, having being replaced by the North America Free Trade Agreement (NAFTA) because Ronald Reagan wanted a truly continental free trade area, embodying Canada, the United States, and Mexico.[42]

The North America Free Trade Agreement: 1994

The North American Free Trade Agreement (NAFTA) was negotiated at the insistence of US President Ronald Reagan. Negotiations began in 1990, shortly after the CUFTA took effect. Spearheaded by the three countries' "pro trade" governing parties and their leaders, Canadian Prime Minister Brian Mulroney, US President George H.W. Bush, and Mexican President Carlos Salinas, negotiations were "fast tracked," reaching an agreement in October 1992 and signing it on December 17, 1992.[43] It was sent to each country's legislative branch or parliament for ratification, a process taking less than 14 months when the US Senate and Congress approved the agreement, respectively, in November and December, 1993.[44] Within that period, Jean Chretien and Bill Clinton, respectively, defeated Kim Campbell (who replaced Brian Mulroney as leader of the Progressive Conservative Party) as Canadian prime minister and George H.W. Bush as US president.[45] Clinton and Chretien ended

up signing the NAFTA into law, albeit they were against it when they were running for the highest office in their respective countries.

The NAFTA, like other trade agreements, encountered fierce opposition. Like its predecessor, the CUFTA, opposition was intense and widespread. Canadian and US labor organizations vehemently opposed the deal for fear of losing "good paying" manufacturing jobs to Mexico. Indeed, the NAFTA became the main election issue in both the United States and Canada. Ross Perot, the US industrialist running as an independent for the country's presidency in 1992, was an ardent opponent of the agreement, suggesting that it would "create a giant sucking sound" of jobs going south to Mexico.[46] He feared that the agreement could derail US control of its economy since one of Perot's campaign slogans was economic nationalism, opposing globalization and the imposition of tariffs and other trade barriers to protect domestic import substitute industries. Bill Clinton indicated that he would not sign any trade agreement that was detrimental to the interests of US workers and the environment. Jean Chretien, leader of the Canadian Liberal Party, threatened to tear the deal apart if elected to power unless provisions were provided to protect Canadian workers and the environment.

US President Bill Clinton and Canadian Prime Minister were on the same "page" with regard to worker and environmental protection. Canada and the United States, being "developed" economies, were deemed to have higher environmental and labor standard laws than "developing" Mexico. The two developed economies' leaders managed to persuade Mexico into reaching two side agreements that would ease their concerns, instituting the *North American Agreement on Labor Cooperation* and *North American Agreement on Environmental Cooperation* before sending the NAFTA to the respective parliaments or legislative branches for ratification.[47] The realization of the two side agreements allowed Chretien and Clinton to declare that the NAFTA would benefit their respective economies and workers.

a. *Key Provisions of NAFTA*[48]

   The provisions instituted in the NAFTA were similar to those of the CUFTA, the most important of which was the elimination of barriers to trade and investment between the three signatories. On January 1, 2016, the day of implementation, the United States reduced over 50% of tariffs on Mexican goods and services entering its border and Mexico responded in kind by removing over 30% of

US exports to the country. Tariffs on the remaining products were to be phased out within 10 years with the exception of some US agricultural goods. To sustain Mexican farmers' livelihood, tariffs on some US agricultural exports were to be eliminated in 15 years. Since the NAFTA has been in effect since 1989, trade between Canada and the United States is almost all tariff-free. Other major provisions included: (i) the removal of nontariff barriers (NTBs); (ii) protection of intellectual property; (iii) improving environmental protection; (iv) enhancing transportation efficiency; and (v) establishing a conflict dispute mechanism.

b. *Benefits and Costs of NAFTA*

Determining the benefits and costs of any free trade agreement is difficult and doing that of NAFTA is no different. However, most economists concluded that it brought more benefits than costs to the three members, albeit exact figures are extremely difficult to calculate. For example, a study commissioned by the Carnegie Endowment calculated that real wage increased only marginally in the United States and Canada, but decreased in Mexico.[49] These studies also concluded that NAFTA did improve US and Canadian manufacturing competitiveness through an expanded market and taking advantage of Mexico's lower wages, labor standards, and environmental protection requirements. As indicated earlier, the free trade agreement was responsible for attracting Japanese and South Korean automobile manufacturers to North America. The NAFTA was also credited for expanding business opportunities for industries in which each country has a comparative advantage. For example, Canadian precision machinery manufacturing prospects were improved under NAFTA, because access to bigger markets brought economies of scale, albeit those of low-technology had decreased.[50]

c. *Costs of NAFTA*

However, the NAFTA might have been a cause of environmental degradation, leading to climate change because of lax Mexican environmental standards. In maximizing short-term profits, firms dumped toxic chemicals into the atmosphere. Because of higher wages and tougher labor and environmental protection legislations, the NAFTA might have "hallowed out" some US and Canadian manufacturing industries, particularly low-technology and labor-intensive ones.

d. *Summary of Benefits and Costs of NAFTA*
It is difficult to determine the exact benefits and costs of NAFTA because some causal factors are difficult to quantify. For example, the future values of the benefits of environmental protection are dependent on future interest and inflation rates, both of which are extremely difficult to estimate. With regard to the loss of "good paying" manufacturing jobs, it is largely attributed to automation.[51] Advances made in technology have increased productivity, producing more with less low-skilled workers. However, some jobs were displaced by globalization, how many it is difficult to estimate. A more accurate assessment might be possible by examining the assumptions and logic behind the number.

The Trans-Pacific Partnership

Donald Trump did terminate the TPP in the first week of his presidency, complaining that the Obama-initiated agreement could be "a disaster for the country."[52] His complaint was the allegation that Japan and China would steal US jobs, accusing Japan of currency manipulation and China could join the TPP "through the back door." On Japanese currency manipulation, Trump probably alluded to Abe's "first arrow" of quantitative easing and later the negative interest rate policy, both of which were intended to depreciate the currency by increasing the money supply. With regard to China entering the TPP "through the backdoor," it might be that he thought it would shift production to a TPP member country (i.e., Vietnam), changing the country of origin. There was a precedence on the "backdoor" theory in US industries investing in Canada to gain access to Canadian and other British Empire markets during the 1870s when the newly established country imposed a 33% tariff on American manufacturers.

However, tearing up the TPP did not reflect the majority view on globalization, in that 58% of Americans supported and only 34% opposed trade, according to a 2016 Gallup Poll.[53] The findings suggest that most Americans believe international trade would enhance US economic growth albeit that protectionism in the US is growing for reasons cited earlier. The majority view has merit because trade does create tertiary industries such as export–import financing and increased standard of living via lower price imports. Nor is the TPP necessarily a "disaster for America" because the rules were written by and presumably for American corporations. For example, the TPP's standards on the

environment, working conditions, and intellectual property protection were so high that they could impede the developing countries' economic development. In that regard, the developed members, particularly America, would gain.

The Transpacific Partnership (TPP), a free trade agreement comprising 12 nations—United States, Canada, Japan, Australia, Singapore, Brunei, New Zealand, Chile, Peru, Vietnam, Malaysia, and Mexico, was signed on February 4, 2016.[54] All the 12 nations have 2 years to ratify the agreement but cannot change the negotiated items. However, if ratification is not attained on February 4, 2018, the agreement will be effective if the six members have a combined GDP of over 85% of that of all the 12 members.[55]

US President Obama worked hard to push the Congress and Senate to ratify the TPP before leaving office, because it was a significant part of his "pivot" to Asia policy, albeit he failed because of Congressional opposition.[56] The "pivot" to Asia was to be Obama's foreign policy legacy and, according to most analysts of international relations, was meant to "contain" or "isolate" China.

Prime Minister Shinzo Abe of Japan and Singapore Prime Minister Lee Hsien Loong were Obama's staunchest allies and supporters of the TPP in Asia for economic and geopolitical reasons. Animosities between China and Japan go back for centuries, culminating when the latter invaded and committed horrendous atrocities on the former between 1937 and 1945.[57] Abe himself is from a family of right-wing militarists, in that his grandfather was indicted as a war criminal. His support base is the militarist right-wing, demanding Abe not to give up Japan's claim on the Diaoyu or Senkaku Islands or being "soft" on China. To minimize the adverse economic impact of his nationalist stance, Abe must lessen the country's economic dependence on China, his country's biggest trade partner and source of tourism. Moreover, none of Abe's policies in reversing a quarter of a century of deflation worked, entrapping in slow or negative growth mode. The TPP was to be the answer to his dilemma, taking the unprecedented move to have the agreement ratified in the Diet, Japan's Parliament, before he traveled to New York to meet Trump.[58]

Prime Minister Lee Hsien Loong of Singapore was pushing for TPP's early ratification for economic and geopolitical reasons. Lee traveled to the United States in 2016, urging the US Congress to ratify the agreement before Obama left the White House, spreading the fear that the United States would lose credibility if it did not.[59] His trade-dependent

economy whose exports account for almost 200% of GDP, is encountering strong headwind because of weak external demand, particularly from China.[60] Moreover, Singapore's unofficial relationship with Taiwan and strong support of the US "pivot" are having adverse effects on the China-Singapore economic and geopolitical relations. For example, the Chinese government took an unprecedented move to inform Hong Kong authorities of a shipment of Singapore-owned military vehicles from Taiwan, transiting the Special Administrative Region (SAR) in December 2016.[61]

However, not everyone agreed with US President Barack Obama's claim that the TPP would bring economic prosperity to all signatory countries, suggesting that the proposed agreement may even cost more American and Canadian jobs.[62] They complained that the TPP was negotiated in secrecy, suggesting that the governments have something to hide from the public. Imposing standards that the developing countries cannot meet is another criticism for the reason cited earlier.

Perhaps the most severe criticism of the TPP was that it was politically motivated, because US President Obama wanted "the United States, not China, to write international trade rules." To that end, one can interpret his statement as an admission that the United States is determined to maintain hegemony in Asia at any cost because China is the largest or second biggest trade partner to all 12 members, including the United States. Thus, the TPP without China is like the NAFTA without the United States. That is, no nation within the TPP would be able to buy the quantity of goods that China has. For example, could the United States or Japan realistically be able to purchase 30% of Australian exports? Moreover, most of the 12-member TPP already have trade agreements with China: ASEAN-China Free Trade Agreement, Australia-China Free Trade Agreement, New Zealand-China Free Trade Agreement, and South Korea-China Free Trade Agreement. Growing at an average annual rate of between 6.5 and 7%, China would likely continue to be all 12 members' major trade partner even if the TPP is ratified. (For those who are interested in the TPP, follow the links.)

The Regional Comprehensive Economic Partnership

In the TPP's place, economies in the Asia Pacific—ASEAN (10 countries) and six countries with which the club already has free trade agreements, namely, Australia, China, Japan, South Korea, India, and

New Zealand—revisited the RCEP nearing the end of 2016 in Indonesia.[63] The RCEP was launched in November 2012 as a regional free trade area. Unlike the US-initiated TPP, the ASEAN-initiated RCEP was to enhance trade by lowering barriers such as tariff reduction, including the following[64]:

a. It will cover trade in goods and services, investment, technical and economic cooperation, intellectual property, competition, dispute settlement, and related issues.
b. Greater commitments to free trade than existing ASEAN + 1 agreements, but recognizing the constraints of each member.
c. Investment will cover protection, promotion, facilitation, and liberalization.

Without the high standard required by the TPP, the RCEP is more doable and practical for all members. There are no conditions such as national security attached to investment. Labor and environmental standards are in accordance with each member's position or circumstances. For example, members cannot bar imports from other countries because of lower working and environmental protection standards. The purpose of the laxed framework is to gradually improve the standards, giving less developed nations in the group to improve their economy, labor, and environmental postures.

It could be argued that the RCEP may be more suitable and potentially beneficial for the majority of Asian countries, because the agreement is really an extension of the "ASEAN + 1" architecture. The ASEAN-China Free Trade Agreement, for example, was the main reason why two-way trade between the ASEAN and China grew from less than US$10 billion in 1991 to over US$470 billion in 2015.[65] One reason was the two economies were (and still are) highly complementary, with ASEAN selling natural resources to and buying manufactured goods from China. With China's "One Belt, One Road" initiative, huge investments in infrastructure (over US$500 billion), a growing middle class, and green energy development (US$320 billion) over the next 3 years, the China market is indeed very attractive.[66] In addition, China's AIIB, Silk Road Fund, and other financial vehicles would be a large source of funding for building ASEAN's infrastructure needs.

Summary Analysis of Bilateral and Regional Trade Agreements

Bilateral and regional free trade agreements will likely continue to be pursued because of their advantages of geographical and ideological proximity and essential for economic growth. As indicated earlier, multilateral agreements within the WTO framework would likely take time to come to fruition, because of the differences in the stages of economic development between the over 180 member countries. It is therefore logical for a country to negotiate a trade agreement with those closest to it geographically, culturally, and compatibility. Geographic proximity reduces transportation costs and risks from piracy and other dangers. Cultural closeness improves understanding between the trade partners, allowing them to resolve issues more easily and timely. Economic complementarity maximizes the benefits of comparative advantage. The ASEAN-China Free Trade Agreement's (ACFTA) success and important role in sustaining the region's economic growth is because it contains the three essential conditions, albeit amid geopolitical tensions between some ASEAN members and China.

Free or freer bilateral trade arrangements would be the answer to curb rising protectionism in the developed economies since they lack domestic consumption, fiscal, and monetary ammunitions to improve socioeconomic well-being. The Canada-EU Trade Agreement (CETA) was finally concluded and signed on October 30, 2016 after Wallonia, a region in Belgium, dropped its veto against the agreement.[67] Canada is setting up a mechanism to forge a free trade agreement with China and India.[68] These two Asian giants were the fastest growing major economies in the world in 2016, estimated at 7.1% for India and 6.7% for China.[69] China, as indicated earlier, is the world's largest consumer of natural resources, including oil, gas, and lumber all of which Canada has an abundance. The two countries' fast growing middle class would be a huge market for Canadian food and consumer products.

Other regions of the world are also embarking on the path of forging trade mechanisms to achieve long-term sustainable economic growth. African nations continue to allocate energy and resources on reaching an African Free Trade Zone.[70] Major South American countries are trying to turn the Mercosur into a customs union.[71] Russia and some of its neighbors set up the Eurasian Economic Union (EEC) as a free trade area.[72]

Finally, the United States will pursue bilateral trade agreements under the Trump Administration. However, Trump's insistence on putting

America's interests first may not garner many trade partners. The world will have a better glance at his posture once renegotiation of NAFTA is concluded.

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CHAPTER 7

The Group of Seven and Group of Twenty

The G7—made up of the United States, Japan, Germany, France, the United Kingdom, Italy, Canada, plus the EU—was established in 1976 to address the Nixon Shock and oil crisis. Being a supranational institution representing the richest and most developed economies in the world, the G7 was writing the rules and regulations of the global trade and financial orders, albeit less so since 2008. That year's financial crisis exposed the G7's economic and financial weaknesses: huge public and private debts coupled with an ineffective monetary policy toolkit, reducing its influence on the global geo-economy. At the 2008 meeting in Chicago, US President Barack Obama announced that G20 would replace G7 as the world's official forum on global economic affairs.[1] The G20 is comprised of the world's largest 19 economies plus the EU, including all G7 and BRICS members, accounting for over 80 and 85% of world GDP and population, respectively.[2]

The Group of Seven

The Group of Seven (G7) was an exclusive "rich nations club" composed of the world's seven most developed and wealthiest nations. The organization, started as the "Club of 5" in 1973 at the White House (making up the United States, United Kingdom, Germany, France, and Japan), was established to discuss world affairs and how they might be addressed in the aftermath of the global oil crisis and the Nixon Shock.[3] Italy was added at the invitation of French President Giscard d'Estaing

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to the club in 1974. US President Gerald Ford invited Canada to join it in 1976.

The G7 accounted for over 65% of the world net national wealth (the difference between gross national wealth and liabilities), 45% of global nominal, and 32% of PPP GDP in 2015.[4] The distinction between nominal and PPP GDP is that the former represents the monetary or prevailing nominal exchange rate value of goods and services produced in an economy in one year, whereas the latter is the purchasing power of the US dollar in the United States compared to that of another country. Because of lower production and living costs, PPP GDP is greater than nominal GDP in developing countries. For example, a haircut costs less than US$2.00 in China compared to over CDN$10.00 in Canada.[5] The purchasing power difference explains why China's nominal GDP was approximately US$11 trillion, while its PPP GDP was over US$18 trillion in 2015. Which is more accurately measuring a country's economic performance and size is a subject of debate. The US Central Intelligence Agency (CIA) argued that PPP measurement is more accurate for China's economic performance and size because its exchange rate is not market-driven, but determined by administrative fiat.[6] The true market value of the Yuan might not be realized because the People's Bank of China (PBOC) only allowed the currency to be traded at a narrow bend of a basket of major currencies, the most important of which is the greenback.[7]

The Invitation to Russia: Turning G7 into G8

Russia joined the G7 in 1997 at the invitation of US President Bill Clinton and British Prime Minister Tony Blair.[8] Being a nuclear power rival of that of the United States and then Russian President Boris Yeltsin's embracing of Western democracy and market economy, Clinton and Blair were of the view that it might be more beneficial for the West to have Russia inside the club. First, Clinton and Blair probably reasoned that adding Russia would strengthen the club's global dominance because no single or group of countries could challenge the newly formed G8 economically, financially, and militarily. Second, Russia was (still is) a major producer and supplier of oil and gas, assuring Europe with indefinite energy security. Third, the G7, the United States in particular, hoped for a "Cold War" dividend, spending less on weapons production and more on economic and employment growth projects.

Russia, for its part, was hoping to gain G7 assistance in developing and rebuilding its shambled economy.

Russia's shift from central planning and communism to market economy and democracy began in the early 1990s when Mikhail Gorbachev attempted to accelerate economic growth to regain public support for the ruling Communist Party. The Soviet economy was tanking under many years of heavy military spending, inefficient economic planning, corruption, the war in Afghanistan, and a host of other revenue-draining fiascos. The last nail on the coffin was the costly arms race with the United States, draining the Soviet treasury to fund an unnecessary and unwinnable competition. Unable to climb out of the deep fiscal hole, the Soviet economy literally collapsed in the late 1980s, with economic growth falling by as much as over 10% a year.[9] The economic woe turned Soviet civil society "upside" down in that people resorted to alcohol and committed suicide to escape the misery and despair. Both of which shortened the average age of the citizens to less than 50 years old, culminating in a serious demographic problem.[10] Public resentment grew but the Party had no new ideas or policies to address an increasingly worsening economy, prompting Gorbachev to introduce perestroika (restructuring), glasnost (openness), demokratizatsiya (democratization), and uskoreniye (economic development acceleration) at its 27th Congress in February 1986.[11]

Ironically, it was Gorbachev's reform policies that were the root causes of the Soviet Union's demise. The union was a loose federation of states glued together largely by the power center at Moscow. When that forced power was relinquished and each republic was given the right to make choices on whether to remain in the Soviet Union or secede, they opted for the latter in the hope that democracy and capitalism might improve their future, culminating in the Soviet Unions' collapse in the early 1990s. And within the Russian Federation, political gridlock if not chaos was the norm because there were over 100 political parties vying for power.[12] The parties' ideological stances were as varied and different as their numbers, ranging from the xenophobic right to the communist left. The dilution of votes precluded any single party to form an effective government, turning the country almost into a dysfunctional state.

The economy was in a worse shape. The former Soviet states, including Russia, did not have leaders or managers with the knowledge to manage a smooth transition from central planning to a market economy. The Russian oligarchs in fact managed and operated the newly acquired

state-owned enterprises in the same or similar way that they did under central planning. Production inputs or equipment were acquired long before they were needed, culminating in huge wastes of scarce resources. For example, windows and elevators for new multistoried buildings were purchased and stored at building sites and left to be rusted before construction started. Nor did the new owners acquire sales contracts before production began, creating bottlenecks and undesirable inventories, some of which were left to rot. Further, Russia did not have the infrastructure system—reliable energy source, transportation mode, procurement, and distribution systems—required to develop the economy. With no answer to fix the problems, Mikhail Gorbachev resigned. While Gorbachev was riled in Russia, he was applauded by the West, winning the Nobel Peace Prize.[13]

After his resignation and leaving the Communist Party, Gorbachev formed his own political party, the Social Democratic Party of Russia, and ran for the presidency of Russia in 1991, but was defeated by Boris Yeltsin, a regional governor from Siberia.[14] Under Yeltsin, the Russian economy worsened, becoming a "basket case" and forcing the government to turn to the West for help. Russia's initial loan request of US$11 billion was raised to US$20 billion by the IMF, subject to the Washington Consensus conditionality.[15] Privatization of state assets meant to improve operational efficiency, but in reality gave oligarchs (former Soviet government officials) the opportunity not only to "steal" the once state-owned enterprises, but also pocketed the money from the IMF as revealed in Joseph E. Stiglitz's book, *Globalization and Its Discontents* (2002).

Yeltsin, who was seen by many in Russia as a "clown and drunk," stepped down and turned the leadership of his party and the government to Vladimir Putin, a former KGB lieutenant colonel.[16] Putin retired from the KGB in 1991 and entered politics, moving to Moscow from his native St. Petersburg in 1996 to join Yeltsin's government and became acting president (when Yeltsin suddenly resigned) in 1999. Since then he was elected thrice, between 2000 and 2012. Barred from running for a third term as president, his protégé, Dmitry Medvedev, ran and won the presidency in 2008.[17] During the period between 2008 and 2012, Putin was prime minister under Dmitry Medvedev. In 2012, Medvedev stepped down to make room for Putin to run for the presidency. Putin won a third 5-year term in that year.[18]

Under Putin, the Russian economy and income surged between 1999 and 2008, growing at an average annual rate of almost 7% because of high energy and mineral prices and rational economic policies.[19] Putin introduced massive expansionary fiscal policies: a flat income tax of 13%, reduced profit tax, and started or restarted industries such as ship building, nuclear power construction, and other strategic industries.[20] During his 8-year stewardship, the economy increased by over 70% and real wages more than tripled.[21]

Putin tightened his control over the Russian economy and polity after his 2012 re-election, prompting critics within and without Russia to accuse him of becoming a dictator and "obstructionist" in global diplomacy.[22] Within Russia, there were complaints of intimidation and harassment of political dissidents. The United States accused Putin of protecting Syria and Iran, who also "annexed" the Crimea and "destabilized" the Ukraine. For his part, Putin accused the United States and its NATO allies of breaking their promise of not expanding eastward. Indeed, NATO did encroach into the Ukraine (Russia accused the NATO, the US in particular, of replacing a freely elected president in the Ukraine with a bunch of what he called "neo-Nazis.")[23] Russia also suspected NATO of attempting to recruit Finland and Sweden into the alliance, albeit the two Nordic countries indicated that it was "renewed Russian threat" that prompted them to explore joining the US-led Western military alliance.[24]

Whether Russia was responsible for the Ukraine crisis should be put into proper perspective. Crimea's population was (and still is) almost 60% ethnic Russian and was once a part of Russia. Nikita Khrushchev (a Ukrainian) gave it to the Ukraine in the early 1960s when he was the Communist Party secretary general. In a 2014 referendum, an overwhelming majority (95.5%) voted in favor of rejoining Russia.[25] With regard to the eastern part of the Ukraine, it is populated by ethnic Russians who complained that the Ukrainian government did not treat them fairly and that they were routinely discriminated against. The ethnic Russians claimed that they were only fighting back against the pro-Western government.

