Event Transcript

The Economist's 2013 Global Economy Survey

Greg Ip, The Economist

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Unedited rush transcript

Adam Posen: Welcome back to the Peterson Institute for International Economics. I'm Adam Posen, the Institute's president. As we've entered this new era where we occasionally have breakfast meetings, we will try to train you all to get your breakfast and come to have a seat, so come on down.

It's my pleasure today to have a very exciting discussion featuring our good friend Greg Ip, US economics editor of *The Economist*, and as you can see on our big screen, his special report on the world economy, which is referred to as "The Gated Globe." This is a very powerful image about something that is neither the free world globalization or flat world globalization that some people would have, but nor is it the tumultuous falling back into World War I kinds of fear some other people have. It's a nuance for you, and it's one that I think is well worth our discussing, which is why we invited Greg to be here today.

As many of you are aware, *The Economist* graciously and quite sensibly relies on a number … interactions with a number of our senior fellows as inputs to their work, and two of our most prominent and most relied upon senior fellows, Arvind Subramanian and Joe Gagnon, who've interacted with Greg a lot over the years, will be providing some comments on this gated globe. That is not to say that they are, in anyway, responsible for what Greg has to say.

Just one more note about Mr. Ip, he is one of the leading economic journalist in Washington and therefore in the US, if not the world. He previously was the *Wall Street Journal*'s Federal Reserve expert, which is where many of us got to know him and relied on his reporting. And he since broaden his mandate in the last few years as the US economics editor at *The Economist*, where he writes occasionally things that look like columns, even though they're unsigned.

We, as many of you are aware, every year *The Economist* has its global economy survey time to come out for the IMF/World Bank annual meeting, and this is the latest one. And as again, I would say one of the more nuanced, the most provocative ones they've produced.

So for format, we're going to ask Greg to come up and present, and then ask, in turn, Joe and Arvind. Then the three of them will ascend to our stage and I will manage traffic for open discussion. Greg, thank you very much.

Greg Ip: Thank you, Adam. I really, really appreciate the opportunity to come and talk to you about this topic. I have to say that coming to the Peterson Institute to talk about globalization is like coming to NASA and talking about rocket flight. I was kind of worried that somebody out in the audience will quickly realize just how little you really know: "Does this man actually know what geostationary orbit is?" "Does this person actually know what a multilateral treaty agreement looks like?" Well, at *The Economist*, if we allow their lack of expertise to get in the way of our writing, we wouldn't have anything in the paper all week, any week. So I had to just sort of plunge ahead, do some research and figure out what I saw, and try and develop a thesis about it. And the thesis that I came up with was what I call "gated globalization."

Now it starts, my story starts five years ago, because a number of tensions were of course roiling the economy in 2008, and it wasn't just a crisis that Lehman unleashed, but also the centrifugal forces that you feared were going to tear the global economy apart and damage the consensus for globalization. And at the very first meeting of the G-20 organized by George W. Bush, there was a concerted effort, and at subsequent G-20 meetings, to push back against those risks; to learn our lessons from the 1930s and not repeat the isolations of that period, which of course means we have to ask ourselves, "Well, did we succeed?"

Now, as Adam said, this is a provocative and nuanced thesis, having some of the most provocative nuances, you can imagine a little bit of a difficult job. And at *The Economist*, we pride ourselves on the motto "Simplify, then exaggerate." And that is not usually consistent with something being nuanced, and so breaking a little bit with that simplistic approach, I sort of came down on, well, yes and no we succeeded.

We succeeded, yes, in the sense that I think the conventional narrative that there was no return to serious protectionism is correct. Traditional protectionism as measured by things like import tariffs, was extremely low. There was a little uptick I think in the first year or two, but it came back down and remains lower than it was in the 1990s. And philosophically, there was simply no intellectual support for a return to sort of '50s, '60s era, or certainly '30s era autarky—the notion that we are better off trading with the rest of the world and welcoming foreign investment has become so entrenched in intellectual and policymaking circles that that bit of conventional wisdom stood up extremely well.

On the other hand, and there is always a but, I think we did, nonetheless, see important rethink of a lot of the precepts of globalization. And the way I characterize it is that if pre-2008 globalization was we aspired to complete freedom of movement capital and people and goods, that since then, we've taken a slightly more interventionist approach where we still want people, capital, goods and services to move across borders, but we're much more selective about which people, capital, goods and services we allow, and the conditions under which we allow that.

I think the global financial crisis and a lot of other tensions going on at the same time, such as the rise of China and its intrusion into developed world goods markets, created a lot of tension and made a desire on the part of a lot of countries to, if possible, manage the process of globalization so that you got its best parts—you got the exports, you got the foreign investment—but you were able to insulate yourself from the bad parts, whether it was excessive inflows of cheap goods, excessive inflows of unskilled labor, whether from Eastern Europe or Latin America, and excessive inflows of hot money and reckless lending.

The failure of Lehman Brothers, somebody remembered that there was a fight going on in Britain over the fact that Lehman had transferred a lot of its assets out of London into New York prior to bankruptcy, which made those assets unavailable to creditors in Great Britain. And around the same time, Iceland passed a law protecting its depositors, but not the foreign depositors of its banks, which again, left the unlucky British holding the bag when those banks went down. AIG of course ran its very large and risky derivatives book out of London, beyond the reach of the most intrusive US regulators, and the euro crisis I think taught, especially northern parts of Europe, the risks of monetary integration and financial integration without a backstop that avoided the excesses of leverage and lending that then came back to haunt many of those banks.

And so those were the sort of fundamental drivers of a desire to rethink and manage better the financial globalization piece of globalization. In 2008 also, almost forgotten in the wake of Lehman's collapse, is that a month or two before Lehman collapsed, Doha collapsed in Geneva. And it collapsed over what seemed at that time the most trivial of issues, which is that some of the BRICs didn't want to lower their various ag trade, and the Americans said, "Well, if you don't, then we … and if you don't give us something on industrial, then there's frankly nothing in it for us." And I think what we now appreciate is that that was the surface strain of a more fundamental divide between two different ways of looking at economic development: the US method which was liberal market capitalism, and a more interventionist model as practiced by the BRICs—Brazil, Russia, India, and China. And it has been increasingly difficult to accommodate those two different approaches to economic development within a single global economic order.

Now, having sort of looked at this thesis, like I'm still an economist when it comes down to, and I ask myself, "What does the data show?" And one of the reasons I was intrigued by this possibility that globalization had taken a breather was that some of the data certainly seem to support that thesis. World trade collapsed in the crisis of 2008–2009, but a lot of that was just really related to the contraction in global demand, and it came back fairly quickly. But at least since that period, we have not seen trade volumes start growing again faster than world GDP, which is different from the decade that came before.

On the financial side, you see the same thing. This is a chart that I've seen in a number of places, and we reproduced it in this week's issue of the magazine. And essentially it shows the total stock of foreign assets of all countries held outside those countries. Now as you can see, you can capture nicely the ebbs and flows of globalization going back over a whole century, reaching a high level in the golden period of globalization when Great Britain was the economic hegemon, shrinking during the First World War and into our period. And then beginning to rise again after the Second World War, taking a pause—what I consider sort of the first pause—around the 1980s, and then taking off in the period of what my fellow panelists have called hyperglobalization, and then abruptly coming to an end three or four years ago.

And so the question is … sorry, let me just go through a few more of these charts. This chart of course, probably you've seen variants of this as well, which shows quite clearly that the enormous flows across borders have dropped rapidly and enormously since 2007, 2008. And even after some recovery from the depths of the crisis itself, which still are levels that are only about a third of the peak level. In fact, we're only at levels that we first reached in the late 1990s in terms of cross-border flows. Obviously, a very large portion of that has been the collapsed and flows within the Eurozone, from North to South and South to North. But it's not just there; if you decompose this data, you'll find that there's been an ebbing of these flows among all regions.

