Trump is right that the global trading system is out of whack

By Andrew Jackson
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U.S. president-elect Donald Trump is widely portrayed as crudely and ignorantly anti-free trade and a powerful threat to a benign liberal world order. In fact, he is responding, albeit not very rationally, to serious problems with the U.S. economy and the global trading system.

Economists and liberal pundits embrace the classic Ricardian view of mutually beneficial gains from trade. They forget the underlying assumptions, namely that trade consists of the balanced exchange of final goods under freely floating exchange rates, with no capital mobility between countries and full employment.

In fact, the global trading system is marked by large, ongoing imbalances, significant short- and long-term capital flows between countries, complex production chains and serious problems of unemployment and under-employment in most countries.

The United States has run a chronic merchandise trade deficit since the early 1980s. It now stands at about 4 per cent of GDP, down a bit from over 5 per cent in the mid-2000s. The flip side of this deficit is persistent trade surpluses in China and developing Asia, Japan and Germany which have pursued export-led growth strategies.

It is a basic tenet of Keynesian economics that trade balances add to or subtract from domestic demand and employment, such that the ongoing role of the United States as consumer of last resort in the global economy has been at the expense of the domestic U.S. economy.

The U.S. trade deficit is the product of corporate globalization and a major shift of standardized manufacturing production to lower-wage developing countries, especially through worldwide value chains. Surplus countries tend to rely on either low wages, or, as in Germany, on very sophisticated, high-value-added production.

As many economists and certainly many voters have come to understand, trade, in combination with technological change, has seriously disrupted shared prosperity in the United States, destroying many middle-class jobs and putting a lid on wages for the bottom 90 per cent.

Chronic trade imbalances have also created a much more fragile global economy. Growth in global demand has come to depend on the willingness of the surplus countries to finance the large U.S. current-account deficit. Foreign capital inflows have inflated U.S. household debt and dangerous asset bubbles.

While Donald Trump has promised to “make America great again” by attacking trade deficits, any across-the-board imposition of tariffs would seriously disrupt supply chains such as those of Apple, and raise prices for U.S. consumers with little impact on U.S. jobs. The United States has become a marginal producer of many lower-end manufactured goods, such as clothing, furniture and consumer electronics.

A turn to “protectionism” will also face fierce resistance from U.S. corporate and financial elites who benefit from the status quo, and seem to have captured key economic posts in the new administration.

Some three-quarters of exports from China and developing Asia to the United States are produced by U.S.-owned transnational corporations and joint ventures, not by Chinese-owned companies. And many U.S. companies produce overseas rather than export from the United States, as in the case of General Motors, which now sells more cars in China than at home.

Wall Street banks profit immensely mediating global capital flows from surplus countries to global borrowers. And U.S. corporate interests have heavily promoted trade deals such as the Trans-Pacific Partnership, which undermine public-interest regulation and promote U.S. dominance in industries such as pharmaceuticals and culture by protecting intellectual property rights.

While it seems highly unlikely that president-elect Trump will significantly challenge the liberal world order, he may plausibly seek to balance U.S. trade in specific industries, such as auto and steel, where the United States still has significant productive capacity. There could even be spin-off benefit for Canada from managed trade in sectors such as auto, where we also now run a large deficit.

Mr. Trump could, and should, also push the case for closer global macro-economic co-ordination to reduce the U.S. deficit through the International Monetary Fund and the G20. Surplus countries should bear the burden of adjustment to chronic trade imbalances by boosting domestic demand rather than relying on export-led growth. Capital controls could also be used to promote needed currency realignments and to reduce wild swings in exchange rates.

Brexit and the election of Mr. Trump pose a serious threat to the liberal trade regime. If we are to avoid crude “beggar-thy-neighbour” forms of protectionism, we need to change the current rules of the global game, which have indeed created many losers.

Andrew Jackson is an adjunct research professor in the Institute of Political Economy at Carleton University in Ottawa and senior policy adviser to the Broadbent Institute.