

## **What will cause the next global economic crises?**

While the whole world watches carefully what might cause the next global economic crises, a divergent set of factors that might trigger it are proposed. One that has caught the attention of the entire world is the US-China trade war. Economists often say that this trade war, as it operates against the principles of free trade and capitalism, might start the next crises. This trade war has had a great effect on stock markets and prices as it is often agreed that imposing tariffs on trade not only reduces it but makes products more expensive for the consumer. As a consequence, a global economic slowdown will follow with a more pessimistic scene set in the stock markets for world growth. However, this trade war is merely a continuation of what many have disregarded: the use of geo-economics as a tool of statecraft to advance geopolitical objectives. China, USA, Russia, Gulf States, and the EU have mastered such tool and, perhaps, have become overly reliant on it. At the cost of economic growth and stability, often, for nations, national security comes first, even if it means disregarding standard economic principles to further their global objectives.

### **What is geo-economics?**

I will be using Blackwill's and Harris's- writers of the book *War by Other Means*- definition of geo-economics: "Geo-economics is the use of economic instruments to promote and defend national interests, and to produce beneficial geopolitical results; and the effects of other nations' economic actions on a country's geopolitical goals."<sup>1</sup> Countries, depending on their economic strength and importance to other economies, may possess a wide arsenal of economic tools which include: sanctions, trade barriers, tariffs,

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<sup>1</sup> Blackwill, Robert D., and Jennifer M. Harris. *War by Other Means: Geoeconomics and Statecraft*. Cambridge, MA: The Belknap Press of Harvard University Press, 2017. Page 20

currency manipulation, foreign aid, Foreign Direct Investment(FDI), trade agreements, oil and gas prices, and bonds.

### **A new way to wage war?**

Waging a military war has become more expensive than ever, and, perhaps, in some cases, the costs might outweigh the geopolitical benefits; hence, a new preferred method of war is upon us and in this one no shots are fired, instead, it is countries with their financial institutions that are targeted.<sup>2</sup> This new method of warfare is a weapon of first resort for the majority of countries who lack a powerful experienced army but possess strong economies from which the whole world might be dependent upon. Countries like China, despite having a powerful army, have resorted to economics when pursuing their geopolitical objectives, as we will see later. The USA and the EU have resorted to sanctions as a weapon to counter those who threatened their geopolitical objectives, whereby a set of commercial and financial penalties are applied towards a targeted set of people or sovereign nations.<sup>3</sup> Cases where this was used include various countries like North-Korea, Russia and, most recently, Iran. Moreover, as Europe's primary supplier of oil and gas, Russia has relied on the threat of cutting of oil supplies to achieve geopolitical objectives. This was seen when Russia periodically cut off oil supplies in the winter with Ukraine and threatened to do the same for the EU regarding the issue of Crimea. Further, China has relied on a variety of tools, but some have proved more effective and deadly. For example, China has decided to quarantine bananas from the Philippines, a key export for the country, after the

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<sup>2</sup> The man that coined the word "geo-economics", he envisaged a world that after the Cold War the world will rely more on economic tools to achieve geopolitical objectives. See: Edward Luttwak, From geopolitics to geoeconomics: logic of conflict, grammar of commerce. *The National Interest* (20) 1990.

<sup>3</sup> Financial Weapons of War, *Minnesota Law Review* (2016), available at: <http://ssrn.com/abstract=2765010> (accessed 12/09/2019)

Philippines in 2012 arrested Chinese fishermen in the South-China sea.<sup>4</sup> Russia has done the same for countries like Poland, when it suspended Polish cheese exports for violations, which have significantly impacted Poland as it relies heavily on Russian consumers for its cheese exports with a value of \$142.5m(2013).<sup>5</sup> Russia also banned wine from Moldova when it was in negotiations for new agreements with the EU.<sup>1</sup> The intent of this was to prevent Moldova from having deeper ties with the EU, which would present a geopolitical threat to Russia.

### **Is geo-economics compatible with Neo-liberal thought?**

Having talked about some examples where countries have used geo-economics, I will talk about the costs it can have whilst being employed in globalised economies. Neo-liberalism is associated with market-oriented policies such as the advocacy for free trade, the elimination of price controls and the deregulation of capital markets, all of which bring about the principle idea of reducing state intervention in the economy. When policy makers look for ways to promote the economy or strengthen it, they will resort to enacting policies that stimulate the supply and demand of the economy. You will want to increase demand in the economy to achieve further economic growth, as consumers will spend on goods and services, which in turn, firms invest their profits and pay their employees who will also then spend on consumption, and this cycle will lead to higher growth in the economy; you will also want to increase supply as this will result in higher economic growth due to the flow of capital and investment that is required to expand it. Both supply and demand go hand in hand. I will not talk about how countries can achieve economic

