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Trump's Economic Labyrinth

Donald Trump's economic-policy agenda during the 2016 US presidential election campaign was a political Rorschach test: where his supporters saw a bold new design for robust growth and greater prosperity, many others in the United States and around the world saw only a cynical blob of dodgy proposals and crossed lines.

Now that Trump must deliver to Congress an outline of his 2018 fiscal-year budget priorities, he and his advisers have no choice but to trade in the campaign inkblot for a governing blueprint. And yet, in his first address to Congress, Trump offered few policy details, even as he called on the assembled representatives and senators to help him "restart the engine of the American economy."

Trump may finally be coming to grips with the headaches that await him as he tries to articulate and enact his economic-policy agenda. An early preview came when Republicans in the US House of Representatives released their

plan to fulfill their longstanding vow to “repeal and replace” the Affordable Care Act, former President Barack Obama’s signature 2010 health-care reform. No sooner had the House Republicans unveiled their hastily drafted bill than it came under withering attack from all sides – including from members of their own party. Repealing Obamacare, it is now clear, was less a plan than a rallying cry for an increasingly fractious Republican Party.

A key question, therefore, is whether, and for how long, Trump’s legislative agenda will be hamstrung by the health-care debate. More broadly, on the generous assumption that the Republicans can find a quick and relatively painless way out of the corner into which they’ve painted themselves, what would realizing that agenda imply for the US and the global economy? *Project Syndicate* commentators’ perspectives on the Trump administration’s main proposals – in areas including taxes, trade, and regulation – provide an indispensable guide to what is possible – if not likely to appear on the policy horizon in the coming months.

Billionaires to the Barricades

Trump offered an initial glimpse of his economic-policy agenda when he assembled his cabinet. And, according to Elizabeth Drew, whose experience as a Washington correspondent during the Nixon administration becomes more relevant by the day, this latest presidential transition was “the strangest – even craziest” the US has experienced. By December, Trump had already loaded his administration with billionaires and former generals, which, Drew observes, placed him “firmly in the camp of plutocrats with little concern for workers and the middle class.” His strategy seems to be to provide “enough bread and circuses” to “distract his supporters from the real direction his administration is taking.”

So far, Trump has certainly played the ringmaster, unleashing a barrage of executive orders, even as doubt about his administration’s legislative effectiveness continues to grow. To Princeton University historian Harold James, Trump’s tumultuous first weeks in office are following the same

pattern as that of past outsider movements that suddenly came to power, such as the Bolsheviks a century ago this year. Once they are in government, James writes, “revolutionaries must try to strike a balance between betraying their supporters’ radical wishes” and undermining their own capacity to govern.

Trump’s address to Congress seemed intended to strike such a balance. But if he escalates his ongoing feud with the intelligence services over his and his appointees’ suspicious ties to Russia, or embraces the mission of White House chief strategist Stephen Bannon (a self-declared “Leninist”) to carry out the “deconstruction of the administrative state,” he could encounter a new problem. As James puts it, “members of the old establishment are the only people who know enough about specific government programs to get anything done.”

Beyond the executive branch bureaucracy, Trump will also have to rely heavily on Congress. “Many of Trump’s policy priorities – including tax reform, some deregulation, a military build-up, infrastructure spending, and the repeal and replacement of the Affordable Care Act – will require legislation,” notes Michael J. Boskin, the chairman of President George H.W. Bush’s Council of Economic Advisers. Building the necessary congressional coalitions will not be easy, particularly given the challenge Trump poses to core components of Republican ideological orthodoxy. As Boskin rightly points out, “Many who support, say, tax cuts and deregulation will oppose [Trump’s] spending increases and demand entitlement reform.”

So, will Republican orthodoxy hold, or will it come to reflect the vision, promoted by Bannon and others, of a nationalist party of the white working class? Nobel laureate economist Joseph E. Stiglitz, predicts that much will depend “on whether House Speaker Paul Ryan is a true fiscal conservative.” Ryan will “rubberstamp” Trump’s agenda, Stiglitz believes, only if he is “not as concerned about the deficit as he says he is.” Still, in many policy areas, Trump and Ryan already agree. Stiglitz notes that the White House and congressional Republicans are now “relatively free to weaken workers’ bargaining power,

deregulate Wall Street and other industries, and turn a blind eye to existing antitrust laws.”