And finally, looking at foreign direct investment, direct investment flows have also waned since the peak of the pre-crisis boom. The question obviously arises at, these are big numbers and it's always dangerous to sort of think that a very large phenomenon, it can be explained by a single variable. Of course temptation is, is that you'll ascribe to the variable that's most conducive to your own case. And so I have tried to avoid that by sort of asking, “Well, how much of this can be explained by things other than policy?”

And Doug Erwin who’s a very good friend of the Peterson Institute has I think a useful way of thinking about it. Sometimes globalization is driven by markets and business decisions, and sometimes it’s driven by policy. And there’s no question that a lot of the trends that I’ve just shown are market-driven. A weak economy is not conducive to growth in trade; imports and exports tend to be highly cyclical, and so they fall further when the economy goes down, and they tend to rise more slowly in a weak recovery as we’ve had. Plus, there’s the fact that as emerging markets growth has slowed, that has also weakened both nominal and real values for trade and commodities.

Then there have been sort of like what I call these business imperatives, which is that even ebbs in the change in the policy environment, a lot of banks in particular would have rethought the extent to which their footprint was sprawling across borders, raising questions about their ability to manage those various risks.

And for example, there are something like half a dozen US banks that entered China in the mid-2000s, and almost every single one of them has now sold the investments that they made. And finally, there are these other ongoing secular business trends such as reshoring. China simply is not a cheap a place to manufacture stuff as it was 10 years ago and so the offshoring trend has slowed and you see anecdotal evidence of some of that activity coming back to the developed world. And the growth of US domestic oil and gas production is also an important inflection point for at least global trade in oil and gas.

So no question, part of what we’re identifying is market-driven. But it’s not just that, and I think sometimes it can be hard to disentangle those trends that are market-driven, those that are policy-driven because they tend to feed upon each other. So when I talk about the desire of banks to reduce their global footprints, they’re responding to the same awareness in the risks that policymakers also have picked up on, which is that when foreign banks are operating within your borders, you are exposed to contagion if those foreign banks get into trouble in other markets.

And similarly, if your banks are exposed to lending conditions in other countries as Western European banks were, for example, to Eastern Europe, then you are at great risk if they get in trouble in those markets. And you’ve seen a concerted effort by regulators in Great Britain, in the Eurozone and here in the United States, to limit the exposure of their banking organizations to that cross-border contagion.

You've seen it in things like some scattershot actions by the Eurozone regulators that are aimed at requiring … even within Europe, foreign banking organizations to maintain a more closely matched book of liquidity of deposits and loans within their own borders, which sounds like a good prudential thing. But if you think about it, if you were to extrapolate that model to the United States and require every bank in your county to have an exactly matched book of deposits and loans, you would do serious damage to the notion of having a single financial market, because you would not be able to transfer savings across political borders to where it's most useful. And a little bit of that is now going on, I think, as a consequence of this fragmentation in the financial world.

When quantitative easing got started in 2009, 2010, there were complaints of currency wars by the Brazilians and others, and that raised the appeal of capital controls as a way to temp down these hot money inflows. Now these were not your father's capital controls. This was not sort of the old-style notion of you simply do not let money in or out, or you impose these Soviet-style quotas; it was much more sort of a 21st century light-touch type of capital controls that took the form of taxes on inflows or outflows, or high-reserve requirements for particular types of bank borrowing, or simply reporting requirements—requiring particular types of capital inflows and outflows to go through an approval route instead of an automatic route, as is the case in India.

Nonetheless, I think that it flowed from the same philosophical rethink of the desire of globalization that was driving some of these other policy actions, which is we have to be much more careful about what type of capital and how much of it we let in, and can't we find a way to separate the good from the bad, and welcome the good and keep out the bad.

And I think Brazil's a very good case here, where they made it quite clear that our model depends on foreign investment: "We want you to come in and build your factories and operate our roads and our ports, but we do not want your hot money inflows just because our treasuries pay 10% and yours pay zero, that is destabilizing to our system."

And also from a policy point of view, there is—and you see this particularly in the rhetoric and the actions of American regulators—a determination not to allow your own national interests, your own diagnosis of what your country needs most; not to compromise that simply because you're trying to be the good global citizen, and come up with global rules. And so you've seen many instances where the application of the new rules of finance in particular, but in other areas have created uneven playing fields.

Now don’t get me wrong, you do have to separate effect from intent. And the intent in these cases is not necessarily to fragment the global financial system, but that as many case is the effect. And the fact that those effects, the knowledge that those effects occur, does not deter regulators whether it’s in Germany or the United States from pursuing this path, speaks to I think the reversal of priorities from a globally consistent set of standards to one that serves national interests most.

And I would not stand here and make the case that globalization has fallen in disrepair or gone into reverse, I mean we’re talking very much again as sort of a nuanced story, where we’re … I think the question we really have to ask is whether at an inflection point, I think a lot of you are familiar with the work of the Chinn-Ito Index which tries to quantify the degree of capital account openness; this thing bounces around a lot.

But I think the message I’m trying to make here is that after a long period in which capital account mobility was the movement towards greater capital account mobility was the order of the day, in the last four or five years we’ve certainly stopped—there has not been an overall trend towards more openness—and in some cases, we’ve gone into reverse.

Again, I would not make the case that we are back to sort of Soviet-style type capital controls, but I think especially—Arvind for example, you’ve made this point—like India and China very much do want to continue towards a world where they are more open to capital than they have been in the past.

But an interesting question is what is their endpoint? Where do they want to end up? And if 10 years ago they sort of aspired to one day be where the United States or Britain are with complete free movement of capital, I think that has changed. They want to end up in a … Joseph Yam of the Hong Kong Monetary Authority put it this way: They aspire not to full capital convertibility, not free capital convertibility. And the distinction is as follows: Full convertibility means that the default is that you allow capital move in and out, but you maintain the ability to interfere with the process, even if it’s just having rules on the books that allow certain reporting requirements and restrictions as needed, to respond to conditions. And that again, I think is consistent with this notion of gated globalization. We want your capital when it’s good for us, and we’re going to decide for our … sorry. Five minutes? Got it, thank you.

And we’re also more discriminating on foreign direct investment. Now this chart, a little lesson on how to lie with numbers. So the UN Commission on Trade and Development does record the number of policy actions designed to liberalize versus restrict FDI. Now you’ll see that even though we have a rising trend, it’s still below 50%, which tells you that the overall trend is towards liberalization, not restriction. But the fact that that trend is tapering, I think, is intriguing. And you're seeing actions, even by countries like Canada and Australia—traditionally very open to foreign investment—putting up restrictions partly because they're much more suspicious, for example, as state-owned enterprises and state capitalism.

And finally, even though traditional protectionism has been very quiescent—thankfully so—we see a lot of evidence of that murky protectionism, that turn to sort of things that are, for want of a better term, our industrial policy are essentially warmed over. No, we don't to keep out imports, but we sure would like to give our exporters a leg up, and so you see much more use of things like export finance, local content requirements—Jeff Schott and Gary Hufbauer had an excellent volume a week ago, looking at the impact of local content requirements; they're very, very costly to world trade, and very, very few of them are caught by the rules of the World Trade Organization.

Part of what is going on here I think is not necessarily a story of globalization per se, but it's a conflict between, as I said, two different ways of how you want to organize your economy. And one of the things that I think is intriguing about the rise of the BRICs is how similar they have all embraced the notion of interventionism and state capitalism, and the so-called Washington Consensus—again the term for which the Peterson Institute can claim ownership—took a bit of a beating. At least that's most caricatured sort of version in the wake of the crisis, when it looked like our model of liberalization didn't work and their model of a muscular state rule worked really well. And it shouldn't surprise that those who see a strong role for the hand of the state in domestic development see an equally positive role for the hand of the state in managing the force of globalization.

