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★ Senior  
★ European  
★ Experts

**The world economy  
in 2020:  
Heading for a crash?**



# The world economy in 2020: Heading for a crash?

## Introduction

Over the past year economists have warned of the increasing risk of a global downturn. Commentators point to the growing trade conflicts between the United States and some of its immediate neighbours (Canada and Mexico), with the European Union (particularly Germany) and most seriously, with China. Any trade dispute that reduces US-China trade significantly is likely to impact on the global economy because they are the world's two biggest economies (by nominal GDP). Although the Chinese economy continues to grow, its rate of growth has fallen sharply as a result of these trade disputes and falling external demand.

There is also a risk of further instability and crises in banking and financial services because not all the reforms identified as necessary after global financial crisis have been implemented. In addition, there are significant risks to the world economy from the unresolved departure of the UK from the European Union and from on-going instability in the Middle East.

The Senior European Experts Group and Regents University London have come together to hold a debate on the state of the world economy in 2020 and to ask whether we are heading for another recession, or even an economic crash not dissimilar to that in 2008.

This paper, prepared by the Senior European Experts, after explaining some of the background concentrates on the trade aspects of this question. Other seminar speakers will address the banking and financial issues and the broader macroeconomic picture.

## Background

### The 2007/08 crisis

In late 2007 world economic growth began to fall; by 2009 it had fallen below zero. In the developed world, the collapse was even more severe with growth falling to almost minus four per cent in 2009.<sup>1</sup> Although growth recovered sharply across the world in 2010, it dipped thereafter and has failed to return to pre-crisis levels. Table 1 shows growth trends since 2011 and the International Monetary Fund's (IMF) forecasts for 2019 and 2020.

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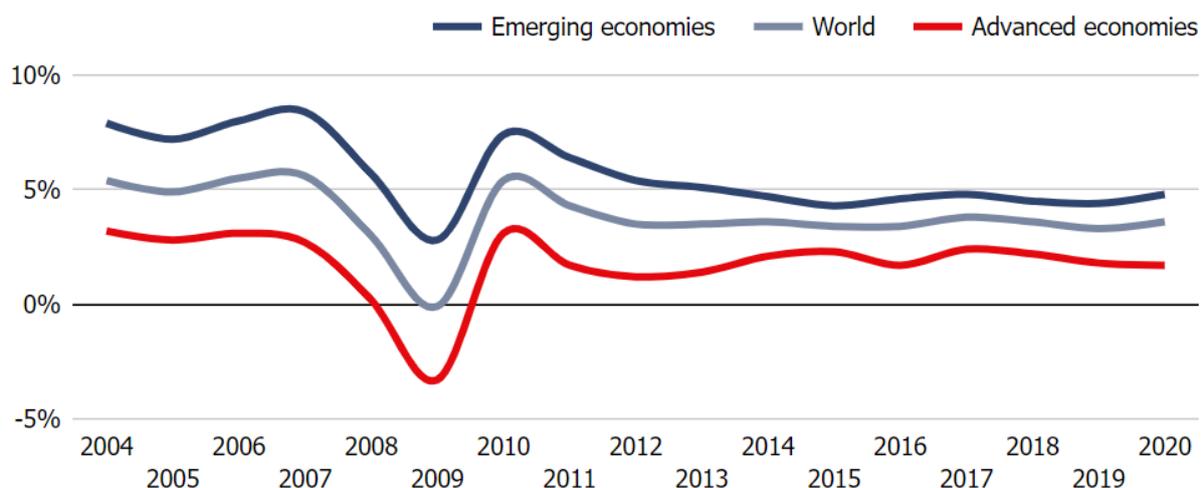
<sup>1</sup> See Chart 1 for a visual representation of this.

