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# Trumponomics: Early Results

The Erosion of Pax Americana  
and Slowdown of Globalization

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Alexander Losev

# About the Author

## **Alexander Losev**

CEO of Sputnik Asset Management JSC (member of Sputnik Group Ltd.), Member of the Presidium of the Council on Foreign and Defense Policy (CFDP, Moscow)

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42 Bolshaya Tatarskaya st., Moscow, 115184, Russia

With the establishment of US global leadership in the early 1990s, the American elite embraced the idea of globalization. The main philosophical and ideological trends became neo-conservatism expressed through military and economic superiority over the other states to achieve a global hegemony and preserve its hyper-power status, as well as neoliberalism that handed corporations and financial institutions the levers to control world markets, production capacities, and cross-border trade. The United States became a post-industrial economy, i.e. an economy based on finances, information technologies and services plus control of cutting-edge technologies and intellectual property while industrial production was moved to developing countries with their cheap labour and low-cost resources.

For two decades globalization and the wholesale transfer of the functions of the state and even some sovereignty to transnational corporations and oligopolies were the defining trends in the world economy and politics creating a new world order with an increasing role of the flow of capital, goods, services and information, and, most importantly, stronger global financial institutions. Even the Silicon Valley IT oligopoly made a bid for world influence and a role in shaping the internal political agenda in the US.

However, the absence of serious political challenges to US hegemony, economic globalization, and the financialization of markets eventually turned geopolitics into geoeconomics. In the sphere of global governance the rigid 'superpower-satellites-periphery-rivals' pattern gave way to direct or indirect dominance of world institutions such as the IMF, the World Bank, the WTO, the Federal Reserve, the Exchange Stabilization Fund, the Bank for International Settlements and others over commodity and financial markets and even relations between states. For instance, *The Economist* believes that the heads of central banks have become more influential than elected politicians are because they can influence all the economic processes, including the incomes of individuals, corporations, budgets, as well as economic cycles in their own and indeed in other countries.

The heavy concentration of world production and labour resources in Southeast Asia, where wealth, technologies, and financial reserves have been accumulated, encouraged China's claim to a full-fledged role in running the world economy and globalization processes. In contrast, the United States have been facing a growing trade deficit (\$566 billion as of 2017) and national debt (\$21 trillion). All this has brought about the erosion of the classical *Pax Americana*.

Liberal world trade, transnationalism of the financial elite, the emergence of supranational actors from among major corporations, investment funds and banks, and changing directions in the flow of capital and resources have devalued America's soft power and the lure of being an ally of the US.

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# Tax Havens and Tax Competition

The established model of global trade and flawed US fiscal policy have led to the popularity of offshores and tax minimization schemes. The returns of American companies on overseas operations account for more than 40 per cent of the total. Some of these proceeds settle in tax havens. The total assets of offshore financial centres today are in excess of \$30 trillion, according to consensus economic assessments. Given the scale of economy, the biggest loser from this activity is the United States, and the main complaint of the authorities against corporations is widespread tax evasion and fiddling with accounts and finances.

According to the Institute on Taxation and Economic Policy (ITEP), US corporations kept \$2.6 trillion in foreign accounts in tax havens. Google Inc. (subsidiary of Alphabet Inc.), one of the largest companies in terms of market capitalization, paid taxes outside the US at the rate of 6 per cent for 10 years. Yahoo! Inc. managed to reduce its tax rate to 1.35 per cent. Up until 2017, American corporations channelled \$12–13 trillion a year through their subsidiaries in the Netherlands. There are also domestic offshore havens in the United States, for example, the laws in Delaware, Nevada, and Wyoming allow corporations to set up fictitious companies to avoid high taxes.

Against the background of increasing tax burden on individuals, American corporations have been reducing their tax burden for a long time. Meanwhile, the US national debt has been growing at an annual rate of \$1.2 trillion over the past ten years, having more than doubled from \$8.95 trillion in late 2007 to \$20.8 trillion in December 2017. Thus, there is a problem to address.

