The Macroeconomic Impact of Trade Wars
(and Brexit counts as one)

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60,000 ceramics lost in a shipwreck
Reflecting truly global trade

The Tang Shipwreck
The ancient roots of Singapore’s maritime trading heritage

In 1998, a shipwreck was discovered just off Belitung Island on the edge of the Java Sea. It contained a remarkable cargo of more than 60,000 ceramics produced in China during the Tang dynasty (618–907), as well as luxurious objects of gold and silver. Bound for Iran and Iraq, the ship provides early proof for strong commercial links between China, Southeast Asia, and the Middle East.

Discovered some 600 km southeast of Singapore, the Tang Shipwreck (also known as the Belitung Shipwreck) demonstrates that the region has been a centre of global trade for more than a thousand years. Singapore lies between two oceans, along a busy sea route running from the Middle East to India, Southeast Asia, and China. This network rivalled the more famous overland Silk Route through Central Asia. Glass was brought from the Middle East, cotton from India, spices and wood from Southeast Asia, and ceramics and silk from China. These economic ties led to the exchange of technologies and artistic ideas, and to contacts between peoples of different cultures.

Southeast Asia lay at the heart of a global trading network in the 9th century. Singapore’s success as an exchange point of global shipping is thus rooted in ancient history. The objects recovered from the shipwreck – some of exceptional rarity – testify to the ingenuity of artists and merchants, and show the lengths to which the world’s consumers would go to obtain such commodities.

(Visit Singapore’s Asian Civilisations Museum)
But trade is interrupted and production moves across borders

VIETNAM AND THAILAND FILL THE MING GAP

The export of Chinese ceramics to Southeast Asia stopped suddenly between 1350 and 1480. The political chaos that accompanied the transition between the Yuan and Ming dynasties explains this. The important ceramic centre at Jingdezhen was captured by rebels in 1352, stopping the production of fine-quality porcelain. Moreover, the new Ming government stopped the export of porcelain, especially of blue-and-white which was reserved for the court. Wars with the Mongols and struggles within the imperial court meant that very little porcelain was produced even for China during the period from 1435 to 1470.

Vietnam and Thailand quickly stepped in to fill this “Ming Gap” by manufacturing large quantities of high-quality ceramics for Southeast Asia. They did not produce precise copies of Chinese ceramics, but rather created new forms, showing that new markets can encourage innovation and improvement. In the 1480s, Chinese porcelain was again exported and China soon regained its monopoly position.

JAPAN FILLS THE GAP IN PORCELAIN SUPPLY

The collapse of the Ming dynasty in 1644 brought political and economic upheaval. The export of Chinese porcelain was nearly stopped between 1644 and 1684.

Dutch shippers had profited greatly from selling porcelain around the world. Needing a substitute for Chinese porcelain, the Dutch turned to the Arita kilns in southern Japan.

IMITATORS IMITATED

The Japanese kilns decorated porcelain in a completely different style from the Chinese. Brightly enamelled in red, gold, and blue, these wares became an instant hit in Europe. The style was later called Imari, after the port from which the porcelain was shipped. So successful was Imari ware that when Chinese exports resumed in the 1680s, Chinese kilns were forced to imitate it.
What China lost when it withdrew

MASS PRODUCTION, MASS PROFIT

The sheer scale of the cargo aboard the Tang shipwreck shows:

- the great popularity of Chinese ceramics in foreign lands in the 9th century;
- the ability to mass-produce thousands of nearly identical ceramics;
- an internal shipping network that gathered products from all over China at one port;
- a financial system that invested and shared profits from the cargo.
How macro models think about trade shocks

• Standard macro forecasting models tend to dismiss these as small and transitory
• Generally, direct inflation impacts are minor and/or the exchange rate adjusts
• If the exchange rate doesn’t move enough, monetary policy can move to offset
• Alternatively, one can think of an investment shock transmitted through heightened uncertainty
This approach is unsatisfactory

• Trade wars are not merely sectoral
• Uncertainty modelling has limitations
  – Can be arbitrary to pick level of uncertainty
  – Some attempts are better (Bloom, Davis, et al), but difficult to disentangle drivers
  – Uncertainty in these models tends to be resolved, but might be ongoing
  – Growth (or decline) in investment tends to understate the associated decline in productivity growth which results
• Ignores political economy of trade aspects
How trade models think about trade shocks

• Standard CGE models are full employment models so really about ‘comparative scenarios’
• Good at showing reallocation between sectors and countries
• Still tends to show relatively small impact of liberalization or reversals thereof
This approach also is unsatisfactory

- CGE models give no dynamics and no predictions for macro outcomes/cycle
- Despite their virtues of sectoral granularity, they do not deal with global value chains and integrated production well
  - Data problem more than theory to be fair
- Like macro models, they do not have a feedback into productivity growth trends or an accounting for political economy
Comparison to adapting macro models to financial shocks

**Financial Shock**
- Can be micro-founded
- Clear direct linkages to investment via collateral/liquidity
- Lots of historical examples from which to draw patterns

**Trade Shock**
- Imposed at the national border
- Impacts real investment as opposed to credit or asset prices
- Very few examples since GATT founding
What is a trade war?

In comparison to a normal trade dispute:

- The issue is one between countries rather than between companies within countries.
- The measures taken are by national origin/ownership instead of by sector.
- The goal is to inflict damage on the counterparty rather than to resolve an issue.
- Escalation rather than resolution is the norm.

This is much bigger and more uncertain.
Trade wars are political shocks

• They are usually undertaken by governments who have zero-sum ideologies and are usually part of a broader move towards economic nationalism

• The primary impact is on investment (as seen in net inward FDI as well as overall returns)

• We therefore have to look at
  – losses of competitive discipline internally as well as of markets
  – pricing in of a possible regime change as well as of transient uncertainty
  – the shift in relative attractiveness in world competition as well as cost competitiveness
So what is the result of Brexit?

This is UK waging a trade war on itself

• It is about national origin and with the EU specifically
• It is waged across sectors
• It is driven by political division at home – and an ethnic nationalist ideology
• Even if it ends up Norway+, staying in the Customs Union is unlikely to be a lasting outcome

The big impact is on investment and productivity

• Cutting out from global supply chains also means less services exports
• British soft power via brands and networks erodes, losing value
• UK can only maintain attractiveness for FDI by race to bottom
• Downward spiral (further) in productivity growth with blame game
• EM-type currency concerns
Brexit = A lot of broken crockery