The Western Alliance, particularly the United States, is sticking to the position that Putin is the "bad" guy in both the Crimea and Eastern Ukraine, expelling Russia from the G8 and imposing sanctions against it in 2014.[26] The EU and US insisted that the Crimean referendum vote was "illegal and illegitimate," refusing to accept it. NATO also claimed

that there was "proof" that Russia dispatched troops under the guise of patriots, willing to help fellow Russians fight Ukrainian persecution.

The G7/G8 Functions

Since 1975, the club has held over 40 annual summits to discuss economic policies, ranging from better coordination among members to poverty eradication. Beginning with the first summit in 1975, the then G5 was pursuing ways and means to assess the impact of the Nixon Shock and global energy crisis, discussing how they could coordinate macroeconomic policies to address the effects of the two issues on theirs and the world's economy. The group had their work cut out for them because it was during this period that stagflation (rising inflation and economic stagnation occurring at the same time) emerged, posing policy challenges. Keynesian economics, calling for proactive government policies, were inappropriate because expansionary fiscal and/or monetary policies could worsen inflation but not necessarily increase aggregate demand.[27] Unable to forge a policy that all members could agree on, the first summit ended with no conclusive answers to the troubled global economy.

Subsequent summits were not much more successful in attaining the goals on which countries agreed prior to holding them. In the 1996 meeting, for example, the G7 leaders that introduced an initiative to reduce the debt burden of the world's 42 heavily indebted poor countries (HIPC) was merely political posturing.[28] The mandate was to make sure that no poor countries should be burdened with debts that they could not service. The funds that were to be used to pay off the debts would be spent on social and economic development programs. Instead of the G7 members putting up the money, they encouraged the IMF and World Bank to determine how debts to the HIPC could be cancelled, restructured, or reduced. To be eligible for IMF or WGB debt relief, however, the HIPC must meet two conditions: commit to the IMF/WBG debt reduction plan and maintain a good track record over time.[29] It was difficult for the HIPCs adhering to the IMF/WBG debt reduction plan because demanding loan repayment before spending on economic enhancing programs in fact worsens the countries' financial resources, disallowing the countries from maintaining a good track record.

Even assuming the two conditions were met, getting debt relief was a two-step process, the first of which was that the HIPC must meet

three criteria: (i) be eligible to borrow from the WBG International Development Agency and IMF Poverty Reduction and Growth Trust; (ii) incur a debt burden that cannot be serviced through existing debt relief regimes; and (iii) establish a Poverty Reduction Strategy Paper (PRSP) through a participatory process within the HIPC.[30] The conditions were not only harsh, but time consuming, a luxury the HIPC did not have. For example, they needed debt relief money (debt payments) to spend on hunger, healthcare, education, and other social services today, not tomorrow. Worse, the HIPC could only proceed to the second stage if the first was successfully attained. The second stage criteria included: (i) acquire a good track record on programs funded by loans from the IMF and WGB; (ii) satisfactory implementation of main reforms up to the date on which a decision to grant debt relief; and (iii) show that a PRSP was implemented for at least 1 year.[31]

The 1996 HIPC debt relief initiative definition of "unsustainable" debt as a country's debt-to-export ratio is between 200 and 250% and debt-to-government revenue ratio exceeding 280% was criticized as too restrictive (and probably arbitrarily derived).[32] First, under that definition, only a few of the 40 HIPC countries were eligible, prompting the IMF and World Bank to lower the debt-to-export ratio to 150%.[33] The amount of reduction was not only too little, but the implementation period took 6 years. Second, the IMF and WGB did not cancel the debts until completion of the two-step process. This meant that the HIPC still had to service the debts, postponing spending on poverty alleviation social programs, healthcare, and education services. Third, the loan conditionality of privatization of state-owned enterprises such as utilities raised the cost of basic goods and services such as electricity. The higher price was beyond the poor's ability to pay. Fourth, creditors were more concerned with the HIPC repaying the debts than their economic development and poverty reduction. Fifth, past arrears became part of the debt relief initiative, suggesting that the HIPC's loan had increased without receiving additional money. The other part was new loans and donations. Adding annually compounding interest rates accrued by the arrears to those of the new loans increased the HIPC debt payment burden.

The criticisms triggered a more proactive response from the G7, announcing a plan to cancel up to 90% of HIPC debts in subsequent summitries. This ambitious posture, known as the Koln Debt Initiative, brought together the Paris Club (an informal group of officials from creditor nations conceived in 1956) and the International Financial

Institutions (IMF, European Investment Bank and others) to establish a comprehensive debt relief program to reduce HIPC debt burden.[34] The goal was to reduce the debt burden of HIPC by over US$70 billion, but the dates on which it was to be begun and finished were not specified. Indeed, the "ambitious debt relief plan" was more rhetoric than substance, since the debt relief to HIPC was loans, suggesting that the poorest nations on the planet continued to owe more to the creditor nations than before the initiative took effect.

Moreover, debt crises were looming in Asia, Latin America, and Russia, prompting the 1999 G7 summit to take a more proactive role in managing the global monetary system. The increased role culminated in the establishment of the Financial Stability Forum (FSF) in 2008, a group made up of the G7's finance ministers and central bankers.[35] It met once or twice a year to assess the international financial system, exchanging ideas on enhancing the efficiency of international financial flow and coordinating macroeconomic policies for the betterment of G7 and global economies.

Since most of the debts were owed to financial institutions of G7 nations, the IMF, and World Bank, the leaders at the Koln Summit took steps to better manage the international financial system. Perhaps the most important of these steps were the calling of discipline in lending practices of creditor nations and strengthening of macroeconomic policies and financial systems in developing economies. On lending discipline, the Koln Summit called for improvement in risk assessment and encouragement of offshore financial centers to uphold regulatory regimes. With regard to emerging economies' strengthening their macroeconomic policies and financial systems, the G7 leaders called for prudent borrowing policies, adopting the flexible exchange rate regime, and increasing cooperation with IMF and WBG to development of sound policies. However, the policies lacked details on how the IMF and WBG could cooperate with and what sound policies are appropriate for emerging economies.

It might be for these reasons that critics argued that not much substance came out of the 1999 Koln Summit. Indeed, some including Joseph E. Stiglitz suggested that IMF and World Bank bailouts might have had added to the receiving countries' economic woes because they were additional loans, adding to the borrowers' debt burden.[36] The increased debt burden reduced spending on economic and social enhancing programs, which could cripple the borrowing nations' development.

Although the G7 continued to hold annual summits, its ability to address economic issues came to an end in the aftermath of the 2008 global financial crisis (to be discussed in this chapter). While a host of issues—climate change, food crisis, nuclear proliferation, the world economy, debt relief and other problems—continued to be discussed at the annual meetings, the rich nations simply did not have the financial muscle or geopolitical clout to come up with meaningful remedies. Literally buried in a sea of debts (with an average public debt/GDP ratio of over 100%) and interest rate nearing zero, the G7 economies did not have the fiscal and monetary toolkits to stimulate domestic aggregate demand.[37] Consumer indebtedness also rose dramatically, averaging almost 100% of disposable income in the G7 and EU.[38] As indicated earlier, inadequate private and public demand was the main reason why the G7 economic indicators (i.e., GDP growth, unemployment, manufacturing activities, and others) were (and still are) on a roller coaster ride, up one month and down in the other. For example, Prime Minister Shinzo Abe's 2013 "three arrows" policies of monetary easing, fiscal stimulus, and economic restructuring policies were hailed (prematurely as it turned out) as the savior of the Japanese economy because the first arrow, quantitative easing increased exports, raised stock values and corporate profits at the beginning of its implementation.[39] However, that optimism turned into disappointment after the gains were eliminated a few months later. The Japanese economy has been zigzagging between stagnation and recession since then.[40] The economies of the other G7 nations are only marginally better, their GDP fluctuating between 0 and 2% growth.[41] The fluctuation between optimism and pessimism could be around for some time in the G7 nations since the projected average annual growth rates are less than 2% in 2016 and 2017.[42]

Economic optimism, too, is fading in the developing economies, but the biggest ones, China and India, are still growing at over 6.5% annually since the financial crisis. China is said to be entering a leveling or "L-shaped" average annual growth rate of between 6 and 7% over the next few years, contributing to over 30% of global economic growth since 2009.[43] India's economy is growing at more than 7% annually since 2014, albeit starting from a relatively small base with a GDP at around US$2 trillion.[44] Moreover, the high growth rate is the result of a change in methodology, measuring GDP using the expenditures instead of the factor cost approach and revising the base year. The change in methodology raised the growth rate data from 5.4 to 7.5% in 1 year.[45] Thus India's economy is

performing relatively well in relation to other developing economies. Since 2015, economic growth in Russia, Brazil, and South Africa was in negative territory largely due to slumping commodity prices.[46] Indonesia and the Philippines showed signs of economic buoyancy with over 6% of growth rate in 2015, but poverty and unemployment have not improved and may even be worse.[47] With regard to smaller developing economies around the world, particularly Africa and Latin America, they are projected to grow between 3 and over 10% over the next few years, thanks largely to the role of the BRICS club, particularly that of China.[48] The "One Belt, One Road," Chinese investments in Southeast Asia, Africa and Latin America, the AIIB, BRICS New Development Bank, BRICS Currency Emergency Fund, and other initiatives would likely increase economic growth in the developing world.

The Group of Twenty

Established in 1999, G20 is an international forum for: (i) government leaders to exchange "notes" on economic and geopolitical improvements; (ii) finance ministers/central bank governors to develop and implement policies that could strengthen the stability of the global financial system; and (iii) labor and employment ministers to develop a host of employment-related policies for the betterment of workers. It was designated as the official forum for world economic and financial matters in 2009.

The club is made up of 19 of the world's largest economies plus the European Union (the list of G20 countries can be found through the links provided in the citation). Together, they account for over 85, 80, and 67% of world GDP, trade, and population, respectively.[50] More importantly, the group is represented by all major developed and developing economies, including G7 and BRICS members.

The G20 annual leaders' summits are preceded by formal gatherings of finance ministers/central bankers and other ministries/departments. Since 2008, the G20 finance ministers/central bankers have been meeting between two and four times annually to discuss policies on sustainable global economic growth. The members' labor and employment ministers meet once a year. G20 should be more able to boost global economic growth because it includes the G7, BRICS, and other economies. Pooling their resources together should give it a huge financial toolkit. And if the developed and developing economies cooperate

in governing and reforming the world geo-economic order, long-term sustainable economic growth should be attainable. Below is an analysis of the G20 leaders' inaugural summit.

a. *The 2008 G20 Washington Summit: The Inaugural Meeting*
   The 2008 summit was the first-time major developing economies participated in a formal gathering as equals (to developed countries) in shaping the global trade and financial systems, discussing the 2008 financial crisis as to why it occurred and how a future crisis can be avoided.[51] In the inaugural meeting, the following actions were taken:
   1. Quantitative easing, with central banks printing money to buy sovereign bonds. In doing so, the leaders hoped for three positive outcomes: (i) injection of additional liquidity into the economy to stimulate consumption and investment; (ii) bailing out banking institutions to stabilize the financial system; and (iii) the central bank to sell the sovereign bonds in the capital markets to earn a profit in the long run.
   2. Consistent coordination and use of macroeconomic policies to address domestic issues, realizing that changes in the money supply would affect the rate of interest which in turn should impact domestic consumption and investment.
   3. Utilization of fiscal tools to stabilize economic activities without incurring unsustainable debt levels. The leaders recognized that additional government spending during periods of economic stagnation or recession would stimulate demand, reversing the downward trend. The definition of sustainable fiscal postures is that the Maastricht Condition, the government debt/GDP, and deficit/GDP ratios be capped at 60 and 3%, respectively.
   4. Encouraging and ensuring international financial institutions such as the IMF and WBG to have sufficient resources to help emerging economies in weathering the financial crisis.

In addition, the inaugural meeting took the following steps[52]:

1. Formulate common financial market reform policies because financial institutions are globalized. These policies were: (i) ensure transparency and accountability; (ii) strengthen regulatory measures; (iii) protect investors and consumers from

unethical practices; and (iv) reform the IMF, WBG, and other multilateral development banks. Improving international financial stability and integrity was deemed necessary to achieve economic growth. The ministers of finance were mandated to carry out the reforms.

2. Ensure liberal capitalism that incorporates the rule of law, unfettered cross border trade and investment, and other free market institutions and practices. Allowing the natural forces of demand and supply was thought to be the most effective vehicle in promoting economic growth.
3. Recommit the 2002 United Nations Conference on Finance and Development to eradicate poverty, attain sustainable economic growth, and promote sustainable development. Helping emerging markets to develop and including them in shaping the global economic order was considered essential for achieving a sustainable and equitable global economy.
4. Ensure global energy and food security and environmental sustainability by addressing climate change, the promotion of renewable energy sources, and efficiency in food production.

Though the 2009 G20 agenda was as admirable as it was ambitious, very few of the goals were achieved because of the uncompromising divergent interests of stakeholders. While the multilateral development banks were encouraged to give developing economies a helping hand, the Washington Consensus loan conditionality of repaying creditors first remained intact. The call for free or freer trade was derailed by the developed economies' refusal to reduce meaningful agriculture subsidies and imposing of NTBs to block imports, due to which they incurred a comparative disadvantage. The efforts to stabilize the financial system went nowhere in that politicians could not agree on the type of reform policies. The new capital created from quantitative easing went to bailing out financial institutions and businesses deemed "too big to fail," restricting loans to businesses and consumers.

Subsequent G20 summits fared no better; a lot of empty promises on achieving long-term sustainable global economic growth and other repetitive goals but they remained just that, empty promises (for readers interested in the annual meetings between 2009 and 2014, follow the links presented in the citation).

G7 and G20 2016 Summits

G7 held its 2016 annual summit in Ise-Shima, Japan, on May 26 and 27, while G20 held it in October at Hangzhou, China, in the same year. The G7 Declaration promised to attain long-term sustainable economic growth by addressing the obstacles (i.e., universal health coverage, migration and refugees, uncoordinated fiscal, monetary, and restructuring policies, etc. (for those who are interested in reading the 32-page document, follow the links provided in the citation).[53] The G20 summit was to achieve sustainable development through innovation, poverty reduction, supply-side reform, global financial and trade policy reforms, and a host of other goals[54] (for those who are interested in the outcomes of the Hangzhou G20 Summit, please follow the links provided in the citations).

The Relevance of G7

The ability of G7 in enhancing long-term sustainable economic growth is questionable. As indicated earlier, the average G7 public debt/GDP ratio is 102.4%, implying that additional government spending could lead to unsustainable debt because that would trigger interest rate hikes and rising taxes. Higher interest rates and taxes could crowd out private sector consumption and investment. On the monetary policy, its effectiveness is literally nonexistent in that the bench rate (set by the central bank based on a direct relationship between GDP and inflation growth rates) is nearing zero and is negative as in Japan and some EU economies. Interest rates that are low generate pessimism as predicted by John Maynard Keynes; instead of spending money on consumption and investment, the economy would put money "under the mattress." Negative interest rate policies erode consumer wealth in the short run and/or capital formation in the long run, both of which could further stifle economic growth. And as indicated earlier, real wage increases are less than 1% because the majority of jobs created are in the low-paying service sectors such as servers in fast-food restaurants.

Other G7 economic and financial indicators fare no better with average saving to income ratio being less than 5%, suggesting insufficient accumulation of future investment funds.[55] The average national external

debt within the G7 in 2014 was over US$6 trillion with the United States' at over US$17 trillion, accounting for over 115% of the club's average GDP.[56] Foreign external debts are defined as money borrowed from foreign governments, commercial banks, and other lenders.

The Relevance of G20

The theme of the 2016 G20 summit was "Toward an Innovative, Invigorated, Interconnected, and Inclusive World Economy."[57] Innovative growth referred to the focusing on science and technology advancements, including the development of new management methods, to drive economic growth. The pursuit of new development strategies that would hasten economic growth was also viewed as a part of innovation. With regard to inclusiveness, the G20 heads of states vowed to narrow the gap between the rich and poor countries. To that end, the G20 countries vowed to ensure that economic growth would be extended to all nations and people, including women, the underprivileged, and children. Interconnectivity was meant to improve global cooperation in promoting economic growth and addressing issues through the development of new initiatives or policies. China's OBOR, for example, was to connect China to Asia, Africa, and Europe through sea and railroad routes. Invigorated growth implied that governments should find ways to re-energize markets around the world to counter challenges. Rising protectionism in the West promises to undermine global economic recovery. To counter that sentiment, governments must and should introduce bold policies or initiatives. For example, China proposed at the G20 meeting the Strategy for Global Trade Growth (SGTG) and Guiding Principles for Global Investment Policymaking (GPGIP).[58]

The SGTG was set by leaders of the G20 at the 2014 Brisbane, Australia, summit to add another 2% to global economic growth by 2018 as a way to add impetus to recovery and attain WTO's Sustainable Development Goals. The SGTG was reiterated at the 2016 G20 Trade Ministers' Statement issued on July 10, 2016 outlining the following strategies[59]:

a. Trade barriers dismantling or reduction through the WTO Trade Facilitation Agreement (TFA) would reduce costs of tradable goods and services by as much as 15% (OECD and World Bank estimates).

b. Harmonizing trade, investment, and related public policies in terms of complementary and enforcement would reduce trade fictions, adding efficiency to the trade and financial systems.
c. Enhance trade in services by improving and increasing the services sectors of the developing economies. The global supply chain is increasingly interconnected and the services components are important in improving connectivity.
d. Expanding trade financial resources. The G20 leaders recognized that poor countries are having difficulties in financing trade. Inadequate financing undermines economic growth because it reduces the quantity of tradable goods and services.
e. Build a more accurate global trade indicator with which countries can monitor trade prospects and problems.
f. The problems that hinder economic growth and development should be addressed because they erode the levels of international trade and investment. Among the problems to be minimized include lack of unskilled labor, rising numbers of refugees from the Middle East and Africa, and rising protectionism in the West.
g. The promotion and encouragement of e-commerce would raise economic growth as demonstrated by the US' Amazon and China's Alibaba online buying. The promotion of trade information in the small- and medium-sized enterprises would enhance their competitiveness in the e-commerce market.

The GPGIP was adopted at the 2016 G20 meeting in: "(i) fostering an open, transparent and conducive global policy environment for investment, (ii) promoting inclusive economic growth and sustainable development, and (iii) promoting coherence in national and international investment policymaking."[60] These objectives would indicate that investment is a key driver of long-term sustainable global economic growth and development. To that end, the G20 members proposed nonbinding principles at the 2016 G20 meeting, which included the following:

a. Governments should avoid protectionism with regard to international investment.
b. Investment policies should be open, transparent, nondiscriminatory, and make conditions explicit.
c. Investment policies should provide strong and enforceable mechanisms to protect the stakeholders.

d. Investment regulations should be transparent and allow participants to play an active role in their writing and implementing.

Summary

Whether G20 will be more effective than G7 in promoting and achieving the goals each group is set is unclear. While G7 lacks financial muscle, G20 is plagued with diversity in which members' interests often collide. For example, India and China are members of the BRICS, but they are also on the opposite sides of a territorial dispute. The Indian foreign policy establishment has yet to forgive China for the war in 1962 over territorial claims based on the McMahon Line.[61] Neither China nor Tibet (at first) recognized the boundary, complaining that it was arbitrarily drawn to steal Chinese territory when the country was weak and unable to defend its territorial integrity. India, however, considered the territory on its side of the McMahon Line as the Line of Actual Control (LOC). Other irritants between the two countries include China's refusal to support India's membership in the global nuclear club, the UN Security Council as a permanent member, and the Sino-Pakistani alliance.[62] To that end, security concerns and domestic politics could derail their respective governments from forging cooperative relations with each other and act as a partner within the BRICS. The voices within India, largely from the security establishment, for allying with the United States are getting increasingly loud. However, those calling for closer Indo-China economic relations are also influential in the Indian political establishment. How Prime Minister Narendra Modi balances between the two conflicting sides would be interesting. Allying with the United States would raise India's status in the West, but may deter or slowdown its economic development. While the West and Japan promise technology transfer and investment, their private enterprises, the real deciders, may not be as enthusiastic as the political establishment given India's inadequate infrastructures (i.e., insufficient road network and power generation facilities), chaotic polity (i.e., too many political parties each protecting its interests at the expense of the nation's), and social problems (i.e., caste system). The Chinese government, on the other hand, has the authority and resources to help India fulfill its "Made in India" dream.

Moreover, mistrust between the United States-led West and China/Russia is such that conflicts between the two sides could emerge over the slightest incidents. The United States and its allies are determined to

block “Russian aggression” and “Chinese bullying,” respectively, in the Ukraine and Eastern Europe and the South China Sea. Russia and China are equally firm on their positions in the “flashpoint” regions. Russia accuses the US-led NATO of breaking its promise of not expanding into Eastern Europe. China is charging that the United States is a “trouble maker” in the South China Sea.

In the final analysis, the G20 is in a stronger position to attain the goals it set because it commands over 85% of world GDP, and the biggest and strongest military and financial system. China’s willingness to spend its huge financial toolkit to invest in the developing and developed economies could be the answer to the world’s quest for long-term sustainable economic growth and geopolitical stability. At the very least, the G20 could strengthen the global trade and financial systems, enabling the world to recover from the 2008 financial crisis. The combined financial resources of the IMF, WBG, ADB, AIIB, NDB, SRF, and ECRF give G20 plenty of financial muscle to address issues and fund infrastructure developments.