**Table 1: GDP growth in major economies: Actual & IMF forecasts (% YoY)**

Country / Area	Post-crisis trend	2018	2019 forecast	2020 forecast
US	2.1	2.9	2.5	1.8
UK	2.0	1.4	1.5	1.6
Euro Area	1.2	1.8	1.6	1.7
Germany	1.9	1.5	1.3	1.6
Japan	1.1	0.9	1.1	0.5
China	7.6	6.6	6.2	6.2
India	6.8	7.3	7.5	7.7

Source: International Monetary Fund, World Economic Outlook Update, January 2019

The yo-yoing of growth can be seen even more clearly in Chart 1, a graph that shows the steep fall and rise of growth across the whole world, in emerging markets and in the developed world. It shows too the faltering performance since 2010 that so worries economists and policymakers.

**Chart 1: GDP growth: Actual & IMF forecasts (%)**

Source: International Monetary Fund, World Economic Outlook Database, April 2019

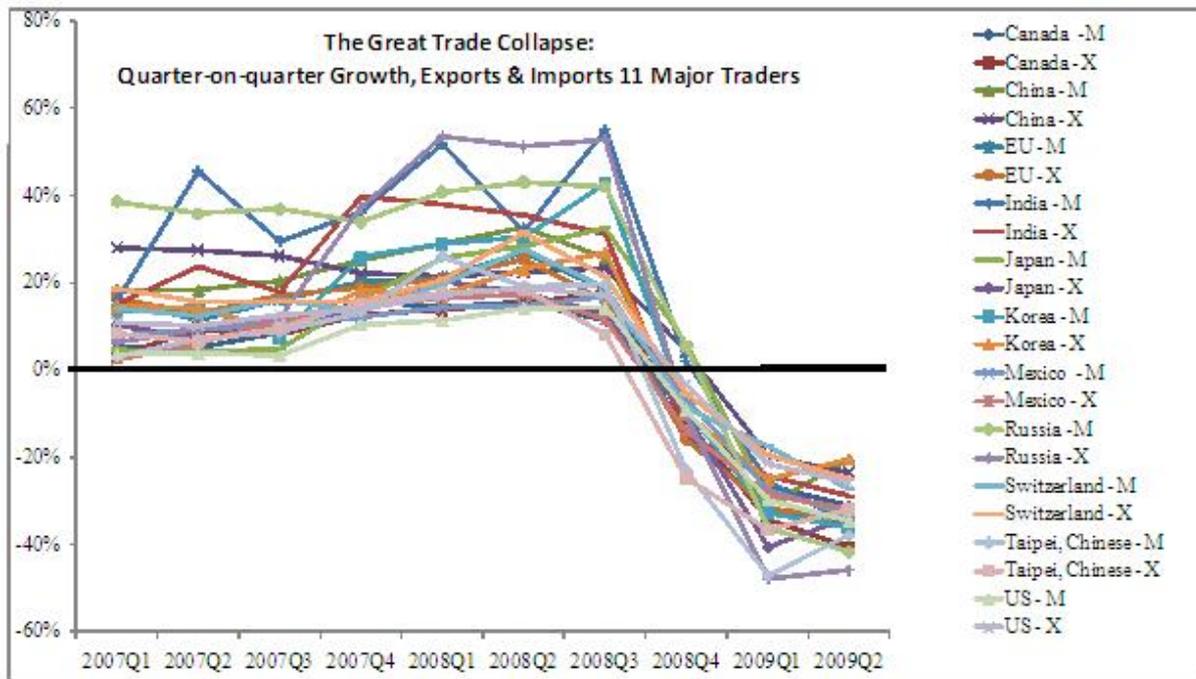
The scale and depth of the 2007/08 crisis is not always understood. Partly this is because of the time delay before the cost to governments of bank bailouts emerged. The US Federal Reserve, for example, provided \$700 billion to rescue US domestic banks and an astonishing \$5 trillion dollars to rescue foreign banks.<sup>2</sup> The British Government spent £136.6 billion rescuing banks; all but £23 billion had been recouped by March 2018, the main loss having been of £27 billion on the rescue of the Royal Bank of Scotland. At their peak, guarantees offered by the Treasury in order to restore confidence in the banking system cost £1 trillion, with a net loss after repayments of £14 billion.<sup>3</sup>