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# Demand for a New Economic Policy in the Spirit of Franklyn Roosevelt and Ronald Reagan

The economist Dani Rodrik introduced the concept of the Globalization Paradox that pinpoints the conflict between democracy, economic globalization, and state sovereignty. Rodrik states that these three goals cannot coexist at the nation-state level. If it is to maintain its policy at the national level the strongest power will sooner or later have to sacrifice one of these three principles. Since democracy and sovereignty are held sacred in the US, it would have to sacrifice globalization to resolve the paradox. Its main rival, China, would probably sacrifice democracy.

Under the circumstances, to preserve its superiority, the United States will have to fall back not on soft, but on hard power with elements of military pressure and protectionism to slow geoeconomic processes and globalization which contributes to the rise of China. US administration officials state that there is a shift in the global balance of power away from American interests. To restore its supremacy the United States, logically, needs a new policy and a new leader, as well as a new ideology. Such ideology would combine the Monroe Doctrine and the ideas of Hans Morgenthau that considers national interests and the threat of the use of force as the main source of power for a nation-state in the international relations.

These ideas sound similar to those expressed by Donald Trump during the 2016 presidential campaign when he advocated industrial protectionism and overtly populist views on trade and immigration, and his aide Stephen Bannon who claimed that the global elite had hatched a 'deep state conspiracy' to undermine American sovereignty through support for free immigration and trade. It is now up to Donald Trump to prove that 'America is First' or at least to attempt to prove it. Since the outcome of his mix of politics, economics, the ideology of conservative Anglo-Saxon messianism, and America's superiority over the rest of the world, already dubbed 'Trumponomics', is far from certain. International partners will quickly turn into rivals and internal political forces in the US defy cohesion, as the split of the elite after the 2016 election is all too obvious.

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# Donald Trump's Economic Programme

Trump's economic programme is based on fiscal reflation, that is, a range of measures aimed to boost production inside the US through government economic incentives (a new fiscal policy) better known as the 'Trump tax reform', which also implies a moderate monetary policy from the US Federal Reserve System and trade deficit reduction. The programme's ideological mottoes are 'Make America Great Again' and 'Trump is the Heir to Reagan'.

To withstand global competition under new conditions the US has to increase its own power and deprive its economic and geopolitical rivals of the advantages they have acquired due to globalization. It has to maintain control over technology and intellectual property and consolidate industry and production chains, capital and resources, including, crucially, energy and raw materials, on its own territory.

A protectionist foreign trade policy, customs and technical barriers as well as export restrictions can promote GDP growth, healthier balance of payments, job creation offering opportunities to pressure rivals. Protectionism makes no sense if the country does not produce enough to meet its internal demand and has no industrial capacity that needs to be protected by import restrictions. Therefore, Trumponomics envisages an industrial policy of some sort, although US manufacturing, including the power sector, accounts for only 21 per cent of the GDP while services account for 78 per cent.

The proposed tools of the new policy are a \$1 trillion increase in federal spending and infrastructure investment and a \$4.4 trillion fiscal reform. Initially the reform was to cut income taxes and corporate profit taxes from 35 to 20 per cent. In fact, in December 2017, Congress approved a corporate tax cut from 35 to 21 per cent, tax rebates on capital spending, and tax cuts when incomes from overseas operations are returned to the US in cash from 35 to 15.5 per cent and to 8 per cent for non-cash transfers. Trump's tax reform envisages instant total depreciation of fixed-assets to stimulate capital investments. Moreover, taxes have been cut for some groups of individuals. The number of individuals covered by a 40 per cent

inheritance tax has been reduced, and a large number of taxpayers have been exempted from the minimal alternative tax.

Household incomes have not increased since the 2007–2008 crisis and some categories of the population have even seen a decrease. In 2009, 109 million Americans lost their jobs or had to accept shorter hours. The American middle class has shrunk from 62 per cent of the population in the early 1970s to 43 per cent in 2016, according to *Market Watch* and *The Financial Times*. The US Bureau of Labour Statistics notes that key industries in which even people without degrees enjoyed comfortable salaries are being replaced by typically low-paying jobs in the service sector.