Deregulation *Déjà vu*

In fact, Trump has already signed an executive order to unshackle Wall Street, by repealing an Obama-era fiduciary rule to protect investors, and rolling back the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. He could also soon fill vacancies on the Federal Reserve Board, including a vice-chair position to oversee financial regulation, which was created under Dodd-Frank but never filled. As Royal Bank of Scotland Chairman Howard Davies describes it, “financial regulation has entered a period of high uncertainty – and high anxiety for policymakers as they await an announcement from Mar-a-Lago.”

According to Gary Cohn, the former Goldman Sachs president who is now chairing Trump’s Council of Economic Advisers, canceling the fiduciary rule was meant to be a “table setter for a bunch of stuff that is coming.” For Harvard University’s Jeffrey Frankel, himself a member of the Council of Economic Advisers under President Bill Clinton, this does not bode well. Given that the fiduciary rule would merely “ensure that professional financial advisers and brokers act in the best interests of their clients,” Frankel concludes that scrapping it can serve “no purpose other than to maximize financial institutions’ profits, at the expense of the average American family.”

Indeed, if Cohn is the one setting the table for Wall Street, former International Monetary Fund Chief Economist Simon Johnson warns, banks’ capital requirements will likely be loosened. This is “exactly what happened in the early 2000s,” Johnson recalls, and “the consequences will be similar: disaster.” Because the Dodd-Frank reforms “can be rolled back without much difficulty,” the Trump administration, which includes some half-dozen Goldman Sachs alumni in senior posts, is “poised to do exactly that.” As a result, Johnson argues, “big banks will get bigger. Capital levels will fall. And reasonable risk-management practices will again become unfashionable.”

Worse still, the Trump administration could begin to undermine financial-system safeguards precisely at the moment when they need to be strengthened. Back in 2015, Harvard Law School's Mark Roe observed that "the big banks are back," owing to the repeal of a key Dodd-Frank provision barring banks from trading derivatives. And in January of this year, Roe reported that "disturbing evidence has emerged suggesting that, overall, the global financial system is no safer today than it was in 2007." According to Roe, the system lacks adequate protections "to guarantee against a rout if several banks failed simultaneously – or, worse, if the entire housing market" experienced "another of its once-in-a-generation crises."

Trump's Tax Shell Game

Trump and congressional Republicans are also finding common ground on taxation. Martin Feldstein, who chaired President Ronald Reagan's Council of Economic Advisers, describes the various proposals currently under consideration, including "a territorial system for taxing US firms' foreign subsidiaries" and "a cash-flow corporate tax." But chief among them is a proposal, offered by both the Trump administration and House Republicans, to halve the corporate-income-tax rate (now at 35%). Feldstein estimates that "the proposed rate cut would reduce revenue by about 1% of GDP, or \$190 billion a year in today's economy," which would be partly offset by increased investment and economic growth.

Still, this policy will pose a challenge for those Republicans who continue to "favor a revenue-neutral tax reform." And, as Barry Eichengreen of the University of California, Berkeley, reminds us, "there are still a few" deficit hawks in Congress.

Eichengreen points out that corporate-tax revenues are far less consequential to the budget balance than individual income taxes, which Trump also wants to reform, "by cutting the top marginal tax rate on ordinary income from 39.5% to 33%." But while tax cuts for the rich are in line with "mainstream Republican ideology," they will be palatable to voters only if accompanied by

tax cuts for the middle class. And yet as Eichengreen notes, “[b]road-based spending cuts to match broad-based income-tax reductions” – necessary to mollify the deficit hawks – “are not politically feasible.”

Whether or not Trump can convince Republicans to abandon budget discipline entirely, Harvard University’s Kenneth Rogoff suspects that his administration will succeed in making “aggressive use of budget deficits to fund its priorities for taxes and spending.” The simple reason, Rogoff explains, is that “whenever one party has firm control of government, it has a powerful incentive to borrow to finance its priorities, knowing that it won’t necessarily be the one to foot the bill.” Anatole Kaletsky of Gavekal Dragonomics seconds that view: “The Republicans’ hegemony will enable easy agreement on tax cuts financed mainly by higher public borrowing.”

