SUPERPOWERS ARE FORSAKING FREE TRADE

Free trade is taking a back seat to powerful nations' politics, hurting developing economies

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The great powers that built and sustained the free trade system now have other priorities. This puts most emerging market and developing economies in a difficult position. The United States and China are changing the system and making other countries choose sides in a growing geostrategic rivalry. The best strategy for other countries might well be nonalignment—not just to protect their own interests, but also to restrain the superpowers.

The importance of safeguarding an open and inclusive multilateral trade system is underlined in a recent World Trade Organization (WTO) report, which argues that open trade (as opposed to all countries protecting their own producers and products) is the best way to cushion the enormous and growing costs of Russia's invasion of Ukraine. The report highlights that, despite the war, global trade continued to increase in 2022, as did trade in global supply chains (which grew 4 percent year over year in the second quarter of 2022). Although experts (writing in *Nature*) initially predicted that the war would drive up food prices and cause millions to go hungry, global markets have in fact stabilized prices (see the food price index of the Food and Agriculture Organization).

The problem is that the great powers are turning away from the free trade system they created. Their priorities are being reordered by global security concerns and sharpening domestic political and economic demands. And for developing and emerging market economies the global trading system is increasingly reshaped by these priorities.

Jobs at home and social cohesion: Since the global financial crisis of 2008, growing criticism of globalization and open trade has rippled across industrialized countries, polarizing politics within them. At the core is the view that trade erodes social cohesion. The anti-trade sentiment was captured and accelerated by US President Donald

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Trump when he imposed tariffs on his country's closest allies and trading partners, including Canada, Mexico, and the European Union, citing the need to protect national security and US jobs and manufacturing. Developing economies, whose economic strategies have been shaped by promises of market access, now risk being shut out of markets.

Winning the technological edge: China and the US are now fully engaged in a race to take the lead in technology. Both see free trade as a disadvantage in that race. In 2015 China launched "Made in China 2025," a 10-year plan for rapid development of its tech industry through subsidies and state-owned enterprises. More recently, the US has deployed sanctions, blacklists, export and import controls, investment restrictions, visa bans, and technology transaction rules, in what has been described as "American techno-nationalism." In October 2022 new restrictions were rolled out limiting China's ability to acquire advanced semiconductors and the technology to make them, to hinder its artificial intelligence capability. For developing economies, the prospect of technological decoupling will likely force a choice between one camp or the other, as countries pressured by the US to cut ties with Chinese technology manufacturer Huawei have already found.

> Nonalignment could permit countries to navigate tough economic straits in their own people's interests and project their own values and priorities in international relations.

Security of supply: The COVID-19 pandemic led to disruptions in trade and supply chains, focusing attention on security of supply. "Friend-shoring"—reducing dependence on potentially hostile suppliers—entered the economics vocabulary. The WTO has argued convincingly that open markets help ensure secure supply, but the major powers are taking a different approach. In December 2022, Canada and its friends and allies (Australia, France, Germany, Japan, UK, US) announced the formation of the Sustainable Critical Minerals Alliance, and the Group of Seven is developing an initiative to invest in a secure supply of critical minerals. For developing economies, this may sound like a return to Cold War politics, when leaders of countries such as Zaire (now Democratic Republic of the Congo) with strategic resources were courted by one side or the other, usually with devastating governance consequences.

Effective climate action: The US and the EU have launched a powerful combination of industrial policy, subsidies, and trade restrictions to motivate businesses at home and abroad to reduce greenhouse gas emissions. In the US the new Inflation Reduction Act includes $400 billion in subsidies for renewable energy and electric vehicles that contain a minimum amount of North American parts. This provision is already returning US companies' investment to the United States and attracting foreign investors such as BMW, Mercedes-Benz, Stellantis, and Toyota. The EU has launched the European Green Deal and a carbon border adjustment mechanism (scheduled to go into effect in October 2023), which imposes an "emissions tariff" on imports. For developing economies, the trade aspects of these initiatives look like "Fortress US" and "Fortress EU": Rich countries responsible for the most climate-threatening emissions are locking others out of the fortresses their prosperity built.