Thus, the reform may increase total demand and improve economic performance in two ways. First, households will have more disposable income after tax, with part of this extra money pushing up demand for goods and services. Second, by allowing companies to deduct new investments from taxation, until 2022, the tax reform encourages them to increase short-term investment, which boosts total demand in the economy for corporations.

At the same time increased issuance of treasury bonds needed to cover the budget deficit due to revenue shortfalls may, by as early as the end of 2019, push interest rates to levels that would be a disincentive to investment. That is why time limits have been set for the tax measures. After 2025 the government is expected to decrease the federal budget deficit and cut interest rates, which would again stimulate investments because by that time the positive impact for industrial production will wear off.

Because the US economy is in a state of full employment, the impact of fiscal incentives on expanding demand will be less, so additional incentives may be introduced to develop new technologies, automate production, and boost labour productivity. Manufacturing today accounts for 11.7 per cent of the GDP, but this share is supposed to grow in the future.

Domestic production is to be stimulated by various protectionist measures, including duties on the import of broad categories of goods from the countries that are the main trading partners of the US. These measures will hit not only metals, but also high-value-added products such as cars, electronics, and household appliances.

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# Budget Deficit

Economic policy based on fiscal reflation also has a downside. In the next few years GDP growth and an expanded tax base will be unable to make up for the budget revenue shortfalls due to cuts in nominal tax rates, while infrastructure projects have a long payback period. All this will inevitably be reducing federal revenue over the coming years and will have increased the federal spending deficit as well as the national debt by another \$11 trillion by 2027.

The national debt today reached 105 per cent of GDP, and by 2020 the debt–GDP ratio may rise to 110 per cent although the economy is set to grow by an annual 3–3.5 per cent. According to the US Congress Joint Taxation Committee, the net losses caused by the programme over 10 years will amount to \$1.414 trillion. According to the Congress Budget Authority and the Senate Committee on Finance, the tax reform will add \$1.441 trillion to the budget deficit and reduce revenues by \$1.633 trillion. However, the taxpayers' incomes may go up by an average of 8 per cent, which in turn will increase the tax base. As a result, the Federal Government may get an extra \$566 billion from taxes paid by individuals and \$683 billion in payroll taxes.

If corporate taxes continue to decrease dynamically, the reform will stimulate investment growth and will enable the enterprises to make deductions from large amounts of capital investment. Thus, according to Tax Foundation's Taxes and Growth Model, American companies could save \$1.2 trillion in the early years of the reform and a further \$1.3 trillion before 2025. If Trump's tax reform goes according to plan, the easing of the tax burden on investment and on labour will add an extra 9 per cent to GDP growth in the long term, according to Congressional expert estimates.

With a population of 320 million and, hence, huge domestic consumer market America has considerable import substitution potential. The main problem, however, is that the majority of American manufactures depend on imported materials and 95 per cent of all clothes and footwear on store shelves in the US are foreign-made. Therefore, the measures to bring industry back to the US where labour is more expensive and the taxes are higher, or the introduction of import duties would send up the prices for goods produced in the US from imported materials and would spur inflation. The textile, chemical,



and automobile industries may be hit the hardest. Problems could arise for manufacturing companies even in the sphere of legal and financial transborder services. Higher inflation would raise interest rates increasing the cost of money and credit rates, which would affect economic buoyancy.

Among measures proposed to cut the budget burden are deregulation of the economy and scrapping Barack Obama's healthcare reform (Obamacare). However, a quick cut in healthcare spending is not an option because it would affect broad swaths of voters and because medical services sector is a domestic market that contributes to the GDP. The Trump administration will likely seek to cut spending on science and education, as well as other social spending. Social expenditure under Obama hit 66 per cent compared with some 15 per cent in the mid-20th century. Such 'socialism' in a country that was considered the bulwark of capitalism throughout the last century, poses high long-term risks for the economy.