But as Trump pursues a traditional deficit-financed supply-side agenda, he will continue to encounter resistance from the majority of US voters who did not support him in the election – and possibly from some of his own supporters, if Republicans cut Obamacare subsidies to help pay for their tax policies. In fact, as former Fed Vice-Chairman Alan S. Blinder notes, “One of the most consistent findings in American public opinion polling for decades is that people want *higher* taxes, not *lower*, on the rich and corporations.”

But Trump may intuit a psychological tendency among his supporters that Nobel laureate economist Robert J. Shiller describes. “Those on the downside of rising economic inequality,” Shiller argues, “typically do not want the government to make the tax system more progressive, to impose punishing taxes on the rich, in order to give the money to them.” Rather, they simply “want to be in control of their economic lives.” However powerful or durable this sentiment may be, Trump’s “America first” economic nationalism certainly seems to have tapped it.

Fiscal Protectionism

The nationalist approach implies another affront to Republican orthodoxy – this time on trade, where Trump is seeking to give domestic producers an

advantage over foreign competitors. But congressional Republicans, eagerly seeking ways to offset the income-tax cuts their corporate backers and wealthy patrons are demanding, have warmed to a border adjustment tax (BAT), which, as Feldstein puts it, “would give the US the international advantage of a value-added tax without levying that tax on domestic transactions.”

Like Feldstein, Allianz Chief Economist Michael Heise, believes that the US would gain a “competitive tax advantage” from the proposed BAT, under which “imported goods and services would be taxed at a rate of 20%, while exports would be subtracted from the tax base, and thus not taxed at all.” But, Heise adds, this assumes that “other countries do not follow suit and eliminate their own corporate-income taxes on export production.”

Heise thinks that the costs of such a “radical reform” would outweigh the potential benefits, and he is not alone in identifying serious flaws in its advocates’ arguments. New York University’s Nouriel Roubini, for example, argues that BAT proponents are simply “wrong” in claiming that the measure “would improve the US trade balance, while boosting domestic production, investment, and employment.” On the contrary, “[s]ome sectors or firms – especially those that rely heavily on imports, such as US retailers – would face sharp increases in their tax liabilities”; and as they pass these costs on to consumers, those at the bottom of the income scale would suffer the most.

More fundamentally, however, a BAT might not even achieve its intended purpose of protecting US producers, owing to the effect that it would have on the value of the US dollar. According to the economists Emmanuel Farhi, Gita Gopinath, and Oleg Itskhoki, who have studied what they call “fiscal devaluations,” a BAT would not “improve US competitiveness for the simple reason that the US authorities maintain a *flexible* exchange rate.” Because “the dollar will appreciate along with demand for US goods,” the policy’s intended benefits would be nullified. Moreover, they note that, “an appreciating dollar would erode America’s net foreign-asset position, because an overwhelming

85% of its foreign liabilities are denominated in dollars, while around 70% of its foreign assets are denominated in a foreign currency.”

Roubini shares this concern, and estimates that, “the value of [US foreign] assets could be reduced by several trillion dollars, in total.” In addition, he expects that “highly indebted emerging economies would face ballooning dollar liabilities, which could cause financial distress and even crises.” It is for this reason that former Asian Development Bank Chief Economist Shang-Jin Wei calls the mere proposal of a BAT a major source of “US-fueled economic uncertainty” that “will rattle emerging markets in 2017.”

Heise, for his part, sees additional global threats associated with a BAT in the US. For starters, “America’s trading partners would rightly view it as a protectionist measure,” and if they were “unwilling to wait through lengthy dispute-resolution proceedings at the [World Trade Organization], they could pursue a policy of tit-for-tat retaliation.” A new trade war is, as he puts it, “the last thing the world economy needs right now.” If Trump and the Republicans want a safer – but no less radical – measure to “‘rebalance’ the tax system,” Heise argues, they should target America’s anomalously high proportion of direct taxation. In this scenario, reforms would “reduce the rate of corporate-income tax, and simultaneously introduce or increase sales taxes on imported and domestically produced goods and services.”