<sup>2</sup> Cited in Adam Tooze, *Crashed: How a decade of financial crises changed the world* (London: Penguin Books, 2018); quoted in 'The real cost of the 2008 financial crisis', John Cassidy, *New Yorker*, 18 September 2018

<sup>3</sup> See Office for Budget Responsibility, *Economic and fiscal outlook*, 13 March 2018, p. 100, Table 4.4

The decline in GDP growth and the loss of employment, the fall in interest rates on savings and stagnation in property markets were all more obvious to consumers than the cost of the bank bailouts. The fall in world trade was less visible but also dramatic – the steepest fall in world trade in recorded history.<sup>4</sup> Chart 2 shows how trade flows fell dramatically in the short-term – by 20 per cent or more – in the main trading nations. Growth in trade subsequently did not recover as fast as economic growth (GDP).<sup>5</sup>

**Chart 2: The great trade collapse, 2008 Q2 to 2009 Q2<sup>6</sup>**



The political impact of the global financial crisis

Whilst policymakers responded to the crisis with a series of interventions, including through the G20 group of the world’s largest economies, the IMF and the European Union, they were unable to protect ordinary people from the impact of the crisis. To some extent, the crisis speeded up trends in Western economies, such as the decline of heavy industries and of manufacturing, whilst at the same time temporarily cutting employment and growth in parts of the services sector.

The political impact of this was not immediately apparent. But commentators have attributed the rise of populism to the financial crisis.<sup>7</sup> The contrast between banks being bailed out while communities suffered factory closures, cuts in public services and individuals faced job losses or pay freezes, was too much for many people. Politicians who defended emergency stabilising measures, such as bank bailouts and public spending reductions, have found themselves being voted out of office in recent years. In part this is because of the long, long tail of the financial crisis (which some economists think was partly

<sup>4</sup> See Richard Baldwin, 'The great trade collapse: What caused it and what does it mean?', VoxEU, 27 November 2009

<sup>5</sup> See European Central Bank, *Monthly Bulletin*, October 2010, p. 17, Chart A

<sup>6</sup> See *supra* n. 4 for the original.

<sup>7</sup> See Cassidy, *supra* n. 2

because of poorly judged government interventions)<sup>8</sup> but it was also because of broader public concern about the impact of globalisation. In the United States this shift in public mood was followed by the election of Donald Trump in November 2016, which in turn led to a major change in US trade policies.

## **The new American trade policy**

### The post-war consensus

The election of President Trump in 2016 marked the end of the post-war consensus in US trade policy. A succession of US presidents since 1945 had helped to dismantle the protectionist policies adopted in the 1930s; to liberalise world trade; and to build a network of global economic organisations whose task is to promote economic development around the world. Key to these institutions was the General Agreement on Tariffs and Trade (1947), transformed in 1995 into the World Trade Organisation (WTO).

US policy was built around the belief that expanding world trade would be of overwhelming benefit to the US as the world's largest economy. Greater competition in imports would raise quality and productivity in domestic industry and the opening up of new markets would further boost US producers. This view was broadly shared by a large number of Western countries, notably the UK, Australia and West Germany. The emerging European Economic Community in the 1960s also embraced this free trade approach, which developed too in Far East in economies such as Singapore, South Korea and, later, Japan.

A series of multilateral world trade agreements resulted in significant reductions in the barriers to international trade both in terms of reductions in duties paid on imported goods (usually known as tariffs) and some reductions in the non-tariff barriers to trade in both goods and services, such as product restrictions and quotas. By the mid-2000s, US support for free trade was taken for granted and the European Union had also become a leading advocate of free trade policies.