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CHAPTER 8

The 2008 Global Financial Crisis: Effects on the Global Economy

The US-originated 2008 financial crisis pushed the global economy, particularly those in the West and Japan, into the "Great Recession," an economic and financial crisis not seen since the 1930s' Great Depression. In the 2008/2009 period, all major developed economies registered negative growth rates, ranging from −0.5 in the EU to −0.7%.[1] Since then, average annual growth rates in the developed economies have barely surged above 2%.[2] The developed countries' weak economies reduced global economy to less than 3% since 2008.[3] China's economy, growing at nearly 10% annually before the crisis, dropped to 6.5% in 2008.[4] Because it affected the global economy, the financial crisis revealed the extent of world economic and financial connectivity.

How Did the Financial Crisis Happen?

There are a number of theories regarding why the 2008 financial crisis occurred: US Federal Reserve's low interest rate policy, excessive saving in Asia, over-leveraging or reckless financial management behavior, and unsustainable fiscal and monetary policies in the West are the most cited.[5] The majority of analysts point to reckless financial management, creating excessive liquidity through over-leveraging of financial and physical assets as the most important cause of the crisis. Whatever the causes, the financial crisis doomed Lehman Brothers in September 2008, sending shockwaves through the global financial system, particularly that of the West.[6] Banks, governments, and consumers in the West found themselves

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buried under a mountain of debts, culminating in a prolonged period of weak aggregate demand. Accounting for over 85% of the economy, it would be difficult for the developed countries to increase GDP growth without appreciable rises in domestic consumption.

Leveraging

Leveraging is the process of borrowing money on a collateralized asset to finance an investment or consumption activity. For example, a homeowner pledges his/her house as collateral to borrower a portion of the property's value to buy a car. Under normal practices, the lender would only loan the money as long as the borrower is able to service the loan and has sufficient equity on the house to cover it in the event of a payment default. In the financial sector, banks leverage by creating financial derivatives (to be explained later in the chapter).

Creative investment bankers develop derivatives to increase excess reserves (loanable funds). For example, suppose Bank A holds US$2 billion in Treasury Bills (TBs), leaving them in its books would only earn whatever interest rate the Federal Reserve pays. To increase income, the bank would securitize government debt holdings, creating a contract with a prospective investor to buy the TBs at an agreed price. Once the investor has bought the contract, the bank receives a "new deposit" in the amount of US$2 billion. Under the fractional reserve banking regime, the excess reserves, "deposit" minus the required reserve ratio (RRR), can be loaned out to consumers and/or investors. The borrowers may deposit the loans either at Bank A or at another bank; either way they (loans) create another new deposit, culminating in the creation of a money multiplier (k = Initial Deposit/RRR) the value of which depends on the RRR.

Illustration: Suppose:

1. Initial deposit is $1000.00
2. RRR is 5%
3. Opening Balance Sheet

Balance Sheet of Bank A

(December 31, 2016)

Asset		Liabilities	
Reserves	$1000	Deposit	$1000

4. Second Balance Sheet

Bank A Balance Sheet

(January 1, 2017)

Asset		Liabilities	
Reserves	$1000	Deposits	$ 1950 ($1000 + $950)
Loans	950		
Total	$1950		$1950

From this simplistic demonstration, the banking system can create $20,000.00 out of the $1000.00 initial deposit. Without reserve requirements or allowing uninhibited derivative creation and trading, banks could theoretically "create money out of thin air" indefinitely. That was exactly what happened in the pre-financial crisis period; banks were allowed bundling and rebundling derivative packages, each time using the original financial instruments as underlying collaterals. In doing so, banks discovered that they could earn immense amounts of profits, emboldening and incentivizing them to take reckless financial management practices to higher levels.

Packaging and repackaging the debt instruments amounted to selling the same product many times because the underlying collaterals of the packages were the same products, culminating in accumulating huge liabilities because the same debt instrument was claimed by more than one investor or buyer. For example, if the original borrower defaulted payment, the banks would have to honor the claims of the multiple of derivatives that used the debt as the underlying collateral, amounting to let's say making a $100 bet with $10. If the gambler lost, he/she would be in the hook for $100, money the gambler might not have. How did that happen or why was this extremely risky gambling allowed to take place?

a. **Glass Steagall**
Some point the finger at the repeal of the 1933 Glass Steagall Act.[7] It was intended to curb commercial banks (take deposits and make loans) from engaging in the investment business. Reckless lending on the part of commercial banks, particularly to stock-market speculators, was blamed for the collapse of the US financial system in the 1930s, forcing many banks into insolvency and erasing

considerable depositors' savings. It could be argued that the Glass Steagall Act Had strengthened and stabilized the financial system by restricting commercial Banks from taking investment banking risks. The main commercial banking business of monetization, taking deposits and making loans under strict regulatory regimes, did just what the act intended. However, the profit picture for commercial banks changed when the US Federal Reserve maintained a low-interest policy, generating low profits.

The commercial banks felt "discriminated" under Glass Steagall, putting them at a disadvantage because they were not allowed to expand business scope. The "real money" was in investment banking. It was for this reason that commercial banks wanted a "more level playing field," resulting in Glass Steagall's repeal in 1999.[8]

The Repeal of Glass Steagall, 1999

The 1999 Gramm-Leach-Bliley Act (GLBA) or the Financial Services Modernization Act (FSMA) that repealed the 1933 Glass Steagall Act by itself was not the cause of the financial crisis.[9] The financial reform legislation was probably meant to liberalize the financial system, putting commercial banks on the same level playing field as the investment banks. The sponsors of the act and President Bill Clinton who signed it into law probably expected that it would enhance economic growth and stability. Instead, banks took advantage of the "new freedom to flap their wings" in creating and modifying financial products, which culminated in the 2008 financial crisis.

The repeal of Glass Steagall allowed banks to "burn" the midnight oil to find ways of developing different types of financial products, the most popular and profitable was financial derivatives. A traditional derivative was derived from a riskless financial instrument (i.e., US Treasury Bills) and only securitized once. However, during the pre-financial crisis period, derivatives were supported by risky debt instruments (i.e., car loans and even subprime mortgages) because the supply of riskless or less risky financial assets such as bonds were exhausted. Worse, the same instruments were used as the underlying collateral many times, using the same asset as collateral for multiple number of loans. The problems were exacerbated by government regulators turning a "blind eye" when banks were breaking rules designed to sustain the stability and integrity of the

financial system. For example, the minimum capital reserve requirement in support of credit default swaps was not enforced.[10]

Financial Derivative

A financial derivative is derived from an existing asset such as a commodity, government bond, stock certificate, and others. Its value depends on the agreed terms between the seller and the buyer and the "quality" (depends on degree of risk) of the existing underlying asset. For example, a high "quality" or riskless asset like a Treasury Bill (TB) is likely to fetch a higher face value. A TB derivative is a contract between the issuer and buyer. For example, the issuer may offer an investor a contract on a TB at a specified price with a promise to repurchase it at a future agreed date. Or the issuer may offer the investor an option to buy the contract back at an agreed date.

A derivative can also be a hedge (shifting risk to a third party) against future exchange or interest rate risk. For example, an importer may decide to pay the current exchange rate (spot rate) between the Canadian and US dollar on the date of transaction. Since currency exchange rates depend on demand/supply conditions, the importer will buy a future contract from a bank guaranteeing the spot or fixed rate on the day of transaction. He/she will pay a premium on the currency contract. To that end, derivatives gave the buyer a piece of mind and earned the seller a profit. However, the introduction of collateralized debt obligations (CDOs) and credit default swaps (CDSs) changed the financial system.

i. *Collateralized Debt Obligation*

   A CDO is a derivative supported by a basket of asset-backed securities (ABS) whose value is based on the "quality" or level of safety (the less risky the basket of debts, the higher the quality) of the instruments within that basket. Payments are made in sequence, basing on the revenues the CDO receives from the securities in it. For example, holders of the safest securities (i.e., Triple A credit rating) would get paid first and the riskiest assets would be the last to be paid, a process referred to as "sliced into tranches."[11]

   The first CDO was issued by Drexel Burnham Lambert Inc., an investment bank no longer in business, for the Imperial Savings Association (also dissolved) in 1987.[12] The CDOs, primarily made

up of corporate and emerging economy bonds and bank loans, were developed to raise revenues for the association to expand loans without incurring excessive risk. However, the lure of profits prompted investment banks to become bolder, incurring greater risk exposure.

As indicated earlier, the depletion of risk-free financial instruments as underlying collateral for CDOs prompted issuers moving into riskier instruments such as mortgages and other risky loans. Though rating agencies downgraded CDOs' rating, their sales grew from US$69 billion in 2000 to almost US$1.4 trillion in 2007 because of higher returns.[13] To gain a higher credit rating, the CDOs were made up of a diversified basket of securities. Portfolio diversification is an investment strategy of incorporating a basket of riskless and risky instruments whose values are not related to each other. In this way, a CDO comprising of such a basket would generate good yields with minimum risk exposure. The selling point was that the "relatively safe" CDOs paid an interest rate of 2–3% points higher than other financial instruments such as government or corporate bonds.[14]

The rise in the sale of the riskier CDOs was also fueled by the period's low interest rates. The US Federal Reserve chairman, Alan Greenspan, maintained the low interest rate policy in addressing the anticipated dot.com bubble, a looming recession and increasing trade deficit.[15] These fears prompted investors to find a "safe haven" for their money, prompting an increase in the demand for US Treasury Bills (TBs). However, the high demand for TBs reduced their yields, forcing interest rates to fall. Investors turned to investing in CDOs for a higher return to capital.

To access the Chinese cash-rich financial market, the US government tried to convince the Chinese government to switch from TBs to the mortgage-backed CDOs. The Chinese State Council (China's equivalent of the Cabinet and the body that approves projects and their funding) did not know what a derivative, let alone a CDO, was. It asked its sovereign fund head (a former Wall Street investment banker) for an explanation and his advice on whether or not to accept the US offer. His definition was both comical and accurate, likening a derivative as a second and subsequent mirror images of a product: "First, put a mirror in front of a cup (which has value because it is made from raw material and by labor), one sees its exact image which he referred to as the stock certificate. Then put another mirror in front of the first, one finds an exact

second image of the cup. The second image is the derivative."[16] So he concluded that buying a derivative is like buying the second or subsequent images of the cup. After his presentation, the Communist leaders had a good laugh, saying thanks but no thanks to the US's offer of switching from TBs to derivatives. However, it did buy Fannie Mai and Freddy Mac bonds only after the US government guaranteed their values.[17]

The investment banks that created the CDOs also meant for the derivatives to be securitized, transferring the liabilities to a third party. Not surprisingly, commercial banks enthusiastically bought into the process. Not only did the debts take out of the banks' books, it also increased their excess reserves (loanable funds) as demonstrated earlier. Securitization also complied with capital requirements because the CDOs were the banks' assets. In this regard, equity to debt ratio (as indicated in the balance sheet) had not changed.

ii. *Credit Default Swap*
A CDS is a contract (swap derivative) between the issuer (the seller) and an investor (buyer) in which the former is guaranteeing the face value of the CDO or a debt obligation in case of payments default on the debt bundle within it. First developed by Blythe Masters of JP Morgan in 1994, the CDS was meant to be an insurance policy against losses from investing in a CDO.[18] Like buying an insurance policy, the purchaser pays the issuer a premium for the duration of the contract. It became very popular during the 2004–2007 period, having underwritten over US$42 trillion.[19] Most, approximately 80%, of the CDS were sold to non-holders of CDOs, referred to as "naked CDS," using the derivative for speculative purposes. For example, a CDS buyer betting car loan borrowers will default payments. If his/her bet materializes, he/she would gain. Since "naked" CDS buyers did not have a stake in the entities, it was in their interest to fan rumors that default payments risks were imminent of a CDS entity.

CDS comes in different formats: single-name, basket credit default (BCD), credit-linked note, and others.[20] The single-name swap is a contract in which the seller takes ownership of a specified loan instrument. For example, the buyer may wish to hedge against default payment of a mortgage, prompting him/her to buy protection from a third party. Basket credit default is made up of a basket of securities developed for the purpose of arbitrage, simultaneously

buying and selling the CDS. For example, the investor buys and sells a BCD at the same time expecting to earn a profit from the transaction. In this example, the buyer and seller have different expectations on the spread of the BCD or the financial posture of the underlying entity. Credit-linked note is a derivative transferring risk from the issuer to credit investors. These are just some examples of CDS.

While CDSs are a form of insurance, they are different from a conventional one such as a life insurance policy.[21]

a. A conventional life or any other insurance policy pays only the indemnifier when the risk occurs; a CDS pays all its holders equal payments as set out in a pre-agreed on market formula, raising the issuer's liabilities substantially.
b. Life or accident insurance can only be issued by a regulated financial institution, ensuring the issuer's ability to pay liabilities and preventing it from over underwriting policies. A CDS can be issued by any institution, regulated or non-regulated and even a person. The issuer can theoretically issue as many CDSs as buyers want.
c. A conventional insurance company is required to hold required reserves, ensuring its ability to honor the policies' liabilities, but a CDS issuer does not need to.
d. The CDS buyer does not need to disclose risks, whereas a conventional insurance does. For example, a person taking out a life insurance policy must disclose all the risks such as health issues that may have an effect of the insurance's liability.
e. A life insurance company determines risks through actuarial measures, whereas the CDS issuer manages risk by hedging. For example, a bank buys a CDS to cover the risks of nonperforming loans.

The unregulated CDS industry turned out to be riskier than that of gambling casinos. Overissuance of CDSs heightened the issuer's financial vulnerabilities because the premiums were unable to cover the amount of liabilities it created, likening the unregulated process to making a $1000 bet with only $100. Lehman Brothers went into bankruptcy because it grossly over-leveraged, holding only US$1 billion in cash but incurring for over US$600 billion in liabilities.[22] Other CDS issuers did not go into bankruptcy, but required tens if

not hundreds of billions of dollars in bailout money from the federal government.

iii. *Subprime Mortgages*

The US Federal Reserve's low interest rate policy prompted a wave of new house constructions across the country, some states (i.e., Arizona, Nevada, etc.) more than others.[23] The expectation was that a housing construction boom would enhance economic growth and make the "American Dream" of owning a house a reality. However, the building frenzy created a dangerous level of undesirable inventory, leaving huge quantities of new houses unsold because the vast majority of people who qualified for a conventional mortgage already owned homes.

Subprime mortgages were introduced to target the very people banks turned down for a conventional mortgage. Most borrowers did not have the required down payment and in fact some were either earning low wages or were unemployed. Enabling this group of people to buy a house, monthly payments must be lowered for a fixed time period of (let's say) 2 years, giving birth to the subprime mortgage or paying the interest on the loans. It was an unsustainable low monthly payment scheme in which it (payment) did not even cover the interest charges (because the Federal Reserve raised interest rates during this period), let alone the principal during the subprime period, culminating in the loan exceeding the value of the house.[24] At the end of the "grace period," moreover, the subprime mortgage holder must make monthly payments to cover both principal and interest during the life of the mortgage contract. The new monthly payments were two or three times those of the subprime period. The interest rates charged on subprime mortgages were also higher than those of the conventional ones because the former was considered more risky and prone to down payments default.

Moreover, many subprime mortgage holders took out personal loans to fulfill another "American Dream," buying SUVs, appliances, and other consumer goods so that they could live the "middle class" lifestyle. The low interest rates charged afforded them to do so. But once the subprime period expired, the vast majority of these mortgage holders found themselves unable to pay mortgage and personal loan payments, forcing the banks to foreclose millions

of houses and culminating in the 2006 “housing bubble” affecting almost half of the United States.[25]

Conventional mortgage loan holders also increased their debt burden, refinancing mortgages because of lower interest rates and loss of jobs. By 2009, the average US consumer debt/income ratio rose from less than 70% in 2003 to over 133% in 2009.[26]

b. **Unsustainable US Fiscal and Monetary Policies**

Some analysts and foreign governments (i.e., China) blamed the US Federal Reserve’s low interest rate policies for the 2008 financial crisis. In the decade before the financial crisis, the US economy was growing above 3% annually, largely attributing to the “dot.com” revolution. However, it bubbled in 2001 (good things do not last forever), prompting the Chairman of the Federal Reserve, Alan Greenspan, to reduce interest rates as low as 1%. He kept the low interest rate policy, perhaps to ensure sustainable economic growth.

The low interest rate policy fueled private and public demand. As indicated earlier, consumers borrowed heavily to finance the “American Dream” lifestyle. The buying binge spilled over to the public sector. The federal government increased spending on national defense and social programs. State and local governments also borrowed heavily to fund their infrastructure and entitlement programs (i.e., pensions). As indicated earlier, the three levels of governments’ spending raised the public debt/GDP ratio to over 100% by 2009.

c. **Inflow of “Cheap” Foreign Money**

Ben Bernanke, the former US Federal Reserve Chairman and Princeton University economics professor, and other defenders of the US central bank’s low interest rate policy, blamed heavy Asian savings and chronic US current account deficits as the causes of the financial crisis.[27] He contended that it was the global “saving glut” that kept global interest rates low, “seducing” governments, financial institutions, businesses, and consumers (presumably in the United States) to increase spending. According to him, much of the Asian (read Chinese) savings were invested in US government bonds, driving down long-term interest rates and eventually mortgage rates, because the latter depends on the former.

Stable long-term interest rates coupled with underserved high credit ratings by US credit rating agencies prompted financial

institutions on both sides of the Atlantic and in Japan to search for riskier investment ventures that would earn higher returns. The CDOs created by US banks were a perfect fit, perhaps a major reason for EU and Japanese banks rushing to buy huge quantities of the US derivatives. The appearance of stability offered by low long-term interest rates extended to the economy, projecting the perception that the returns to investment would be greater than the costs. Both subprime mortgage lenders and borrowers were perhaps guided by this optimism, which was strengthened by undisrupted rise in housing prices since the 1980s.

Effects of the 2008 Financial Crisis

Whatever caused the 2008 financial crisis, its adverse effects on the global economy are real and remain intact even today. As indicated earlier, the financial bubble culminated in a credit crunch, pushing the Western economies into a "Deep Recession." The housing bubble destroyed or significantly reduced many families' wealth, putting them on a dangerously high level of indebtedness. Massive public spending pushed the public debt/GDP ratio upward, leaving governments with little fiscal ammunition.

1. *Financial and Housing Bubbles*
   Financial institutions did not know exactly how much liabilities were being created, leading to a "financial bubble," a situation in which banks owed more money that they possessed. Fearing a financial system collapse, the US government introduced the Troubled Asset Relief Program (TARP) in October 2008, the purpose of which was an attempt to bailout financial institutions holding mortgage-related securities and deemed "too big to fail."[28] Originally the Congress authorized US$700 billion, the amount was reduced to US$475 billion after the Dodd-Frank wall Street Reform and Consumer Act was passed.[29] Since the bailout, the economy has been growing between 1.5 and 2.5% annually.

   However, the financial crisis still had an adverse effect on US businesses in that banks hesitated to make new loans. To increase liquidity and preempt an economic collapse, the US Federal Reserve resorted to quantitative easing (QE), printing over

US$2.1 trillion new money to bail out the financially strapped big banks and businesses between 2008 and 2010.[30] Instead of lending the bailout money to businesses and consumers, the banks kept them in their vaults, presumably to pay off the undetermined amount of liabilities. The business community, including firms that received government bailout funds, was using the money to innovate and automate production, culminating in rising unemployment.

Unable to service the debt in the aftermath of the subprime period forced many people into bankruptcy, creating a "housing bubble" in 2006, because the massive foreclosure left millions of houses empty. The "housing bubble" not only destroyed the middle class but further exacerbated problems in the financial system, because it left banks with a large number of nonperforming loans that in turn caused a cash flow issue or credit crunch.

1. *Credit Crunch*
   A credit crunch is a situation in which neither businesses nor consumers are able to obtain bank loans. As indicated earlier, without new bank loans, businesses and consumers were unable or unwilling to spend, forcing huge numbers of businesses either downsizing operations or filing for bankruptcy protection. Unemployment almost doubled from less than 5% in 2007 to over 8% in 2012.[31] Since 2013, unemployment declined to the pre-crisis level, but largely due to many discouraged workers leaving the labor market and the jobs created were mostly in the low-paying service industries.

2. *The Deep Recession*
   The 2008/2009 period is referred to as the "Deep Recession," plunging the G7 economies (with the exception of Canada which was helped by China's huge buying of its resources) into negative territory and pushing the developing economies on a downward trajectory. The IMF estimated that the advanced economies (of the United States, EU, and Japan) contracted by −0.5% in November 2008, down from +0.5 from the previous month.[32] The recession in the developed economies adversely affected the economic global economy, reducing its growth from 3.0 to 2.2% in the same 2 year period.[33]

   Although the world economy in general, and those of the developed economies in particular, have somewhat recovered from the

recession, they are expected to remain stuck at very low growth rates, respectively, at less than 3 and 1.2% in 2017.[34] To climb out of the fragile recovery, the developed economies require external demand for reasons cited earlier.

Remedial Policies

To spur economic growth and prevent a similar financial crisis from happening again, the developed countries resorted to printing new money and negative interest rates and the US government passed the Dobb-Frank Wall Street Reform and Consumer Protection Act (Dobb-Frank) on July 21, 2010.[35]

1. *Quantitative Easing*
   Quantitative easing, as mentioned earlier, is the process by which central banks print money to buy government debt instruments (i.e., Treasury Bills). It supposedly has two purposes: inject additional liquidity into the economy in the short run and selling the sovereign debts to prospective investors in the long run. It is hoped that an injection of additional liquidity into the economy would lower interest rates and depreciate the currency, thereby boosting private domestic demand and exports. The government would spend the proceeds of debt instrument sales on public works projects and/or other social goods and services such as educational and healthcare services. Increases in aggregate demand would enhance economic activities and employment. Additional private and public spending would have a spillover or multiplier effect, triggering the rise of tertiary industries such as retail trade and services. In the longer term, the central bank would sell the government bonds to potential investors for a profit.

   Japan was the first country resorting to QE in 2001 to pull its economy out of the deflationary spiral.[36] Injecting over US$300 billion into the commercial banking system, the intention was to encourage massive lending to businesses and consumers. However, that monetary policy stance did not work because businesses and consumers failed to respond to the gestures, as the almost two-decade old deflation had imposed a sense of pessimism on the business community and in the general population. Stagnating

or falling prices discouraged investment and increased unemployment. Moreover, government spending on public works programs was seen as "building road and bridges to nowhere," because it was seen as "make work" projects. Neither did the printing of US$60 billion in 2010 to increase exports work because of weak external demand.[37]

Japan resorted to QE again in 2014 as the first of Prime Minister Shinzo Abe's "three arrows" to pull the economy out of the over two-decade deflation, targeting an annual inflation rate of 2% annually.[38] Appointing a person who supported Abe's economic policy as the governor of the Bank of Japan, the central bank bought massive amounts of government debt instruments, estimated at over 89 trillion Yen a year. The huge increase in the money supply depreciated the Yen from US$0.013 to US$0.083.[39] While it did increase exports (for a short time period), the policy stance raised a number of problems, including the accusation that Japan was creating a currency war. Deflation also persisted and the temporary gains in exports and the stock market evaporated.

