

## **EconoFact Chats: A Changing Economic Geography**

**Adam Posen, Peterson Institute for International Economics**

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### **Michael Klein**

I'm Michael Klein, executive editor of EconoFact, a non-partisan, web-based publication of The Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at [www.econofact.org](http://www.econofact.org)

### **Michael Klein**

The United States has played an important and central role in the world economy over eight decades. In a new article in Foreign Affairs, Adam Posen, the President of the Peterson Institute for International Economics, one of this country's premier think tanks, argues that United States policies and institutions help not only this country, but much of the rest of the world thrive in the post World War Two era. But he notes that this is now changing. The title of Adam's article is "The New Economic Geography: Who profits in a post-American World?" The quick answer is not the United States, nor its allies. The Trump administration's America first policies will, Adam argues, make this country and much of the world a poorer, less economically stable place. What policies did the United States pursue over the past 80 years that promoted its own fortunes, and those of many other countries? How is that changing now? And who will profit? Will it be China? To answer these and other questions about this important shift in the world economic landscape, I'm pleased to welcome Adam back to EconoFact Chats, Adam, thanks for being a guest once again on EconoFact Chats.

### **Adam Posen**

Thanks for having me, Michael, and congratulations on keeping EconoFact Chats going at this high level. It's a great contribution.

### **Michael Klein**

Oh, thank you for that, Adam. Adam, in your article, you say that the United States provided a set of global public goods after the end of World War Two. In economics, we refer to public goods as ones that help everyone. Things like good roads and highways, a stable and fair legal system, and a healthy and clean environment. What global public goods did the United States provide in the post World War Two era?

### **Adam Posen**

I use the term public goods, Michael, a little differently than the strict economics version, because with public goods, you can't limit access, and you don't necessarily gain transactionally

from it. But in the broader sense, the US did provide a number of things, starting with national security, including navies that meant, with a few small exceptions, people could ship goods all over the world without even thinking about it, reduced defense spending in a lot of places and forward provision of troops, which then were paid for by places like Germany and Japan, but which mattered and projected security...but in the more economic sphere, a big one, which I know you've written about, is the existence of the incredibly deep liquid anonymized Treasury market, the US Treasuries, which allowed people to park money in and out of something safe, something liquid, something where they could sell and buy vast amounts of money without affecting the prices. In addition to that, that led to a currency, the dollar, which people could move in and out of without much worry, and safe haven during times of strife. We also had, in line with what you mentioned, a set of rules protecting property rights and adjudicating disputes over them, whether it's in trade dispute settlement through the WTO and various trade deals, or literally in courts of law, where US commercial practice either was followed or set a model which people could follow. So there were a whole bunch of things extending throughout the sphere of investment, of consumption, and of commercial transactions.

### **Michael Klein**

You refer to these things as, in economic terms, a form of insurance. What did you mean by that?

### **Adam Posen**

Well, again, it may not be strictly a form of insurance, the way a finance professor would say it. But essentially what happens is the US, by providing some amount of security, whether it's security to keep money in dollars, security to put your container on a ship, security that if you engage in trade, that you have a court of appeal, that people are then willing to make investments. So the analogy I give is, imagine you have a beach house someplace nice, maybe even Cape Cod near you, and if you didn't have a certain amount of insurance, which you pay for in premia, you wouldn't be willing to invest in the house, because you'd be worried about it burning down or getting broken into or something. But if you have the insurance, you're more willing to invest. And these kinds of insurances led to people investing in the system that we had, and the kind of globally integrated commerce and investment that we benefited from. Another point about this, particularly on the national security side, but to some degree on the economic side, is that this is a very special kind of insurance, because by virtue of providing the insurance, the US actually to some degree was reducing the risk. So if you put troops forward in Germany and extended a nuclear umbrella to Europe, you were reducing the risk to Europe. You weren't just covering if a risk came to pass. So that's different from, say, if Liberty Mutual or Chubb or State Farm is busy insuring a house, they don't reduce the actual amount of risk to the house. Whereas, in the US case, if you create a good, solid legal system, if you create a good, solid military, you actually may reduce the risks in addition to covering against them.

**Michael Klein**

You said that this provision of global public goods and this type of insurance by the United States was a win-win policy. So the United States won, but so did the rest of the world. Why is that?