We did see movements towards openness and reform gathered strength in the early part of the 2000 in Brazil and India. They have essentially stopped or turned back in the last few years, and Russia's never really began. China is the interesting case of course where they seem to be at an inflection point, where the last five years were sort of a period of stagnation on the reform and openness side, but there are positive signs that they might actually be moving in the other direction.

But if you actually talk to people working on the ground in places like India and Indonesia, Chinese see a high degree of skepticism about whether the governments in power really have changed their stripes. This is a survey that's done by the US-China Business Council. And the main message here is not that people are turning their back on China, but if you see what's been going on over the last few years, a definite waning of the optimism and enthusiasm that has tended to drive the very large expansion of Western activity in China over the last decade or two. Partly this is because of domestic market itself has slowed down, but partly it's weariness and fatigue battling repeatedly against the barriers that China has put up to the expansion and activity of Western companies in there.

To return to a final point which is on the free trade side, I don't want to characterize the United States in particular as having turned its back on free trade; that is definitely not the case. But when you look at the fact that no new deals have been signed by Obama in his five years of his presidency, you do ask exactly what his priorities are. And I think that the story of Doha, which was a story that was shared both by the outgoing Bush administration and the incoming administration, was that the world had changed and that the countries that we traditionally were allowed to get away with a higher degree of protectionism for the sake of a global deal, were no longer wards—no longer in need of that special treatment; they were full-fledged competitors, and there was no way the United States, the administration was going to go to its farm-state senators and ask for sacrifices, unless they got something real in return. And the inability to strike those kinds of deals, I think, is what has really held up the multilateral agenda.

The positive side of course is that—and, Arvind, you'll recognize this chart because I got it from you—is that the liberalization didn't stop, it didn't go in reverse, we didn't actually abrogate deals; it simply moved into different directions along regional channels. And the way I characterize this is that we still want free trade, but we want it with countries that think the way we do. And so to the extent that we can, the United States can get a Chile or Mexico or Japan to come along with our vision of liberalization, whether it's beyond the borders or at their border, we welcome them in. And the other countries will have to make up their own mind whether they can have that as well. I think I want to draw to an end there.

The final point is of course, and this is particularly relevant I think this week given the absolutely pathetic performance of our leaders in the last week or two, which is that if you buy in to the notion that globalization isn't just a product of technology, it's also a product of policy approval and economic leadership, you need to be very, very worried about the lack of American leadership on both the strategic front and the economic front, because frankly, at Congress they cannot agree to actually not default; it's not a Congress, it seems, well-equipped to make the sort of sacrifices, strategic tradeoffs necessary to keep the globalization going forward. I'm going to wrap it up there and look forward to some comments.

Adam Posen: Thank you so much, Greg. It was a real overview with lots of good stuff from us and even from some other people. And on that note, I'd like to call upon Joseph Gagnon who is a senior fellow here at the Institute. Many of you know him as one of the world's leading advocates and analysts of unconventional monetary policy. He's of course done enormous work both prior to joining the Institute four years ago and since, on exchange rate regimes and the impact of currency interventions on trade and on growth. And Joe has some comments for Greg, if I can get to the next PowerPoint. Here we go. See, I'm not totally incompetent. Joe.

Joseph Gagnon: Thank you, Adam, and it's a pleasure to be here and to talk about *The Economist*'s special report. I thought it was really quite a nice read and a clever use of a gated metaphor to combine several different developments that aren't completely identical and sort of done it nicely. The basic point is that there are policy limits being placed on globalization. According to the report, the seemingly inexorable forward march of globalization has halted since 2008. And a couple of things that are pointed to are that capital flows, at least in gross terms, but also we'll see it in net terms to some extent, are down from their pre-crisis peaks, and that trade has stopped growing faster than GDP. I'm going to focus more on the finance part, and I guess Arvind may focus more on the trade part.

One question I think for both of these is how much of these trends are cyclical or temporary, and how much are they secular? I think, well time will tell, and I don't have a strong view.

Okay. So one question is, how harmful are these gates? And the report I think comes down, and I agree that on trade, it would seem hard to argue that more gates is really good. On finance, it seems that the case may be stronger, and the report also seems to acknowledge that. Although it seems to slightly waffle on the finance side, in particular in one place the report says that policymakers overestimate their ability to distinguish between good and bad capital, but elsewhere it says that global financial globalization was too much of a good thing. Now these two statements aren't exactly contradictory, but they do capture a bit of the flavor of "Well, how good is this? Is this good or not good?" I'm going to argue that there is an emerging consensus here that maybe we can distinguish somewhat between good and bad capital going forward.

So to take you through that … so I'm going to basically make two points, and this is the first point, which is can we distinguish, and are people distinguishing rightly between good and bad capital? What do capital flows do? Do they allocate capital efficiently? That's what we normally think of as economists—they should send capital where its marginal product is highest. In terms of net flows, they should equalize rates of return across countries, and the data seem to strongly reject that in many different ways. I'm going to come back to that a little bit later. In terms of gross flows, well even if you don't equalize rates of return, you might be providing some diversification benefits which is good for everybody, and there's some support for that, I think. Also, capital can be linked to a technology and competition that can help to transfer technology and increase competition around the world which would be a good thing, and I think especially through foreign direct investment, we think maybe that's true.

So then this leads to a sense of a hierarchy of capital, and maybe that it isn't so hard for policymakers to decide between good and bad capital. In particular, I think there's wide agreement that foreign direct investment is very beneficial. Portfolio equity seems to be relatively also beneficial; real estate is not a very big category. Then we get to debt, and in terms of debt, I think there's, even within their hierarchy, but there's also starting to be some more costs and benefits here. Debt … we have sort of the excess of debt relative to equity seems to be a pervasive problem in economies, and so this is something to worry about. If it's in local currency and it's long term, then maybe it's still somewhat beneficial, although it can be argued. As you go to short-term debt you have more issues. And then if you're borrowing in foreign currency, then we have either long term or short term, then we have definite concerns. Although there could again be exceptions, particularly if you're exporting and earning a lot of foreign currency revenues, maybe you could borrow in foreign currency, but others shouldn't be.

There seems to be an emerging consensus, I think, and in particular the capital that was at the top of that hierarchy has a stabilizing property. These sort of beneficial forms of capital have the property that in good times, the payments on these forms of capital rise. So when you have a good year, you payout more in returns on this form of capital, and when you have a bad year, you payout less. Including on the deft flows, if it's local currency through the exchange rates, so your exchange rate falls when you have a bad year, and this is stabilizing. This sort of helps the world, it keeps you from going bankrupt which is very costly and sort of has an insurance property.

As you go to shorter term debt, then you have issues such as rollover risk which can rise up in bad times, and again this is sort of counter the insurance principle. And then as you go to foreign currency debt, this is definitely destabilizing because if you have borrowed in a foreign currency when you have a bad time, typically your currency falls and that makes your payments more onerous, more burdensome and you have more failures and bankruptcies.

And one other point is that these benefits which are clearly there from the issuer and also there from the purchaser's point of view, because the investors get more diversification and a better return profile from the more stabilizing forms of debt.

Okay. So the other point I would like to make is, mentioned in the article—I wish it had been highlighted a little bit more—a couple of quotes that I really liked in this survey are, which says foreign exchange intervention is a zero-sum game, and by artificially depressing interest rates in the recipient country, it also encourages excess of borrowing and bubbles there. Two statements which I align myself very strongly, so I think that's right.

