Sunday Wrap

Happy Sunday,

It's been a truly extraordinary week in the world of global politics. In the middle of the epic – multi-decade - battle between the US and China for global supremacy, and Europe's struggle to remain free of nationalist governments and as far away from their crossfire as possible, four important events took place just this past week, namely:

- **On Tuesday, in his State of the Union address, US President Trump claimed (questionably!) that the US has restored its undisputed global leadership role.**
- **On Friday, China's all-powerful government met a new and potentially significant challenge to the legitimacy of its governance model when Li Wenliang, the Chinese doctor first persecuted for raising alarm about the new deadly coronavirus, died in Wuhan.**
- **Meanwhile in Europe, Boris Johnson, in power after having driven his traditional center-right Tory party into the arms of the nationalists, delivered his (mostly deluded) vision of post-Brexit UK.**
- **And in Germany, the CDU mothership, and virtually everyone else in German mainstream politics and society, revolted – successfully - against (small-state) Thuringia's CDU rapprochement to the far right AfD.**

I'll first step back for a minute to summarize how I believe we got to a situation in which these four events are connected and how they may tell something important about the future of global governance. I'll then briefly address each of them:

1. The background:

These past four decades of reforms in China, initiated by Deng Xiaoping (focusing on economic liberalization, technology and openness to the world, but always under tight government control), and turbo-charged by globalization, have turned China into an emerging global superpower. That said, per capita income in China remains at only about 15% of that of the US (30% if calculated in PPP terms, i.e. adjusted for price differences), and to achieve truly middle-income status (let alone high-income levels), freedom of thought for the population, open communication and mobility of people and capital will be critical. But will the present Chinese political regime allow a critical mass of this to develop? That remains to be seen.

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Meanwhile in the US and Europe, these past 3-4 decades have also seen huge progress in technology, which, along with outsourcing of production (part of globalization) and Reagan-Thatcher-era deregulation of markets, have led to massive changes in traditional labor markets. As a result, the political base for the traditional political parties has started to shift.

During this period the US has mostly been basking in the glory of having won the Cold War (remember Fukuyama's "End of History") and the technological supremacy of Silicon Valley. In Europe, the attention following the "fall of the Wall" shifted to "the European project" of inclusion of Central Europe, the Single Market and the euro.

But the huge changes in required skills in this new world of technology and globalization were not matched by appropriate educational opportunities for the critical parts of the population in the US and Europe - and the financial windfall of global developments landed on only a small part of society. As a result, income distribution worsened dramatically in the US and (considerably less so) in Europe.

Now add the emergence of social media to this picture of social replacement, migration and poor income growth for big chunks of the population. In contrast to established media (where processes and legal responsibility are in place), social media has become a fertile ground for unchecked postulates and extreme views, fueling an ugly brand of "identity politics" – with increasing evidence of foreign powers and vested interests fueling the flames. As a result, the mainstream of Western society has lost the ability to frame the national narrative – and populist nationalism has gained ground.

Depending on the democratic structure, in some countries (e.g. the US and UK) nationalists took over the existing center-right parties (and thereby now the governments, causing a stunning collapse in those parties' traditional values), while in others (including most of Continental Europe) they gained power (although rarely governing power) via the establishment of new political parties and movements. This has left the traditional political parties in Continental Europa with a dilemma whether to cooperate with the rising nationalist parties and agendas, or whether to draw a clear line between these new forces and their own traditional values.

2. And now the four events of this past week:

If there is a central conclusion to be drawn from these four examples, it's the display of utter insecurity, disguised behind a wall of nationalist bravado, by governments from Washington, to London to Beijing - while Germany (across all non-far-right political landscape and in society more broadly), when tested, has solidified its clear position of not compromising with a nationalist far-right party. This leads me with lots of worries about the global outlook – and with a degree of continued trust that Continental Europe has a chance of staying politically sane through it all.

I'll take the four events in turn:

2.1. Trump's America

Putting aside all the usual politics, including the use of highly selective data, "grey-zone truths" (if not outright lies) and the bizarre calling out of individuals, that comes with the state of the union in the US, I took away the following two key messages from Trump's address on Tuesday:

First, Trump repeated his claim that the US has been victimized during the decades of post-war multilateralism. For example, he claimed, “Unfair trade is perhaps the single biggest reason that I decided to run for President”, adding that “for decades, China has taken advantage of the United States”. On military matters, he pointed out that US allies hadn’t paid their fair share of the cost of defense.