### The challenge to free trade

President Trump has challenged the established orthodoxy by claiming that free trade works to America's disadvantage. His argument is that the long-term decline of US heavy industry, particularly in the automotive, steel and extraction sectors, has been partly caused by what he alleges to be unfair competition from lower cost countries, notably China and Mexico.

It is true that economic studies show that, while there are significant overall benefits to expanding trade, including from increasing imports, there can also be negative welfare consequences. While the private benefits of increased trade fall largely upon the workers and businesses directly involved, the overall benefits to the economy can be thinly spread, particularly where there are limited means of redistribution of wealth. The welfare losses from trade are also concentrated in particular businesses and sector and their regional impact can also be severe. Consumers undoubtedly benefit from (for example) the importation of better quality and cheaper products than those produced in the home market but for those working in the domestic sector competing to produce those goods, the consequences can be loss of

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<sup>8</sup> See, for example, John B Taylor, *Causes of the Financial Crisis and the Slow Recovery: A Ten-Year Perspective Economics*, Economics Working Paper 14102, Hoover Institution, January 2014

employment and wider social costs to the community. But it is difficult to be sure whether losses in employment are due to trade factors or other issues such as technological change.

Critics of international trade, of which Mr. Trump is only the latest and most prominent, have been making these arguments for some years. The counter-philosophy to free trade, protectionism, was in fact the orthodoxy during much of the interwar years. It was protectionism in the 1930s, which triggered a dramatic drop in world trade (by 50 per cent between 1929 and 1933<sup>9</sup>), and the recognition that it had greatly worsened the problems caused by the Great Depression, that led post-war US policymakers to abandon it in favour of open trade.

### The importance of China

Contemporary critics of the world trade system argue that it is the interaction of the lowering of barriers to trade and the emergence of lower cost economies in the developing world that has created a new situation not comparable to that before 1945. In this view, the ability of an authoritarian China to compete on WTO terms with a country like the United States, even though China does not have the same employment, intellectual property and rule of law requirements that impose costs on US businesses, has given Chinese businesses an unfair competitive advantage. Many other countries, including the EU and Japan, share this analysis but do not agree that it is best dealt with by unilateral action.

This is the so-called “China effect”, where expanding trade with that country has been followed, it is argued, by falls in employment in related sectors in importing countries. Studies in the US indicate that about 10 per cent of the employment lost in manufacturing between 1999 and 2011 was due to Chinese imports. Similar studies show falls in manufacturing employment in other Western countries. In the case of the UK, up to a third of the decline in manufacturing’s share of employment between 2000 and 2015 may have been due to the growth of Chinese imports.<sup>10</sup>

This analysis disregards the fact that while China’s annual average GDP growth over much of the last 30 years has been almost 10 per cent, most of the expansion in economic activity has been domestic in focus, taking 850 million people out of poverty.<sup>11</sup> It is also true that some countries (Germany is an example) have experienced job losses in some sectors adversely impacted by imports from China whilst others sector have expanded due to growth in exports to China and to other markets.<sup>12</sup> The same phenomenon has not been seen to the same extent in the US and UK however, which may explain the impact on low income households and the subsequent electoral concern.<sup>13</sup> But it must be emphasised that the bulk of the decline in manufacturing employment has been caused by factors other than trade.

In the 2016 US presidential election Mr. Trump was able to mobilise many of those in America who either have lost out as a result of changes in the economy, such as the decline

<sup>9</sup> Nominal world trade: see Jakob B. Madsen, ‘Trade Barriers and the Collapse of World Trade During the Great Depression’, *Southern Economic Journal*, 67(4), 2001, pp. 848-868, p. 851

<sup>10</sup> João Paulo Pessoa, *International Competition and Labor Market Adjustment*, CEP Discussion Paper No 1411, Centre for Economic Performance, London School of Economics and Politics, 4 March 2016, cited in Michael Gasiorek, Julia Magntorn Garrett & Ilona Serwicka, ‘Winners and Losers from International Trade: What do we know and what are the implications for policy?’, Briefing Paper 33, UK Trade Policy Observatory, University of Sussex, 15 July 2019