But I think it didn't really, the article survey didn't really follow this through as much as it could have. In particular, I think there's a widespread view which you've been hearing a lot lately, that quantitative easing in the central countries is really driving a lot of capital flows, perhaps risky capital flows into emerging markets. I just don't think that's supported by the evidence at all.

If you look at the flows we've seen, despite extraordinary quantitative easing measures, capital flows to emerging markets are not particularly large, and in fact, they have been negative on net. There have been some gross flows it's true, not larger than normal, but the net flows have actually been in the opposite direction. And I think it's actually not even a coincidence. I actually think that there's something going on here, and I think it's the foreign exchange intervention in particular.

Something happened about 10 years ago in 2000 in which emerging and developing economies, on balance as a group, stopped borrowing and they started to lend. And this shift, as you can see is quite large; it's several percent of their GDP. We're talking about a trillion and a half dollars here of swing from borrowing to lending, which is a net swing—not a gross swing because gross flows can move a lot—but net flows, for net flows a swing by that much is quite substantial.

And it's led … so the swing, just to read the graph, the swing is the blue line, is the net borrowing of emerging markets. And as you see in 2000 it switched to net lending to the rest of the world of about a peak of over 4% of their GDP. In 2007, it's now running about one and a half percent of emerging market GDP. This was led by what the governments were doing, which is what I had quoted earlier—the official flows, which is mainly reserve accumulation, soaring in this period.

So this is often been referred to as the uphill flow of capital, and I think it would have been an important sort of gate to talk about in the survey, that capital is now flowing uphill in a way that seems counter to what you would want. And so some people have referred to this as new mercantilism, and I think it deserves relatively more focus in the report.

So, conclusions; and here I'm going to basically agree with the report, that governments everywhere but especially in emerging markets—and I think that was clear from Greg's nice presentation—especially in emerging markets, are adopting a number of gates measures to limit and redirect globalization. And we saw several of them, and I think the one I would like to add is the one I finished which is now, about the reserve accumulation and the massive redirection of capital. But we haven't rolled back globalization per se real large. I think some of these limits are beneficial, and in particular I think controls on more risky forms of capital are good. And I think when you go further, I think too many countries are still borrowing too much in risky foreign currencies which they shouldn't be. Other of these limits are harmful, I think in particular the favoritism in trade, I think it's harder to justify—and I mean favoritism both with respect to specific countries, but also with respect to international champions, things like that, I think it is something that we need to be on the watch for. And of course, as I said the mercantilist flows of official capital is sort of subverting the opening of the world into a way that doesn't seem to make economic sense. Thank you.

Adam Posen: Perfect, Joe. Exaggerated nuance. It was right on spot.

I'd now like to call upon Arvind Subramanian who is the Dennis Weatherstone Senior Fellow here at the Institute. Arvind, as many of you know, straddles the world both geographically in the topics he covers, but particularly has insights into long-term growth strategies, economic models in the sense of countries' models and their impact on the world trading system. It's been our pleasure to have him with us the last several years, and we look forward to his remarks today. Thank you, Arvind.

Oh, I didn't put on your slide.

Arvind Subramanian: Favoritism is a [inaudible 00:33:10].

Adam Posen: Oh, dear, yes, I'm falling behind. There we go. You're absolutely right, sorry.

Arvind Subramanian: Thank you very much, Adam. It's a great pleasure to be here. First of all, I want to congratulate Greg on I think a really excellent survey. People have said exactly why it's so good this nuance, you know, the metaphor of the gated … the gates on globalization. Just right, I think a really very good, great read. What do we do without *The Economist*? No question about that. So having said that, one has to do to *The Economist* what *The*

Economist does to everyone else, which is unafraid, irreverent bashing that they do. I think we need to inflict that on *The Economist*.

So I want to make three points. The point is that this is a slightly kind of anxious concerned view on the world, and I want to say maybe there is a very positive spin to give on what *The Economist* and Greg make out to be slightly negative or even cautionary developments. Then I want to focus on maybe some of the real thing that we should be worried about which the survey didn't focus enough on, and then I want to get into this last thing of do we need a hegemon to sustain the onward march of globalization, and take a slightly … again, a more optimistic view.

So this is kind of optimism against the kind of cautious, or the caution or the wariness of Greg's survey. So first, this is the chart [inaudible 00:34:42] enough hyperglobalization, and that dip there is it cyclical, is it structural? The one point I would like to make is that when you look at the world trade to GDP ratio, especially … oh, my God, I keep doing this. Oh, there's no pointer, okay. If you look at the end … the one thing … the point to take away from this is that world trade to GDP also depends a lot on convergence. If convergence is taking place, trade to GDP ratios will rise automatically. And in some ways what has happened in the last 10 years, the trade to GDP ratio is endogenous; it's grown because of that. And in fact, the dip that you see and the pickup is also partly a consequence of growth.

So as much a story about growth driving trade, as trade driving growth, which you need to separate out when you analyze developments in the trade to GDP ratio. So that's just the kind of a small point, but I think the big thing that I think the survey misses is the fact that, you know, we've had this enormous structural shock to the Western economies. And I would call them two shocks: the cyclical shock—the Great Recession; and the massive under-recognized structural shock—import shock. This is a thing that Krugman uses in his new paper, which just shows basically, imports are coming from much poorer countries in all the Western world. The average income level of import partner declining sharply, and in the US, US has suffered this massive China shock. If you look at the China shock to US, the economy relative to the Japan and Mexico shock, I mean it's just orders of magnitude bigger. And yet, we did not see any serious protectionism in the US, EU or Japan, especially in the US.

So I think this is … I view this as extremely optimistic and positive, especially if you can [inaudible 00:36:31] the magnitude of the shocks that hit these economies. So I think the protectionist dog that didn't bark, I think is one of the big good … very good pieces of news about the world economy.

Now on the policy changes themselves, I have a slightly more optimistic take, or a different take because … you know, China and India are just liberalizing across the board on FDI. I mean, they're in fact liberalizing too much on the capital account—at least India is. And China needs to maybe do more. And in the last six months, India has done much more to FDI liberalization than it had done in the previous 20 years maybe. And Brazil, too, has undone its capital controls [inaudible 00:37:08].

So if you remember the Chinn-Ito Index that Greg showed which showed the decline in policy openness on the capital account, if you want to weight it by the size of an economy, I'm wondering … Greg and if you updated it, I mean, I think things may look a bit different and start looking up.

And just a kind of an aside, I mean if you look at policy change for the first time, if you think about globalization also involving people and immigration, the prospect of immigration from the US … it's not happening but we know because of the underlying demographics, it's going to kind of happen.

So I have a slightly more positive view on what's been happening in terms of policy. What didn't happen in terms of policy is I think a big story of this. So that's my point number one.

Point number two, on the de-globalization, I think the three things that the report could have dealt with more. I think mercantilism, I think would have merited a section in itself. I'll kind of build a little bit on what Joe said, you could argue that China ran the most protectionist policy in history. If you believe that in the 2000s, the Chinese currency was undervalued, depending on when and how you measured, 10%, 20%, 30% or so.

We could quibble about this, but it was … the problem however is that, again here's where the nuance comes in, the period when it was most mercantilist coincided with the hyperglobalization in the book. And now, in fact, when the world economy's come down, you know, market it has receded. So it makes it a difficult kind of story to tell as you know, "Oh, my God, Chinese mercantilism ruined the world economy," it didn't; it coincided with this.

