

Original Release of the Interview with Michael Pettis published in Tages-Anzeiger on August 6th.

## **«This is the beginning of a longer-term, partial reversal of the globalization process»**

**Professor Michael Pettis answers questions about the causes and consequences of the Trump Trade War.**

**Interview: Markus Diem Meier, Tages-Anzeiger, 6. August 2018**

**Do you think the US is right in their criticism of China? They say Chinas behaviour is unfair and to the disadvantage of the USA. Is that still true?**

Yes, but it is not because of explicitly mercantilist policies on the part of Beijing. The problem is that Beijing's growth model has depended heavily on suppressing domestic demand, and using the rest of the world to resolve this domestic demand deficiency. This is why China has such a high savings rate and needs a large trade surplus. Beijing promised ten years ago that it would urgently rebalance domestic demand, but this has proven politically very difficult to do.

**The same is Trump saying about Europe. Is it true in this case?**

It is true primarily about Germany, which in 2003-05 imposed labor policies that, as in China, suppressed domestic demand in favor of international competitiveness. The difference between China and Germany on this point is that Beijing recognizes that its current demand distribution is unsustainable and it has been trying – albeit unsuccessfully – to rebalance. Berlin, on the other hand, seems to have no understanding of how labor policies that suppressed German consumption and forced up the savings share of GDP (while forcing down the investment share of GDP) first hurt Europe and are now hurting the world.

**What is the effect of the tariffs the US is slapping on Chinese and European goods? Donald Trump seems to hope it will narrow the current account deficit of the US versus China.**

I am not convinced that tariffs will have any substantial effect on trade imbalances because, as I have argued before, including in the pages of this magazine, I am convinced that it is capital flow imbalances that drive the trade imbalances, and not the other way around. Without addressing capital flows into the US I don't think tariffs will have any impact on trade imbalances besides perhaps reducing overall trade volumes slightly. It does seem, however, that Washington is increasingly focusing on capital inflows.

**What is the problem with this deficit for the US - also versus Europe? Donald Trump has said (in the context of the Europeans) this deficit is a loss for the USA?**

The deficit isn't a loss. If we lived in a world of insufficient savings, in which investment is constrained by low savings, the deficit would not be a problem at all for the US because it would result in higher investment as foreign savings poured into the US. But we haven't lived in such a world for many decades, and so the deficit represents either higher unemployment

for the US or higher debt. I am not sure Trump fully understands this, but then I am not sure policymakers in other countries understand it either.

**What role does the dispute over the Trumps trade war play for Switzerland as a small open economy?**

Switzerland has run persistent trade surpluses for decades, in large part because it has aggressively sterilized capital inflows and prevented domestic demand from reflation. If excess Swiss savings were exported primarily to developing countries, who needed the capital for domestic investment, Switzerland's trade surpluses could be seen as adding to global growth. But of course most Swiss capital go to developed countries who don't need it, as soaring reserves indicate, and so Swiss policy acts as a net drain on global growth. If Washington is successful in restructuring global trade and capital flows so that countries with weak domestic demand can no longer freely export excess savings and their deficient domestic demand, I expect this to affect Switzerland adversely. With such a high trade surplus I would imagine that it would be very difficult for Switzerland to adjust quickly.

**Would there be a better way for the US to deal with China or the Europeans?**

In principle the US should have organized a new global conference in which countries agreed to a new and more appropriate global trade and capital flow regime, but I think this was always unlikely to happen as there is no strong incentive for the surplus countries to agree to a new set of rules. For the US to act unilaterally was always the worst possible outcome for the global economy, but it might have also been the only possible way to force the issue.

**What do you think of the deal Donald Trump has struck on Wednesday with Jean-Claude Juncker, President of the EU-Commission?**

In the end Europe's interests, perhaps excluding Germany, are quite similar to those of the US, and I suspect that after a certain amount of confrontation and domestic posturing they will ultimately agree. Whenever I speak to policymakers from European countries that suffered from the great internal imbalances prior to the global crisis, it is clear that there is a great deal of anger towards German policies.

**What policy is needed for the US-Government to end current account deficits versus China or Europe? If there is no alternative, why not?**

The US must address its role as the capital importer of "last resort". Most people, and even most economists, do not understand how capital inflows automatically reduce domestic savings in advanced economies. The US clearly does not need foreign capital for domestic investment, but most advanced economies, and even some developing economies, are awash in excess savings. Because these countries are afraid to invest their excess savings in developing countries, who need them and can use them productively, roughly half of the world's excess savings end up in the US (or, to a lesser extent, the UK), mainly because no other advanced economy has the necessary financial infrastructure, and as long as the US (or the UK) is forced to import foreign capital, it has no choice but to run a trade deficit.

**The US-President also seems to think the currency devaluation of the Chinese Renminbi in the previous months is an adverse act to neutralise US Tariffs. Is that so?**

I don't think it is, except maybe in the very short term, and only as a pretense. Beijing knows that sustained currency depreciation worsens domestic imbalances and could easily ignite another outpouring of flight capital. Its debt problems are too severe to allow either.

**He seems to think the same of the Eurozone: That the ECB leaves the rates low so that the euro stays weak against the Dollar. Does he have a point here?**

In Europe things are more complicated. There are really two Europes – one with an undervalued exchange rate and one with an overvalued exchange rate – forced to share the same currency without any other adjustment mechanism. Whatever the euro does makes one side or the other worse off.

**Some analysts think Trumps measures and threats are just a way to get concessions from other countries. So is there a chance that the trade relations will be better in the end because of Trumps behaviour?**

I very much doubt it. I think we are living a period in which globalization must go in reverse as countries – especially Western democracies – try to regain the control of domestic wages, income inequality, and fiscal policy, that they progressively lost in an increasingly globalized world. This problem didn't start with Trump and it won't end with him.

**Is Trump helping his voters with his trade war? Do they get more and better jobs or higher wages because of it (in comparison to a situation without these actions)?**

If he is effective in causing the US trade deficit to decline sharply – which I am not sure he will be – then his policies will clearly be good for US households because it means that growth can be maintained without such a high growth in debt.

**At least for an outsider it is not totally clear what Trump really wants. What do you think his goal is and is there a chance to reach it.**

I cannot really say. Trump confuses not just the Chinese and the Europeans, but also the Americans.

**What do you think are the consequences of this whole dispute for the international trade?**

The beginning of a longer-term, partial reversal of the globalization process.

**Does all this also hurt global growth? At least until now that seems not to be the case.**

Trade war and a contraction in global trade always hurts global growth, but not by nearly as much as is suggested from overly-excited statements by mainstream economists, who tend to be very ideological and historically illiterate. The pain of a global trade contraction is however not symmetrically distributed, and this is clear from history. It is borne mostly by the surplus countries.

**And what are the consequences for international cooperation and the existing trade bodies (like the local agreements and the WTO)?**

As I said above, I think we reached the peak a few years ago of the latest wave of globalization. Over the next decade or two I expect to see a reversal.