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<sup>4</sup> "The China-Philippine Banana War." Asia Sentinel, June 6, 2012. <https://www.asiasentinel.com/society/the-china-philippine-banana-war/>. (accessed 12/09/2019)

<sup>5</sup> Astley, Mark. "https://www.dairyreporter.com/Article/2015/02/23/Russia-Suspends-Import-of-Polish-Cheese-Products-after-Violations." Dairy Reporter, February 23, 2015. (accessed 12/09/2019)

growth, I will discuss why geo-economics clashes with this type of thinking. When countries use geo-economics, they look for ways to prevent a country from achieving growth, which basically is to use tools that create a contraction in the target's economy; this may in turn result in very high internal pressure in the target country as the people start to suffer, thus leading to concessions to the aggressor.<sup>6</sup> Sanctions are, for example, meant to forbid a country from purchasing capital that is necessary to increase supply, or import goods which are necessary and in high demand. Bans on exports deprive a country from a source of income and deprive it from the ability to balance its trade import deficit, if it has one. Cutting off oil and gas supplies will essentially lead prices for these commodities in the target country to skyrocket, which will lead to a drop in economic growth, perhaps triggering a recession, as almost all countries in the world rely heavily on energy produced from oil and gas. Of course, this is just the scratch of the surface, as a rise in any commodity price will have a devastating impact in an economy that is a net exporter of it. Therefore, the idea of the state making economic decisions irrationally for geopolitical gains is completely incompatible with neo-liberal thought.

### **Global economic impacts of geo-economics**

As I explained earlier, countries that end up as targets of geo-economics might suffer devastating consequences, however, it is not only them that can suffer, but the whole world. Through globalisation, countries have become essentially reliable on each other for a varying set of products, as each country specialises in a certain sector and uses profits in return to buy necessary products for the economy. Larger economies have grown to specialise in a variety of sectors making many states dependent on them. This leads to vulnerability, making

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<sup>6</sup> Baldwin, in his analysis, states that through the use of economic statecraft, countries can get nations to "do what they would not otherwise do." See: Baldwin, David A. *Economic Statecraft*. Princeton: Princeton University Press, 1985.

dependent states perfect targets for geo-economic actions. While targeting small economies won't have much of an impact, if important economies begin to wage war on each other through economic means, then the world that is dependent on them might suffer in return. The US-China economic war does not only include the trade war, and the economic consequences these two countries have produced and will produce in the future, will most certainly have a negative impact on world growth.

### **History repeating itself**

While Trump's trade war has surprised many, his actions are no stranger to history. The United States has employed protectionism throughout all its history. While the USA sank in a deep recession in 1929, the great depression largely took global effect as a result of American protectionism through the Smoot-Hawley Tariff Act 1930, which led to largely anticipated retaliations from large trading economies; hence greatly exacerbating the depression.<sup>7</sup> The USA also resorted to protectionism when England in 1828 forbade it from trading with her colonies, which resulted in the highest ever tariff levels in its history, consequently leading to a recession.

### **The great power showdown**

According to the ancient historian Thucydides, when one nation starts to grow to the point that it threatens the dominance of the other, then war is inevitable. This is what is called the Thucydides trap and it is thought that the rise of China as a superpower challenges US world hegemony and as history has previously proven, war is usually the result.<sup>8</sup> What is not considered is that the

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<sup>7</sup> Whaples, Robert (March 1995). "Where Is There Consensus Among American Economic Historians? The Results of a Survey on Forty Propositions". *The Journal of Economic History*. Cambridge University Press

<sup>8</sup> Graham, Allison. "The Thucydides Trap: Are the U.S. and China Headed for War?" Harvard Kennedy School Belfer Center, September 24, 2015. (accessed 12/09/2019)

war has already started, and it's not fought with guns and bullets this time, but through economics. The next global financial crisis has become an inevitability. The US-China trade war has reduced world economic expansion to just 2.6%, according to the World Bank.<sup>9</sup> Moreover, the IMF states that the trade wars could wipe US\$455 billion off the world's GDP in 2020.<sup>10</sup> And these estimates have not even considered Trump's fresh new 15% tariffs as of September 2019 on Chinese consumer products that range from smartphones to clothes, which worth US\$300 billion. According to the World Bank's president, David Malpass "there's been There's been a tumble in business confidence, a deepening slowdown in global trade, and sluggish investment in emerging and developing economies."<sup>11</sup> A direct impact that could be seen from the US-China trade war, was found in Singapore, which might be heading for a recession. Having China as its biggest trading partner, Singapore's Ministry of Trade and Industry slashed its forecast of GDP growth in 2019 to 0%-1%, saying: "with the ongoing downturn exacerbated by the uncertainty caused by the US-China trade conflict."<sup>12</sup> We have also begun to witness panic among financial markets with investors turning to short term 2 year bonds, instead of 10 year bonds, which created the inverted bond yield curve; known as a historically reliable indicator, once the curve becomes inverted, recession shortly follows after.