Critics blamed the government for not focusing on Japan's real problems: an aging and declining population and inadequate resources allocated for innovation. The demographic issue could erode future aggregate demand because fewer workers would be supporting a larger retiree population. Not paying attention to innovation would undermine Japanese competitiveness.

As indicated earlier, the United States resorted to three rounds of QE between 2008 and 2012, culminating in the Federal Reserve holding over US$2 trillion in bank debts, mortgage-related securities, and Treasury Bills by the end of 2010. QE1 (November 2008) bought US$600 in mortgage-backed securities, which did little to stimulate economic growth. However, by 2009, the Federal Reserve held over US$1.75 trillion of the mentioned debt instruments. The Federal Reserve too carried out QE2 in 2010, purchasing another US$600 billion in Treasury Bills. The money was largely spent on infrastructure repair and helped state and local government public works programs, resulting in an annualized economic growth rate of around 2%.[40] QE3 took effect in 2013 in which the central bank printed US$40 billion, later raised to US$85 billion per month to relieve housing market debt risk, raising inflation to 2% and reducing unemployment to 6.5%

per year.[41] QE3 stopped in December 2014 when the targets were achieved, but it left the Federal Reserve holding an accumulated US$4.5 trillion in a variety of debt instruments.[42]

The European Union (EU) began quantitative easing via buying corporate bonds as a way of injecting liquidity into the economy. In May, 2009, the European Central Bank (ECB), the EU's central bank, purchased 60 billion Euros of a specific corporate debt instrument referred to as "covered bonds," whose values were backed by revenue streams generated from mortgage or public sector loans.[43] Securitization of the debt instruments was considered a safe way of creating cash because of their low risk level.

The ECB president, Mario Draghi, expanded QE, buying 60 billion Euros of debt instruments from Euro Zone governments, central banks, and other institutions in 2015 to revert a looming deflation.[44] The financial crisis hit the EU hard, business prospects were diminishing, unemployment rising, and some member states, particularly Portugal, Italy, and Greece were recording a negative growth. The wealthier members, the UK, France, and Germany, were in a state of economic stagnation, growing at less than 1%. Indeed, the EU's economic woes and deflationary threat continued in 2016, prompting the ECB to raise purchase of sovereign and corporate bonds from 60 billion to 80 billion Euros per month.[45] However, the ECB vowed to continue buying sovereign and corporate bonds until the inflationary target was met.

An added inflationary QE policy was the offering of extremely "cheap" 4-year loans to EU area commercial banks. The goal was to encourage banks to make loans to businesses. However, the less than optimistic economic outlook did not attract many borrowers. The commercial banks therefore used the ECB loans to buy sovereign debts, affording them a reasonable return to investment at the expense of the ECB and by the extension, the Euro Zone taxpayers.

The effectiveness of quantitative easing on reversing the economic misfortunes created by the financial crisis is a subject of debate among scholars and experts. The IMF credited the West's QE with averting a system risk (entire financial system) and was responsible for bottoming out the recession in the Euro Area at the end of 2009.[46] The US Federal Reserve suggested that QE was responsible for the marked stock market price increase of 15%, culminating in a rise in consumer spending in 2010 and prompting

Ben Bernanke, the then chairman, to contemplate another round of the monetary easing policy.[47] While Feldstein was not sure whether it was QE or an increase in consumer spending that lifted the stock market values, he did state that a 15% rise in stock prices would add US$2.5 trillion to household wealth, since Americans owned US$17 trillion in stocks and mutual funds.[48] At the same time, household savings in the United States decreased from 6.3 to 5.3%.[49] To that end, it is difficult to determine whether it was an increase in wealth (attributed to QE) or a decrease in savings that increased consumer spending during that period.

Available economic data would suggest that QE did not do enough to break the “2 percent” economic growth ceiling. As cited earlier, private sector growth was largely in the low-end services sectors such as fast foods, resulting in wages increasing only marginally at less than 3% and less than 1% growth in consumption between 2009 and 2015. Private investment spending remained flat due to insufficient domestic consumption and weak export markets, suggesting that investors would be more receptive to demand than an increase in the money supply. Additionally, QE’s impact on the value of the US dollar vis-a-vis other major currencies was also minimal. This was because the greenback is the major world reserve currency to which investors gravitated in the event of global financial uncertainty.

Other criticisms of QE included the erosion on the real value of pension funds and wealth, increasing the rich–poor gap, inciting currency wars, and expansion of debt monetization. According to EU and Pensions Europe economists, QE reduced returns on pension fund investment and personal savings, both of which would decrease consumption.[50] Kevin Warsh, a former Fed board member and a panelist in Brookings Institution conference on QE and income inequality, argued that QE enriched the wealthy more than the poor because the richer segment of society can afford to buy bonds and stocks.[51] Major developing economies, particularly the BRICS, complained that QE amounts to currency manipulation on the part of the developed countries for reasons cited earlier. According to Richard W. Fisher, former president of the Federal Reserve Bank of Dallas, QE puts the central banks on the path of continuous debt monetization.[52] Fisher seemed to imply that whenever a government needs money, all it has to do is to

"arm-twist" the central bank to print more money. Because the greenback is universally accepted, the United States theoretically has an endless supply of money.

2. *Negative Interest Rate Policy*
   A negative interest rate policy (NIRP) is self-explanatory, in that the deposit rate is set below 0%, the purpose of which is to discourage savings or encourage consumption and investment. Switzerland was the first country to adopt NIRP on foreign deposits in the 1970s to stifle the Swiss franc's appreciation.[53] At that time, oil-producing countries were awash with cash from the sale of oil, a large quantity of which found its way into Switzerland because the Swiss Franc was a stable currency and the country was a safe haven to park money. Incoming deposits put an upward pressure on the value of the Swiss franc, eroding the country's competitiveness. However, the deposit kept on coming. Since then, the ECB, some countries in the EU (i.e., Germany), and Japan are adopting this unusual monetary policy to spur economic growth or escape the deflationary spiral.[54] In this regard, NIRP has the same effect as QE, increasing the money supply to reduce interest rate, causing currency depreciation and increasing inflation.

   The rationale behind NIRP was "forcing" the economy to spend because money hoarders (savers) have to pay to banks for depositing money. Coupled with inflation, depositors' real wealth would fall, thus it made sense for them to spend it. A rise in consumer spending would spur investment growth because the latter is dependent on demand. Moreover, because banks are receiving income from depositors, they may waive or lower lending charges, thereby incentivizing investment further.

Whether NIRP will succeed where QE has failed to prevent or escape deflation and enhance economic growth is unclear. So far, that policy stance has not worked, in view of the economic statistics that came out of the countries that implemented the negative interest rate policy. Indeed, it has raised a number of concerns.

First, NIRP reduces real wealth, resulting in potential erosion in consumption. The logic behind this argument should be clear: consumption is directly related to the level of wealth. Second, the monetary policy stance could worsen financial market volatility because of credit risk increase. The NIRP would make it easier for companies and individuals to borrow, increasing the number

of loans, which in turn could lead to higher rates of default payments. Third, NIRP could reduce capital formation, undermining future economic growth because insufficient loanable funds would limit the amount of capital available for investment and raise interest rates. Fourth, NIRP could lead to "beggar thy neighbor" trade policies because the injection of liquidity does cause currency depreciation. By intentionally undermining the currency value, the country becomes a currency manipulator.

3. *Government Financial Reforms and Consumer Protection*
In an attempt to ensure that the 2008 financial crisis would not happen again, the United States introduced a set of reforms to regulate the financial system and protect consumers from predatory practices. These reforms, initially proposed and passed by the Obama Administration in 2010, were incorporated under the Dobb-Frank Wall Street and Consumer Protection Act (Dodd-Frank) because of the two lawmakers' huge involvement in its creation and passing. Senator Christopher Dobb and Congressman Barney Frank were, respectively, the chair of the Senate Banking Committee and Financial Services Committee. Generally, the act was to reform financial services management and practices, strengthening the regulatory system and providing consumer and investor protection. For example, banks were prohibited from "propriety trading," in which depositors' money was used to invest the banks' portfolio.

Whether the act would prevent history from repeating itself is unclear, but it did not escape criticism. Donald Trump suggested that the Dobb-Frank Act went too far, implying that it could stifle financial system competitiveness. In this regard, he repealed some part of it, dismantling the Volcker Rule on "propriety trading."[55]

Some fear that President Donald Trump's reduction of some provisions that protect consumers and curb excessive risk-taking of Dobb-Frank could lead to another financial crisis. According to Michael S. Barr, a law professor at the University of Michigan, allowing slicing away financial regulatory regimes could be troubling in that investment banks may take greater risks to increase profits.[56] For example, rescinding oil companies from reporting payments to foreign companies could open the door for corruption. Trump's order also plans to repeal the fiduciary regulation requiring investment advisors to put their clients' interests first.

The absence of fiduciary responsibility could put the clients' financial position at risk.

Trump's supporters would argue that repealing Dobb-Frank would enhance financial sector growth and increase economic activities. Allowing banks to increase the level of liquidity (i.e., creating and trading derivatives) in the economy would enhance economic growth. Easing loan requirements would make it easier for small businesses to borrow and start or expand production. Gary Cohen, Director of the White House National Economic Council, went further, arguing that Dobb-Frank stifled financial industry growth because the act prohibits banks to use the "well-capitalized" banks to increase profits and, by extension, the economy.[57]

Summary

The 2008 financial crisis has had a serious impact on the global economy. For this reason, global financial reforms are needed. The financial system is the "heart" of the economy, thus harmonizing the world's financial institutions becomes more urgent. In this regard, globalization is essential, in that countries, both developing and developed need to cooperate in discussing and addressing the issues associated with international financing and capital movement.

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CHAPTER 9

The Washington Consensus Versus The Beijing Consensus

The Beijing and Washington Consensuses are development models for developing countries, but the approach between the two is very different. The Beijing Consensus, coined by Joshua Cooper Ramo, an American journalist, was really "state capitalism," a "trial and error" approach to build a modern economy that could improve people's livelihood and a strong national defense to protect the country's "core interests," defined as national security, territorial integrity, and economic interests.[1] That approach was popularly known as "Socialism with Chinese Characteristics," a theory introduced by then leader Deng Xiaoping.[2] Embracing globalization was an important strategy to his theory. The Washington Consensus was a term coined by the English economist, John Williamson, a resident scholar at the Washington-based Institute for International Economics.[3] The policies were based on neoliberalism, an Anglo-American brand of capitalism that suggested the market determines resource allocation, goods production, and distribution. Central to neoliberalism was Anglo-American "universal" rules on human rights and other democratic values, a political architecture referred to as liberal democracy. While the West, particularly the United States, insisted that the Washington Consensus could be a "one-size-fit-all" model for developing economies, China suggested that its development model may not be suitable for other developing countries because of differences in history, culture, economy, polity, and civil society.

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The Washington Consensus

Rationale and History

Some Latin American countries, particularly Argentina, encountered serious economic and financial crises, said to be caused by authoritarianism, cronyism, and state-owned enterprise (SOEs) mismanagement in the 1980s and 1990s.[4] During that era (and even now), most Latin American countries were ruled either by military dictatorships or members of an elite made up of European-descendent families who owned the majority of the nations' wealth and land. The wealthy landowners/business tycoons and ruling elites were, for the most part, closely connected if not the same people. They governed and managed the countries as if they owned them, culminating in extreme inequality in income distribution, and political and social status. The richest 10% of the wealthy European-descendent population owned more than 70% of the wealth and land, whereas the majority of indigenous and slave-descent peoples could hardly etch out a minimum subsistence level of living.[5] The result was perpetual underdevelopment and poverty because the vast majority of the populations did not have the financial resources to support and sustain domestic production.

Economic reforms did not help because privatization was merely the selling of state-owned enterprises to those who were well-connected to the ruling elite, a cosmetic change from publicly to privately owned monopolies.[6] Although the newly privatized firms were efficient at the outset, they were price-gouging to the extent that the majority of the population was unable to pay for the goods and services these enterprises produced. And over time, the privately owned monopolies were just as inefficient as when they were publicly owned.

Moreover, the countries that were plagued by the financial crisis adopted the fixed exchange rate regime (presumably to maintain export price stability), which turned out to be more harmful than beneficial to the economies.[7] To maintain the peg, the central banks sold foreign reserves and/or raised interest rates. The depletion of foreign reserves limited the countries' ability to repay foreign currency-dominated loans. Rising interest rates eroded domestic aggregate demand in that they stifled investment, consumption, and international competitiveness. The crisis-ridden economies became a "basket case," forcing them to seek loans from the IMF and other foreign-owned financial institutions to bail them out.

The crisis-ridden countries already knew that economic and financial reforms compatible with the Washington Consensus were required to secure an IMF or Western loan. According to Joseph Stanislaw and Daniel Yergin, American authors and economists, Williamson's 10 policy recommendations were in fact a reiteration of those developed by South American economists to address the continent's economic problems.[8]

Washington Consensus Policy Recommendations

The Washington Consensus' 10 policy recommendations were based on neoliberal policies of unfettered capitalism and liberal democratic ideals as summarized below[9]:

1. Fiscal discipline was a response to the huge budgetary deficits accumulated by most if not all governments during earlier decades, culminating in serious balance of payment issues and hyperinflation, particularly in Latin America where inflation was over 1000% in some of the continent's countries. The impoverished groups were especially hit hard because the low wages were practically wiped out by the high inflation rate.
2. Redirect government spending from nonproductive areas such as subsidies to inefficient state-owned enterprises to pro-economic growth, poverty reduction, and competitive activities. Increase in education, healthcare, and infrastructure investments were likely be in the minds of reformers.
3. Widening of the tax base and putting in place a marginal tax rate that would not hinder incentives to work or go into business. The tax reforms were probably seen as a way of increasing tax revenues and promoting economic growth at the same time.
4. Interest rate liberalization was perhaps meant to allow the market in determining the appropriate or real equilibrium interest rate, but was not presented as such. Without financial market reform (which did not occur at the time Williamson presented his policy recommendations), interest rate liberalization or reform would be a "pie in the sky" policy.
5. Competitive exchange rate probably meant that the value of a country's currency should be determined by the supply of and demand for it. This would prevent "beggar-thy-neighbor" currency manipulation policies and attain an exchange rate that is consistent with unfettered trade.

6. Trade liberalization, allowing unfettered movements of goods across national borders. In this way, the benefits of comparative advantage could be fully captured. At the same time, countries should be allowed to impose modest tariff rates to protect domestic industries or allow them time to become more efficient and competitive. International trade was seen as a way of promoting economic growth.
7. Unfettered or relaxed condition for inbound foreign direct investment was considered conducive to economic growth because it would bring new investment spending and advanced foreign technology. Politically motivated obstacles (i.e., national security excuses) would only hinder the efficient movement of capital and technology, thereby undermining economic growth.
8. Privatization of state-owned enterprises was seen as a way to improve production efficiency and competitiveness. Profit-maximization is the mirror image of the least-cost method of production. And consumer loyalty is largely dependent on price and quality.
9. Deregulation meant introducing policies that would ease market access and exit. However, the government should retain regulations that protect public safety, including labor standard and environmental rules.
10. A legal framework protecting private property was deemed desirable and necessary to sustain economic, political, and social stability. A legal recourse available to lenders and investors would protect their interests.

The policy recommendations would be practical in a "perfect world" in which everyone is equal and the market is unimpeded by institutional obstacles. However, they were considered "motherhood and apple pie" because promising economic growth, creating employment, and improving living standards (goals everyone wants) is one thing, realizing them is quite another because the market is not as competitive or unfettered as the neoclassicists or neoliberalists suggested. For example, product market equilibrium was blocked by monopoly power and other imperfect market institutions such as industrial concentration, an industry controlled by a small number of large firms. These enterprises could and did resort to price-fixing to enhance their financial interests, normally at the expense of the consumers. It was probably not an accident that gas

prices of all major oil companies at the pump were identical or marginally different within a region or city in the United States and Canada. Labor market equilibrium remained elusive because of binding negotiated wages. Even without binding agreements, organized labor would rather withhold services than take wage cuts. Money or capital market equilibrium was difficult to attain because savers and borrowers do not always respond fully to interest rates. In an economic slowdown when interest rates are low, consumers and investors might hesitate to borrow because of pessimistic outlook. Foreign exchange market equilibrium was distorted by "beggar thy neighbor policies" (currency manipulation) practiced by some countries to gain an export advantage.

Perhaps no one was more aware of the contradiction between economic reality and the Washington Consensus polices than Williamson.[10] Fiscal discipline was meant to be an application of fiscal policies in the Keynesian sense, not in the neoclassical tradition of avoiding deficit financing during recessions. According to Keynesian economics, expansionary fiscal policy of increasing government spending and/or reducing taxes during an economic downturn is appropriate because it stimulates investment and consumption. On the other hand, imposing austerity programs during a recession or economic slowdown has the opposite effect. Greece, for example, was forced to reduce the size of the public service and pension payments in order to meet the ECB and IMF loan conditionality. The result was over 25% unemployment and public debt/GDP ratio of over 120% since the financial crisis.[11]

Criticism of the Washington Consensus

The Washington Consensus was not criticized for its neoliberal policies, but for the way lending institutions applied the policies and the unrealistic assumptions behind them. The assumption that the "one-size-for-all" development model could be applied to all developing economies was unrealistic. One, developing economies had neither the democratic institutions nor the economic conditions to make neoliberalism work. As indicated earlier, a small number of the ruling and business elite controlled the means of production and distribution. Two, in painting all developing nations with the same brush, the IMF and WBG were guilty of "fallacy of composition," a term John Maynard Keynes accused the Classicists of during the 1930s.[12] In the developing world, each country had its own unique problems and prospects, requiring a unique set

of policies to address them. The classicists wrongly assumed that the macroeconomy was an extension of the microeconomy because business prospects and problems are not the same for all industries. For example, bankruptcy firms enjoyed increases in business while the automobile industry was pushed to the brink during the Depression years. Critics also complained that the IMF and World Bank adopted the Washington Consensus policies as loan conditionality—fiscal responsibility, unfettered international trade and investment, and privatization—to serve the interests of Anglo-American enterprises rather than the countries they were supposed to help. For example, Stiglitz speculated that the privatization condition that IMF imposed on Russia might be an excuse to give Anglo-American oil companies to take over the countries' vast oil and gas reserves.[13] Moreover, the United States and some other developed countries never resorted to austerity measures during recessions in the post-WW-II period. To that end, the IMF or WBG loans were not intended to lessen or erase the recipient countries economic woes, repaying loans before spending on economic-spurring programs did little to help recovery. Lack of economic growth in fact forced borrowing nations to default payments on old loans, forcing borrowing nations to ask for new ones.

Summary Analysis of the Washington Consensus

The neoliberal model only made sense if the market was truly competitive, allowing the laws of demand and supply to flap their wings freely. However, that market structure had not, if ever, existed as defined by Adam Smith, the "father of capitalism."[14] Indeed, most, if not all, economies were dominated by a small number of large firms. For example, a handful of firms accounted for over 60–70% of GDP in the United States and Canada, respectively, an industrial environment made for collusive behavior.[15] All one needed to look at was the almost identical pricing strategy of goods and services produced by oligopoly industries. Although the predatory pricing strategy had created both benefits and costs (lower consumer prices due to innovation but undermined competition), it prevented the realization of economic efficiency defined as consumers getting the lowest possible price and firms employing the least-cost production method.

Moreover, there was no reason to suggest that privately owned firms were more efficient than state-owned enterprises. B.C. Hydro, a wholly

British Government-owned utility company, producing and distributing electrical energy to the province, had kept prices affordable to all its citizens and enterprises.[16] This scenario could also be found in the United States where the Tennessee Valley Authority (TVA), a federally owned power utility company, was able to charge prices far lower than those of privately owned ones.[17] One reason why the Chinese government did not privatize state-owned enterprises that produce "strategic" goods (i.e., telecommunication, gas, etc.) was to ensure universal access, a policy that played an important and positive role in sustaining economic and social stability.

Further, transforming from one form of governance architecture to another takes time and political will. For the West to demand an immediate transformation from "feudalistic" institutions to democracy and neoliberalism in fact did more harm than good as demonstrated in the West's "regime" change postures in the Middle East and North Africa.

Finally, the harsh loan conditionality that the IMF and WBG imposed on borrowing nations was counterproductive for reasons indicated earlier.

The Beijing Consensus

Contrary to Western skepticism and relentless propagation that the Chinese economy would collapse under its development model, China's "Socialism with Chinese Characteristic" has done wonders for its economy and people. China's 1980 GDP climbed from US$202 billion in 1980 to US$10.8 trillion in 2016 in current prices and over US$20 trillion in PPP terms is unprecedented.[18] Its average annual growth rate of less than 7% since 2014 remains the world's economic spotlight, contributing to over 30% of global economic growth. Within the less than 40-year period of economic reforms (from 1978 to the present), China is responsible for 90% of total global poverty reduction and the only country to meet the United Nation's Millennium Goal. The US-based consultancy, McKinsey & Co., predicted that over 75% (of a total urban population of over 775 million) or over 570 of China's urban consumers will be in the middle class by 2020, loosely defined as those earning between US$9000 and US$34,000 per year.[19] Another interesting statistical revelation is that China's (PPP) GDP accounted for a little over 2% of that of the world in 1980; that figure jumped to almost 18% in 2016.[20]

Adjusting for relative cost-of-living differences, China's middle income class would be compatible to that of the West in that prices of nontradable services and the cost-of-living are much lower than those in the developed Western and Japanese economies. In conducting a survey on the cost of a haircut, the author found that a man's haircut cost between US$1.00 in the countryside and US$5 in first-tier cities such as Beijing. In the same observation, a one-way subway ride throughout the entire subway system cost less than US$0.40 in Beijing, compared to over US$3.00 in Vancouver, British Columbia's sky train.