To stimulate investment financing there is a move to repeal the Dodd-Frank Act which substantially limited the activities of commercial banks after the 2008 crisis. It also has to be borne in mind that domestic consumption accounts for 70 per cent of the GDP in the US and total personal debt stands at \$18.91 trillion, or 95 per cent of the GDP. The working age population in the US is 62.9 per cent of the total, or 159.7 million. Therefore, it seems logical that new jobs and higher living standards would be created for US citizens, and those working under temporary contracts should be moved to permanent employment status. By the same token, every opportunity has to be used to limit the economic involvement of migrants who are willing to work for smaller wages than the Americans. The number of foreign workers (legal and illegal labour immigrants) stood at 27 million in the last year of Obama's presidency.

The main goals of Trumponomics are development of domestic production and improvement of the labour market as well as bringing back American capital from abroad. The Trump administration intends to solve these tasks through a new fiscal policy and investment in infrastructure, but that may prove to be insufficient. America has to eliminate imbalances in international trade. That is why a revision of international trade agreements, such as the WTO and NAFTA, is a constant subject of discussion. Part of the policy consists of imposing decisions on allies and satellites, for example, restrictions on cooperation between American corporations and companies of US allies with the states listed in the Countering America's Adversaries Through Sanctions Act in spheres that are sensitive in their economies. US foreign policy must serve its national interests.

Besides, in most countries American goods are subject to VAT (value-added tax) while in the US there is no VAT on imported goods with the exception of a sales tax in most states. The US is expected to respond to the imbalance by phasing in new duties on imported goods and by asymmetric taxation on its exporters and importers so that the difference in tax rates will cancel out the advantages of the countries trading with the US should they resort to dumping or competitively devaluing their national currencies.

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## Support of Energy and Basic Sectors

The US economy is well endowed with its own natural resources. Therefore, the immediate goal of Trump's industrial policy is to support basic sectors such as power, oil and gas, transport and heavy machine building, the mining as well as the steel and aluminium industries. Protective measures and customs tariffs aimed to support these sectors. A world trade war has not yet started, but the US is gradually intensifying its protectionist narrative, with Trump personally announcing duties on the import of steel and aluminium, \$60 billion worth of duties on goods from China, and on European built cars.

Energy policy and energy security loom large in the US economic programme. The United States is the world's biggest consumer of energy. It accounts for 25 per cent of the world's power consumption, which roughly matches the share of the American economy in the world GDP. The US consumes 19.7 million barrels of oil a day. Its own oil production reached 10.3 million barrels in March 2018, but that still covers only 52 per cent of its needs, while 48 per cent are to be imported. The tariff policy has to take this ratio into account: 68 per cent of US oil imports is duty-free. However, in the future, if the US manages to meet three quarters of its oil and petroleum products needs domestically, import duties on oil are likely to be introduced and the corresponding agreements with its NAFTA neighbours revised. The proposed cut of the profit tax and introduction of duties would stimulate domestic oil and gas processing and thus increase domestic demand for raw hydrocarbon commodities and the exports of processed products.

The gas sector is in a much better position. In addition to oil, natural gas extraction has resulted from the 'shale revolution'. The US Midwest and

Northeast are gradually becoming natural gas producing centres. Natural gas extraction in the United States has soared during the past decade. Since 2009 the US has been the world's biggest producer of natural gas, ahead of Russia, because of the shale gas extraction technology. The proven gas reserves in the US are comparable to those of Saudi Arabia, but are 5.5 times less than in Russia and 3.7 times less than in Iran.

Gas production growth is spearheaded by the Marcellus and Utica areas in the Appalachians. In 2017 the US was producing an average of 73.6 billion cubic feet of gas a day, with total gas output reaching 758 billion cubic meters in 2017, according to OPEC. The Energy Information Administration (EIA) expects that shale gas will not only cover US domestic energy needs, but will make it a leading liquefied natural gas (LNG) exporter: new liquefaction facilities are already being built in Louisiana and Maryland.

As natural gas liquefaction technologies improve, the gas market will become global, opening up opportunities for the export of American LNG. An assessment is underway on the need for pipelines, gas storage facilities, terminals, and tankers for LNG export. In parallel four more gas liquefaction facilities are under construction and by the end of 2019 liquefaction capacity in the US will have increased from 5.6 billion cubic feet to 9.6 billion cubic feet per day, which will be boosting American exports of natural gas.