And then, I think the most [inaudible 00:38:45] thing about this mercantilism I would say is that I think that this cannot be replicated by other emerging market countries for three reasons. I think Chinese-style mercantilism requires three prerequisites. I mean, maybe it requires autocracy as well, but leave that aside. It needs a close capital account, it needs a Lewis labor supply, and it needs fiscal prudence. India comprehensively failed on all these scores, and so do most countries because they're opening up their capital accounts.

So I think, going forward, the story … I mean Germany might be very mercantilist, but I think it's unlikely that Brazil … Brazil can't because it's an open capital economy. Over or none of Latin America can really maintain sustainably undervalued currencies. So going forward I would say this is also … we've had a mercantilist saga, it didn't create, in fact it coincided with the boom, it's receded and it's not going to be replicated going forward. So not such bad news after all.

Now, on the demise of multilateralism, Greg generously caught me saying this is multilateralism as we know it is over, and to some extent it's true. But here again, I would qualify this a little bit by saying, look, let's not lament about Doha. Doha was small fry, nobody wanted it, it was an aberration and it doesn't really solve the world's problems multilaterally. So you need to be concerned about multilateralism, but not about Doha. I think, in fact, the argument is that we need something much bigger, much more meaningful and much more current with recent developments. Doha is really outdated.

And on mega-regionalism, I'm conflicted frankly, like Greg is. On the one hand, I do think it needs … especially because now, as I said in the first time in history, the four biggest trading partners are doing this amongst themselves. That's why I think multilateralism is in jeopardy, but maybe competitive liberalization work, and there are some early signs that one of the intents of this, which is to put pressure on China, is perhaps working—China is moving forward, or at least threatening to move forward; FDI agreement, playing ball in the services negotiations in Geneva. So it's possible that this could actually work on China and then we get much more meaningful liberalization.

Last point, I think the real deglobalization story, I think *The Economist* missed. And which is that I think the world is becoming more protectionist in the following sense, or more close to the following sense, which is that the composition of world output is shifting from the rich countries which are less protected, to the poorer countries which are more protected, and it's shifting from manufacturing which is more open, to services which is less open. So if you look at that global shift, actually you could make the case that in fact, endogenously the world is becoming more close.

And that's a point, Greg that you missed, so I think you should make amends next time around. In fact, if you look at services, again much more close in developing countries. Manufacturing also close, but the point is that it's certainly shifting towards developing countries which are on average more protectionist, or policy barriers are higher, but also within that it's shifting more to services which is intrinsically more-

So I think this is a kind of compositional shift story that I think is worth thinking about. Last point, I mean Greg rightly says, you know, globalization has been sustained by the hegemon, the benign hegemon, the US—now it's being threatened. By the way, my prediction that the renminbi will eclipse the dollar within 10 to 15 years, Mr. Ted Cruz is on my side on that score. I'm very happy, the more he does this, the more my prediction …

Ted Cruz: [inaudible 00:42:15].

Arvind Subramanian: Yeah, exactly. Now, I think what sustains globalization? Convergence which I've mentioned, technology which Greg mentioned, and then what Jagdish calls the three I's: Ideas, Interests, and Institutions. On technology, I think the spread of this is far from complete; I think there's much more technology to spread to sustain globalization, especially in the emerging market and developing world.

On ideology, I would insist that the reappraisal after the financial crisis was not that capitalism and globalization was discredited, but as Joe also said and it said in the report, that finance as we knew it is discredited—domestic finance and global finance. So the ideology that globalization is still good, certainly New Delhi and Beijing, it's not been dented by any means. I think that the kind of murky protectionism that you talk about is a little bit the developing world trying to imitate China. You know, that we can get this technology, force companies to transfer technology and so on, but I don't think fundamentally this ideology of globalization has in any way been dented.

Institutions. Yes, we still have the WTO, maybe a little bit irrelevant, but it's still playing a constraining role as Greg also mentions in his thing. So we still do have institutions. For example, the legal dispute settlement angle of the WTO is thriving. Everyone is going to it; they're respecting its rules. And even the fact that we get murky protectionism, is a tribute to the fact that the WTO is an institution and its rules are working and people are … even if they want to breach it, they have to work around it.

The last point I will make is this: I think in some ways the globalization finally is sustained by the enmeshing of private interests. You quote this book by Roger Angell, the … what's it called? I quoted it in my book as well. Sorry? The *Grand Illusion* … Norman Angell, *Grand Illusion*, and there's a lovely phrase actually where he says that … it's not he, but Lord Esher says that this is about … these interests, it's kind of pregnant with the restraining influences of these things, that that's why globalization is going to be sustained. Of course we had World War I, that's a different matter, but I think that what is new about the world in the last 10 years and going forward is not just that these private interests are building up all over, but what … you know, other term [inaudible 00:44:44] I call, this phenomenon of criss-crossing globalization—that is it's no longer the case that the poor guys get capital and technology from the rich, and the rich guys get the commodities. And you have this kind comparative [inaudible 00:44:57] comparative advantage world. We're getting much more a criss-crossing world where flaws are both ways, FDI is both ways, people are both ways, and that changes the underlying dynamic for globalization I think quite fundamentally.

And this is an example from a paper that we did, if you look at global two-way FDI flows. This is a measure of two-way flows. It's a Grubel Lloyd index, one of course means perfect two-way flows and zero means no two-way flows. In FDI, you're finding more and more two-way flows. So China invests in FDI in this and gets it back, I think it's going to change the need to maintain open FDI and so on.

So on this, let me end by saying that I think this criss-crossing globalization is enmeshing its very thing, and I want to quote Salman Rushdie's book *Midnight's Children*, where I think the protagonist Saleem Sinai says, "All of us brown, white, black are leaking into each other like flavors when we cook," and I think this is the kind of world going forward, which I think is very optimistic from the point of view of sustaining globalization.

Adam Posen: Fantastic, Arvind. If I can ask Arvind, Joe and especially Greg to come up now for the discussion. As I've said several times, the Peterson Institute for International Economics' mission is to try to make globalization as sustainably beneficial for the people of the US, for the people of the world. And every once in a while, it's good to unpack what that concept globalization means and take stock of where we are. And I think while we're not at a new Washington Consensus, I do think the forms have overlapped between our three speakers and our more nuanced view is extremely important and a good place for public discussions, not just today to start. I would certainly echo the idea that what was overturned was what I've referred to as "high church, super financial capitalism," which doesn't mean that sort of low church, more down-to-earth forms of capitalism have been repudiated.

Unless Greg has some particular point he wishes to zing our commentators with, or correction …

Greg Ip: Can I just respond to a couple of points that I heard? I can make it real quick.

Adam Posen: Very briefly.

Greg Ip: Okay. So I guess when you end up with a lot of data, some of which goes in the positive and some in the negative direction, you could come out either way. And I chose, I think perhaps to take up, as you said, a slightly more concerned view. But, Joe, I wanted to respond you think that it is possible to distinguish between a bad capital, and at the end of this process, I'd like to call myself skeptical. You say FDI is good, hot money inflows are bad, but we've seen in the evidence that when gates are imposed on hot money inflows, companies will find ways to disguise what were hot money as FDI. You'll see, in the case of Brazil, a suspicious spike in FDI right after the attacks on inflows came in. We know that multinational enterprises may have the ability to choose between retained earnings or outside finance, and they will arbitrage between those two depending on the policy environment; that is not available to small and medium-size enterprises, it's distortionary and it's bad. And I think that policymakers who believe that they have the ability to do this are tempted to obliterate some of these more macroeconomic negatives and execution issues in the pursuit of those things.

Arvind, I wanted to respond to a few things, you said first of all …

Adam Posen: Not a few things, Greg. One or two key things.