Rationale Behind China's Remarkable Economic Achievements

In the aftermath of the Korean War, the Chinese government pursued a cautious and pragmatic approach to accelerate economic growth, deemed necessary for achieving the four modernizations: agriculture, industry, science and technology, and national defense.[21] Solving the country's food problem was "front and center" because of mass starvation. Industrialization was considered necessary for nation building, expanding from resource and agricultural production to manufacturing of defense, industrial, and consumer goods. Manufacturing, requiring a huge pool of skilled, semi-skilled, and unskilled labor, was also deemed necessary to employ the country's massive population. Unlike farming, industrialization required access to large population centers, prompting urbanization or building new cities to feed the manpower needs of manufacturing plants to be established across the country. Science and technology advancement was deemed essential for improving innovation and competitiveness in the production of consumer and military goods. A strong and modern national defense posture was considered necessary to protect the country's "core interests."

The transformation of the Chinese economy could be divided into three parts or stages: the period between 1953 and 1980; the post-Cultural Revolution reforms; and post-Deng Xiaoping economic policies.

(i). *Early Economic Development Model (1953—1980)*

China's development model was based on the former Soviet Union's Five-Year Plans (FYPs) architecture, but adjusted to accommodate China's history, political, and economic institutions. In the first FYP (1953–1957) focusing on industrialization produced mixed results, succeeding in establishing an industrial

> base but did not produce sufficient food to feed the large population, prompting the leadership to "shift gear." The second FYP (1958–1962), popularly known in China as the "walking on two legs," focusing equally on agriculture and industry (which included national defense and infrastructure construction) to enhance economic growth.[22] However, the 2nd FYP was high-jacked by Mao's disastrous Great Leap Forward Movement (1958–1960), a period that witnessed a 30% decline GDP, 33% decrease in agricultural production, and 57% erosion in industrial output.[23]

Mao had a vision of surpassing the UK in steel production within 5 years, calling the masses to focus on producing the metal. Steel production was deemed essential for manufacturing machinery and weapons. Mao's unprecedented influence on the people prompted huge response; farmers and industrial workers abandoned their tasks to build blast furnaces to make steel. In doing so, farms were left unattended and foods unharvested. Because farmers and workers knew nothing about metallurgy, the hastily construct furnaces produced low-quality steel, unsuitable for manufacturing machines and weapons, culminating in a huge waste of resources that the country could hardly afford.

The greatest tragedy of the Great Leap Forward Movement was the massive numbers of people who died from starvation, estimated at tens of millions, depending on who was writing the history (readers are cautioned to determine how the writers derived the numbers of people that died from starvation. The official Chinese government number was 16.5 million, the most widely accepted number in the West was 30 million, but June Chang and Jon Halliday put the figure at 70 million in their book, *Mao: The Unknown Story*.[24] (For which number is more accurate, the reader is urged to examine the method by which each source was applied to calculate it.)[24] In addition to farmers not farming, the "sparrow campaign" of killing the insect-eating birds led to the mushrooming of the grain-eating locust population. During that time, China recorded its worst drought, turning fertile farm lands into dust bowls.

However, the Great Leap Movement also established farm collectives and township and village enterprises (TVEs) which quicken the process of industrialization and agriculture modernization. Farm collectives were to bring economies of scale because their large sizes would accommodate machinery to be imported from the West and Japan. Mao also wanted

China to industrialize. To that end, he established TVEs (which became state-owned enterprises) to make industrial goods. Mao was aware that manufacturing required a pool of skilled labor, he therefore established training facilities. To that end, it could be argued that Mao built the foundation for China's manufacturing comparative advantage.

Mao took responsibility for the disastrous results of the Great Leap Movement, stepping down in 1962 to allow Liu Shaoqi, the second most powerful leader at the time, to take control of the government and revive the economy. With the help of Deng Xiaoping and other members of the leadership, Liu introduced the "material incentive" programs, appointing managers on the basis of merit and compensating cadres and workers on the basis of rank and contribution.[25]

However, Liu's success in pulling the economy from the brink heightened corruption and set the stage for factional conflict within the Party. Officials indulging in lavish lifestyles on the nation's dime caused resentment from the masses. More serious was Liu became more popular than Mao, prompting the latter to accuse the former of deviating from continuous class struggle and moving down the capitalist road. To regain control of the country, Mao enlisted a reluctant Lin Biao to mount the Proletariat Cultural Revolution (1966–1976) in an attempt to regain power.[26]

It was during the 1966–1976 period that the 3rd and 4th FYPs were instituted, both of which generated growth.[27] While the economy declined by 5% from 1966 to 1968 because farmers and workers left their jobs to protest against corruption and feudalism (the two major reasons for the widespread support of the Cultural Revolution), it rebounded between 1969 and 1975. Mao regained his sense of pragmatism and did not want to destroy China's economy; he asked Zhou Enlai to revive the economy. Zhou's first task was to enlist the support of the security forces to bar Red Guards from destroying factories, culminating in an annual average growth rate of 9% during the Cultural Revolution period.

However, the economy did contract to—0.2% in the first half of 1976 when Mao was incapacitated.[28] From the beginning of 1976 until the death of Mao, the Gang of Four (led by Mao's wife Jiang Qing) took control of both the government and the Party and recalled the Red Guards to crush the "capitalist roaders," a term for anti-revolutionaries. Jiang Qing presented herself as Mao's successor, giving her the authority to carry on with the Chairman's continuous class struggle. The result

was disruptions in agricultural and industrial production. The economy was pushed almost to the brink, starvation was looming, and civil society and polity were crumbling. Another civil war was not ruled out because both the leadership and the population were against the Gang's overly zealous revolution. Jiang Qing became the most hated woman in China, culminating in massive protests against her and the Gang of Four.

Luckily for China, Mao died and spared the country from economic and political destruction. Before he died, Mao appointed Hua Guofeng, a mid-level Party official (who was said to be able to work with the conflicting factions of the Party) as his successor.

The Cultural Revolution officially ended shortly after Mao died in September, 1976.[29] Hua opposed the Gang of Four but shared Mao's revolutionary ideals.[30] With the help of the civil, police, and military leaderships, Hua arrested the Gang. However, he refused to rehabilitate Deng Xiaoping because the latter favored economic reforms, moving away from central planning and collectivism toward limited capitalism.

Hua was removed from power in 1980 for sticking to the farm and industry collective model, stifling industrial production and creating a food crisis.[31] His officials in charge of agriculture were said to be corrupt and mismanaged farm collectives, inflating farm production figures to give the appearance of success. The practice exacerbated the grain shortage problem at the collectives because the officials had to send more grain to the central government for distribution to the cities. Industrial output stagnated because reward was based on need rather than on ability and contribution.

Hua's removal from the apex of power paved the way for Deng to become the country's de facto top leader, albeit he did not hold any official government position.[32] Deng did not waste any time in directing cadres to begin the reform process. He ordered experiments with capitalism and opened China to the outside world.

(ii). *Post-Cultural Revolution Period of Reforms: The Deng Xiaoping Era*

Deng was careful not to let reforms deviate from socialism; were that to happen, China could descend into a civil war at worst and factional clashes at best. At that time, the Communist Party had two camps, reformists and Maoists. To his credit, Deng managed to reform China's economic and political architectures without causing a rift between the opposing factions within the Communist Party.

Economic reforms included transitioning central planning to market economy and embracing globalization. This unique development path promoted the idea that a "parallel" economy comprising of both state-owned and private-owned enterprises might work (indeed it did). The state was to own and control "strategic" industries (i.e., banks, energy, transportation, national defense, telecommunication, etc.), whereas "nonstrategic" sectors (i.e., clothing, etc.) were to be privatized. Prices of strategic goods were to be set by the state, ensuring universal access. Nonstrategic goods' prices were to be determined by the market. The two-tier pricing system was responsible for increased economic efficiency and sustained social stability.

Perhaps Deng's greatest contribution was his experiment in private enterprise, which unleashed people's entrepreneurial spirit and hard-working ethic. Allowing farmers to sell products in the open market and urban dwellers to operate small businesses, farm production and the number of private businesses literary exploded across the country. Private ownership forever unleashed people's entrepreneurial spirit and hard work ethic from which the government could not be turned back.

Deng was painfully aware of China's economic and technological backwardness and in need of foreign capital. To narrow the gaps, he opened China to the world and sent cadres and students overseas (particularly to the US, UK, and Japan) to study science, technology, engineering, economics, and management methods. Deng also invited overseas experts to teach these fields at Chinese universities. He set aside historical animosities between Japan and the US, forging closer economic relations with the former antagonists. To capture foreign investment, advanced technology, and management methods, he established special economic zones (SEZs), strategically located in Shenzhen, Xiamen, Zhuhai, and Shantou.[33] They were the ancestral homes of the Overseas Chinese whose descendants have the knowledge, capital, and connections to make the SEZs a success. Geographical proximity to Hong Kong (which China used as a trading hub) was another reason for the four SEZ's locations. Hong Kong's currency was fully convertible in the foreign exchange market and a gateway to the outside world. Indeed, Hong Kong's importance in helping China to build its economy might be the main reason why it tolerated British colonial rule until 1997. When it was reunited with the mainland, Hong Kong was allowed to maintain the status quo (with the exception of defense and foreign affairs) for another 50 years under the "one country, two systems"

posture.[34] The policy, originally meant for Taiwan, was a recognition that it would take time to close the gap in the different stages of development and ideological stances between the two regions. The expiry date was deliberately made ambiguous, suggesting possible extensions if conditions were still not "ripe" for a "harmonious and peaceful" reunification. The Chinese government did not really care how long it would take Hong Kong and Taiwan to be reunited with the mainland as long as they did not declare de jure independence.

On political reforms, Deng established a collective leadership (known as the Standing Committee of the Central Committee of the Communist Party of China) made up of between seven and nine members, whose maximum time in office and mandatory retirement age was, respectively, 10 and 70 years.[35] Members of the Standing Committee were to be "selected and elected" on the basis of demonstrated competence. The new governance architecture was meant to prevent life-long rule like that of Mao. Under the collective leadership, the president or secretary-general was to act more like the "chairman of the board" rather than as "chief executive officer" of an enterprise. The members, usually representing different factions within the Communist Party, would debate behind closed doors, on issues and policies. Only after a consensus or compromise was reached would a policy be officially announced. In short, democracy was within the party and differences were discussed behind closed doors.

(iii). Post-Deng Xiaoping Economic and Political Reforms:
Deng's successors continued reforming the country's economy and polity. Under Jiang Zemin, the third-generation leaders took China into the WTO and expanded membership to entrepreneurs.[36] Hu Jintao and the fourth-generation leadership rebalanced the economy, replacing export and investment with domestic demand as the engine of economic growth.[37] The fifth-generation leaders under Xi Jinping added economic restructuring and innovation, spending more funds on research and development, replacing low-valued goods production with those of value-added.[38] Political reforms, however, were more measured, gradually allowing limited freedom of expression, movement, speech, and religion. Gradual political reforms were deemed the right course of action because internal stability is essential for maintaining long-term sustainable economic

growth. It was internal chaos, the fighting between various warlords and foreign occupation between 1800 and 1949 that prevented China from building a modern economic, political, and social order.

In 2016, Xi Jinping was elevated as the "core" of the Chinese leadership, meaning that he would be given more power to lead China in the increasingly troubled years ahead.[39] His "promotion" to the status that of Mao and Deng was a recognition that Xi was a strong leader able to deal with the tough external and internal challenges that China would be facing in the coming years. Newly elected US President Donald Trump was threatening China with a trade and even military conflict, nominating or appointing of anti-China hawks to senior positions, questioning the "one China" policy, and threatening a 45% tariff on Chinese imports. His secretaries of state and defense are expounding "tough" stances on China, Rex Tillerson vowed to disallow China from occupying the islands it built, James Mattis threatened to increase military assets into South China Sea.[40, 41] China was prepared for the worst in dealing with the United States until Trump made a "U-turn," engaging instead of confronting the country. Trade relations with the EU was also expected to deteriorate because it refused to grant China market economy status (MES) at the end of 2016 as mandated by WTO rules. The EU fears that Chinese industrial overcapacity would force many EU industries into "dire straits." Internal issues such as economic slowdown, rampant official corruption, ethnic tensions, increasing demand for independence in Taiwan and Hong Kong, unequal wealth distribution, environmental degradation, and other domestic issues will be taxing the party leadership. The "core" status gives Xi the authority and resources to deal with the many problems that China is expected or will likely face in the coming years.

Selected Post-Deng Period Reforms

Post-Deng leaders have followed his "Socialism with Chinese Characteristics" theory that is popularly referred to as state capitalism in the West. It was first articulated by Chen Yun, one of the Eight Elders that ruled China at the time (all eight were over 80 years of age).[42] China's self-taught "chief economist" compared the model to a

birdcage, the bird and cage, respectively, representing the economy and the plan. According to this analogy, if the bird was not allowed to fly, it would be stifled or even die. But if the bird was allowed to fly freely, it would fly away. Chen also recognized that the bird would grow, requiring a bigger cage to keep it healthy. That is, the plan must be resilient and flexible to accommodate a growing and healthy economy.

The plan was a series of FYPs of which China has established 13 since 1953.[43] The targets and guides (strategies for attaining the targets) of each FYP were debated and planned 2–3 years in advance. Failures and successes of each FYP were analyzed as to why the targets were not met, affording the government to come up with more effective policies. For example, rebalancing the economy from export and investment to domestic demand driven was the focus of the 12th FYP (2011–2015). Relying on export and investment as the engines of growth was in the words of then-premier, Wen Jiabo, "unbalanced, uncoordinated, unstable, and unsustainable" (the four "uns").[44]

To the government's credit, it quickly rebalanced and restructured the economy from an export-led growth model to one that was domestic-demand driven, focusing on innovation in 2014. With a population of 1.36 billion people, the rebalancing policy worked, in that consumption rose from 35% in 2013 to over 50% of GDP in 2015, the major reason why the economy was able to grow steadily at between 6.5 and 7% since then.[45] With regard to economic restructuring, the economy was to climb the value chain, moving away from low-technology to value-added products such as information technology and precision machinery. Low-technology industries were relocating in less developed countries in Southeast Asia, South Asia, and Africa.

The 13th FVP (2016–2020) was to focus on economic restructuring: investing more on innovation as a way to climb the value chain, producing high-end products such as electronics and precision machineries and aviation products. That target was to be attained by spending more money on research and development, from less than 2% today to 2.5% by 2020.[46] Another strategy was increasing outward bound foreign investment, whose main purpose was to acquire advanced foreign technology. As indicated earlier, China had indeed invested over US$100 billion on foreign acquisition and new investment in the West in 2015. The industrial restructuring policy was expected to be achieved by 2025 as indicated in the "Made in China, 2025" initiative.[47]

Summary Analysis of the Beijing Consensus

"Socialism with Chinese characteristics" is neither perfect nor suitable to other nations, but it has worked for China because it is compatible with the country's history, economic, political, and social institutions. During China's over 5000-year history, the people have never exposed to democracy, accepting authoritarian rule as long as it serves their interests. In that regard, the Communist government has "served the people," lifting over 700 million people out of abject poverty, reducing poverty altogether by 2020, and putting over 500 million in the middle and upper middle classes. Although not in the degrees enjoyed by people in the West and other democracies, the government has improved human rights, allowing religious freedom, limited freedom of expression and speech, and freedom of movement and enterprise. All one needs to do is to visit China, have a conversation with the people, or listen to them talking to each other in the market places and universities, and on the streets. He/she can judge whether China is as repressive as the Western media and China critics claim.

That said, political dissent against the state, particularly that the government speculated of being instigated by foreign powers to destabilize the country, would not be tolerated. The Tiananmen Square protests, for example, were quickly and violently crushed because the government received reports from the intelligence community that foreign powers were involved. Deng Xiaoping believed that had the protests were not crushed, they would destabilize the country, culminating in an internal implosion. Whether or not Deng had made the right call, history will decide but increasing numbers of people in China agreed with and supported his decision. On Hong Kong's 2014 Occupy Central-backed Umbrella Movement, many Hong Kong people and the government believed it was funded and instigated by foreign countries.[48] Whether the majority of Hong Kong people believed their government and some compatriots on the allegations, a 2014 poll conducted by the Hong Kong Research Association showed that 68% of Hong Kong people opposed the "Occupy Central" protests because they believed the movement had nothing to do with democracy, but to disrupt the territory's economy, polity, and society.[49]

Authoritarianism, along with pragmatism, experimentalism, and gradualism are perhaps the main reasons why the Chinese economy has grown so big in so short a time. Authoritarianism is imposed to push

effective and timely policies through because "tomorrow's bricks cannot build today's housing needs." For example, spending hundreds of billions of Yuan to alleviate poverty without having to go through time-consuming discussions and debates are responsible for lifting the huge number of people out of poverty. While leaders are not elected by universal suffrage, they are for the most part capable pragmatists well aware of the country's needs. For example, the government's allocation of over a trillion Yuan to build infrastructure proved to be a pragmatic and effective policy, in that building roads, railways, airports, and energy generating facilities led to increases in investment. The Chinese government's gradualist approach to policy implementation, "groping every stone when crossing the river" has spared the government from making huge mistakes like the former Soviet Union. The government has never been shy about experimenting with new ideas, albeit they might not be compatible with communist ideology. It was Deng Xiaoping's experiment with capitalism, allowing farmers to lease land from the state to grow their produce and city dwellers to operate small businesses that made the private sector the largest producer of the Chinese economy, estimated at over 50% of GDP in 2012, compared to literally zero in 1980.[50] China's economic success has afforded it to accumulate a huge financial reservoir to address impending problems or promoting economic growth. For example, China is planning to spend over US$500 billion to extend its high-speed railway system to the underdeveloped western part of the country, enhancing economic growth in Tibet, Xinjiang, and Gansu by 2020.[51] The Chinese government is also spending US$360 billion on green energy development and eradicate poverty entirely by 2020 or within the 13th FYP. [52, 53]

The government has a good track record of fulfilling its promises on spending and economic reforms. To that end, there is reason to believe that China will be able to achieve an annual growth rate of between 6.5 and 7%, at least by the end of the 13th FYP, effective from 2016 to 2020. This optimism is strengthened with China's commitment to globalization through the "One Belt, One Road" initiative, AIIB, Silk Road Fund, CEPC, and investments in Latin America and Africa. China is also participating in the ASEAN-initiated RECP and Russian-led EEU.

China's economic growth would likely slow down to well below 6% beyond 2020 for a number of reasons. One, the size of the GDP will be bigger, thus mathematics is not on China's side. Two, no country can grow at "nose-bleeding" rates forever without risking "crushes." For this

reason, high economic rates are neither possible nor desirable. Three, the services sectors would likely become increasingly important in the economy, they generally are less "productive" in terms of growth. Four, eventually China will run out of "underdeveloped" regions and sectors, reducing spending on infrastructure construction. Five, unexpected developments that impact the economy may emerge. Who knows what nature and China's antagonists will have on the country in future years. There may be natural disasters or competitors ganging up to mount a war against it. For example, some members of the Congress seem to be itching to pick a fight with China based on subjective or even manufactured "facts." For example, Senator Marco Rubio of Florida and Senator Tom Cotton of Arizona are lobbying the Congress and Senate to pass an act punishing Chinese officials for human rights violations in Hong Kong.[54] He ignored the fact that the student activists, pan-democrats and Occupy Central were allowed to criticize the Chinese and Hong Kong governments and hold demonstrations that appear to contradict the charge that Hong Kong is less free now than under British colonial rule. In a number of conversations this author had with Hong Kong residents, the colonial government would not have allowed anti-British protests. Judging from the reports published by the territory's newspapers—South China Morning Post and Hong Kong Standard and readers' comments made in the articles—the Umbrella Movement and other "pro-democracy movements" were riled and accused by many in Hong Kong of being "in the pocket" of foreign powers, because not only protests against British rule did not exist, but some pan-democrats (i.e., Anson Chan) were senior officials of the colonial government.[55] Six, reforming SOEs, culling internal dissents, capping growing indebtedness, and other issues would be difficult. For example, government attempts to reduce industrial overcapacity have encountered strong resistance from the SOEs that produce the product because they did not want to lay off workers. The relevant SOEs' position is that they exist for and to serve the people, not making huge profits or pleasing trade partners. In light of these problems, governing China is a difficult task.

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CHAPTER 10

BRICS and China Initiated Global Trade Initiatives and Financial Institutions: Alternatives to the US-Dominated IMF and WBG and ADB

While Western populist politicians are calling for de-globalization, particularly trade protectionism and immigration restriction, the developing economies, led by China, are moving in the opposite direction. China established the Silk Road Economic Belt and the twenty-first century Maritime Silk Road (One Belt, One Road or OBOR), reviving the ancient trade routes linking the country to Europe from its northern, central, and southern regions. To support the OBOR, the Silk Road Fund (SRF) was set up to invest in nations located along the OBOR corridors. China established the Asian Infrastructure Investment Bank (AIIB), believed by many to be an alternative source of funding infrastructures construction (to the US-dominated IMF and WBG, and Japan-controlled ADB). Additionally, China and fellow BRICS members (Brazil, Russia, India, China, and South Africa) formed the BRICS New Development Bank (NDB), a development bank and the Currency Emergency Reserve Fund (CERF), a pool of funds to assist developing countries in addressing a financial crisis.

The Silk Road Economic Belt and Twenty-First Century Maritime Silk Road (One Belt, One Road)

First proposed to reopen the original Silk Road that started over 2000 years ago by Chinese President Xi Jinping, the OBOR trade initiative was introduced in October 2013 to connect China with Eurasia through

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infrastructure construction, cultural exchanges, policy coordination, financial cooperation, and widening the scale and scope of trade and investment.[1] Of the five connectivity stances, infrastructure construction (which include road, railway, port, and airport construction, and shipbuilding) was the most important because they improve efficient transportation of goods. Cultural exchange, particularly people-to-people exchanges, would increase understanding between people and nations, avoiding unnecessary mistakes or misinterpretations of events and decisions that might lead to confrontation between countries, particularly the major powers. Financial cooperation or integration would reduce transactional costs, avoiding exchange rate volatility and another financial crisis. Financial and trade policy coordination would facilitate and promote trade. Unfettered trade and investment would increase economies of scale, leading to higher levels of productivity and competitiveness.