**Adam Posen**

Well, Michael, I mean, when we think about insurance like you or I, renters insurance for an apartment for one of your students, or auto insurance, generally, you're paying for a service, but you're getting something back, right? So there's some room for negotiation over what's a fair price, what's the price you're willing to pay. But ultimately, the peace of mind and the insurance, for want of a better word, against downside risk of something very bad happening enables you to do things you otherwise wouldn't. So I'm willing to get in the car and drive, and I'm willing to leave my house during the day and not worry about watching it, because I have insurance. And so these kinds of deals that the US was providing gave room for other countries or their economies and the businesses and the households within them, to diversify their investment, expand their businesses, get a greater variety of goods and services available, make price discovery, and...but at the same time, the US did benefit, because part of the deal was the US got to set the agenda in national security affairs, whether it was around Iran or Israel or Taiwan or other places. And the US got to be disproportionate compared to its size in the world economy, in the extent to which it got investment, particularly foreign direct investment, people holding their assets in dollar denominated things like treasuries. So again, the other economies, the businesses and households within them, the investors, got a benefit. They got something safer than they could provide sitting at home without the US involvement, but the US got a very large share of the economic activity because of that.

**Michael Klein**

In your Foreign Affairs article, you say that President Trump switched the US from a global insurer to an extractor of profits. What policies did you have in mind and how these made the United States like a character in a movie that says, "nice world economy you have here...a shame if something should happen to it."

**Adam Posen**

Exactly. So it is basically like in a movie. It's a protection racket. You go from saying, okay, here's the policy, and I have the Geico Gecko, or the Liberty Mutual LiMu, or the Flo from Progressive. And I'm advertising, I'm trying to get your business, but I charge you something, but it's a charge you're willing to pay to...you have to pay me so I don't do you harm. And what I have in mind are the first, most visibly, the arbitrary application of tariffs on other countries. So like we suddenly had huge tariffs on Brazil because Trump didn't like how the judicial process in Brazil was treating the previous president, or against very small economies that export things like vanilla or cocoa that have a trade surplus with the US, because that's how they earn a living. And

there's no vanilla and cocoa grown in the US, but you suddenly get wiped out because of this. And the most visible example, though extending beyond trade, are two. First we see in the cases of South Korea and Japan, the so-called trade negotiations, President Trump, Secretary of Commerce, Lutnick, Secretary of the Treasury Bessent, saying to their counterparts in Tokyo and Seoul, you must put up 3, 4, \$500 billion of money to invest in the US, which, by definition, since we're asking for it, you weren't going to do anyway. And that's basically extorting, that they will tie up the money and get a huge share of the proceeds from it. Similarly, we have issues in the investment space having to do with treasuries. They haven't officially done this yet, but members of the Trump administration, including the Treasury Secretary, have repeatedly floated ideas about making the ability to get in and out of treasuries, or whether you're taxed on treasuries, a condition based on whether the US government likes you, on whether you're a particular nationality or not. And these are all measures in which you say you've got some savings invested here, you've got some money you've accumulated, you've got trade, and if you don't behave the way we want, we'll take it away.

**Michael Klein**

Well, Adam, weren't there factors beyond the current administration that have contributed to the splintering of the world economic order?

**Adam Posen**

Indeed, the splintering of the world economic order, I would prefer to say the corrosion of it, because it's sort of uneven, little bits of holes here and there, has been building for a while. And as you and I talked about on previous episodes, and as I wrote about a while ago, the US has been essentially withdrawing from globalization, basically since 2000 compared to every other country pretty much on Earth, except North Korea and Bhutan. But at the same time, the US did continue to provide these basic, important insurance policies in national security, in the treasury market, in fair treatment of trade, and that all has truly changed under the Trump administration. Under the Biden administration, there was definitely some skepticism towards trade and some selective interventions that I didn't entirely support, but you didn't get the same kind of direct threats to other governments or other investors or other people that the Trump administration is engaging in now. That's pretty unprecedented. There were always exceptions, like sanctions on Iran over nuclear weapons, but they tended to be extremely limited, and very much tied to national security, not to economics.

**Michael Klein**

People in the administration argue that this is just asking countries that benefited from the largesse of the United States to begin to treat the United States, in their words, 'fairly.' How would you answer that point?