<sup>11</sup> World Bank, ‘The World Bank In China’, 1 October 2019

<sup>12</sup> Gasiorek, Magntorn Garrett & Serwicka, *op. cit.*

<sup>13</sup> *Ibid.*

of heavy industry in states like Michigan and Ohio, or whose jobs have been lost due to changes in public policy, such as those working in coal mining in West Virginia, to create a coalition of voters opposed to the existing free trade system. Similar arguments to those deployed by Trump have been made in many EU countries and have influenced the attitude of voters towards proposed EU trade agreements (and indeed, Brexit) in recent years.

### Trump's trade strategy

President Trump's trade strategy is to force the US's largest trading partners to the negotiating table through threats of and actual unilateral action by the US against imports that his administration claims amount to unfair competition. For example, the US imposed \$250 billion of new tariffs on Chinese imports in 2018.<sup>14</sup> The President has also proposed putting increased tariffs on imported vehicles on the grounds "that the present quantities and circumstances of automobile and certain automobile parts imports threaten to impair" national security.<sup>15</sup> In May 2019 he also imposed restrictions on the Chinese telecoms giant Huawei, again citing national security. Trump hopes that by using these sorts of tactics he will be able to obtain better trade terms for the US through bilateral, rather than multilateral, trade agreements.

Trump's policies largely disregard the US's obligations as a member of the WTO; and he has also been seeking to disrupt the work of the WTO, for example by declining to approve appointments to the WTO's Appellate Body, behaviour that if it continues could leave the WTO potentially unable to operate the dispute resolution system which has become the keystone of the global trading system since it was adopted in the 1990s.

These tactics are played out against a continuous stream of rhetoric that portrays America as a victim of unfair international trade and so a loser from globalization. The term "globalist" has joined "liberal" as one of the most common insults in US domestic politics.<sup>16</sup> It is often used to describe those who oppose Trump's trade policies or who believe that the post-war trading system has brought benefits to the US economy and its people. This portrayal of America as a victim ignores US dominance in many global economic sectors. For example, 16 of the world's 25 largest technology companies (by market capitalisation) are headquartered in the US; the top four are all American businesses.<sup>17</sup>

The big question is whether Trump's tactics will work. His supporters point to the renegotiation of the North America Free Trade Agreement, which improved its working for the US but in reality the gains were modest.<sup>18</sup> Trade with China is on an altogether different scale and Trump's decision to extend his disputes to the EU has increased the risk of a global downturn as a result.

US tariff increases on Chinese goods have been countered by increases on US exports to China. The result has been a 16 per cent year-on-year fall in Chinese exports to the US but a 22.4 per cent reduction in US exports to China.<sup>19</sup> There have been increases in US tariffs on Canadian and Mexican goods too with consequent retaliatory action by those countries.

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<sup>14</sup> 'Trade war: US-China trade battle in charts', Daniele Palumbo & Ana Nicolaci da Costa, *BBC News*, 10 May 2019

<sup>15</sup> 'Trump Delays Auto Tariffs For 6 Months', Camila Domonoske & Avie Schneider, *National Public Radio*, 17 May 2019

<sup>16</sup> See 'The Origins of the 'Globalist' Slur', Ben Zimmer, *The Atlantic*, 14 March 2018

<sup>17</sup> GlobalData, 'GlobalData announces top 25 global tech companies by Market Cap for 2018', 29 April 2019

<sup>18</sup> Geoffrey Gertz, '5 things to know about USMCA, the new NAFTA', Brookings Institution, 2 October 2018

<sup>19</sup> 'China exports fall in August as US trade war bites', *BBC News*, 8 September 2019

The cost of the higher tariffs on US imports from China will be passed on to consumers through higher prices at an average annual cost of \$460 per family in the US.<sup>20</sup>