The One Belt, One Road is a series of trade routes located along the original Silk Road first named by the German geographer, Ferdinand von Richthofen in 1877.[2] The new land central routes begin at Xi'an, China to Western Europe via Central Asia, Russia, Eastern, and Central Europe. The Twenty-First Century Maritime Silk Road (One Road) trade routes originates from Fuzhou, China to Western Europe through the South China Sea, Malacca Strait, Indian Ocean, the Red Sea, and the Mediterranean Sea. Over 60 countries are located along the land and sea routes. When the OBOR integrates with the Russian-led Eurasian Economic Union (EEU), a northern route would be added, transporting goods from Beijing to Western Europe through Mongolia, Russia, and four Eurasian countries.[3]

Since its revelation in 2013, the OBOR, two-way trade between China and the over 60 countries situating along the routes reached nearly US$1 trillion, almost 25 percent of the country's total in 2015.[4] This early success gives reasons for optimism that the trade initiative would reach between US$4 trillion and US$8 trillion, explaining (perhaps with the exception of India) why 130 nations and 7 international organizations attended the OBOR or Belt & Road Initiative (BRI) forum in Beijing on May 14-15, 2017. Russian President Vladimir Putin and Chinese President Xi Jinping agreed to integrate the Russian-led EEU with the OBOR conundrum.[5] The EEU, comprising of Russia, Armenia, Belarus, Kazakhstan, and Kyrgyzstan, came into effect in 2015 and has a combined GDP of over US$4 trillion.[6] Two-way trade between China and the EEU was almost US$200 billion in 2015.[7] The US$54 billion China Pakistan Economic Corridor (CPEC)

project, when completed, would add impetus to the OBOR because it will shorten the distance between China and the Middle East as well as reduce transportation cost and risk going through the Indian Ocean, the pirate-infested Malacca Strait, and the South China Sea.[8] The OBOR is also to be extended to Oceania and Latin America in that two-way trade between China and major South American economies reached US$290 billion in 2013, an impressive volume considering the figure was only US12 billion in 2000.[9] This figure is expected to increase because China is the biggest buyer of resources and investor in Latin America. In addition to already US$200 billion invested, China plans to invest another US$200 billion in the continent over the next 10 years, mostly in building infrastructures.[10]

OBOR could be seen as China's "Marshall Plan," earmarking US$1.4 trillion to build infrastructures and invest in the participating countries.[11] The CPEC alone cost over US$54 billion. The funding would come from China's massive foreign reserve holding of over US$3 trillion, to be distributed through China Development Bank, the SRF, and China Export-Import Bank. Once completed, the countries situated along the OBOR and China would be comprehensively if not totally interconnected and integrated.

Drivers of OBOR

In view of the importance of globalization in propelling the Chinese economy to become the second largest in the world, other drivers of the OBOR could be addressing: protectionism and populism in the West, industrial overcapacity at home, and global economic recovery.

As indicated earlier, China is one of if not the biggest benefactor of globalization, attracting foreign investment largely from Overseas Chinese investors and sending goods to the West and Japan. The 2008 financial crisis, however, exposed the vulnerability of the economy by being overly dependent on exports. To that end, the pursuit of alternative trade partners becomes urgent. However, to be able to increase exports of manufactured goods to and imports of resources from developing economies, their infrastructure must be improved. Moreover, most developing nations along the routes are underinvested and underdeveloped. Investing in these countries' infrastructure and industries would spur economic growth, enabling them to import Chinese goods. To that end, Trump's threat of imposing a 45 percent tariff on Chinese goods would be less painful to the economy.

Another driver was the industrial overcapacity, particularly in the industrial and construction sectors resulting from over- or mal-investment that created serious economic distortions in misallocation and wastage of scarce resources. The undesirable level of steel inventory not only threatened domestic economic growth and social stability because of imminent plant shutdowns, but also culminating in possible trade wars between China and the West. For example, both the EU and the US imposed anti-dumping measures against Chinese-made steel and refused to grant China MFN. The OBOR in 2013 was a way to address the problem. First, the production overcapacity could be exported to the developing economies along the corridor for infrastructure construction. The OBOR would present new investment opportunities for the Chinese for both private and state-owned enterprises producing these and other products. Second, China would not be vulnerable to US anti-dumping duties, albeit the country bought 18 percent of the total Chinese exports in 2015.[12]

A third driver was China had accumulated massive amount of foreign reserves and other capital resources (US$3.1 trillion, US$20 trillion in deposits, US$1.2 trillion in US Treasury Bills, etc.) over the years. OBOR is seen as a mechanism to protect and increase the value of those capital accumulations. US Treasury Bills pay a very low return on investment, ranging from 0.47% on 1 month to 3.04% 30-year maturity terms.[13] If these huge sums of money can be invested or monetized, they would not only reap higher returns on capital but also create employment in the countries located along the corridor, including China.

A fourth motive for instituting the OBOR was enhancing long-term economic growth and global recovery. Chinese President Xi Jinping was right in indicating that globalization is the only way to attain long-term economic growth in his 2017 WEF speech in Davos.[14] As indicated earlier, the West and Japan have exhausted their fiscal and monetary policy effectiveness, disenabling them to climb out of the economic malaise that in turn created protectionism and populism.

Since the developed economies, primarily the US, is retreating from globalization, China is well positioned to lead the world's globalization process, affording it to set a new economic and geopolitical order in light of rising protectionism in the West. With the TPP dead, some of its members are "jumping on the OBOR bandwagon" to sustain their national interests. Vietnam, for example, chose not to ratify the US-led trade agreement perhaps because the country may not live up to its human rights and labor standards. Malaysia and the Philippines rerouted their

policy stance to seek closer economic relations with China. Japan and Singapore, for geopolitical reasons, are the only two countries not showing interest in joining China on negotiating RCEP, a free trade agreement covering all 10 ASEAN and six other countries in the Asia Pacific. Besides, the TPP would not likely be as beneficial as Obama, Abe, and Lee professed because China is most if not all 12 members' biggest trade partner. To that end, the TPP would be as effective as NAFTA without the United States. And with the future of TTIP in doubt and Trump threatening every nation that does not "put America first" as a condition for negotiating trade agreements, OBOR could be the answer to revive global long-term sustainable economic growth.

The Silk Road Fund

To support the OBOR, the Chinese government established the SRF on December 29, 2014.[15] Funds from the State Administration of Foreign Exchange, China Investment Corporation, Export-Import Bank of China, and China Development Bank would finance investments and promote trade, economic cooperation, and connectivity under the OBOR initiative. With an initial capitalization of US$40 billion, the SRF's first investment was the US$1.65 billion in Pakistan's Karot hydroelectric power project under the OBOR framework.[16] The Karot Hydropower Station was chosen because it is located in the CPEC, the "jewel in the Crown" OBOR initiative. Building the dam would improve energy security, enhance Pakistan's economic growth, shorten China's trade routes to the Middle East and Europe and minimize geopolitical risk by not sailing through the Indian Ocean, Malacca Strait, and South China Sea in which the United States navies maintain a strong presence.

The Asian Infrastructure Investment Fund

The Asian Infrastructure Investment Bank (AIIB) is a Chinese-initiated infrastructure investment bank first proposed in 2013 and opened for business on January 16, 2016.[17] It has 57 founding members, including staunch US allies such as the UK, Germany, France, Italy, and Australia. Canada was accepted as a member on September 23, 2016. The only two major economies not applying for membership are Japan and United States, citing unconvincing governance standard and transparency reasons. Indeed, James Woolsey, a former senior adviser to President Donald Trump

disagreed with the US and Japanese position, stating that it was a strategic mistake for the United States not to join the AIIB.[18] He is not alone in accusing the Obama Administration of turning down an invitation to join the development because it is needed to fund the over US$8 trillion infrastructure needs in Asia over the next decade.[19] Prominent economists such as Lawrence Summers, former treasury secretary in President Bill Clinton's cabinet and Harvard University economics professor emeritus, argued that not joining the AIIB would cause the United States to lose its "role as the underwriter of the global economic system."[20] Not being a member, the United States would not be able to bid on projects under the AIIB framework, thereby squandering American businesses and employment.

Why Did China Establish the AIIB?

It could be argued that China proposed and acted on establishing the AIIB because the United States dragged its feet in reforming the US-dominated IMF, WBG, and ADB to allow major developing nations playing a bigger role in their governance architecture. As indicated earlier, the G7 nations controlled over 60 percent of the three banks' shares and voting rights. Being close allies, the other six members normally sided with the United States on governance and policy matters. Moreover, the three banks were accused of serving the interests of the United States, Europe, and Japan rather than those of the developing economies they were meant to help. The ADB, for example, gave preference to countries that procured products from Japan. China was especially frustrated with less than 5.5 percent of the ADB's voting rights, whereas the United States and Japan have a combined 26 percent of the bank's shares and 31.3 percent of voting rights.[21] However, the US and Japan refused to reform the share and voting rights structures to sustain their dominance in the Asia Pacific region.

Another reason might be that China is using "soft power" to promote itself as a "responsible stakeholder." There was almost consensus agreement on why many developing nations in Asia were unable to realize their potential level of economic growth due to an inadequate and poor infrastructure system, ranging from energy sources to transportation systems. The WBG and ADB did not do enough to meet the infrastructure investment requirements of the Asia Pacific. It was for this reason that developing Asia jumped on the opportunity to join the AIIB.[23]

Finally, the AIIB would be a catalyst for promoting China's economic interests in that financing infrastructure construction could alleviate its industrial overcapacity problems and strengthen the global trade and financial systems. Building roads, railways, shipping ports, and airports would increase connectivity and integration between China and the countries located on the OBOR corridor and trade partners in the Americas. Increasing trade and investment between China and these countries would increase the internationalization of the Yuan because using the Chinese currency as a medium of exchange for trade and investment purposes would reduce exchange rate volatility and costs.

AIIB Governance Architecture and Share/Voting Rights Structure[24]

For readers interested in the AIIB's governance architecture and shareholding/voting rights structure, please follow the links. Suffice it to indicate in this book that these are based on those of existing multilateral development banks. On governance, the highest level is the board of governors to which each member-country appoints one member. It sets out the bank's policies, rules, and regulations. The board of governors meets once a year. The AIIB's 12-member board of directors is drawn from the board of governors and is responsible for overseeing the bank's daily operations.

The shareholding and voting rights structure is based on fund contribution; the greater the contribution the greater the number of shares and voting rights. China, being the biggest capital contributor, has, respectively, 33 percent and 27 percent of shares and voting rights.[25] However, unlike the US-dominated IMF and WBG, no nation has veto powers over policy formulation and implementation.

AIIB Loans

In the same year that AIIB opened for business, the bank on its own or in cooperation with existing supranational financial institutions such as the ADB approved and made four loans. The AIIB, ADB, and the UK's Department for International Development (DFID) co-financed a US$100 million to build the 184-km section of the Shorkot-Khanewal Motorway M-4 in Pakistan.[26] Another co-financing loan with the WBG is the US$216.5 million to Indonesia for a National Slum Upgrading Project.[27] This project is expected to improve the living conditions of Indonesia's "poorest of the poor." The AIIB is collaborating with the

European Bank for Reconstruction and Development (EBRD) to loan Tajikistan US$27.5 million for the Dushanbe–Uzbekistan Border Road Improvement Project.[31] The AIIB, either on its own or in cooperation with other MDBs, is expected to loan US$509 million for infrastructure projects in the energy, transportation, and urban development sectors in Pakistan, Bangladesh, Indonesia, and Tajikistan in 2016/2017.[28]

Most analysts would agree that the AIIB has made a good start in carrying out its mandate, fulfilling the promise of inclusiveness in funding critical projects to address the infrastructure deficiencies of the Asian countries. Cooperating with existing MDBs would strengthen and stabilize the global financial system. Contrary to US and Japanese critics, there is no evidence that the AIIB is replacing the three MDBs under its control. On the contrary, it is in fact welcoming the cooperative efforts of the IMF, WBG, ADB, and other MDBs of other countries in view of the bank's co-financing loans with the EBRD, DFID, ADB, and WBG. The AIIB is filling the financial gap between the amount of capital available and that needed to build an infrastructure system that cold enhance economic growth, global connectivity, and integration.

BRICS New Development Bank

The BRICS NDB was first proposed by Indian Prime Minister Narendra Modi at the fourth Summit held in Delhi in 2012 and became operational in July 2015.[29] Its start capital was US$50 billion and gradually rose to US$100 billion with each of the five members paying an equal amount. Voting rights are in accordance with shareholding. Its headquarters are in Shanghai, China and the first regional office to be established is in Johannesburg, South Africa.

Unlike the AIIB and other MDBs, the NDB is to focus on or give priority to projects relating to renewable energy development, particularly in member countries. In 2016, the NDB supported a number of projects, including a US$300 million loan to Brazil for developing solar and wind energy; US$100 million loan to Russia for hydropower expansion; and US$250 million to India for the development of solar and wind energy.[30] Loans in financing green energy projects in China and South Africa were also approved. The loan to China would be raised through a bond issue in the country, paying a 3.07 percent rate of return. The total value of loans approved in 2016 was nearing US$1 billion, enabling the borrowing countries to reduce emission of over 2.9 million tons of carbon dioxide (CO_2).

Over the next five years, the NDB is expected to loan out US$2.5 billion each year for a total of US$10 billion.[31] In addition to the BRICS, the loans are directed toward middle- and low-income countries. It should also be pointed out that the NDB is open for membership to all countries belonging to the United Nations.

BRICS Currency Reserve Fund

The BRICS Currency Reserve Fund (CRF) was established in 2014 with a capital of US$100 billion to make short-term loans to developing countries undergoing a temporary financial issue such as balancing the international balance of payments.[32] Contribution to the CRF was:

Country	Amount (in billions of US dollars)
China	US$41
Russia, Brazil, India	18 (each)
South Africa	5

To that end, the CRF is the BRICS alternative to the IMF, the only difference is that the CRF offers a relatively more attractive alternative source of temporary financing for developing economies. Aside from paying a rent, convincing the lender why the loan is needed, and how it could be repaid, the CRF does impose conditions like those of the US-dominated IMF.

Many nations, including Russia, had "a bad taste in their mouths" borrowing money from the IMF because of its harsh loan conditionality. As indicated earlier, Russia's IMF loan was in part responsible for the country's economy turning into a "basket case," while insisting on privatization of state-owned enterprises culminated in inefficiency, wastes, and social discontent. It could also be argued that the West, particularly the United States, was using the IMF and WBG to impose its values of democracy and human rights on the borrowing nations.

Summary Analysis of China/BRICS Trade and Financial Initiatives

Some in the United States accuse the BRICS, China in particular, of scheming to replace it, as the new world hegemony. The OBOR was seen by the US anti-China crowd as China not only attempting to

rewrite the global trade rules, but also as a "Trojan Horse."[33] OBOR's critics point out that the Chinese trade initiative excludes the United States and Japan. The AIIB, NDB, and CRF are alleged to have been established for the purpose of replacing the IMF, WBG, and ADB because the BRICS/China MDBs are lending to the same borrowers as those dominated by the United States and Japan.

However, there is no credible evidence to indicate that any of the accusations against the major developing economies' trade initiative and financial institutions exist. On the allegation that China is planning to replace the United States as the global hegemon, it has in fact always advocated or encouraged other nations, including the United States, to participate in the OBOR. Indeed, the trade initiative is indirectly extended to Latin America. Xi Jinping, for example, has agreed to it and the Latin American nations he visited accepted China's proposal of raising the level of trade, investment, and connectivity between them. According to the United Nations, OBOR's globalization stance would increase economic growth for the over 60 countries located along the rated routes. The UN claim is not without merit for reasons cited earlier. The Chinese trade initiative is a viable alternative export market and source of investment for all the participating nations.

Many world experts appear to agree with the assessment that the OBOR, AIIB, NDB, SRF, and CRF could enhance and strengthen the global trade and financial orders. Columbia University's Joseph Stiglitz opines that the NDB "marks a fundamental change in global economic and financial power."[34] His opinion is based on the theory that existing MDBs do not have sufficient resources to meet the infrastructure demands of the developing world. The infusion of funds from the developing economies would give them clout on the global economic and financial stage. One might also add that borrowing nations would most likely prefer the NDB to the IMF, ADB, and WGB for funds because the BRICS bank does not impose economically unsound conditionality and ideological values.

It could be argued that joining the AIIB would help president-elect Donald Trump's "Make America Great Again" campaign slogan. To create the "millions of jobs" he promised, Trump might not be able to find a better partner than the country he demonized during his campaign. Cash-rich Chinese enterprises (both private and state owned) are eager to invest in the United States, but are prevented from doing so because of perceived national security threats. China certainly has the capital and technology

to help Trump on his proposed US1 trillion infrastructure construction and repair programs because it has over US$3 trillion in foreign reserves and proven efficiency in road, bridge, railway, and power construction. If allowed to invest in the United States, Chinese firms would dramatically raise the over 85,000 jobs, existing ones, already created in 2015.

In view of early decisions taken by China's and BRICS' trade initiative and financial institutions, there is reason to believe that OBOR, AIIB, NDB, SRF, and CRF supplement and strengthen the global trade and financial order. Co-financing projects in the developing economies with ADB and EBRD demonstrated a willingness to cooperate between the newly established and existing MDBs. Cooperation not only brings in additional funding, but also enhances mutual understanding. China's extending all nations to join the OBOR initiative indicates that advancing globalization is necessary for attaining sustainable long-term global economic growth and geopolitical stability. To that end, OBOR reflects the Chinese government's interconnected, inclusive, innovative, and invigorated economic growth stance.

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CHAPTER 11

The Future of Globalization: Should It Be Promoted or Ended?

The original drivers of globalization, unfettered trade, and investment did enhance global economic growth because taking advantage of comparative advantage brought economies of scale. The increased wealth in turn made rapid advancements in transportation, communication, and other economic-related technologies possible. Through transportation and communication, the world became more interconnected, integrated, inclusive, and innovative. Inclusive economic growth was responsible for lifting hundreds of millions of people out of poverty in the developing world. Low priced imports from the developing economies increased the average family's real income in the developed countries, raising its standard of living. Integrated economic growth defused geopolitical conflicts, resulting in over 70 years of relative peace between major powers. Interconnected economic growth created an efficient international supply chain, increasing economies of scale because of enhanced regional division of specialization. Advanced transportation, communication, and information technologies brought peoples closer together and made decision-making more efficient and quick. Affordable air, rail, and ship fares enable increasing numbers of people to travel, leading to better understanding of other countries' culture and customs. Moreover, the world needs unfettered trade and investment to recover from the 2008 financial crisis, because exports accounted for approximately 30% of global GDP in 2016.[1] In the United States, exports accounted for approximately 14% of GDP, but contributed to 30% of its GDP in 2014.[2] The export/GDP ratio had grown to over 17% in 2015

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and selling goods and services to other countries remained just as if not more important to the US economy. In countries where populism and protectionism are rising, their dependence on globalization, particularly trade, investment and immigration, is even more pronounced. The 2015 export/GDP ratio for Germany, France, and the Netherlands was, respectively, over 48, 30, and 82%.[3]

Rising Populism and Protectionism in the West

Although far-right political parties failed to gain power in the 2017 general elections, protectionism and populism are rising in the West. Brexit, the election of Donald Trump as US president, the defeat of the Italian referendum on senate reform, and rising popularity of right-of-center or far-right politicians in France, Germany, and the Netherlands are signaling that the West might retreat from globalization and end immigration from non-European countries. As indicated earlier, Brexit owed its victory to its supporters' claim of overly liberal or unsustainable immigration laws, allowing Eastern Europeans, the Middle East, North Africa, and South Asia to settle in the UK. In periods of slow economic growth, immigrants are seen as competing with local workers for jobs and social programs. Mr. Trump's election victory owed no small part to his rhetoric on building a wall along the US-Mexican border and have Mexico pay for it, tearing up the TPP, renegotiating the NAFTA, banning Muslims from entering the United States, and imposing a 45% tariff on Chinese imports. It does not matter that his charges are "fake news" or "alternative facts."[3] Over to Europe, France's National Front Party leader, Marine Le Pen, vowed to hold a referendum on leaving the EU and end nonwhite immigration in the election campaigns.[4] Geert Wilders, leader of the Netherlands' anti-Muslim Freedom (PVV) party and Germany's far-right Alternative for Deutschland Party (AfD) shares Le Pen's de-globalization sentiments.[5, 6] Le Pen and Wilders remain popular and influential albeit defeated in the 2017 elections.

Effects of De-globalization

If populism and protectionism succeed, history could be repeating itself. The rise of Adolf Hitler's Nazi Party was largely due to a successful campaign that falsely labeled the Jews as behind Germany's economic woes. Today's Western politicians are following the same script, blaming other countries for stealing jobs and closing manufacturing plants. Just like in the 1930s, far-right and extremist groups are demanding their governments to close national borders on trade, investment, and

immigration. History tells us that it was protectionism that caused the Great Depression and populism created racial hatred, culminating in the slaughtering of millions of Jews and other "inferior" peoples by German Nazis in Europe and Asians (Chinese and Koreans) by Japanese militarists in Asia. A similar scenario cannot be ruled out if populism and protectionism dominate the foreign and trade policy agenda.

Will There Be a Trade War Between the United States and China?
In spite of the anti-rhetoric coming out of Trump and his team, this book would argue that a trade war between the world's two largest economies will be very remote. President Donald Trump and his accomplished team of advisors and senior officials (among them include successful billionaires and highly educated academicians and analysts) no doubt are aware of the consequences of a trade war between the United States and China. As indicated earlier, the economies of the United States and China are increasingly intertwined in that over 65% of "Chinese imports" are in fact produced by US firms or US-Chinese joint venture enterprises. China and America are also each other's biggest trade partner and major investor. A trade war would be detrimental to both countries' economic and national interests. After all, nations "have no eternal allies or enemies, only national interests," to paraphrase the British eighteenth-century diplomat, Lord Palmerston.

Another reason why there will not be a trade war between the world's two largest economies is that the accusations that the United States anti-China crowd pointed at China may not be true. Jack Ma, founder of the Chinese e-commerce giant, Alibaba, indicated that China was not stealing US jobs or "raping" the country as Mr. Trump and some of his senior officials insinuated. In a speech at the WEF in Davos, Mr. Ma said the United States spent over US$14 trillion on 13 wars and Wall Street "wiped out US$19.2 trillion in income."[7] Had that money been spent on the American people, he seemed to imply, Trump would not need to "Make America Great Again," because it might have already been great.

Did Globalization Steal West's Jobs, Closing Its Factories, Worsening Its Economic Woes?
According to a study carried out by the University of Pennsylvania's Wharton School of Business, automation and the focus on higher returns to investment are the culprits.[8] Shareholders demanding higher returns to investment and executives wanting huge wage compensations were the drivers of innovation

and production relocation to countries in which wages, labor, and environmental standards are lower. As indicated in Chap. 7, much of the bailout money was spent on replacing workers with machines to increase productivity and profits. Not complying with the host countries' environmental and worker safety rules led to environmental degradation and decreased worker safety. The Taiwanese-based Foxconn electronics manufacturing plants in mainland China, for example, was forcing factory workers to work long hours under regimented military conditions, resulting in a number of workers committing suicide.[9] Profit over environmental concerns culminated in the dumping of toxic chemicals into the atmosphere, rivers, and lakes and the ground.