In reality, however, not only did multilateralism deliver huge – but poorly distributed – economic benefits to the US, it provided the US with enormous sway on global affairs via its influence over key international institutions, including UN bodies, WTO, IMF and the World Bank. Yes, China didn’t play by market rules, and the Europeans didn’t pay their fair share of defense costs, but to address those issues the “Trump way” is sure to lead to nothing more than a Pyrrhic victory.

Second, Trump claimed that he has changed all that in just these past “three short years”. He boasted about the economic performance, basically all true, although he forgot to mention that he has also generated the largest fiscal deficit on record, and that the trade deficit has gone up, not down, as a result of his policies. And, according to Trump, the US is now again admired around the world, and China is no longer taking advantage of the US. The transcript is here: Trump’s 2020 State of the Union Address

I would argue that Trump has made the US considerably more vulnerable than it was three years ago: economically and in terms of trust around the world, and therefore also militarily. And, apart from in Russia, there is no evidence that the US is more admired around the world today than it has been in the recent past.

And his attorney-general, Willian Barr, seems to agree!

As you know, few things have occupied US-European affairs more during this past year than the planned roll-out of 5G technology in Europe. China’s Huawei (a company very much the product of state-directed research into technology) has been pushing hard for a role, while the US government – and many Europeans – have worries about the security issues involved in letting a Chinese company build this critical infrastructure.

The key issue, however, is whether there is any viable alternative to Huawei, if we want 5G. To be honest, I don’t understand all the details of the security, and how one may or may not be able to deal with it, in the various phases and components of the roll-out of 5G – or about the trade-offs that would come with alternative providers.

But I noticed – with no small amount of amazement – that on Friday, William Barr suggested that US and European governments should encourage Ericsson and Nokia to seek US companies to take controlling shares of the companies to provide a US alternative to Huawei.

Two thoughts came to mind: First, the US administration is apparently acknowledging that a Chinese, not an American, company is leading global technology in this strategic area and that two European companies are the closest runner-ups (which doesn’t really square with Trump’s bravado). Second, like a bigger brother, Barr apparently feels that it would be safer to have this competing technology in the US rather than in European hands.

In other words, much has changed (China is ahead of the US in an important area of technology), and little has changed (Europe is still part of the US security umbrella.) To be continued …. I’m sure.

(Yes, also in US politics, on Wednesday, the Senate acquitted Trump on both articles of impeachment, but that was a foregone conclusion. The vote came down strictly along party lines (with the exception of Mitt Romney), illustrating – whatever the evidence of the trial – the deep tribal division in American society and politics. I’ll leave it like that.)

2.2. The political challenge to China from the new coronavirus.

I wrote about the new coronavirus last Sunday, arguing that the much-used parallels to the 2003 SARS outbreak may lead us to unsubstantiated comfort with respect to the seriousness of this new outbreak, to the impact on global economics, and on markets.

Today, I wonder about the political ramifications in China of the authorities' inadequate handling of the situation. First, we had the political leader of Wuhan answering on national television – to a question why it had taken him a week to make public the discovery of this new threat – that he had followed the law, waiting for clearance from Beijing to make this outbreak public. Then on Friday, the death of Li Wenliang, the doctor who had first raised alarm about the discovery, triggered a serious outbreak of criticism of the Chinese political leadership. Dr. Li had first been persecuted for – allegedly – spreading false rumors, although the Chinese supreme court later came down on Li's side, saying that the Wuhan authorities should have listened to him. In a deathbed interview, Li said that he thought, "there should be more than one voice in a healthy society".

In spite of the extensive control over social media in China, it seems that Li's death on Friday has caused a serious debate in China, raising questions not only about the exact (lack of) timely communication of this crisis, but of the broader issue of government-controlled media. As far as I understand, President Xi has been mostly MIA while lower ranking government officials have been sent out to communicate to the public, which suggests that the political fallout – if there is a lasting one – will lead to scapegoats in the lower, and local, ranks rather than at the top.

As implied by Dr. Li shortly before his death, the real issue is, of course, that a healthy (and hence long-term sustainable) society "needs more than one voice". If China had more than one voice, the handling of the outbreak of the coronavirus would no doubt have been better – and Europe's and the US' worries about links between Huawei and the Chinese government, and hence security issues in 5G, would have been easier to deal with.