Greg Ip: Okay. On this question of you thought it was very impressive that you think that there's been a rejection of financial globalization but not overall capitalism, I have to say that I think in the minds of a lot of voters and politicians there isn't a big distinction and you'll find that the same people pushing back against financial globalization, often also pushing back against unfettered trade. And again, this is a nuanced version, nobody's calling it an autarky, but if you listen just to the words of some of the leaders in the Democratic Party and the president himself, you'll often find the two things: It's not we want globalization; we just want to manage the process better. Therefore, when we do free trade, we want to make sure it works for the middle class and the working class, so we're going to put in labor and environmental standards and all those other things. So I guess I see on that front that at least while we may draw the distinction, I think a lot of people do not.

Adam Posen: Thank you for being concise, Greg. I think I see my friend Bruce Stokes is in the audience, and one of these charts, one of Greg's charts was from the Pew survey. Bruce is the guru of public cross national attitudes of globalization. Bruce, I don't want to put you on the spot but I will. How do you feel about Greg's—you can come up to the mic—how do you feel about Greg's characterization that the popularity of globalization is going backwards, and in particular that there isn't a distinction between finance and turbo globalization, hyperglobalization and good old-fashioned globalization?

Bruce Stokes: Certainly. To Greg's point, the last point about belief in free market capitalism, I mean our data's very clear, it's been declining for the last two years around the world. So I think it's probably a distinction that the public doesn't make between financial capitalism and it just don't bleeds over into a …

Now, in terms of outright support for protectionism, nobody does it consistently; we don't do it consistently enough to really be clear about this, but every time we ask it, basically people, in theory, still believe that trade is good for their country. Even 60% of Americans think it's good for the country. It's just when you ask them specifics, then they don't agree. They say it kills jobs, it lowers wages, and they don't even believe that it lowers prices, which is of course the main rationale for trading.

But it's not clear that's gotten much worse over time, I just think people are of two minds of this, and that's really been consistent for prior to the crisis. So we hope to maybe ask these questions again next year, just to see if it's gotten worse. And it may [inaudible 00:51:04] the margins I've got, but I think that our data show the real contradiction is that people believe in globalization in principle, in theory; they just don't believe it in practice because of the impacts on their personal life.

Adam Posen: Yeah, Arvind.

Arvind Subramanian: So my question would be that even if that's true, right, I mean how do you explain the fact that … other work has shown that the China shock has—by David Autor and people and Gordon Hanson—has led to a lot of labor market displacement in the United States? And in the face of this, we saw very little protectionist response. I think that's absolutely telling, staggering in fact.

Bruce Stokes: No, I'd agree. I mean it hasn't translated into the kind of legislation you saw in the 1980s against Japan.

Adam Posen: Or even major public protest.

Greg Ip: So, if I can just respond to that. I guess I … again, I sort of see this glass as half-empty and not half-full. Now we are sort of hobbled by the fact that we lack a really good consistent polling question on this front. I look at WSJ/NBC poll for example and they last asked it in 2010, but you do, to the extent you have that data, and Matt Slaughter and Gord Hanson in their work for the Institute have shown this quite clearly, you see a steady decline in the intellectual support for free trade among Americans, and most notably among white-collar workers, which I think shows that they too are unsettled by the threat to their livelihoods, whether it's from, say, outsourcing or whatever. It is true that, no, we did not have a dramatic upsurge in protectionism, but remember what your own data show, that we've actually seen in the last few years a big decline in the rate of penetration by China, partly because China itself, its economy, [inaudible 00:52:35].

So I don't think it's anything inconsistent in my story to say that as you saw hyperglobalization affect people's lives, it started to, with a leg, produce a policy and a political reaction. It was just last November that the Republican candidate for president ran on a platform of bashing China, like more so than any Democrat had ever done. If Mitt Romney was today the president, I think we would have a somewhat different …

Adam Posen: He also didn't get very much out of running on that platform.

Greg Ip: I'd say that if you ask why he lost, it wasn't because of that platform.

Adam Posen: But it certainly wasn't enough to make him win.

Greg Ip: True.

Adam Posen: But anyway, thank you, Bruce, for pitching in a thing to this. We're now open for questions and comments. There's a microphone traveling in front, or you can go to the microphone in the back. I normally prefer to leave to ask non-institute people to speak first, but since nobody's volunteering … oh, good. Somebody there. Please identify yourself.

John Veroneau: Yes. John Veroneau, Covington & Burling. Thanks for the panel. My question is regarding regulation. Historically, trade liberalization was about dealing with trade border measures—tariffs, et cetera—but as more countries developed and flexed their own regulatory muscle, some of those muscles they're flexing in a protectionist way, but even if they aren't, my question is how much of this regulatory buildup in various countries will be a drag on globalization?

Adam Posen: And as Greg mentioned, we did have an excellent new study by Gary Hufbauer, Jeff Schott, Cathleen Cimino that we released about a week ago, looking at particularly the issue of local content requirements which is one form of those. Does anybody, Greg, Arvind … anybody wish to comment?

Greg Ip: Well, I certainly think it's awfully important. And I think one of the points I make in my survey is that one reason the multilateral agenda has sort of ground to a halt is because it's accomplished so much on the traditional side of goods. The average bounded tariff has fallen steadily over the last three or four decades, and as you try, and therefore push the frontier of globalization into services I think you're making this point, you'll run into domestic barriers that are easily … forms in protectionism that are not easily identified as such.

I mean, the fact that China for example, is developing its own standard for wireless telephony I think goes exactly to this point. I mean, they have their own domestic priorities for doing that, but to the rest of the world, it kind of looks like protectionism; and explains why the United States, in its desire to push the frontier of liberalization forward, has gone the route of Trans-Pacific Partnership where they can go behind the border. Two things like intellectual property protection, like does India want to sign on to our standards of IP protection when they see that their approach to generic drugs as essential to their whole health and development agenda, those are two very different visions about where you want to go on something. And I think that's one of the reasons a multilateral route has ground to a halt.

Adam Posen: It's a really important issue I just was going to say. Arvind and Fred Bergsten are helming a multi-authored project on US-India trade and economic integration. And, Arvind, you may want to say something about that particular example.

Arvind Subramanian: Yeah. See, I think that just in finance, Joe said we're kind of arriving at a new consensus. I think the IP point, I think intellectual property is actually very different. I think the lack of convergence in international IP standards is not anti-globalization, not even remotely anti-globalization. Because I think some countries at lower levels of development need access to cheaper drugs, so the tradeoff that they draw between innovation and dissemination is going to be different as you move up the income spectrum. And because it's very development-specific, I find it hard to argue that the fact that India may not have the US, where the US draws the boundary, as somehow … because that's how most countries were when they were poor. So I think it's that's not to me an example where regulation is a barrier, or differences in regulation are a barrier.

Adam Posen: Great. Jeromin.

Jeromin Zettelmeyer: Jeromin Zettelmeyer, PIIE. Just directly on that point, based on the new book by PIIE, I was wondering whether maybe local content requirements are the dog that did bark after the 2009 crisis.

Arvind Subramanian: My response to that is that remember, mine is a story about why the West, despite the massive structural shocks, didn't get protectionist. Those dogs, or those puppies that are barking, are mostly in the emerging market world. And my question is how much quantitatively, how quantitatively significant are these?

Adam Posen: I think it's worth flagging and I'm grateful to Jeromin for raising that. Gary, Jeff, Cathleen really did emphasize that this was a problem across countries, even though they made a big thing about Brazil, there were also issues in Canada and the US that they featured. And it is interesting if we can take it down a level from the very high concept, is a question of if there is going to be something of an infrastructure boom in coming years, or public investment boom which a number of people are talking about as one potential source of growth, obviously these government procurement in local content requirements may play a bigger role, they may also then come under greater scrutiny so that it's all to play for in a sense.

Nick and then the lady at the back mic.