The EIA energy forecast sees the United States as a net exporter of natural gas starting in the second quarter of 2018 and every month of 2019 because exports via pipeline to Mexico continue to increase along with LNG exports. This portends pressure on the consumer markets in Europe and Asia through economic and military-political levers. China, for example, has been offered an opportunity to increase imports of American LNG to offset the imbalance in bilateral trade.

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## Trump's Infrastructure Plan

The Trump team's initial plan was to allocate \$1 trillion for infrastructure development. However, Congress did not approve the proposed level of federal budget financing bearing in mind the increased deficit caused by the tax plan and defence spending. Before announcing his new proposals in February 2018 Donald Trump said via Twitter that 'this will be a big week for Infrastructure.

After so stupidly spending \$7 trillion in the Middle East, it is now time to start investing in OUR Country.'

Eventually, Congress was presented with a \$1.5 trillion plan to stimulate infrastructure investment of which only \$200 billion would be federal money and the remaining \$1.3 trillion would be private or state budget investments. Half of the federal budget appropriations – \$100 billion – will go to the Department of Transportation, the US Army Corps of Engineers, and the Environmental Protection Agency to be then allocated to the modernization of rail transportation and highways, seaports and airports, water supply facilities and hydroelectric stations. A further \$50 billion in federal funding will finance infrastructure projects in agriculture and agriculture related energy and water distribution systems. The remainder will be used to finance ongoing transport and utilities infrastructure loans and innovation projects in the transport and energy sectors.

The Trump administration's infrastructure plan contains some positive proposals that would open US infrastructure projects to more private participation, but the possibility of attracting more than a trillion dollars of non-federal and private assets will be limited without restructuring current infrastructure financing through the introduction of tolls and fees on users and without further changes in the tax policy. The plans put the burden of infrastructure financing on the states, but this does not resolve the ongoing problem of how to provide individual states with additional capital without politically unpleasant measures such as raising local taxes or extra user fees.

The main and virtually insoluble question is how to improve the infrastructure without paying for it. While the decision to appropriate \$200 billion in federal funding is likely to be passed, there are more questions than answers concerning the other items. Congress, especially the Democrats, is unlikely to back the plan of non-federal financing by states and municipalities, while private investors will be unable to pay trillions for US infrastructure.

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# Long-Term Goals and National Interests

The top-level doctrinal document, the National Security Strategy, adopted in December 2017 identifies four key national interests of the US:

1. Protect the American people, the homeland, and the American way of life.
2. Promote American prosperity.
3. Preserve peace through strength.
4. Advance American influence in the world.

The US plans to achieve energy self-sufficiency by 2025 and to concentrate on its territory not only research centres and new technology development facilities, but also production units where innovations will be introduced to become core technologies of a new industrial order.

The United States will seek to become an economic autarchy that is 'invulnerable' to external threats and preserves its leadership holding back rivals and competitors. It will promote prosperity, concentrate capital, resources, and production capacity in the country to meet its present and future domestic needs and not to be dependent on the imports of goods or commodities, especially critical ones. A multi-sector economy, different barriers on the country's perimeter, high technology, financial and military-political independence, a system of stimulating internal demand and a strategy for breaking into foreign markets – are the measures that would make the country immune to external influences, regional crises, and barriers erected by third countries, even strong ones in economic and military-political terms. These goals are served by a sharp increase in national defence spending and support for the military-industrial complex. Thus, the goal of creating a dynamic internal manufacturing sector turns out to be the priority of industrial policy.

Trumponomics will create conditions for the return, to the US, of the sectors that are key to national security. At the same time, foreign policy will seek to create hotbeds of tension in various regions of the world in order to increase supplies of American weapons and military equipment to its allies. Thus, Trump's 'peace through strength' concept would help mobilize industry and transform the economy to prepare it for a new technological order.