**Adam Posen**

I think it is a misunderstanding of how good a deal the US got, and whatever reasons, I don't pretend to be in the heads of people in this administration, or any administration, but for whatever reasons, they seem to feel that the US has been played for a sucker and taken advantage of, whereas most of the rest of the world rightly sees it as the US had most of the advantages. This is partly so...what I think they've got wrong is, first, they view trade deficits as inherently a problem, whereas they're not. They actually mean that people want to invest more in the US than elsewhere. They view declining manufacturing employment and increasing immigration as a problem, and politically that may play well, but on any economic basis, or frankly, stability, social stability basis, both of those are signs of an economy where the majority of domestically born or documented migrants are moving up the value added chain, and so we are able to manufacture the same with fewer people, and we're able to make use of people at lower incomes to do things Americans don't want to do, like screw in the back of iPhones, or home health care jobs. But the third and biggest thing, which I think they are aware of but they hide, is, again, going back to what you said, Michael, running a protection racket instead of an insurance scheme. You can make a profit on insurance. Chubb Insurance is a very profitable company. You can say to your clients, these other countries and companies, and say, look, Russia is more powerful. China is more powerful. We need to basically up the premiums. You need to pay a bit more. That's one thing. But coming around and saying if you don't pay me more under the table right now, I'm just going to withdraw my policy, and in fact, you not only don't want me to withdraw the policy, you can't, because if I withdraw it, I'm going to beat you up...that's different. So I think the administration gets the economics wrong, and has this perception of having been played for a sucker, which is not justified on the facts. And then their behavior is that of more gangster-like, rather than renegotiating the prices, what's a fair premium.

**Michael Klein**

How will this changing role of the United States affect its allies? And which ones do you think will be most affected?

**Adam Posen**

This is something which I've come to call, although I didn't put it in the article, the irony of the alliances, which is the economies that were most integrated and most dependent on the US, and which also had a big security reliance on the US, are the ones who are being most harmed. Because, on the one hand, they have the least choice about getting out of US demands. And at the same time, the Trump administration, though they don't say it this way, effectively, has decided we can't strong arm China, and attempts to strong arm Russia don't have any traction because they're too disconnected from us, but we can really strong arm South Korea and Japan and the UK and Canada because they're tied to us. So the answer is, the countries that are getting most hurt by this process are Japan, South Korea, the United Kingdom, Canada, and then there's

a close second tier you can talk about, potentially Australia, potentially Germany, potentially Poland, Singapore. And the thing is, these countries could have been brought along if you decided, for national security or economic reasons, you wanted to have a bigger internal market and keep out what they consider unfair Chinese competition, which the Biden people also wanted...you could have done a more voluntary alliance. Created a fortress North America that actually was attractive. And some of these countries, like Japan, were working on that premise. Their elected officials were actually sort of looking forward to Trump because they thought they'd be on the inside of this US market. Grow inside the US market, give up some of the stuff they have in China for the sake of having preferred access in the US, integrated military, integrated technology, and instead, they've been getting strong armed. Now the UK, for now, is getting a better deal, but that's just because President Trump, for whatever reason, likes the UK at the moment. I wouldn't count on that.

### **Michael Klein**

So do we see countries lining up to do what the administration is demanding? Or is there resistance? I guess, continuing with our mafia movie theme, if we make an offer that they can't refuse, can they, in fact, refuse it?

### **Adam Posen**

Well, the answer is no in the short term, but yes, in the longer term. And again, it depends on your neighborhood. So if you're in the godfather's neighborhood and he's walking by your fruit stand every day, you don't have much choice. If you're a little further out in the borough. And occasionally you get a truck shipment from his company, that's one thing. And then if you're way out in New Jersey somewhere and under a different crime family, you probably can ignore it, but I mean leaving the joking analogy aside, essentially, if you're Japan or Korea or some other smaller economy that has very large US military presence because you have a very genuine threat from North Korea or China or Russia or whatever, you don't really have any choice. On the other hand, even in those countries, ultimately, investors and households can choose not to buy American products. They can choose to say, well, the risk-reward profile of investing in US assets is less good than they used to be. I'm going to reallocate my portfolio. And we see this in Canada, for example. It's like gravity when we've talked in trade terms, like with Brexit and Europe in the past, or Ireland and UK, Canada can never get away from the US, it would just be impossible. But even within that, Canada can resist, and over time, seek to build up alternatives, and they don't even have to do it through central government. Individual households, individual investors and businesses will make decisions. And so this goes back to something. I had written about in the fall ahead of the election, to no avail, that part of the problem with the Trump administration worldview and approach is they're acting like it's a one on one bargaining between the Godfather and the fruit stand seller, or a little less harshly, two business people, or two governments in the summit. But there are knock on effects. People of agency, investors,

companies, households, have agency. And over time, they can choose to opt out. And then a final thing Michael, which isn't captured in the mafia analogy, or you can make it that way, like when Sicily got sick of certain mafia behaviors...the South Koreans, our population and press is enormously outraged by what was done to these workers at plants in the US who were there legally, or who had overstayed a legal work visa by a few days or a couple of weeks, and who were building exactly the kind of plants that the US wants Korean technology to build in the US, and who were there because there weren't in the place the plant was supposed to be, the kinds of skilled construction workers for battery plants or semiconductor plants. And they were doing nothing wrong. And they end up with a couple 100 people in shackles and in essentially prison for a week or two. And so then you start getting into things, or like Mark Carney talking about elbows up against the 51st state in the lighter vein, where, even if the economics says you can't get away, people still want to get away. So this is why I think ultimately it doesn't pay for the US.