Nick Lardy: Nick Lardy at the Peterson Institute. Greg, one of the areas where I think your analysis was quite nuanced was on the whole issue of state capitalism. I recall the cover story *The Economist* had last year that basically was claiming the demise of market capitalism. You seem to take a much more nuanced view. I know you weren't responsible directly for that cover story, but why are you taking a much more nuanced view on that issue than your colleagues?

Adam Posen: And you can read for nuanced implied accurate.

Greg Ip: Well, since we have no bylines, how do you know I didn't write that article? I reserve the right to actually associate myself with whatever you like, and disassociate myself from whatever you don't like.

You know, a question that I ask myself is whether I'd started this project six months later I would have come out in a different place, because a lot has happened in the last six months. And one of the things that happened is that what we saw with the brief, sort of like turmoil, when the Fed began to talk about taper, was the disparate way that it hit some countries and not others. And it hit Brazil, Indonesia and India harder than it hit, say, Turkey, Poland or … sorry, not Turkey. Then it hit, say for example, Poland or Malaysia and Mexico. And I think one of the reasons why is that the market sensed that this first group of countries which were much more in the state capital intervention direction of things had really managed to flub it in the last four, five years. They had one or two good years using state-directed lending to basically ride out the post-crisis slump quite effectively, that it completely blew the opportunity to use that policy space to proceed with reform. India and Brazil are basically the story of stagnation on the reform front, and what I think that at least if …

unfortunately, I think they both have to go through an electoral cycle before they can get [inaudible 00:59:30] again.

But to the rest of the world wondering which model to follow, I think it’s become clearer now than it was 12 months ago, that model doesn’t work. And I think like a Chile, or Mex- I think what’s happened in Mexico is very interesting. For example ,they want to amend their constitution to bring foreigners back into the oil and gas sector because they’ve had … they’ve seen their failure to develop that because of the restrictions they’ve had. And what’s going on in China’s very, very interesting. I mean, China is responding more to its internal imperatives than to any external pressure, but to the extent that a lot of other countries were reacting to the China threat by adopting a more sort of adversarial approach on globalization and their own sort of intervention, to the extent that China itself rethinks that model. That actually I think takes down the tension with other countries.

So I think the bottom line is we’ve seen, I think the state capitalist model looks more discredited today than it did a year ago, and to the extent that I have associated this gated globalization as the product that people lost like state capitalism. I think it’s a good thing for globalization to the extent that state capitalism has also seen its better … that its best days increasingly look to be behind it.

Adam Posen: Arvind, you can be very brief, but hold on one second, I want to do a plug for which Nick is too modest to make. Nick’s current book in progress for the Institute is attacking the notion that state-owned enterprises are and will continue to be dominant in China, and pointing out how much it’s the private sector that has driven Chinese growth.

Arvind Subramanian: Two quick responses: one, the most state capitalist of all was not affected by how the crisis, i.e., China, you know … which is really the second point, I think how much of Brazil, India, South Africa, Indonesia being more affected is due to state capitalism, as opposed to just macroeconomic vulnerability and macro mismanagement is an open question.

Adam Posen: I just have to note, unfortunately Joe Gagnon has to leave in five minutes, so if anybody has a finance-related question, please plug it in now.

Jo Marie Griesgraber: Okay, thank you. Briefly …

Adam Posen: Could you identify yourself ?

Jo Marie Griesgraber: Two questions. Jo Marie Griesgraber, New Rules for Global Finance. And could the reason for the low response in the United States in favor of protectionism, could it be the reduced influence of the labor unions? The second question is, when I heard the topic "The Gated Globe," I thought it would be about inequity and unequal distribution. And could you address some of the distributional and inequitable realities that we're living with right now? Does that relate at all to your gated communities?

Adam Posen: Could I ask Joe if he has any thoughts that he wants to … from any of the last discussion before you have to go?

Joseph Gagnon: No, but I could. On that issue, I think there is a lot of work on sources of inequality, and I'm focused more on the US and advanced economies. And trade is a natural place to look, and most people think it has some role, but my sense is most people think it's technology fundamentally is more important, and I guess I believe that, I've been thinking about it a lot is that the nature of information technology is kind of destroying sort of the middle ground of employment to some extent and boosting the high-end returns. That would be true without globalization, I guess. I don't know, I don't have anything more to add.

Adam Posen: Just let me say at the Institute, thanks to the ERANDA Foundation, we have a project going with Jacob Kirkegaard, Thomas Hildebrandt, David Blanchflower, on compared of inequality. We'll be presenting some preliminary results from that in early November, you'll receive an invitation. But just to be a little more exaggerated and less nuanced than Joe, we've seen inequality rise throughout the vast majority of the world's countries, and not even just rich countries. And this has occurred, irrespective of and sometimes uncorrelated with the extent of opening to trade. The US has opened to trade less in some ways than other countries in recent years in terms of the change, and it's seen the biggest rise in inequality, and a lot of that can be traced to our unique fiscal policies. But so where to a degree that there's a universal force, it's much easier to argue that it is technology and not trade because that seeps through borders simultaneously.

Greg.

Greg Ip: I want to make a plug. One of the reasons this special report didn't deal much with inequalities because last year's special report on the global economy was all about inequality by my colleague Zanny Minton Beddoes, and it's still available on our website. I strongly recommend it, it is superb. I didn't want to retread a lot of that ground, but I think there are connections here that perhaps not as strong as I would have expected. I would have expected more of an explicit linking of the two, and some of the political discourse. But I think it's there, even in an indirect sense. I think a lot of the backlash against finance and financial globalization is driven by the idea that a very fortunate upper crust did extremely well from finance over the boom period, and left the taxpayer and the average

American or the average European holding the bag. And I think that drives a lot of the political backlash you've had against financial globalization.

If you look at the rhetoric of some of the populous parties that are now rising in Western Europe, and this is something I didn't get much into, but it worries me greatly, that there is a very stream of anti-elitism, of a concern of anti-globalization. Not because that they're intellectually consistent, but because they sort of play off that same kind of resentment as well. So I worry that I see that the alternative for Deutschland, you know, has now supplanted the Free Democratic Party as the protest party in Germany. I worry that the national front in France has been gaining adherence.

You talked about immigration; immigration flows are down in the last four or five years. Now part of that is because of convergence—you know, fewer poorer Mexicans, therefore less emigration. But it's also the case that on immigration, like other [inaudible 01:05:21] things, we have seen a more gated approach to policy. If you ask yourself why has immigration policy not moved forward in this country, it's because Republicans want … they're very happy to let the high-tech engineers, the PhD's come into this country. They don't want the unskilled workers coming in, and you see that same ambivalence replicated throughout Western Europe as well.

Adam Posen: I think that's a really important point.

Arvind Subramanian: The question that was raised about weakening—nobody answered—the weakening of the power of labor, I think that's a really excellent point. Because to me, one of the puzzles has been why is it that when there was so much clamor against the Chinese exchange rate intervention, why didn't that translate into much more serious action in the United States. And my partial answer was even in Congress, the power of labor was considerably weakened relative to corporate interests who didn't want to take action against China. And so that is a very important point.

Adam Posen: I would also echo Greg's plug. Zanny Minton Beddoes' survey last year on inequality really was excellent, and I'm not sure that much … unlike where Greg had to keep up with a very fast-moving target, I'm not sure that much has changed in the years since then. Please.