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# Results of the First Year of Trumponomics

The economic statistics for 2017 show that the US economy condition improved in the first year of Donald Trump's presidency. It has achieved more stability. The positive dynamics of the real GDP in 2017 have confirmed the positive effect of growing personal consumption spending, exports, investments in commercial real estate and fixed assets, federal and local public spending and federal government spending, which were partly offset by a drop in investment in inventories.

Internal demand jumped by 4.6 per cent, the fastest growth in three years, showing the economy's strength. Consumer spending, which accounts for more than two thirds of economic activity in the US, grew by 3.8 per cent in the fourth quarter, also the fastest growth since the fourth quarter of 2014. Strong domestic demand was shored up by expectations for the long-term effect of tax cuts.

Improved well-being of households was also driven by the run-up in stock market, growing real estate prices, and an increase in wages because companies started to compete for skilled labour and some states raised their local minimum wage. All this will continue to sustain consumer spending.

Much of the growth in consumer demand was met by imports which increased by 13.9 per cent in fourth quarter of 2017, the most impressive growth since the third quarter of 2010, which compensated for the increase in American exports due to the weakness of the dollar.

In 2017, the US economy became more diversified and less dependent on the performance of specific sectors. An active FED policy stabilized the banking industry, which, combined with low volatility in financial markets, boosted financing loans, including mortgage loans.

According to the FRS Beige Book, economic activity showed moderate or average growth, and a quarterly 3 per cent growth rate in the economy was thought unimaginable at the time of Trump's inauguration in early 2017. Growth points were concentrated in consumer spending and investment in business expansion. Corporate investment in equipment and other fixed capital were up by 11.4 per cent, the strongest showing since the third quarter of 2014. The weak

dollar, the strong oil market and the strengthening of the world economy, which in turn stimulates exports, support the current GDP growth rate.

Unemployment is dropping even among African Americans and Latinos, having hit the lowest point in the last 40 years. Jobs are being created even in America's Rust Belt. The increased buoyancy of production, construction, and the mining industries in that region created almost half a million jobs during the first year of Trump's presidency. Apple's plans alone would increase profits in the US by \$250 million, create 20,000 jobs and open a new business campus. Apple will pay \$38 billion in taxes to the Department of the Treasury.

After a decade of working outside the US, manufacturing companies are again creating jobs in the US. Fiat Chrysler announced that it was moving a plant with 2,500 workers to Michigan. The media has reported similar wage increases or new jobs at Disney, The Home Depot, JPMorgan Chase, FedEx, and other companies. The latest Quinnipiac University poll shows that after the first year of Trump's presidency 70 per cent of Americans consider the economy to be 'excellent' or 'good', the highest figure in the last 17 years.

According to Automatic Data Processing Research Institute (ADP), the positive indicators became stronger at the start of 2018. American companies created more jobs than expected, indicating that the labour market remains healthy. ADP data shows a transition from temporary employment, where it existed, to permanent employment and growing demand for experienced workers. There is a demand for young workers in the labour market, which gives America an edge over the other developed countries, especially Europe where youth unemployment is a problem.

Moody's, based on ADP data, has concluded that 2018 will be the 8th consecutive year of the economy creating over 2 million new jobs. *Bloomberg Economics* predicts that unemployment will drop below 4 per cent in the early months of 2018. The positive impact of growing aggregate demand is borne out by the upsurge in trade, and the transportation and utilities sectors over the past 6 months, which increased employment in the sales servicing sector.

The new head of the US Federal Reserve System, Jerome Powell, declared in the Fed's Summary of Economic Projections published on March 21 along with a statement from the Federal Open Market Committee (FOMC) session that 'when fiscal changes are made it is important that to the extent possible they be directed at enhancing the productive capacity of the economy,' which is likely to be reflected in stronger GDP performance in the short term.

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# Imports Hold Back America's Economic Growth

The US GDP grew by 2.6 per cent in 2017 on an annualized basis, the fourth quarter indicators being lower than in the third quarter in spite of increased consumer spending at the end of the year. The reason is that growing income and consumer activity in the US increase imports. Imports, which is subtracted from GDP growth, has been growing at a record rate over the past seven years. In 2017, the US imported \$2.89 trillion worth of goods and services and exported \$2.32 trillion, leading to a \$566 billion trade deficit.