This “trade war” has no immediate end in sight. Indeed, Trump remains keen to spread his disputes with China and the NAFTA countries to Europe, especially the EU. Tariffs of 25 per cent on imported steel and 10 per cent on imported aluminium were imposed by his administration in March 2018, leading to the EU imposing retaliatory tariffs worth £2.4 billion on various American products. Trump seized on the long-awaited WTO arbitration ruling in October 2019 on subsidies to European aircraft maker Airbus with the announcement of new tariffs worth £6.1 billion on aircraft and other EU imports, despite the expected WTO ruling against the US on subsidies to Boeing, and the likelihood then of EU retaliatory action.<sup>21</sup>

### **The World Trade Organisation: multilateralism at risk?**

The effect of Trump’s policies on the work of the WTO has so far been diffused but real. It is unlikely that threats by the Trump administration that the US to leave the WTO will be realised because that would require the consent of Congress. But disruptive behaviour by the Trump administration still represents a challenge to the WTO.

#### Dispute resolution under threat

The US is currently refusing to nominate new members to the WTO’s Appellate Body; if two members due to retire in December 2019 are not replaced, there will not be enough members to hear cases and dispute settlement system will effectively grind to a halt.

The difficulty for the WTO is that it agrees its decisions by consensus and with 160 member countries that makes it vulnerable to disruption by a single member. Unanimity also impedes reform. The US is not alone in believing that the WTO needs to be reformed but although the Trump administration has vociferously objected to the current *modus operandi* of the WTO it has not put forward any reform proposals of its own. Commentators suggest that the US may be seeking a return to the non-binding arbitration procedure which operated before 1995.<sup>22</sup> While non-binding arbitration had some value, it was not as effective as a binding mechanism that ensures that member countries of the WTO accept and implement the outcome of arbitration in trade disputes to which they are a party.

Member countries have responded to the approach of the Trump administration by working bilaterally or in groups to achieve their trade goals. Canada convened a meeting of trade ministers from 13 countries in 2018 to discuss reform of the WTO. Another group of countries have gone ahead with the idea of a Trans-Pacific trade treaty without the US (it was originally negotiated by the Obama administration and subsequently abandoned by Trump). A much larger group of 76 WTO member countries, which in this instance includes the US, has begun negotiating an agreement on e-commerce, a growing area of trade where WTO rules largely do not yet apply.<sup>23</sup>

<sup>20</sup> Study by the London School of Economics cited in ‘How Much Will Trade War Cost You by End of Year?’, Quoc Trung Bui & Karl Russell, *New York Times*, 1 September 2019

<sup>21</sup> ‘US set to impose tariffs on \$7.5bn of EU exports in Airbus row’, *BBC News*, 2 October 2019

<sup>22</sup> ‘World trade returns to the law of the jungle’, Jakob Hanke, *Politico*, 19 December 2018

<sup>23</sup> See Marianne Schneider-Petsinger, ‘The Path Forward on WTO Reform’, Chatham House, 7 May 2019

### Towards an alternative trade policy

The historic success of GATT and the WTO means that it is in the interests of the great majority of countries to maintain the multilateral approach to the regulation of trade. This is particularly true of mid-sized and smaller countries who cannot exercise the leverage in trade negotiations of the larger economies such as the US, China and EU. If the small and medium sized countries come together in groups they have the potential to increase their leverage within the WTO; that is in essence what the EU has been doing as the majority of its members are small countries.

Small and medium sized countries can negotiate trade agreements that comply with WTO rules and which do not need the participation of larger countries like the US. The way in which Canada, Australia and Chile came together with other countries to save the Obama administration's Trans-Pacific Partnership demonstrates their willingness to take a lead in protecting the trade system and their commitment to advancing it further despite the objections of Trump and others.

But the ability of any country to participate in trade agreements will depend in democratic societies on political support being maintained for free trade policies. Trump was able to build on a long history of political support for protectionism in the United States and similar sentiments can be found in many other countries. Trade has always been politically contested. Political leadership is needed in each generation to make the argument for free trade when its benefits can appear less obvious (because they are spread widely across the economy) than its potentially adverse consequences.