### **Michael Klein**

Adam, do you think this opens the door for China to step in and become the provider of global public goods, and through this, the dominant global economy, and replace the United States in its former role?

### **Adam Posen**

Theoretically, yes, in practice, I don't think so. So theoretically, there is a shortage now of these safe assets to put money in. In particular, consistent rule of law, various forms of insurance. Nobody in their right mind trusts the Chinese Communist Party on any of those bases. And so one can be clear eyed about that while saying the US recedes. So in theory, China can make some moves and step into various gaps the US is creating. And inherently, I think they will get some benefits here or there. Countries and investors that previously were leaning towards the US may say, well, China's having all the strings attached to Chinese investment, or having dependence on the Chinese market isn't ideal, but the alternative now is less attractive than it used to be. But in terms of a global role, ultimately, as long as President Xi and the Communist Party are running things the way they run things, as a foreigner, I would not trust putting money in and out of the renminbi bond market. I would not trust that I could depend on access to Chinese markets. Look at the way China treated South Korea and Australia, and was it Lithuania or Latvia in recent times. So what you end up with is a world that's a less nice place, because neither China nor the US are providing it. Again, there are specific things China can do. So China recently announced at the WTO public forum that they would voluntarily give up special and differential treatment, which I'm sure you've talked about, or will talk about on your show, that this was essentially self designation. We're still a developing country, so we should be treated like Cameroon or Guinea or whatever, and get preferential trade. And that was always a wrong thing for China to be doing, always for the last 25 years. So that was an act of leadership, and

that'll buy them some things. But ultimately, just because the US recedes, doesn't mean China gets to step in.

**Michael Klein**

What about regional alliances? Will European countries or the ASEAN countries try to replace American hegemony with their own group arrangement?

**Adam Posen**

I think the Europeans and the ASEAN countries have much more of an upside than the Chinese do or the Americans if we stay on the current path. Neither of them, obviously, you said regional alliances, which I think is right, neither of them can obviously replace the US in security terms, national security terms, and Europe would have to undergo a very large change to replace the US in Treasury bonds, but it can make a partial start. And if Europe chooses to step up through issuing more euro bonds, as my colleagues, Olivier Blanchard and Ángel Ubide have argued, is in Europe's self interest anyway, through having a rules based respect for adjudicating disputes, being welcoming to at least skilled and educated migrants and students around the world, and not being as laissez faire or extractive as China or the US has become towards developing countries, I think Europe could play a big role, both in the sense of gaining, and in the sense of providing some of the public goods the US has ceased to provide. I think, ASEAN and Japan and South Korea, to the extent the US lets them, they have some hope of doing that in the region. Asia is much more diverse, much less integrated. You can't quite do what the Europeans do, but you could do a lot. And then potentially, on the trade front, you have CPTPP, the Comprehensive Partnership for Trans Pacific...or whatever it is, CPTPP, I can never remember the acronym...anyway, that is looking towards a trade deal between EU and the CPTPP countries, and then if Korea gets in, then you have a very large share of world trade that would be rules based. So I think there's a lot to play for and a lot of positive upside. And you mentioned regional and again, to some degree, geography and gravity will constrain this, but there's a lot of upside there.

**Michael Klein**

So to conclude, Adam, these policies have been called an American First policy. But from what you're saying, it really doesn't seem like these are promoting the interests of the United States. Would you agree with that?

**Adam Posen**

Yeah, that's my view, Michael. I think in the very short term, you're going to get a lot of things that look like wins for the Trump administration, and shedding of some things that ostensibly were costs, or where the US was being taken advantage of. But as I conclude the article, 'they paved paradise and put up a casino with what will soon be an empty parking lot,' and so this is



over time going to...and over not that much time I'm talking a few years, going to put the US in much worse shape.

**Michael Klein**

Well, Adam, I always learn a lot by talking with you, and I appreciate you coming on as a guest once more, on EconoFact, and congratulations on the Foreign Affairs article, and, of course, the continued success of the Peterson Institute for International Economics.

**Adam Posen**

It's a mutual admiration society, Michael, thank you for what you and your team do with EconoFact Chats, and again, the quality of discussion. I'm proud to be part of it.

**Michael Klein**

Thanks for that.

**Michael Klein**

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