In the age of Trump, it's time to change the global trade game

By Andrew Jackson
April 26, 2017 – *The Globe and Mail*

It is now three months into the presidency of Donald Trump, and policy makers around the world are still unsure how to respond to the new administration's challenge to the liberal global order and the looming threat of "America First" trade policies.

One line of thought has been to dismiss Mr. Trump and many of his cabinet members as economic illiterates who will hopefully soon see the error of their ways and accept that free and open trade is a win-win proposition.

Another more convincing approach advanced by leading economists such as Joseph Stiglitz, Dani Rodrik and Larry Summers has been to concede that the global trade and investment regime has indeed produced many losers who have been attracted to right-wing populism, and that the rules of the game should be rethought.

Prescription should begin with acknowledgment that the large United States trade deficit does matter for the domestic U.S. economy in terms of lost output and employment. A major increase in manufactured imports from low-wage developing countries was a significant cause of the declining fortunes of blue-collar industrial workers and their communities over the past two decades.

To be sure, technological change has also been a major factor, but increased capital intensity to squeeze labour costs is very much a response to increased international competition rather than a purely autonomous force.

So-called free-trade agreements such as NAFTA and those under the WTO, championed by U.S. governments and corporate interests, have facilitated a major shift of U.S. industrial capacity overseas. Indeed, their whole point was and is the reciprocal commitment to open up domestic markets to imports by lowering tariff and regulatory barriers to trade and by requiring national treatment of foreign corporations.

Classical economic theory notwithstanding, nothing in these agreements guaranteed balanced outcomes, and the United States lost significant domestic market share to offshore producers (including the subsidiaries of U.S. corporations) while failing to build sufficient export capacity in technologically advanced industries to offset lost production and lost jobs. The high U.S. dollar over much of this period undercut positive restructuring in response to global competition.

Martin Wolf of the Financial Times among other influential commentators recently argued that the United States trade deficit is not caused by free and open trade, but is the product of Made in America macro-economic policies. Specifically, the propensity of American consumers to spend more than they earn and the propensity of the federal government to run deficits means that the national savings rate has been very low, sucking in foreign imports and foreign savings.

This view has some basis in economic theory, but the real problem is not low savings but weak business investment. The ability to borrow from countries recycling their trade surpluses means that the United States has been easily able to finance its deficits without encouraging greater domestic saving through higher interest rates.

The view that the trade deficit is mainly a domestic issue leads to the policy prescription that the federal government deficit should be sharply cut, including through higher taxes. This would indeed lower the trade deficit by reducing consumer spending, but at the significant cost of jobs and growth. Conversely, as Mr Wolf argues, implementing the Trump program of deep tax cuts would likely increase the United States' trade deficit by boosting consumer spending on imports. This might well test the continued willingness of surplus countries to increase their holdings of U.S. dollar-denominated assets and precipitate another global financial crisis.

The key point is that the world has a major interest in gradually reducing the United States' trade deficit through concerted policies to slowly re-balance trade, thus avoiding the need for austerity in America and minimizing the risk of another financial crisis.

International institutions such as the IMF and the G20 need to acknowledge that a major source of the United States trade deficit has been and remains an over-valued greenback that should be countered by currency appreciation as well as by expansionary policies in surplus countries such as China and Germany. (As widely noted, Canada-U.S. trade in goods and services is roughly balanced and the exchange rate is reasonable.)

The best way to confront unilateral protectionist measures is to take multilateral action to reduce chronic trade imbalances. This was supposed to be at the heart of the G20 agenda after the 2007 financial crisis, but there has been only limited progress.

Other countries should also respond to Mr. Trump's call for "fair trade" by taking measures to raise wages in developing countries and thus reduce competitive pressures on workers in advanced industrial countries. While low labour costs are a legitimate source of competitive advantage, the suppression of trade unions and denial of basic labour rights as defined by the International Labour Organization has kept wage growth artificially low in many countries in relation to rising productivity.

Strong labour rights provisions within trade and investment agreements should be combined with recognition of the need and right for government to regulate in the public interest and to deliver public services so as to maintain social standards.

In conclusion, the global response to right-wing populism must begin by acknowledging the defects of the global free-trade regime, and taking multilateral action to change the rules.

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