Politically motivated trade protectionist measures undermined economic growth, causing loss of jobs and erosion of economic prospects in the West. As indicated earlier, President Obama's slapping a high tariff on Chinese-made tires in 2012 resulted in the loss of US chicken exports to China and raised the price of tires at home, both of which cost the US economy over US$2 billion to save 1200 jobs in Ohio. Putting the loss in perspective, if one job generates US$75,000, Obama sacrificed over 26,000 jobs to protect 1200. Banning investments from countries deemed "unfriendly" or posing a "national security threat" to the West squandered opportunities that could have enhanced economic and employment growth. The Obama administration's barring a Chinese firm from taking over a German high-technology company in 2016 not only diminished the latter's financial viability but also subjected Germany to "extraterritoriality," infringing on the country's sovereignty.[10]

It should also be pointed out that in the past 2 years, the People's Bank of China (PBoC), China's central bank might have overvalued the Yuan by selling foreign reserves to prevent it from falling and curbing capital flight.[11] If demand/supply forces were allowed to flap their wings, the Yuan would be worth less vis-à-vis major world currencies, including the greenback. Moreover, the US Treasury Department has yet to name China a currency manipulator though it encourages its central bank, the PBoC, to accelerate the Yuan's reform, allowing the market to determine its value.[12] It could in fact be argued that Japan, the EU, and the US were deliberately depreciating their currencies through quantitative easing because increasing the money supply does reduce currency values.

Who Created the Migrant and Refugee Issue?

There are different theories explaining why millions of migrants from the Middle East and Africa are swamping into Europe, but an article

written by Ben Swann for Truth in Media in 2015 pointed the finger at US. Middle East policies.[13] The article suggested that the refugee crisis started with the Iraq War. The United States invaded Iraq based on its intelligence community's report that the country's dictator, Saddam Hussein, possessed WMD. That report (which turned out to be false) gave the United States the excuse to bomb the country, turning it into a dysfunctional state wrought with sectarian conflicts, displacing and killing many innocent Iraqi men, women, and children. The US public was as outraged as the rest of world at the invasion, in that Obama in part won the 2008 presidential election for opposing the Iraq War, calling it a "stupid war." However, he bombed Libya, causing hundreds of thousands of refugees leaving the country for Europe.[14] Over to Syria, the United States helping anti-government rebels and Russia defending the government have created a seemingly unsolvable war, which could lead to an endless flow of refugees escaping that country. Germany alone has taken in over a million Syrian and other refugees from Africa and Middle East in 2015.[15]

The Iraq War was opposed by the world community, including close US allies, France and Canada. France opposed it at the UNSC and Canada refused to contribute military assets and soldiers to fight in Iraq.[16, 17] With the exception of the UK (who supported the war), Canada and France found the invasion of Iraq immoral and catastrophic, displacing and killing hundreds of thousands of innocent people for no reason other than an ideology promoted by the neoconservatives like Paul Wolfowitz.[18]

The Iraq War was a fiasco for the invaded as well as the invader, killing around 5000 American soldiers and wounding many times more.[19] Instead of Iraqi oil revenue financing the war, it cost the United States between US$1.7 (reported in mainstream US media) and US$3 trillion (Columbia University Nobel economist Joseph E. Stiglitz), depending on who did the calculations. Add salt to injury, China (whom the US neoconservatives considered to be America's biggest threat) benefited from the US fiasco, acquiring major concession rights in the Iraqi oil industry.[20]

President George W. Bush and the neoconservatives led by Vice-President Dick Cheney argued that Saddam Hussein was a "bad guy," threatening global peace, sponsoring terrorism, and a ruthless dictator.[21] They believed he possessed weapons of mass destruction (WMD) that could pose a threat to his neighbors and the United States. To the US

neoconservatives, he must be stopped. Another reason that supporters of the Iraq War cited was terror groups had control of some Iraqi oil which were sold in the foreign market to buy weapons for carrying out terrorist acts.

History will decide on who created ISIS or ISIL terrorism, but the Middle East was relatively calm, terrorist acts were rare if occurred at all, and the Muslim refugee problem was practically nonexistent. Saddam Hussein was an oppressive dictator to be sure, but he managed to cap sectarian conflicts between the three warring factions—Kurds, Shiites, and Shias. There was no "Arab Springs" until the West decided on "regime change" on countries that were deemed suppressive and not in lockstep with American-style democracy or liberalism.

The Impact of Globalization on the Developed Economies

The West needs globalization more than at any time in human history amid rising populism for insufficient domestic consumption power and ineffective monetary policy tools. Moreover, banning imports does not necessarily mean a boom for import-substitute manufacturing and increasing domestic employment because of significant rises in production costs. Higher domestic labor costs and disruptions of the global supply chain would raise the price of the final product. For example, an independent research organization estimated that the Apple iPad2 would cost the consumer US$1140 if the product was to be completely developed, manufactured, and distributed in the United States.[22] The United States might not necessarily regain the high-paying manufactured jobs in the long run because companies would innovate and increase automation to be competitive. For example, Mr. Trump's 2016 concession of giving Carrier US$7 million to save 1000 jobs might only be a temporary political gambit, because the company indicates that it will spend the money on automation and innovation.[23] There is also the fear that companies asked to remain in the United States would expect governments to continue paying incentive programs or tax concessions. All they need to do is threaten to leave the United States.

Germany, France, UK, and some other European countries are not on the same page as Mr. Trump on threatening to close borders on imports from other countries, albeit their far-right politicians support the

US President. These regions/countries, with higher private and public debt GDP ratios and slower economic growth rates, are in a worse economic and financial shape than the United States. They need to forge closer economic relations with developing economies, particularly China. British Prime Minister Theresa May's "U-turn" on cooling the former Cameron government's new "golden era" of Sino-UK relations promoting Chinese participation in the UK's energy and railway sectors is an economic necessity.[24] The concern over Chinese investment was propagated in an article written by former British Foreign Secretary Malcolm Rifkind and published by the British think tank Henry Jackson Society (HJS), which was paid by the Japanese Embassy in London to fan the "China threat" rhetoric.[25] Japan's deliberate spread of "fake news" could be an economic and strategic mistake, because China is its biggest trade partner, selling between 18 and 20% of exports to the historical enemy.[26] An added problem for Mr. Abe is Mr. Trump's seemingly friendly stances on Sino-US relations.[27]

The world economy is too integrated to be decoupled or de-globalized. For example, economic growth in the developed countries have had an adverse effect on the developing and resource-based economies. Imposing NBTs on and unable to buy Chinese-made goods has had a global impact on the global economy. Falling from over 10% annual growth rate to less than 7% has reduced China's demand for world natural resources, hitting hard the Australian, Canadian, Brazilian, Russian, and other resource-based economies. These countries have neither the market size nor the infrastructure to support an industrial base that could allow them to be wholly economically independent.

Insurmountable global issues such as climate change, security, financial system instability, and other problems require cooperation between the major stakeholders. The Paris Accord on climate change could not have been realized without the United States and China working together to push it through. Nuclear weapon proliferation control would not be possible without the cooperation and collaboration of major powers. For example, the Iran nuclear agreement discouraging the Islamic Republic from developing nuclear weapons is made possible because of the collaborative efforts of the US, Russia, China, UK, France, and Germany, the Permanent Five + One framework.[28]

Still, to fulfill his promise to his supporters, President Trump took the United States out of the Paris Accord, calling it a "Chinese" hoax. The newly elected president argued that the Paris Agreement would destroy

American jobs because it would restrict the production of oil and coal.[29] Reviving the coal and oil fracking businesses is part of his strategy to create "high-paying" jobs and to "Make America Great Again."

The West and East Asia are facing a demographic issue in that the fertility rate is lower than the death rate, 1.5 and 2.2, respectively.[30] If the trend is not reversed, sustainable future economic growth would be elusive, particularly in the developed world. A declining working labor force would not be able to support an increasing retiree population and maintain economic growth and competitiveness at the same time. A smaller workforce would be paying higher taxes and producing less.

Mr. Trump seems to recognize that globalization is needed to defuse international geopolitical tensions between the United States/Japan and China, and NATO/Russia by reaching out to China and Russia. The Western alliance complains that Russia annexed the Crimea, sent troops into Eastern Ukraine, and was about to invade countries in Eastern Europe.[31] Russia, for its part, accuses NATO of negating on its promise of not expanding into Eastern Europe. Japan and China/Russia tensions are rooted in territorial claims in the East China Sea, Sea of Okhotsk and North Pacific Ocean, and Japanese war crimes committed in China during WW II. Japan demanded that Russia return the islands that it conceded to the Soviet Union after WW II before a peace treaty between the countries can be signed.[32] On the other hand, Japan refuses to give up the islands that the Cairo Declaration and Potsdam Proclamation demanded from Japan to return the territories, including the Diaoyu or Senkaku Islands it annexed or stole from China before WW II.[33] During the Obama presidency, China and the United States were at odds over the South China Sea territorial disputes between China and a number of ASEAN members: the Philippines, Malaysia, Brunei, and Vietnam. China accuses the United States of stirring up trouble by interfering in disputes on a region over 10,000 km from the American shore. The United States, on the other hand, claims that "freedom of navigation and overflight" in the South China Sea is a US "national interest." However, the South and East China Seas issues might be addressed, at least for the moment. Mr. James Mattis, US Defense Secretary, announced that a diplomatic solution would be pursued to settle the territorial disputes and geopolitical conflicts.[34] Trump's acceptance of the one-China policy would go a long way in reaching a US-China détente. Should Trump' words turn into deeds, the world can enjoy a sigh of relief. And

Mr. Trump's respect for Russian President Vladimir might reduce tension between Russia and NATO.

Further, US President Donald Trump seems to understand that globalization cannot be totally discarded, albeit he will only seek bilateral trade agreements that benefit America first. In this regard, he is following through with his campaign message, signing an executive order to renegotiate the NAFTA with Canada and Mexico and terminate the TPP on his second day in office.[35] On commercial relations with China, Trump may be genuine in forging a constructive relationship with the US' biggest trade partner, having picked the governor of Iowa (who has known Chinese President Xi Jinping for over 30 years and is a strong supporter of US-China trade relations) to become US Ambassador to China. Also, Trump's sole representative to the 2017 Davos, Anthony Scaramucci, indicated that the Trump administration will build a "strong relationship" with China, saying he respects the country and its president.[36] Trump made the same commitment himself with a letter and a phone call to Mr. Xi Jinping, promising to build a "constructive" relationship with China. Finally, Trump reached an agreement with China which may reduce trade frictions between the world's two largest economies.

Other nations are even more enthusiastic on promoting globalization, particularly on trade and investment. Mr. Xi Jinping, China's president explicitly stated that globalization is necessary to achieve global long-term sustainable economic growth and geopolitical stability in his WEF keynote speech.[37] Heads of states in Europe, Asia, Africa, Oceania, and Latin America are promising to promote globalization, realizing that access to export markets and inbound foreign investment are essential for sustaining economic well-being. The prime ministers of Australia, New Zealand, and other Asian leaders are interested in reviving the RCEP and negotiate the Free Trade Area of the Asia Pacific (FTAAP) that include all APEC members.[38] Japanese Prime Minister Shinzo Abe is desperate for a free trade and investment agreement in that he pushed through the ratification of the TPP.[39] Mr. Trudeau's interest in reaching a free trade agreement with China, modeling after that of between China and Australia, becomes more urgent in light of Mr. Trump's decision to renegotiate the NAFTA and terminate the TPP. Being the world's second largest economy with deep pockets and considerable room for economic expansion, China is an attractive market for Canadian resources and a source of foreign investment.

Immigration

Anti-immigration sentiments in the West, like trade protectionism, might only be a temporary setback because human migration is both historical and necessary. One, migration has been in existence since the birth of humanoids, two-legged beings fanning out across the globe in search of food, shelter, and a place for putting in roots. In so doing, immigrants made positive contributions to the lands on which they settled. This was especially true in the "New World": United States, Canada, Latin America, New Zealand, and Australia. Nomadic tribes from Asia and other parts of the globe were said to have sailed to Oceania and trekked to the Americas tens of thousands years before the Europeans came. Then people from other parts of the world came to the new countries, helping to establish the economies, political architectures, and civil societies. Indeed, immigrants made it possible for the United States to be the leader of global innovation. As indicated earlier, over 50% of scientists and engineers in US universities, research facilities, and Silicon Valley were foreign-born.

Canadian Prime Minister Justin Trudeau is fully aware of the benefits of immigration, taking in over 25,000 Syrian refugees.[40] The country's 1.6 fertility rate is far below the 2.2 replacement rate, prompting the Canadian government to increase the annual number of immigrants from the present 275,000 to 1% of the population or 320,000.[41] In view of Canada's huge physical size and small population, even that number may not be enough. Sustainable economic growth requires an adequate domestic market, which can bring economies of scale and a tax base that would not cripple private consumption and investment. At the present, the average Canadian spends almost half of his/her income paying taxes: income, property, sales, and other forms, leaving less disposable income on consumption. If the demographic issue is not addressed, the financial position of the future Canadian working population would be overburdened with taxes, risking an economic meltdown.

The United States is the only developed country that does not have a demographic issue with a fertility of 2.06 (nearing the replacement rate of 2.1), thanks to the high birth rates of African and Latin Americans in addition to a relatively open immigration policy that takes in over 1 million legal immigrants and millions more of illegal ones annually.[42] The US Census Bureau has predicted that foreign-born Americans will make up over 18% of the over 400 million population by 2040.[43] In 2015, 13% of the 320 million population was foreign-born.[44]

Europe's anti-immigration stance may be understandable in that the continent is literally bursting at the seams with millions of refugees from the Middle East and Africa, but it too faces a demographic problem with an average fertility rate of a little over 1.6.[45] Chancellor Angela Merkel seems to be aware of the problem, prompting her to take in over a million refugees amid public opposition.[46] While other European leaders appear less visionary, fearing that additional refugee inflow from non-European countries would add fuel to the fires of racial tensions and overtaxing of social programs, they too realize that without immigration, their socioeconomic well-being would be threatened in the long run.

The major sources of immigration will likely be from the developing countries, particularly those of South Asia, Africa, Middle East, and Latin America because of their higher fertility rates ranging from 2.5 to over 4.0, political conflicts, and poverty.[47] Refugees from the Arab world and dire poverty in Latin America, Africa, and South Asia are forcing many to seek a better life in the developed countries. Illegal immigrants from Mexico and Central American countries risked dangers to enter the United States, seeking an opportunity to support their families. Further, the illegal Latino immigrants are a blessing to the country's farmers, hospitable industries, and homeowners because they are willing to work at wages and conditions that native-born Americans reject.

Taking the analysis on immigration to its logical conclusion, it is in the interest of the developed economies to introduce more open-door policies. Such a policy could create a "quadruple win" of—addressing demographic issues in the developed economies; promoting mutual understanding between racial groups; reducing poverty and misery in the developing countries; and enhancing global economic growth.

To preempt potential problems (i.e., racial tensions, overtaxing social programs, etc.), immigration policies must be well-thought out. Annual numbers of immigrant intakes need to coincide with the host countries' economic and financial positions. New immigrants must be given the knowledge and resources to fit in with larger communities.

The Influence and Effects of Domestic Politics and Vested Interest Groups in the Developed Countries

However, because of domestic politics and the influence of vested interest groups, promoting globalization will not be easy in the West, particularly amid stagnating economic growth and persistent high

unemployment. Vested interest groups (that were set up to maximize members' benefits to win farm lobbying groups in the developed economies opposing reduction or dismantling of agricultural income) remain politically influential and strong, forcing politicians to take cautious slow approaches in shaping pro-globalization policies. Ironically, lacking political will to dismantle irrational policies is a major cause of rising populism and protectionism because these policies undermine rather than enhance economic growth. For example, farm subsidies increase the price of food, leaving consumers with less money to spend on other goods and services. Farm subsidies also create trade frictions, reducing the volume of tradable goods and services.

Rising populism and protectionism in the West also influences immigration policies and treatment of nonwhite immigrants. To gain popular support, governments impose discriminatory measures such as banning Muslim women wearing the burqa in some EU countries and making racism more frequent and overt on both sides of the Atlantic. Muslim men are routinely discriminated against in the labor market, racially profiled, and mosques, temples, and synagogues defaced with derogatory signs. Nonwhites were told to go "back where they came from" or beaten up for no reason other than the color of their skin. The irony is that racism has "radicalized" a number of Muslim men, carrying out terrorist acts on both sides of the Atlantic, the latest being a terrorist attack in Berlin killing 12 people and injuring many more in early mid-December 2016, creating a "vicious circle" that promises to intensify hate between racial groups.[48] The leader of the far-right One Nation Party in Australia, Pauline Hanson, demanded an end to nonwhite immigration, suggesting that her country is "swamp with Muslims and Asians."[49]

Impact of Domestic Politics and Ideology

Another obstacle preventing globalization from realizing its potential benefits is domestic politics in the West. The US Congress-funded US-China Economic and Security Commission recommends that Chinese investment in the United States be closely scrutinized to determine whether they pose a national security threat.[50] The ideologically and politically motivated commission is said to be responsible for the squandering of many job-creation opportunities, particularly the IT and so-called "duel technology" sectors. For example, Chinese IT firms such as Huawei are banned from doing business in the United States,

particularly those involving the federal government. The successful Chinese firm, China National Offshore Oil Corp, takeover of Canada's Nexus in 2012, an Alberta-based oil company, raised alarm bells for the country's anti-China crowd.[51] Because the Chinese company was a state-owned enterprise, opponents of the deal were quick to accuse the government of selling out Canadian resources to the communist state. The former Conservative government (no friend of China) caved into the anti-China crowd, "dragging its feet" on reaching a bilateral investment agreement (BIT) with the Asian economic power.[52] Moreover, Mr. Gus Van Harten, a York University law professor, wrote an open letter to then Prime Minister Stephen Harper published in the October 12, 2012 Tyee Newsletter, warning that a BIT with China could risk Canadian taxpayers in the hook for billions of dollars.[53] In Australia, voices crying out against Asian investment grew increasingly louder. As mentioned earlier, the Australian government blocked Chinese companies from buying a large cattle ranch and energy firm for "national security" reasons. However, neither the governments nor those opposing Chinese investment have convincingly explained why China would threaten Australia, Canada, or the United States. Nor was there any proof that China threatens these countries.

Major Power Rivalry: Real, Imagined, or Fabricated?

Whether big power rivalry between the United States and China is real or imagined depends on whose side one listens to. Based on interviews with Chinese defectors and declassified national security papers, Michael Pillsbury claimed in his book that China is secretly planning to "take over the world" in his book, *The Hundred-Year Marathon, China's Secret Strategy to Replace America as the Global Superpower*.[54] His reasoning was that China not only "used" the United States to develop its economy, but also cleverly deceived Uncle Sam into believing that it is becoming "one of us"(the United States). Pillsbury's "proofs" were based on "Shi" and "Wei qi," respectively, a Chinese tactic and game which he claimed to be based on deception. For example, China is projecting itself as a global responsible stakeholder with the OBOR, AIIB, and other initiatives, but according to Pillsbury, that is a deception to put the United States off guard.[55] "Wei qi," a game invented in China over 2500 years ago, is played with movement of little stones, the end game of which is to take away all of the opponent's stones or block it

into a corner from which it cannot escape. The end game, according to Pillsbury, will be 2049, the 100th anniversary of the People's Republic of China.

Pillsbury's claim that China would supplicant the United States by 2049 is debatable and is not consistent with its history and deeds. Fu Ying, China's Foreign Affairs Committee Chair, dismissed Pillsbury's claim as "nonsense."[56] She insisted that China is only interested in building an economy that is capable of improving people's lives and protecting the country's "core interests." Moreover, history will tell us that China has never invaded or colonized other countries during its over 5000-year history, albeit it had the military resources and technology to do so. As indicated in Chap. 2, China could have colonized Asia, Africa, and even Europe. Unlike Europeans, Chinese seafarers were only interested in trade with the regions and peoples they encountered.

Peter Navarro, Trump's newly appointed National Trade Council (NTC) Chair, claims China was responsible for closing 25,000 factories in and stealing 57 million jobs from the United States in *Death by China*, a book he and Greg Autry wrote in 2012. His claims were based on the accusations that China manipulated its currency and unfairly subsidized exporters. However, Navarro's claims ignore the impact of automation and that jobs were leaving and factories closing in the United States before China joined the WTO in 2001. Relocating production to China or any other country is a business decision on the part of US enterprises. US businesses have a responsibility to maximize shareholders' return on investment, the main reason for relocating production abroad. Also, in a market or neoliberal system, price is the final arbitrator, reflecting consumers' ability and willingness to pay. In doing so, consumers would have maximized their self-interest. His accusation that China is manipulating the Yuan is at odds with the US Treasury Department's assessment and that of other analysts. He conveniently forgot the US' own currency manipulation stances: quantitative easing and deliberate devaluation in 2002. On unfair trade practices against China, Navarro should brush up his history on US trade policies. As indicated in Chaps. 5 and 6, it is the US subjective application of NBTs and unfair subsidies that hindered development in the emerging economies. On human rights, the Americans who have worked and visited China would disagree with Navarro on human rights abuse and religious repression. It should be pointed out that in China, collective rights triumph over individual

rights, explaining why pro-democracy activists garner little support from the general population. Moreover, not everyone in the United States subscribe to Mr. Navarro's view of China. A film hyping up the China threat rhetoric based on the 2012 book, *Death by China*, is described by New York Times journalist, Neil Genzlinger, as "unabashedly one-sided."[57]

Pillsbury and Navarro are not the only ones fanning the anti-China rhetoric, some mainstream/cable news media and pundits in the United States, Japan, Britain, Australia, and India are propagating that China is their countries' biggest threat and attempting to supplant the United States as the regional hegemon in Asia. Harry J. Kazianis, an American journalist and policy analyst, reminded America that China's building of islands within the "Nine-Dash Line" in the South China Sea is to push the United States out of Asia.[58] In the same article, he complained that President Obama's "lackluster" response only emboldened the communist government's "aggression." China has a different take on the issue, claiming that the "Nine Dash Line" was drawn by the Nationalist government in 1947 and supported by the United States before the Communist won the civil war against pro-US Chiang Kai-shek.[59] Moreover, there were no territorial disputes in the South China Sea until the Secretary of State Hillary Clinton announced in Hanoi, Vietnam that the South China Sea is an American "national interest.[60] Her remarks prompted the Chinese government to act decisively on protecting the territory and waters within the "Nine Dash Line."