But will, and can, the Chinese authorities open their society to a meaningful public debate on all the important issues in life? That remains to be seen. Without it, I seriously doubt the long term success of the Chinese economy – and in between, the risk exist of further nationalism, ultimately to whip up a view of external adversaries undermining Chinese prosperity.

In a just published article in Project Syndicate, former Austrian PM and respected China analyst, Kevin Rudd, argues that China will not change in this direction under Xi, but also that his agenda is indeed one of policies which includes several potential coalitions with the US and others. Rudd's article is here: The Coronavirus and Xi Jinping's Worldview

2.3. Boris Johnson lays out his vision of the UK post-Brexit

Now moving on to Europe – at the risk of getting caught in the global wave of nationalist governments – where one major country, the UK, has fallen on its sword of national delusion more than three years ago.

With "Brexit done", PM Boris Johnson outlined in a major speech on Monday his vision for the UK post Brexit. While delusionary in terms of the UK's possible role in today's world, his speech was also encouraging as he expressed his unwavering commitment to free trade and multilateralism - and he emphasized repeatedly his desire to have friendly cooperation in virtually all affairs with the rest of Europe. If nothing else, it was a reminder of the fallacy of the often-heard claim of similarities between Trump and Boris Johnson.

Boris Johnson claimed that the UK is "re-emerging after decades of hibernation as a campaigner for global free trade. … And yet my friends, I am here to warn you today that this beneficial magic [of free trade] is fading. Free trade is being choked … The mercantilists are everywhere, the protectionists are gaining ground. From Brussels to China to Washington tariffs are being waved around like cudgels even in debates on foreign policy where frankly they have no place - and there is an ever-growing proliferation of non-tariff barriers and the resulting tensions are letting the air out of the tires of the global economy."

One would be forgiven for wondering how he could imagine the UK making a difference in this world by being by itself, rather than integrated with the world's biggest trading economy, by shyness – or modesty (read: realism) – never seemed to be an issue for the prime minister. First he took on the US, and then Europe:

Boris Johnson noted (to the US ambassador in the audience) that "if you want to sell insurance across America, Mr. Ambassador, you still have to deal with 50 separate regulators, and it is high time I think we all agree that [the US] cut[s] their punitive tariffs on Scotch whisky." And "It is an incredible fact that we still sell not one hamburger's worth of beef to the US, not one kebab's worth of lamb, and as I speak the people of the US are still surviving without an ounce of Scottish haggis which they continue to ban Mr. Ambassador." But, of course, according to Johnson, when the UK and US start negotiating a trade deal, "it goes without saying that of course the NHS is not on the table and no we will not accept any diminution in food hygiene or animal welfare standards." All I'll say is that I wish the UK government good luck with its trade negotiations with the US …

Johnson then turned is fire on examples of European distortions of trade, only to be followed by: "I wish to reassure our friends [in the EU that] … we will not engage in some cut-throat race to the bottom. We are not leaving the EU to undermine European standards, we will not engage in any kind of dumping whether commercial, or social, or environmental … we want a comprehensive free trade agreement, similar to Canada's. But in the very unlikely event that we do not succeed, then our trade will have to be based on our existing Withdrawal Agreement with the EU … The question is whether we agree a trading relationship with the EU comparable to Canada's – or more like Australia's."

And more broadly, he believes in multilateralism, although it seems as if he hasn't followed the news these past decades: "I was there when they negotiated the Uruguay Round (Me: I remind you that this started in 1986). I saw it completed in Geneva (in 1993) when they gaveled it out - And it was one of those events that people hardly reported, but it was a fantastically important event in the life of the world. And it was a critical moment in my view that helped to lead to almost two decades of global growth and confidence … I don't wish to exaggerate our influence or our potential influence, but then nor would I minimise the eagerness of our friends around the world to hear once again our independent voice again in free trade negotiations and our objective is to get things started again …"

Nice to hear, but, somehow, I feel that the UK's friends will just listen politely, and then say something like "that's interesting …"

My bottom line is this: Between the two Brexit visions (the "can do" free trade vision, vs the insular protectionist vision seemingly favoured by Theresa May during her tenure), Boris Johnson is coming down clearly and forcefully on the former. That's good news – although it still leaves one wondering about the realism of it all.

The speech is here, and well worth a read, if, for nothing else, the amusement of Boris-speak: PM speech in Greenwich: 3 February 2020

2.4. The German reaction to the CDU's (and FDP's) flirtation with AfD in Thuringia.

As I mentioned above, as nationalism started to infect Western democracies in a more profound way, a key issue in European main politics became whether to distance yourself from these forces or whether to embrace some parts of their policies and to cooperate with the extreme parties under the excuse that they represent some percentage of the population.