There is wide recognition that the WTO does need to be reformed. Although the approach of the current US government goes beyond what most other WTO member countries want to see, the WTO does need to change. Not least because the world economy is changing and a system designed to regulate trade in goods is less relevant to a world where most advanced economies are based on services rather than manufacturing. The absence of an effective mechanism to regulate trade in digital services is an example of the gaps in the WTO's regulatory system.

### **What happens next?**

*"Escalating trade conflicts are taking an increasing toll on confidence and investment, adding to policy uncertainty, aggravating risks in financial markets and endangering already weak growth prospects worldwide."*<sup>24</sup>

As the newly appointed head of the IMF has pointed out, two years ago nearly 75 per cent of the global economy was in an upswing with increasing growth; today, the IMF expects slower growth in 90 per cent of the global economy. This downturn is despite a complicated economic picture. Almost 40 emerging market and developing economies are forecast to have GDP growth in excess of five per cent in 2019 and yet despite historic low levels of unemployment in the US and Germany, there is a "softening" of economic activity.<sup>25</sup>

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<sup>24</sup> OECD, 'OECD sees rising trade tensions and policy uncertainty further weakening global growth', 19 September 2019

<sup>25</sup> Kristalina Georgieva, IMF Managing Director, 'Speech: Decelerating Growth Calls for Accelerating Action', 8 October 2019

The IMF says this has several causes but it is particularly the consequence of trade disputes: “global trade growth has come to a near standstill”, they point out. In 2019, the IMF predicts falls in global trade will mean a loss of US\$400 billion worth of trade with double that loss in 2020.<sup>26</sup> So the problems in the world trade system discussed above are now having a significant impact on national economies and if they continue that negative impact can only worsen.

Is there hope for improvements in the trade picture? While there have been political developments in the EU which suggest the beginnings of a backlash against populism, such as the May 2019 European Parliament elections when populists failed to achieve than expected breakthrough and the defeat of the Freedom Party in Austria in October 2019, the overall picture remains unsatisfactory.

To a large extent the world is forced to wait upon the decisions of the Trump administration and/or its successor, at least far as its use of protectionist measures is concerned. Uncertainties remain about the extent to which Trump will continue to impose tariffs on imports. A change in US policy could result from the 2020 presidential election if Trump fails to be re-elected but many of his potential Democrat opponents are similarly sceptical about free trade. However, they would be unlikely to be as disruptive as Trump has been.

In Europe the recent criticism over the proposed trade agreement with the Mercosur Latin American countries (because of the policies of the populist president of Brazil, especially on the protection of the Amazon rainforest) show that concern about trade organisation is not confined to the Americas. The support for state aid in a number of EU countries, including France and Italy, threatens to undermine the progress made over the last 30 years in reducing taxpayer subsidies to businesses with all the market distortions they brought.

On the other hand, Trump's actions have served to demonstrate how much support there is for the WTO and the trading system. It may be that the US will leave the WTO or that other WTO members will have to recreate it in a different form without the United States. Too many countries have too much at stake to allow the WTO to wither away and protectionism to return. Trade has grown so much in volume and value since 1945 that as the IMF confirms its economic importance cannot be ignored. The present crisis could drag on for several years but it is unlikely to wreck the world's trading system in the way that US policy did in the 1930s.

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<sup>26</sup> See 'Projected Global GDP Loss from Trade Disputes' in *ibid.*



## Senior European Experts

The Senior European Experts Group is an independent body consisting of former high-ranking British diplomats and civil servants, including several former UK ambassadors to the EU, and former officials of the institutions of the EU.

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 [senioreuropeanexperts.org](https://senioreuropeanexperts.org)

 [info@senioreuropeanexperts.org](mailto:info@senioreuropeanexperts.org)

 [@SEE\\_Group](https://twitter.com/SEE_Group)