Trumping Trade

Of course, the BAT is hardly the only proposed policy that now threatens to launch a new trade war. Eichengreen lists multiple laws on the books that already authorize Trump to pursue his trade-policy goals unilaterally: the 1962 Trade Expansion Act allows him to restrict “imports on the grounds that they threaten US ‘material interests’”; the 1977 International Emergency Economic Powers Act could allow him to disrupt trade “on the grounds that the loss of jobs to Mexico and China constitutes an economic emergency”; and so forth.

Similarly, according to Joakim Reiter and Guillermo Valles of the United Nations Conference on Trade and Development, even if Congress prevents Trump from abandoning trade agreements or imposing tariffs, he has a variety of means at his disposal to bend global trade patterns in America's favor – at least temporarily. For example, the US president has “extensive leeway” to impose anti-dumping duties on foreign goods, and to file possibly frivolous claims against other countries at the WTO. He can also follow his predecessors in using the “home market as leverage to demand concessions from other countries” – particularly “countries that are seen as piggybacking on American openness.” And he can negotiate “deals directly with foreign companies in order to reduce exports to the US, or to cap their market share,” as the US did with “car, microchip, steel, lumber, and machine-tool manufacturers” in the 1980s.

But, as Yale University's Stephen S. Roach points out, the US trade deficit is a “multilateral problem” that cannot be solved “one country at a time,” even by a self-proclaimed great “dealmaker.” Unless America addresses its savings shortfall, Roach argues, its “current-account and trade deficits will only widen.”

Unfortunately, Trump has never shown any interest in crafting comprehensive solutions to complex problems. He could have “moderated his anti-trade tone” after winning the election last November, Roach observes. “Instead, he has upped the ante.” Like other *Project Syndicate* contributors, Roach worries that Trump is issuing “a series of early warning shots in what could turn into a full-blown global trade war.”

That certainly is true of China, Trump's trade *bête noire*. Keyu Jin of the London School of Economics believes that Trump “is unlikely to back away from” his many campaign promises to take action against Chinese imports. But he would be wise to reconsider. While “a trade war would undoubtedly hurt both sides,” Jin argues, “there is reason to believe that the US has more to lose.” She lists a raft of measures China could take if Trump were to start a trade war.

“If China switched from Boeing to Airbus,” she notes by way of one striking example, “the US would lose some 179,000 jobs.”

And yet it could happen, if, as Jim O’Neill, a former chairman of Goldman Sachs Asset Management and former Commercial Secretary to the UK Treasury, suggests, the Trump administration’s approach to China is utterly detached from reality. “As Chinese household income continues to rise,” O’Neill points out, “demand for some of the US’s most competitive goods and services will only increase.” The irony in Trump’s blustering approach is that his own goals would be better served were he to do nothing. “Rather than spewing nonsense about China manipulating its currency,” O’Neill argues, or threatening to disrupt relations with America’s biggest trade partners, Trump “should be encouraging market forces to rebalance bilateral trade.”

The Fog of Trump

Trade is hardly the only feature of Trumponomics that remains baffling to *Project Syndicate* commentators. Blinder notes that, “judging by Trump’s own statements and his cabinet picks, he’s on the wrong side of almost every” economic issue, according to public-opinion polls. One explanation for this, offered by former Polish Finance Minister Jacek Rostowski, is that “Bannon is calling the political shots, and is more interested in building a permanent populist ‘movement’ than he is in getting Trump reelected.” In this scenario, Rostowski notes darkly, “[i]f Bannon wants to transform the American political landscape, an impeached or defeated Trump could become an ideal martyr.”

Columbia University’s Jeffrey D. Sachs has another explanation. “[T]here are three versions of Trump,” Sachs argues: “friend of [Russian President Vladimir] Putin, wealth maximizer, and demagogue.” And he is probably right that all three Trumps “are really one.”

But Trump’s inability to consolidate his administration’s economic-policy agenda reflects not only his own conflicted interests. More important, he and the Republican Party are caught in the grip of James’s “revolutionary

dilemma.” And there is no guarantee that his administration’s efforts to strike a balance between delivering on implausible campaign promises and actually governing will end well, as the mounting chaos surrounding the effort to repeal and replace Obamacare suggests. On the contrary, as Sachs warns, Trump can be expected to paper over his administration’s policy contradictions and political dysfunction with “appeals to greed, nationalism, patriotism, racism, and fear.”

In that case, a trade war could be the least of the world’s worries.

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