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9 Inman, Phillip. "Trump's Trade Wars Sent Global Investment Tumbling – World Bank." The Guardian. Guardian News and Media, June 4, 2019. <https://www.theguardian.com/business/2019/jun/04/trump-trade-wars-sent-global-investment-tumbling-world-bank>. (accessed 12/09/2019)

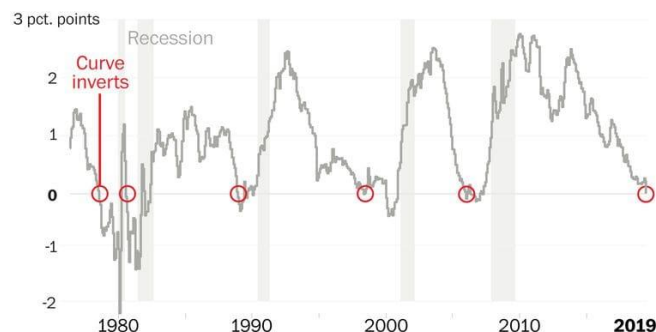
10 "IMF's Lagarde Warns of 'Self-Inflicted Wounds' from US-China Trade War." South China Morning Post, June 6, 2019. <https://www.scmp.com/news/world/article/3013300/us-china-trade-war-imfs-christine-lagarde-warns-self-inflicted-wounds>. (accessed 12/09/2019)

11 Wagner, Daniel. "Why World Bank Aid May Be the next Front in US-China Rivalry." South China Morning Post, February 7, 2019. <https://www.scmp.com/comment/insight-opinion/united-states/article/2185183/donald-trumps-pick-head-world-bank-means-us>. (accessed 12/09/2019)

12 "MTI Expects GDP Growth to Be '0.0 to 1.0 Per Cent' in 2019 ." Accessed September 12, 2019. [https://www.mti.gov.sg/-/media/MTI/Resources/Economic-Survey-of-Singapore/2019/Economic-Survey-of-Singapore-Second-Quarter-2019/PR\\_2Q19.pdf](https://www.mti.gov.sg/-/media/MTI/Resources/Economic-Survey-of-Singapore/2019/Economic-Survey-of-Singapore-Second-Quarter-2019/PR_2Q19.pdf).

### An inverted yield curve usually signals trouble

Historically, when the yield on 10-year Treasury bonds dips below the yield for 2-year bonds, a recession has followed.



Note: Only the first inversion preceding a recession is marked.

Source: St. Louis Federal Reserve, Wells Fargo Investment Institute

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<sup>13</sup>As seen in the diagram, the 10-year bond yield curve is falling, which means that 2-year bonds now yield more to investors than the former. This panic could have stemmed from many factors, but as we have seen with stock markets, investors are very susceptible to statements Trump makes, thus, fear that the US-China trade war might not end anytime soon, has triggered this sudden panic.

### Conclusion

With the next global crises looming ever closer, it has become inevitable and the question has now become: what will happen when it comes, not when will it come. I have talked in this essay about 2 interconnected themes: first, geo-economics and second, the trade war. The trade war, as I stated in the beginning, is merely a continuation of economic warfare that has long existed before Trump's trade war. The imposition of tariffs is essentially a geo-economic instrument, which Trump is using to counter China's emergence as a power, and even if this means economic loss; only proving that currently, the USA is facing a significant geopolitical threat which it must silence. The global recession that will come about is a result of not only the trade war, but of the increased use of geo-economics that will see even more importance after this

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<sup>13</sup> Marte, Jonnelle. "Recession Watch: What Is an 'Inverted Yield Curve' and Why Does It Matter?" The Washington Post. WP Company, August 14, 2019. <https://www.washingtonpost.com/business/2019/08/14/recession-watch-what-is-an-inverted-yield-curve-why-does-it-matter/?noredirect=on>. (accessed 13/09/2019)

next recession. After this next recession, the world will be split between China's and USA's trading partners. One can only estimate that such powerful economies will take advantage of those who will be impacted the most by this next recession through FDIs and foreign aid. After all, national security in the long term matters more to nations than short term economic stability, and with a slowdown in globalisation, powerful economies will seek to create economic spheres of influence, disguised under trade agreements and regional free trade zones, and this next recession will be the result of long simmering tensions and mistrust between economies that, might, end globalisation.

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