In Scandinavia (including my native Denmark) and – more pronounced - in Austria, the philosophy of the mainstream parties has very much been one of cozying up to the far right, accept their votes to underpin minority governments, or even go into coalition with them. In clear contrast, in France, when campaigning for the presidency, Emanuel Macron took the exact opposite view and rejected forcefully, and effectively, the nationalism of the far right. In Germany, the policies of the mainstream parties have so far been one of no-cooperation with the far right, although parts of CDU/CSU, and the FDP, seemed at times to flirt with the idea of some possible cooperation with the AfD.

But in Germany, this past week, this all came to a head when, against all odds, the leader of the miniscule FDP in the small state of Thuringia (FDP entered the state parliament with less than 100 votes above the threshold), local FDP leader Thomas Kemmerich became prime minister of the state with the backing of CDU and the AfD.

The fact that the state CDU party broke ranks with the national CDU leadership caused a major uproar, with national political leaders, including Chancellor Angela Merkel, CDU Chairwoman Annegret Kramp-Karrenbauer, as well as political leaders from SPD, the Green, and Die Linke condemning the cooperation, calling for new elections in Thuringia. (The fact that the Thuringia's AfD is headed by Björn Höcke, representing the extreme right of the already far-right party, and a man the courts have verified as a fascist, surely made this particularly unacceptable to the mainstream.)

With the entire mainstream (and far left) German political establishment and society as a whole, as well as spontaneous demonstrations in Thuringia, Berlin and elsewhere, Kemmerich stepped down after just one day in the office, leaving Thuringia in political chaos. New elections have been discussed, but the more likely scenario seems to be another vote in the state parliament to find another prime minister.

It's too early tell the political consequences, but early opinion polls suggest that the FDP, including its national leader (who didn't come out forcefully against this constellation), Lindner, CDU leader AKK (seen as too weak to prevent it from first happening), and - to a lesser extent, AfD, are the main losers from this mess, while the Green, SPD and die Linke (including their popular former prime minister) may be the winners.

On the national level, the Thuringia misery has probably increased the risk to the grand coalition in Berlin as tensions between CDU/CSU and the SPD have risen to a new high. The next litmus test of the population's trust in the existing parties comes on February 23, when elections in Hamburg will take place. We shall see…

But the one clear take-away is that the German political establishment, and the population at large, rejected also in practice (and not just in words) any cooperation with the far-right AfD, and that leaves us believers in Europe, in tolerant policies and in multilateralism with a good degree of comfort in this otherwise increasingly uncertain world….

As I wrote in the introduction, this past week's four key events illustrate my worries about the outlook for global governance – and my continued trust that Continental Europe has a chance of staying politically sane through it all.

But Europe needs to exercise its influence around the world wisely, whether in terms of policies or appointments to key institutions. And in this respect, I'll need to leave you with a word of caution also for Europe:

The IMF is by far the most important global economic institution, and one (so far always) headed by a European. Without a doubt, the various managing directors of the IMF, including Christine Lagarde, managed the IMF very well through the global upheavals, not least the European sovereign crisis. In doing so, they all relied heavily on the IMF's excellent management team and outstanding staff.

In this light, one must wonder about the new IMF MD, Kristalina Georgieva's, urgency to change the IMF management team and (less visibly) the culture of the place. At a time when Poul Thomsen, head of the European department, is about to retire (incidentally for hitting the same age limit that was waived for Georgieva to take her job), it was announced this past week that First Deputy MD, David Lipton and Chief Administrative Officer Carla Grasso, both will leave the IMF at the end of the month. In reaction to the news of Lipton's departure, former IMF chief economist, now at the PIIE, Olivier Blanchard tweeted: "It is difficult to believe that whatever management reorganization at the IMF is desirable, it requires the departure of David Lipton. David has played a fundamental role at the IMF since 2011, and his early departure is a serious blow to the institution." I couldn't agree more.

It'll be interesting to see who'll arrive to fill the many top IMF positions now being vacated, but these are big shoes to fill. As someone (full disclosure: I'm ex IMF staff) who believes that the institution has played a key role for decades and will continue to be critical for the stability of the global economy, I have to say that I'm getting a bit nervous about the early signals from Georgieva.

And on that note, I wish you all a good Sunday afternoon.

Best

Erik

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