

## ECONOMICS



### YANIS VAROUFAKIS

Yanis Varoufakis, a former finance minister of Greece, is Professor of Economics at the University of Athens.

---

NOV 28, 2016

# Trump, the Dragon, and the Minotaur

ATHENS – If Donald Trump understands anything, it is the value of bankruptcy and financial recycling. He knows all about success via strategic defaults, followed by massive debt write-offs and the creation of assets from liabilities. But does he grasp the profound difference between a developer's debt and the debt of a large economy? And does he understand that China's private debt bubble is a powder keg under the global economy? Much hinges on whether he does.

Trump was elected on a wave of discontent with the establishment's colossal mishandling of both the pre-2008 boom and the post-2008 recession. His promise of a domestic stimulus and protectionist trade policies to bring back manufacturing jobs carried him to the White House. Whether he can deliver depends on whether he understands the role America used to play in the "good old days," the role it can play now and, crucially, the significance of China.

Before 1971, US global hegemony was predicated upon America's current-account surplus with the rest of the capitalist world, which the US helped to stabilize by recycling part of its surplus to Europe and Japan. This underpinned economic stability and sharply declining inequality everywhere. But, as America slipped into a deficit position, that global system could no longer function, giving rise to what I have called the Global Minotaur phase.

According to ancient myth, King Minos of Crete owed his hegemony to the Minotaur, a tragic beast imprisoned under Minos's palace. The Minotaur's intense loneliness was comparable only to the fear it inspired far and wide, because its voracious appetite could be satisfied – thereby guaranteeing Minos's reign – only by human flesh. So a ship loaded with youngsters regularly sailed to Crete from faraway Athens to deliver its human tribute to the beast. The gruesome ritual was essential for preserving *Pax Cretana* and the King's hegemony.

After 1971, US hegemony grew by an analogous process. The Minotaur was none other than the US trade deficit, which devoured increasing quantities of the world's net exports. America's burgeoning deficit was financed by billions of dollars of daily net inflows into Wall Street from the foreign (and often US) owners of these distant factories – a form of modern tribute to the Global Minotaur.

The more the deficit grew, the greater its appetite for Europe's and Asia's capital. What made the Minotaur truly global was its function: it helped recycle financial capital (profits, savings, and surplus money). It kept gleaming German factories busy. It gobbled up everything produced in Japan and, later, in China. But at the same time, Wall Street learned how to turbocharge these capital inflows through exotic financial instruments. The floodgates of financialization burst open and the world was flooded with debt.

In the autumn of 2008, the Minotaur was mortally wounded after running into the wall of private debt that was a by-product of its appetite. While the Fed and the Treasury refloated US markets (at the expense of weaker Americans left behind since the 1970s), nothing would be the same: Wall Street's capacity to continue "closing" the global recycling loop vanished. The US banking sector could no longer harness America's twin trade and budget deficits for the purposes of financing enough domestic demand to sustain the rest of the world's net exports. From that moment on, the world economy would find it impossible to regain its poise.

Following the Minotaur's mortal wounding, America has not only the Fed and the Treasury to thank for helping to avoid a new Great Depression. The US was also saved by the Dragon: the Chinese government cranked up domestic investment to unprecedented levels to pick up the slack created by the contraction in spending in the US and Europe. For many years, China allowed credit creation by its formal and shadow banks to run amok, even permitting them to benefit from the Fed's easy-money largesse by taking out dollar-denominated loans. Put succinctly, the Dragon stepped in to rebalance the West when the Minotaur no longer could.

China's leaders knew what they were doing. They were creating a bubble of unsustainable investment to give Europe and the US a chance to get their act together. Alas, both failed to

do so: America because of the standoff between President Barack Obama and the Republican-controlled Congress, and Europe for reasons too painful to recount. And when the perfect storm hit in 2015, with US interest rates climbing while commodity prices fell, China had to crank up credit creation once more.

Today, China's credit boom is underpinned by collateral almost as bad as that on which Bear Stearns, Lehman Brothers, and the rest were relying in 2007. Moreover, because the Chinese renminbi is grossly overvalued, corporations are borrowing dollars to repay their legacy dollar-denominated debt early, putting downward pressure on the exchange rate.

Trump's plan for helping those left behind since the 1970s, to the extent that one is discernible, seems to turn on two axes: a domestic stimulus and bilateral deal-making under the threat of tariffs and quotas. But if he plays hardball with China, pushing the Chinese to revalue the renminbi and employing threats of tariffs and the like, he may well end up pricking the bubble of China's private debt – unleashing a deluge of nasty consequences that would overwhelm any domestic stimulus he introduces.

In that case, Trump's infrastructure spending would morph into more corporate welfare, implying a negligible multiplier effect. That, in turn, would set the stage for future austerity, as panic over further US interest rate rises and federal budget blow-ups put the squeeze on the government's existing unfunded commitments (for example, Social Security).

If Trump's medium-term economic strategy is to have any chance of success, he must grasp that it is not US public debt, but Chinese private debt, that needs to be restructured. Otherwise, US Treasury yields could go through the roof, severely weakening US debt sustainability.

Likewise, Trump must realize that he cannot make America great again by emulating Ronald Reagan's unfunded stimulus. That trick worked when the Minotaur was chained and fed; it won't work when the Dragon has run out of fire. Instead, if Trump truly wants to rebalance the US economy so that growth benefits the abandoned people to whom he has promised so much, he should emulate Franklin D. Roosevelt and pursue a Keynesian makeover of Bretton Woods.

*<http://prosyn.org/jRIRPqF>*