With regard to territorial disputes with Japan over the Diaoyu or Senkaku Islands, they were returned to China under the 1943 Cairo Declaration, as indicated earlier. Because China was embroiled in a civil war until 1949, the United States took control of the islands. After Mao Zedong won the revolution, however, the United States changed its mind and placed the rocks under Japanese administration.

Territorial disputes between China and Japan were in fact put in the backburner before 2012. Deng Xiaoping and Japanese leaders agreed to shelve the disputes for wiser future heads of governments to settle when the two countries were forging closer geo-economic relations. The issue erupted only after the then governor of Tokyo, Shintaro Isihara, announced that his government would buy the islands from the "owners."[61] Japanese Prime Minister Yoshihiko Noda, unintentionally created a diplomatic row with China, by buying the islands first.[62] To him, it

was a genuine gesture to maintain good Sino-Japan relations. But to the Chinese government people, nation, and government, Noda's purchase represented Japanese ownership and a denial that there were territorial disputes between the two countries. In a recent declassified 2012 e-mail to the then US. Secretary of State Hillary Clinton, the United States urged Noda to consult China before making the purchase, implying that China might not be the aggressor.[63]

George Yeo, former Foreign Minister of Singapore, is suggesting that China does not want to replace America as the global hegemon.[64] Mr. Yeo may have a point because there are many insurmountable problems that the Chinese government must address, needing a prolonged period of peace with the outside world. China may in fact be glad that the United States wants to be the world's "big brother" because of the amounts of money and resources required to maintain that position. China would rather spend the money to develop its economy. Moreover, Chinese President Xi Jinping has indicated on a number of occasions that falling into the "Thucydides Trap" would serve no one's interest, calling for a dialogue between the world's two largest economies to iron out the differences. Mr. Trump seems to agree with Mr. Xi for reasons already mentioned.

With regard to "big power rivalry" between the United States/NATO and Russia, mistrust between the two sides is entrenched too deep to be discarded by Mr. Trump's public reaching out to Mr. Putin. Many in Trump's own Republican Party (i.e., John McCain) are deeply suspicious of Mr. Putin, insisting that he is responsible for the Ukraine crisis. Russia is NATO's reason for existence and unification of Europe. To ensure its continuation, NATO has increased its military presence in the Baltics and countries (i.e., Poland) near the Russian border. Russia, on the other hand, believes NATO has rescinded on its promise not to expand at its border. Mr. Putin opines that it is NATO that caused the Ukraine problem.

However, a real military showdown between NATO and Russia is remote. One, whether Russia is as aggressive as some in the West make it out to be is debatable, depending on which side tells the story. Two, the two sides possess enough nuclear weapons to destroy the world many times over, making a military option unthinkable.

While there is no indication of big power rivalry, name calling between the United States and China is making US allies in the Asia Pacific nervous, putting them in a dilemma. Australia, Japan, and other

US allies in the Asia Pacific region rely on China for their economic well-being, but are dependent on the United States for security.

A Case Study: Australia

The impact of a China-US trade or geopolitical rivalry is greater on Australia than on any of the US allies in the Asia Pacific. Australia has joined every war the United States participated in since WW II, because either the former felt it owed the latter a debt of gratitude for saving it from Imperialist Japan or being pressured by the savior.[65] Those wars cost many Australian lives and huge sums of money, albeit they had nothing to do with Australia. Neither Vietnam nor Iraq were Australia's enemies or threatened its national security. That is also true with China, in that the communist country has not shown any sign of threatening Australia or taking over the country. However, that did not stop the opposition Labor Party demanding the government to send warships and fighter jets in support of the US "pivot" to Asia, flying and sailing alongside those of the US on "freedom of navigation and overflight operations" in the South China Sea.[66] Under intense domestic political pressure, the Liberal government did consider siding with the United States against Chinese "aggression and bullying" its neighbors. However, its consideration is put on hold perhaps for two reasons: China is Australia's biggest trade partner and is vulnerable to Chinese military attacks in a Sino-US military conflict.

The Liberal government is well aware that Australia's "lucky continent" label is owed to China's rapid economic rise, buying huge quantities of its natural resources, investing heavily in the country (though not always welcomed), and sending hundreds of thousands of students to study at its universities and schools and tourists to visit Australian sites. Bob Carr, a former foreign minister, indicates that no country in the Organization for Economic and Cooperation Development (OECD) is more dependent on China, selling a third of Australia's exports to China, A$82.9 and A$243 billion in 2014, respectively.[67]

Added to Australia's internal debate on China is Donald Trump's terminating the TPP and appointing Peter Navarro as the NTC chair, Wilbur Ross as commerce secretary, and Carl Icahn as regulatory special adviser. Trump's ending the TPP effectively shut Australian exports out of the other 11 economies that signed the agreement, making the country more reliant on China. Should Trump act on the three appointees'

advice regarding US-China trade, both economies would take a hit, culminating in lower Chinese demand for Australian resources.

Australia is put it in a very difficult policy position. Siding with the United States will damage the economy and may even endanger Australian lives and properties. But pursuing an independent foreign policy, maintaining or normalizing trade and investment relations with China will be difficult in light of Australia's security ties with the United States and domestic political opposition.

Globalization: The Only Choice Going Forward, but the Road Would Be Bumpy

The world cannot turn its back on globalization. Developed countries' leaders, including Mr. Trump, are aware that accessing foreign markets is necessary to "Make America Great Again." For example, Mr. Trump's reaching out to China on building a "constructive" relation is motivated by economics and geopolitical realism. Being the United States' biggest trade partner and major investor, China is in a position to help Trump achieve his campaign promise. For example, China has the technology, resources, and funds to invest in Trump's US$1 trillion infrastructure building and repairing programs. On geopolitics, not only is there no reason for a US-China nuclear conflict, but it may lead to mutual assured destruction and mutual economic destruction.

The developing economies, particularly China, Russia, Brazil, and India, will push globalization forward. China will take the "One Belt, One Road" initiative to its full extent. Brazil and Russia must have external markets to buy their resources and invest in infrastructures and industries to spur economic growth. India is in dire need of foreign investment in its industries and infrastructures to realize the "Made in India" policy. Smaller developing countries around the world are highly dependent on the major economies for their economic well-being. Indonesia and the Philippines, for example, are openly welcoming Chinese investment to build their infrastructures and industries. As indicated earlier, the new Philippines president put aside a favorable international court ruling to renew better relations with China. The Asian superpower could be the new champion and leader in the next round of globalization if America decides to withdraw from the global economic and geopolitical order.

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CHAPTER 12

A Final Word on Globalization

Globalization, for all its flaws and mismanagement, has benefited the world. Hundreds of millions of people in the developing countries have been lifted out of abject poverty, consumers in the developed ones have enjoyed higher living standards, technology has been advanced by leaps and bounds, and world war has been averted for over 70 years.

As argued throughout this book, globalization is needed more than at any time in human history. The inhibitive consumer and public debt levels created by the 2008 financial crisis have stifled domestic demand, suggesting that the developed economies need to access foreign markets to escape the fragile economic recovery. The developing economies need foreign investment and export markets for economic development. Geopolitical uncertainties—international terrorism, nuclear weapons proliferation in North Korea, territorial disputes in the South and East China Seas, and mistrust between the major powers—require international cooperation for a solution. Trans-border issues such as climate change, financial system reforms, and global security demand globalization's input.

Are China and Russia, Respectively, an Aggressor in the South and East China Seas and the Ukraine?

On branding China as the aggressor in the East and South China Seas, Chinese Foreign Minister Wang Yi told the United States to brush up its history on the territorial disputes.[1] He was referring to the US's role

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in drafting the Cairo and Potsdam Declarations mentioned in Chap. 1. Wang is suggesting that the disputants should consider history in its entirety before making charges on which side the aggressor is. Moreover, China has always promoted diplomacy to address the disputes, a posture that appears to be supported by the US Secretary of Defense, General James Mattis.

With regard to Russian aggression in the Ukraine, Chicago's professor John J. Mearsheimer argued that the Ukraine problem was not Russia's doing, but the crisis was the West's fault.[2] He argued that NATO was pursuing an excuse to preserve its existence and expansion into Eastern Europe, instigating the ouster of the Ukraine's democratically elected but pro-Russian President Viktor Yanukovych. Mearsheimer hinted that NATO was well aware that Putin would send troops to prevent the US-led alliance encroaching into its western border, creating an excuse to blame Russia for the Ukraine crisis.

Did China Manipulate Its Currency and Carry Out Unfair Trade Practices?

Whether China is stealing American jobs and "raping" the country through unfair trade practices and currency manipulation is debatable. It is true that the Yuan was pegged to the US dollar at a fixed rate of $1US = 8.25 Yuan between the 1990s and 2005, but it saved a number of Asian economies because China did not match their devaluation.[3] According to the China General Administration of Customs, US–China trade was approximately one-fifth that of today. With lower currency values, the Asian economies gained an export advantage to avoid a complete economic collapse. However, the critics did not mention that the US Federal Reserve deliberately depreciated the greenback by 33% over 20 years, supposedly to maintain price stability and encourage investment in 2002.[4] The devaluation could also be interpreted as currency manipulation because it lowered the price of American exports. Moreover, China released the peg against the US dollar (and pegged the Yuan against a basket of currencies at a managed-flexible exchange rate) in 2005, resulting in a 34% (in nominal terms) and 42% (in inflation-adjusted terms) increase vis-à-vis the greenback from 2005 to 2013.[5] Yet, US trade deficit with China increased from approximately US$130 billion to US$420 billion in the same period, suggesting that the country did not manipulate the Yuan to gain an export advantage

or the US trade deficit was inflated.[6] As indicated earlier, China has intentionally appreciated the Yuan in the last two years, perhaps to avoid further criticism from the United States and prevent capital flight. On accusing China of unfairly: subsidizing exporting enterprises, giving tax breaks, and selling land and materials at discounted prices, the US critics are guilty of "the pot calling the kettle black."[7] The United States unfairly subsidized its farmers in the forms of direct subsidy of US$20 billion, albeit "two wrongs do not make a right."[8] As indicated earlier, the United States routinely applies subjective reasons for imposing anti-dumping and other NTB measures against Chinese imports.

Just because China has a large current surplus with the United States and has accumulated a huge foreign reserve pool, it does not necessarily mean that it is a currency manipulator. The WTO does not consider the criteria as currency manipulation. As indicated earlier, over 65% of Chinese "imports" into the United States are produced by US outsourcing or Sino-US joint-venture firms. China did not sell the products to the United States, it is a contractor or a part of American firms. In most cases, China provides only labor and land since factories (i.e., Foxconn) are owned by non-mainland Chinese investors. Under normal accounting practices, the transactions would be labeled as intracompany trade rather than international trade. However, US Customs records the total value of imports of which China only accounts for a small percent of the figure as in the iPad (11%). Finally, China's desire to buy more high technology products was blocked by the US Congress for national security reasons.

Is There a Big Power Rivalry?

A big power rivalry requires an existent power containing the rising power or the latter challenging the former. China has too many problems to address at home to undertake military adventurism against a power much bigger than it. Its military expansion is for defensive and historical purposes, given its small number of nuclear weapons in relation to the United States and other powers. It was in part a militarily weak China that the League of Nations gave the German concession to Japan, ignoring the Chinese protests.[9] With regard to Russia, it is hardly in a position to push NATO out of European Europe. Its economy has tanked by low oil and commodity prices. With the exception of its large number of nuclear warheads and advanced missile technology, Russia is

outmatched by NATO's formidable military resources. Moreover, there is no reason for Russia to gain more territory, given its huge landmass.

Problems and Prospects of Globalization

There is a ray of hope that leading world leaders and nations are working toward an economically and geopolitically global order. Mr. Trump sending a letter to Mr. Xi to build a "constructive" relationship between the two largest economies and the former's reaching out to improve relations with Mr. Putin are steps in the right direction. Mr. Trump's letter to Mr. Xi was followed by a meeting between the top diplomats of China and the United States in Germany.[10] Chinese Foreign Minister Wang Yi of China and US Secretary of State Rex Tillerson vowed to build a strong and constructive relationship between the two countries. In the next day, the US Secretary of the Treasury, Mr. Steven Mnuchin, called China's senior economics officials, promising economic cooperation with the country.[11] For reasons explained earlier, the EU, BRICS, African Union, Latin America, and Asia, and other countries/regions, international trade, and investment are essential for their economic growth.

Populist politicians in the EU and Australia will find out that their isolationist and anti-immigration postures would put their nations in worse shape than they are today. Australia, for example, needs Asia, particularly China, as a market for its resources and a source of investment funds. Mr. Trump's "America First" condition for a trade agreement with any country is neither realistic nor desirable. Trade and investment are based on comparative advantage, implying that both sides must benefit, not just the United States. Like business needing a buyer and a seller, a nation must import before it can export for cash flow reasons. History will tell that populism, the root cause of racism, hurts the victims in the short run, but would harm the entire nation in the long run. Racial violence would lead to economic, political, and social instability in the long run, as was the case in the United States, Europe, and South Africa. History will judge populist politicians harshly as with Benito Mussolini and Adolf Hitler. On protectionism, it brought nothing but despair and misery as was the case during the Depression era.

Taking the analysis to its logical conclusion, no nation can stand alone, not even the United States. America is great because it promoted globalization: setting up a trade and financial system albeit to its advantage and attracting the world's best and brightest to its universities and

research institutions. With the exception of China, the West and the United States in particular has in fact benefited more from globalization than the developing nations. Globalization did not turn out the way it was supposed to for the West, mainly because its business and political elites placed their own interests over those of the nation and did not pay enough attention to those who were displaced by international trade and investment. To capture the potential benefits of globalization, benefits must be shared and costs cooperatively addressed.

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Index

A
Abe, Shinzo, 155
Across-the-board, 99
Allied Powers, 1
Anglo-American Alliance, 2
Anti-dumping, 99, 101–103, 108
Asia-Pacific Economic Cooperation (APEC), 122
Asian Contagion, 78
Asian Development Bank (ADB), 75, 92
Asian Infrastructure Investment Bank (AIIB), 3, 211, 215
Asian Tigers, 31, 32
Association of Southeast Nations (ASEAN), 14
Austerity measures, 79, 80
Authoritarianism, 190, 204

B
Beggar thy neighbor, 57
Beijing Consensus, 189, 195, 204
Blair, Tony, 148
Branstad, Terry, 41
Bretton Woods, 49, 57, 63, 65–68
Brexit, 8, 14
BRICS, 4, 8, 211, 218–221
British East India Company, 55
British pound, 82

C
Cairns Group, 104
Cairo Declaration, 43
Canada-EU Trade Agreement (CETA), 132, 142
Cancun Ministerial Meeting, 111, 112
Capital flight, 79, 80
Cartier, Jacques, 54
Ceuta, 51
China Pakistan Economic Corridor (CPEC), 212
China, 1, 3–7, 9–15
Churchill, Winston, 63
Clinton, Bill, 148
Cold War, 148
Collateralized debt obligations (CDOs), 171, 173
Columbus, Christopher, 52
Common Agricultural Policy (CAP), 100, 103

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K. Moak, *Developed Nations and the Economic Impact of Globalization*,
DOI 10.1007/978-3-319-57903-0

Commonwealth, 58, 62
Comparative advantage, 20, 21, 23, 26
Core interests, 7
Countervailing duties, 101, 102
Credit default swap (CDS), 171, 173
Cultural Revolution, 198, 199
Currency devaluation, 78
Currency Emergency Reserve Fund(CERF), 211

D
de Gama, Vasco, 52
De-globalization, 1, 9, 10, 12
Diaoyu (Senkaku) Islands, 4
Dobb-Frank, 179, 184, 185
Doha Development Rounds (DDR), 111, 116
Dot.com revolution, 35
Dutch East India Company, 54

E
Economic and Strategic Review Dialogue (ESRD), 32
El Nina, 36
El Nino, 36
Emergency Currency Reserve Fund (ECRF), 3
Enlai, Zhou, 198
Eurasian Economic Union (EEU), 11
Euro, 82
European Central Bank (ECB), 122, 130
European Coal and Steel Community (ECSC), 122
European colonization, 49, 51, 57
European Economic Community (EEC), 38
European Monetary System, 126, 128
European Union (EU), 122–123, 126, 127, 129–131
EURATOM, 123, 124
Experimentalism, 204

F
Fair competition, 107
Fake news, 226, 231
Financial bubble, 177
Financial derivative, 168, 170, 171
Five-Year Plan (FYP), 196
Fixed exchange rate, 64–68
Foxconn, 25
Francis I, 53

G
Gang of Four, 198, 199
General Agreement on Tariff and Trade (GATT), 97, 98, 111
Geneva Ministerial Meeting, 113, 116
Genie coefficient, 36
Glasnost, 149
Glass Steagall Act, 2, 169, 170
Globalization, 1, 8–12, 14, 15
Gorbachev, Mikhail, 149, 150
Government procurement, 99, 101, 111, 113
Gradualism, 204
Gramm-Leach-Bliley Act, 170
Great Depression, 1
Great Leap Forward, 197
Great Recession, 167
Greenhouse gas, 36, 37
Gross Domestic Product (GDP), 1
Group of Eight (G8), 148, 151
Group of Five (G5), 152
Group of Seven (G7), 147
Group of Twenty (G20), 147, 156

H
Havana Charter, 97, 105
He, Zheng, 50

Heavily indebted poor countries (HIPC), 152
Heckscher, Eli, 21, 22
Hong Kong Declaration, 115, 116
Hong Kong Ministerial Meeting, 113
Housing bubble, 176–178

I
Inclusive, 160, 161
Industrial revolution, 37
India, 1, 3, 4, 7, 10
Innovative, 160
Interconnected, 160, 161
International Monetary Fund (IMF), 2, 3
International Trade Organization (ITO), 97, 105
Invigorated, 160
Iran Nuclear deal, 231
Iraq war, 229, 230
Iron curtain, 88
ISIL, 230
ISIS, 230

J
Japanese yen, 82

K
Kennedy rounds of negotiations (Kennedy Rounds), 98, 100, 101
Keynes, John Maynard, 1
Koln Summit, 154
Korean war, 29
Krugman, Paul, 22
Kyoto protocol, 36

L
Lehman Brothers, 167, 174
Leninist-Marxist-Mao Zedong thought, 24
Liberalism, 230
Linear, 99
Liquidity trap, 61
Lisbon Treaty, 126, 129
Loan conditionality, 77, 79–81, 88, 92

M
Maastricht Treaty, 123, 126, 127, 129
Major power rivalry, 237
Market Economy Status (MES), 102
Marshall plan, 75, 88–92
May, Theresa, 39
Mearsheimer, John J., 34
Merkel, Angela, 39
Ming Dynasty, 50
Moak and Lee, 34, 43
Molotov plan, 89
Most Favored Nation (MFN), 105
Multi-fiber arrangement, 101
Muslim, 41

N
Nairobi declaration, 116, 117
National interest, 227, 232, 239
Navarro, Peter, 41, 43
Negative interest rate (NIRP), 179, 183
Neoconservative, 229, 230
Neoliberalism, 189, 193
New Development Bank (NDB), 3, 211
Nine dash line, 239
Nixon shock, 66, 67
Non-Agricultural Market Access (NAMA), 108
Non-tariff Barriers (NBT), 2
North America Free Trade Agreement (NAFTA), 40, 41, 135
North Atlantic Treaty Organization (NATO), 7, 12, 15

O
Obama, Barack, 30
Offshoring, 23, 25
Ohlin, Bertil, 21, 22
Oil shock, 66
One Belt, One Road (OBOR, Belt, Road), 4, 9, 11, 211–213
Opium Wars, 55
Organization for Economic Cooperation and Development (OCED), 87
Ottoman Empire, 49, 68
Outsourcing, 23–25, 36

P
Paris Accord, 231
Paris Ministerial Meeting, 113
Perestroika, 149
Permanent Court of Arbitration, 4
Pillsbury, Michael, 237–239
Pope Nicholas V., 55
Populism, 42
Portuguese colonization, 51
Potsdam declaration, 248
Pragmatism, 198, 204
Protectionism, 22, 24, 31, 42
Pump priming, 62
Putin, Vladimir, 150, 151

Q
Qing, Jiang, 198, 199
Quantitative Easing (QE), 67

R
Ramo, Joshua Cooper, 189
Refugee, 228–230, 234, 235
Regime change, 8
Regional Comprehensive Economic Partnership (RCEP), 122, 140
Renaissance, 49
Reserve currency, 82
Ricardo, David, 21

S
Samuelson, Paul, 21, 22
Schengen area, 126
SDR basket, 82
Securitization, 173, 181
Shanghai Cooperation Organization (SCO), 11
Shaoqi, Liu, 198
Silk Road, 4
Silk Road Fund (SRF), 211, 215
Slave trade, 55
Smoot Hartley Act, 59
Socialism with Chinese characteristics, 189, 202, 204
Song Dynasty, 50
South China Sea (SCS), 4, 7, 14
Soviet Union, 88, 89
Special economic zone (SEZ), 200
Stable Thesis, 56
State capitalism, 189, 202
Sterling Area, 58
Stiglitz, Joseph E., 77
Stolper, Wolfgang, 21, 22
Subprime mortgage, 170, 175, 177
Sustainable development goals, 160
Swiss Formula, 115

T
Technical barriers, 101
Thucydides Trap, 33
Tokyo Rounds of Negotiations (Tokyo Rounds), 97, 101
Trans Pacific Partnership (TPP), 11, 40, 41, 121, 138–141, 214, 215, 226, 233, 241
Treasury Bills, 168, 170, 172, 179, 180

Treaty of Brussels, 123
Treaty of Paris, 122, 123
Treaty of Rome, 123, 124, 126, 129
Trump, Donald J., 39–41

U
United Kingdom (UK), 1
United States (US), 1, 2, 4, 7–12, 14, 15
UN Security Council (UNSC), 29, 229
Uruguay Rounds of Negotiations (Uruguay Rounds), 97, 98, 103, 104, 107, 109
US-Canada Auto Pact, 122, 133, 134
US dollar, 78–80, 82
US Federal Reserve, 167, 170, 172, 175–177, 181

W
Washington Consensus, 77, 78, 80, 85
White, Harry Dexter, 1
Williamson, John, 189, 191, 193
World Bank Group (WBG), 3
World Economic Forum (WEF), 24, 214
World Trade Organization (WTO), 97, 103, 105, 107
World War Two (WW II), 76

X
Xi Jinping, 24, 40, 41

Y
Yeltsin, Boris, 148, 150
Yongle Emperor, 50
Yuan, 82