

Matthew C. Klein, Michael Pettis, *Trade Wars Are Class Wars: How Rising Inequality Distorts the Global Economy and Threatens International Peace*, Yale University Press, New Haven, 2020.

The expansion and evolution of international trade has been a major driver of world history and a key feature of globalization. Through the ages, trade has had a tremendous impact on both the fate of nations and the life of ordinary citizens around the world. The scholarly debate on trade is rich and varied, with competing models and often divergent opinions. The public debate on such an important issue, however, has been for many years dominated by a specific set of views – a neoliberal consensus that emphasizes the benefits of the expansion of global trade but tends to overlook the social and distributive effects of that process. This consensus has been seriously challenged by the global financial crisis of 2008 and the Great Recession that followed, and then by the rise of populist movements in many countries, a phenomenon that culminated in Donald Trump’s victory in the 2016 US presidential election. The Covid-19 pandemic has had an additional disruptive

impact on trade and economic activity in general and has even further highlighted the economic and social imbalances created by globalization. It is no accident that the new US administration led by Joe Biden has put the objective of restoring the living standards of the American middle class at the center of both its domestic and foreign policy agendas.¹ As these lines are written, the world is beginning to look beyond the health emergency, and a new chapter in the history of global economic relations appears to be about to begin.² This context makes the debate on trade once again a crucial issue, while the need to make sure that the next global order meets the expectations of prosperity and social justice of ordinary people around the world seems more compelling than ever.

Although rising skepticism toward free trade and unfettered globalization is in many respects justified by a long record of crises and waves of economic instability, many of the recipes that have been promoted – and sometimes adopted – in recent years appear to be equally debatable. This is particularly true with regard to the revival of economic nationalism and protectionism that has characterized the platforms of populist parties and leaders. The trade policies adopted between 2017 and 2020 by the Trump administration have been the quintessential demonstration of this revival, as well as of the controversial implications of harsh forms of protectionism, such as “trade wars.” This is why a new book by Matthew C. Klein and Michael Pettis, *Trade Wars Are Class Wars: How Rising Inequality Distorts the Global Economy and Threatens International Peace*, represents an interesting attempt to address the need to rethink trade and globalization without falling into the pitfalls of counterproductive and dangerous forms of extreme economic nationalism.

Matthew Klein is a senior writer at *Barron's*, where he specializes in economics, while Michael Pettis is a professor of finance at Peking University's Guanghua School of Management and the editor of the *China Financial Markets* blog hosted by the Carnegie Endowment for International Peace. Their book is divided into two parts. In the first three chapters, the authors review the basic elements of the debate on

¹ “Inaugural Address by President Joseph R. Biden, Jr.” The White House, January 20, 2021, <https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/01/20/inaugural-address-by-president-joseph-r-biden-jr/>; Antony J. Blinken, “A Foreign Policy for the American People,” U.S. Department of State Press Release, March 3, 2021, <https://www.state.gov/a-foreign-policy-for-the-american-people/>.

² Harold James, “Globalization's Coming Golden Age”, *Foreign Affairs* 100, no. 3, May/June 2021, pp. 10-19.

global trade, from the theories that underpin our understanding of the issue to the impact of technological change and the relationship between trade and finance. In the second part – last three chapters – Klein and Pettis analyze three case studies that can illustrate the economic and social imbalances created by recent developments in international trade and globalization: China, Germany, and the United States.

The problem with the current debate on international trade, the authors argue, is that it is informed by ideas that are now obsolete and inadequate to explain today's reality. Technological and logistical innovations – such as containers and global supply chains – along with political developments such as the rise of tax havens, have transformed and distorted international trade flows. At the same time, the expansion and liberalization of international capital flows and new developments in global finance – such as the mortgage-backed securities that played such an important role in the financial crisis of 2008 – have further distorted international trade. In today's global economic system, Klein and Pettis observe, goods, services, and capital don't move around efficiently and in line with rational investment calculations, but rather follow routes dictated by changes in credit conditions and speculative sentiments like fads, bubbles, and panics – or the urge by some governments to protect themselves from this kind of risks.

Countries can pursue long-term economic growth and the development of a solid industrial base through high savings or high wages. High savings contribute to economic development by extracting resources from workers and households and making credit cheaper for businesses, while high wages favor development by giving the working and middle classes the resources to consume more and boost demand. According to Klein and Pettis, a successful and sustainable economy needs a combination of high savings and high wages. The problem in today's world, they argue, is that major economic actors have adopted increasingly radical versions of the high savings model. This is unsustainable and is creating major distortions in the global economy, such as massive and persistent current account surpluses in some countries and deficits in others.

This situation leads to the core argument of Klein and Pettis's analysis: today's trade imbalances are the result of unsustainable policies that transfer wealth from the working and middle classes, who consume most of their income, to the rich, who save and use most of their resources to accumulate financial assets. Persistent deficits and rising debt – such as the ones the world economy has been experiencing in the last decades and that have been fueling calls for protectionism and trade wars – are not the result of profligacy or cultural factors. Rather,

they are determined by policies that affect the domestic distribution of income. When governments adopt policies that generate a systematic transfer of wealth from workers and other categories that spend most of their income on consumption to categories that spend most of their income on financial assets, the country will inevitably experience an excess in savings that won't find an outlet in the domestic economy, because the depressed demand will in turn depress investment. As a result, the country will experience a current account surplus. Since on the global level all surpluses must be balanced by equivalent deficits, other countries in the system will have to run current account deficits. This situation is inefficient and unsustainable, Klein and Pettis note, and one major reason why these imbalances have proven so difficult to correct is that they are advantageous for elites and rich people, who benefit disproportionately from the high savings growth model sustained by extracting resources from workers.