Responding to a war of aggression: When Russia invaded Ukraine, outraged Western powers quickly put together a package of economic and trade sanctions. However, many countries did not join them. Several developing economies grappled with issues including their reliance on Russia (for security or for grain), the failure to consult them about the sanctions, and fears that such a sanctions regime could work against them in the future.

The powerful states' new priorities mean a far less certain world for smaller states and developing economies. The world economy may split into two rival blocs: the consequences are modeled in recent work by the WTO that projects welfare losses (or cumulative reductions in real income) as high as 12 percent in some regions, with the largest in the lower-income regions.

There is already evidence of US-China economic decoupling (beyond the technology decoupling cited earlier). Chinese direct investment in the United States fell dramatically from a peak of $46.5 billion in 2016 to $4.8 billion in 2019. This reflects controls on incoming capital imposed by the US government Committee on Foreign Investment in the United States and a sharp increase in control of outbound capital by the Chinese authorities. More recently—although in 2022 US-China trade flows hit an all-time record of $690.6 billion—the percentage of Chinese goods in total US imports fell, as did the value of US goods exported to China as a percentage of total US exports. A recent report by DHL and the Stern School of Business finds far less decline in cross-border flows between China and US allies. Decoupling may be a slower and more limited phenomenon elsewhere in the world.

If the US and China pursue a new strategy of balance-of-power politics, both will seek to enhance their power by demanding unequivocal allegiance. For a rival superpower, more "allies" means more credible power to make threats (whether economic or military) and a greater prospect of deterrence. But for all other countries, the calculation is different.

Some countries may find it advantageous to align with one side or the other. During the Cold War, Western Europe aligned with the United States and benefited from an open rules-based system that enabled postwar reconstruction, growth, and democracy. But the Cold War had other implications for many decolonizing countries whose corrupt and repressive regimes were propped up by the United States or the Soviet Union.

For some countries, it will make more sense to use nonalignment to bolster regional trade, investment, and production—exclusive of the great powers. In the words of a Singapore minister, "If we take sides, that is highly disruptive, either for our security or our economy."

For developing economies, the uncertainties of the global trading system mean that most will want to negotiate trade, investment, aid, weapon purchases, and security from several sources. India and some African countries, among others, still rely heavily on Russian arms. Others depend on Russian energy, food, and fertilizer. Joining in sanctions against Russia for its illegal invasion would cost them dearly. Many countries are strongly dependent on Chinese aid, trade, and investment and are currently resorting to bailout loans from China. They also need markets in Europe and North America.

Nonalignment could permit countries to navigate tough economic straits in their own people's interests and project their own values and priorities in international relations. Nonaligned Singapore refused to support Indonesia's invasion of East Timor in 1975, opposed the US invasion of Grenada in 1983, and opposes Russia's ongoing invasion of Ukraine.

By remaining nonaligned, countries could use their collective voice to urge the world's great powers to use (or even create new) multilateral processes and institutions to help the world navigate the new priorities. This would not only give smaller and developing economies a voice, but would restrain the most powerful states from actions that would damage those that are smaller.

The great powers' new priorities are currently being set and implemented unilaterally. If great powers are more and more concerned with balancing their own political and economic interests without regard for longer-term mutual interests, including those of other countries, the latter need to remind them that their support is conditional on processes that include them.

The global balance of power is unstable, and it is not clear where the relationship between the United States and China will land. Their rivalry is sharpening. Yet their influence over global trade affects not just their power relative to each other but the future of all countries. The rest of the world would do well to prepare itself with a measure of self-reliance in the meantime and to use nonalignment to make sure that both superpowers relate to each other in a way that does not endanger all others. FD

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