Alan Wolff: Alan Wolff, National Foreign Trade Council. Realizing the dangers or prognostication, and I remember well the cover of *The Economist*, maybe in 1989, that talked about 21st century the century of Japan, one of the charts was a global economic leadership, China rising relative to the US falling, still US ahead. So my question is, looking ahead, leading towards what [inaudible 01:07:08], leading how the timing of the evolution. I mean what's happening now in Geneva is, I think you were all right about Doha was not the issue, Doha was a symptom. It's a symptom of a lack of consensus of moving forward with liberalization. There is no consensus in the WTO on liberalization. And until there is one, there's not going to be a lot of it other than on a plurilateral basis. But the question is, on China, how quickly do you think it will move? And are they compelled to move in a direction we'd like to see them go? Where are they taking us? And do they actually adopt a leadership role? When? Thanks.

Adam Posen: Thank you, Alan.

Greg Ip: I don't have any simple answer for you, but I have a couple of thoughts. One of the questions I wrestled with was how important was the fading of the United States as the hegemon important to the forward march of globalization? And people can comment on different sides like this. I mean, if you look at the post-war period, the fact that the United States considered, thought that containing the Soviet Union was intrinsically linked to its ability to spread free market capitals, and it was much more willing to use access to its own market, and to allow disparate levels of progress in liberalization to proceed. Because that was so tightly wound up with its own geopolitical aims.

If you go back to the '80s, you know, of course in '89, I don't remember that cover but I'll take your word for it. And I suspect that 10 years from now, somebody will use my cover here and mock me in exactly the same spirit. But what was interesting about the difference between Japan-US trade tension in the '80s versus China-US now, is that at the worst point of the Japan-US tensions, it never ever spilled over the strategic relationship. They were our unsinkable aircraft carrier, and the defense establishment was a moderating force on the tensions on the economic side. Today, you don't have that. If anything, I perceive that the political side and the economic side, the tensions between China and the United States tend to feed off of each other instead of tend to constrain each other.

And I'll give you an example. I didn't get into this in very much detail, but Japan is a big investor in China, right? But we also know there's a lot of history and political tension between them. And when the fight over the islands, the Diaoyus and the Senkakus, erupted, you had these riots in China that were targeting Japanese factories, Japanese cars and so on, and very quickly afterwards, sales of Japanese cars in China plunged, and they still are not back to that old level. Now, that was not a tension driven strictly by economic factors; it was not the case that Japan and China were fighting over a strictly economic issue, but it was a case of the geopolitical tension spilling over on to the economic relationship. And the extent that the United States is less able to be in there as a moderating influence, keeping that under wraps, I do worry.

Now, at the end of your presentation, you talked about the possibility I think that the institutions are important. And at the end of my survey, I come out sort of moderately optimistic, that even if the United States is not able, through its own economic power force of will, to impose free market capitalism on the rest of the world, we've gotten to a place where most of the rest of the world actually sees it in their own interest, and we'll get to that place without that outside pressure. I don't really know whether that, which is a positive force, versus this geopolitical then which is a negative force, I'm not exactly sure which wins.

Arvind Subramanian: I agree with everything that Greg said. Whether China or US multiple our world is something that I dealt with in my book. But the one point I would make is the US-Japan, US-China comparison, kind of the opposite view that when the US and Japan had all these tensions, there was much more protectionist action against Japan. In fact, that was the most protectionist phase in US history. Partly because I think Japan was not as kind of geopolitically strong as this, but also partly because the Japanese, unlike the Chinese, did not create a vested interest for FDI, US FDI in its country. I think because China got all these US FDI, it kind of co-opted American capital, and that's why when the structural shock was much greater for China, you saw much less protectionist action.

Adam Posen: Yeah. No, I think that's a very important insight. Marcus Noland here, Fred Bergsten and others have written about the exchange of hostages as it were in the Japanese trade wars, where it was only a one-way exchange that we got their FDI here. Whereas in China, for all its problems, it is a two-way exchange; I think it's a very important point. I think this will be our last question.

Dave Nagel: All right. Dave Nagel with BP. One of the slides showed … mentioned shale oil and gas, and among the various factors that play here that you're looking at, how important is that trend and that technology and that development. Is it at the margin, or is it larger than that?

Adam Posen: Thank you, Dave.

Greg Ip: Obviously, if you're doing a sector by sector breakdown, it's huge. I mean it's more important in terms of these forces than almost anything else that's going on. I don't know whether it's important enough to change the overall picture, but I think it's important in a couple of ways. First of all, part of the reshoring you see in the United States is because energy is cheap here, and energy-intensive activity such as in petrochemicals are once again competitive. So that would fall into the category of market-driven deglobalization, and it's not anything to get worked up about, it's simply companies responding to the varying cost of factor inputs. It's entirely sensible that that leads to some reduction in cross-border flows of energy-intensive products, that's fine.

Where I think there's an interesting question is whether it affects the geopolitical sphere as well. So there's an ongoing debate in the foreign policy community whether, as the United States becomes less dependent on imports of foreign oil and gas, it therefore becomes less politically committed to involvement in the Middle East and so on. Now, at his UN speech, Barack Obama raised that concern and said explicitly, "No, that's not the case." But I think that people outside the country do worry, and that you can hear it in the way tea party people, the isolationist wing of the tea party talk, they bring this up as a reason why we do not have to like overcommit ourselves any longer to the rest of the world.

So I do wonder sometimes whether the prospect of greater energy independence in the United States weakens the geopolitical bond that has helped hold the globalization story together.

Adam Posen: If I could just make two additional plugs, we have a study coming out in the next few weeks, several weeks, by Trevor Houser who has been the energy expert for us, on the impact on US, specifically US economy and trade of the shale gas revolution. And actually we built off of BP's publicly, the best publicly available numbers in terms of energy projections, which Dave knows this, but which BP provides on the economic analysis, and we look forward to releasing that. But just picking up on something Greg said, as many of you are aware, Gary Hufbauer did a policy brief earlier this year, saying the argument for bottling up—if you'll excuse the expression—natural gas in the US versus exporting and trading it like we would any other good, doesn't hold up. And we came out consistent with our views on globalization, that there should be free trade in natural gas. Yeah, Arvind.

Arvind Subramanian: There's a talk that struck me yesterday that if more and more natural gas and shale gas is going to be discovered around the world as it seems, everyone in every country you're finding more and more deposits—Africa, Asia, Central Asia, everywhere—then the question is that, is that phenomenon intrinsically going to lead to much more state capitalism around the world, because these things, resources, are going to be exploited and stuffed by big public sector companies or governments themselves. And I think that imparks a kind of slightly darker view about development, the natural resource curse, state capitalism. That's I think a bigger thing at play which I think we need to think much more about.

Adam Posen: I would encourage that and I would also tell that another forthcoming study from the Institute, whatever the topic is we're ready. Marcus Noland

and Cullen Hendrix have a new study on reconsidering the resource curse that is going into production shortly.

But let me just close by first of all thanking Greg. We do have a wonderful relationship with Greg and the other economics people in general at *The Economist*, but for giving us, as we've already said, a nuanced but pointed study. And it's very provocative, it helps organize our thoughts, and Arvind and Joe took us from there. And I think it's been a very fruitful discussion.

I would like to make two quick observations: One, it is interesting that this group talked mostly about trade—foreign direct investment—what economists call the real side of the economy, and that's fine. And in a sense, I think that's right, but I think it does underscore Joe's earlier point, that in the sense we have moved past the high point of the financial globalization, and we're focusing on the real side integration which is where the real money is.

And the second thing is, one word that didn't come up, even with Dave's prompting, was climate change. And while that's not a specialty of this institute, and Greg cannot cover anything … everything, excuse me … cannot cover everything. He can cover lots of things. He cannot cover everything in one survey as well as he did, it is something that the gated model is ill-suited to cope with, and I think we all have to keep that in mind, even if, as Arvind pulls us in the direction of optimism, justified—we hope—for globalization.

So thank you, Greg. Thank you, Arvind. Thank you all very much.