China and Germany are outstanding examples of the consequences of adopting extreme high savings strategies. China's current development strategy has generated sustained economic growth and has boosted the legitimacy and centralized rule of the Chinese Communist Party. The price of this economic and political model, however, has been excess capacity, persistent trade surpluses, and the impoverishment of Chinese workers and ordinary households. Far from being a sophisticated long-term geopolitical strategy, Klein and Pettis argue, the Belt and Road Initiative is in fact a flawed attempt to prolong a high savings model that has served well the interests of China's political and business elites but has penalized the living standards of millions of workers and generated massive global imbalances. Germany is similarly responsible for the rise of global trade imbalances, and its policies have had a major negative impact on the economy of the eurozone. In the early 2000s, politicians in Berlin decided to restore the country's competitiveness by adopting a high saving strategy revolving around cuts in social spending, increasing labor flexibility, and wage compression. These policies generated trade surpluses for Germany but in fact reduced investment opportunities in the country. German savings thus found an outlet in other eurozone countries that were experiencing sustained economic growth – such as Spain and Greece – and fed bubbles that eventually burst during the euro crisis. Instead of opting for a rebalancing, the German government persisted in its pursuit of austerity measures and pushed other eurozone countries to do the same. Far from restoring the deficit countries' competitiveness and fiscal stability, however, these policies have led to further distortions of the eurozone's economy and a massive deterioration of European living standards. The result is that the euro area, in Klein and Pettis

words, “has become the world’s biggest source of global imbalances.”³ Interestingly, the authors observe, in the last few decades the United States has adopted economic policies that were very similar to those adopted in Germany. This has led to a similar deterioration of the living standards of the American working and middle classes. Instead of generating German-style surpluses, however, such policies have led to deficits and massive debt. The reason of this outcome, Klein and Pettis observe, is to be found in some specific characteristics of the US economy, such as its openness, the concern for the rights of foreign investors, the dollar’s status as the global reserve currency, and the fact that US sovereign debt is abundant, easy to trade, and considered free of default risk. The US has thus ended up absorbing the global savings glut and the excess manufacturing capacity of the surplus countries. Far from being a privilege, the US’s central position in the global economy has turned out to be a burden that fell disproportionately on the shoulders of American workers, who saw their jobs and incomes deteriorate because of deindustrialization and insufficient investment. Trade wars, Klein and Pettis conclude, are not primarily conflicts between countries, but rather conflicts within countries – the results of policies that disproportionately benefit the rich and the holders of financial assets at the expense of the working and middle classes. The global imbalances created by excess savings in countries such as China and Germany are generating dangerous anti-trade sentiments around the world, and the risk is that, just like in the 1930s, a rise in protectionism and economic nationalism ends up threatening not just economic stability but also international peace. What is needed are short- and longer-term policies aimed at favoring greater international cooperation in the effort to recalibrate the “savings” and “wages” components of global economic development and ensure that workers and middle-income families around the world get a fairer share of the wealth they produce.

In *Trade Wars are Class Wars*, Klein and Pettis challenge both the mainstream consensus on trade and globalization and the protectionist and nationalist backlash. Their thesis is bold, and this can generate debates and controversies. The purely economic understanding of the Belt and Road Initiative, for example, may be an unnecessarily narrow explanation of a multifaceted economic statecraft initiative undertaken by leaders in Beijing that is having important political and strategic implications – although the focus on the CCP’s reluctance to abandon the high savings model is indeed compelling. The book is not very specific

³ Klein and Pettis, *Trade Wars Are Class Wars*, p. 229.

about some recent major developments in the global economy, such as the rising importance of information and data and their relevance in terms of trade and international economic relations.⁴ The authors nonetheless do analyze the impact of technological change on the economy, and the overall analysis of trade wars and global imbalances remains solid and informative. The authors' focus on the domestic distributional effects of trade and international economic policies is valuable. Among other things, such an approach complements a recent analysis of the social consequences of fiscal policy in the United States by Emmanuel Saez and Gabriel Zucman.⁵ The book also contributes to the debate on the euro crisis and adds interesting elements to the view that the austerity measures championed by Germany have actually been counterproductive.⁶

Klein and Pettis have managed to revisit the insights of some of the most influential economic thinkers of the past – such as Adam Smith, David Ricardo, Alexander Hamilton, Friedrich List, John Atkinson Hobson, and John Maynard Keynes – and to produce a fresh and informative analysis of current trends in international political economy. Their book is timely and informative, and their thesis is bold but intriguing and insightful. *Trade Wars Are Class Wars* brings valuable insights and fresh thinking to a debate on global trade that badly needs to focus more on the need to correct imbalances and promote social justice among and within countries.

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⁴ Matthew J. Slaughter and David H. McCormick, "Data Is Power", *Foreign Affairs* 100, no. 3 (May/June 2021), pp. 54-62.

⁵ Emmanuel Saez and Gabriel Zucman, *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay*, Norton, New York, 2020.

⁶ This view is famously shared by Nobel Prize-winning economists Paul Krugman and Joseph Stiglitz. Paul Krugman, *End This Depression Now!*, Norton, New York, 2012, pp. 166-187; Joseph E. Stiglitz, *The Euro: And Its Threat to the Future of Europe*, Penguin, London, 2017).