Growing imports in the wake of economic acceleration in the US highlights the problems faced by the Trump administration in meeting the 3 per cent annual GDP growth target. The trade imbalance in favour of imports cut 1.13 per cent off GDP growth in late 2017. Statistics show that investment in inventories also held back GDP growth in the fourth quarter subtracting 0.67 per cent from total output after a 0.79 per cent increase in production in the preceding period. The growth in consumer spending spurred inflation. The Core Consumer Price Index (CPI) rose by 1.9 per cent during the year.

The main sectors that contribute to the trade deficit are consumer goods and automotive. In 2017, the United State imported medicines, TV sets, clothes and other household items to the tune of \$602 billion and exported just \$198 billion worth of consumer goods. The imbalance added \$404 billion to the trade deficit. The US imported \$359 billion worth of cars and parts and exported \$158 billion worth, adding \$201 billion to the deficit. Protective tariffs, customs barriers, and new technical requirements are the only way to achieve a quick reduction in imports since the current import substitution capacity is limited by the available production capacity.

America's main rival in this area is China, 'the world factory', which has been accused of stealing American technology and using dishonest trade practices. As of the end of 2017, the situation in trade with America's most difficult partners was as follows: with China, a deficit of \$375 billion with the total trade volume of \$636 billion; with Mexico, \$71 billion and \$557 billion; with Japan, \$69 billion and \$204 billion, and with Germany \$65 billion and \$171 billion, respectively. The high percentage of imports in domestic consumption and the growing trade deficit year after year threaten to undermine the sustained



growth of the US economy. The constant trade deficit damages the economy because it is financed through debt. The US can buy more than it produces because it borrows money from its trade partners.

Another problem caused by the trade deficit is that it makes the American economy less competitive. Buying goods abroad over long periods of time, US companies lose expertise and production capacity, and, consequently, jobs and competitiveness. Which is why, the Trump administration is likely to step up its protectionist rhetoric and pursue a corresponding policy in 2018. To justify new tariffs the administration may invoke the little-used section of the Trade Expansion Act of 1962 that allows import restrictions for national security reasons.

However, these tariffs will likely to be challenged by the US's partners in the World Trade Organization (WTO). Such a policy will increase the risk of full-scale trade conflicts. On 1 March 2018, President Trump announced plans to introduce tariffs on steel and aluminium (25 per cent and 10 per cent, respectively) applicable to all countries.

The biggest beneficiary from the new import tariffs will be the steel sector because it has the biggest capacity. However, the US still depends to a large degree on the import of aluminium to meet its demand, so the policy in the non-ferrous metals sector is expected to be more flexible. American aluminium producers will be unable to quickly increase domestic production, partly because it depends on the cost of electricity. Instead, it is likely to concentrate on cost-cutting and improving rolling and casting technologies.

The new tariffs on steel and aluminium will hit metal producers in Canada, Russia, Brazil, Mexico, and China, i.e. the main exporters of steel and aluminium to the US. Even so, the global effect would depend more on the dynamics of the commodity exchange prices of both metals because the United States is the biggest importer and the biggest player in the commodities market.

The introduction of tariffs and quotas would raise production costs in the engineering industry. American automobile manufacturers have already expressed concern that steel and aluminium prices may rise, which would reduce revenues in America's automotive industry and bump up prices for vehicles. This in turn could reduce demand for cars in the US. Statistics show that automobile sales began to slow in early 2018 and some facilities are experiencing brief declines. The administration will respond by imposing tariffs on imported cars.

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# The Era of Trade Wars Begins

On 2 March 2018, US President Trump wrote on his page on Twitter that ‘...trade wars are good, and easy to win.’ One of the tenets of Trumponomics is the recognition that in the global market the US does not have partners with whom it needs to cooperate, but rivals with whom it has to compete in upholding America’s economic interests. This stance has very negative implications for world trade, which accounts for an estimated 55 per cent of the global GDP, and for multilateral trade agreements.

The biggest losers in a potential trade war would be the countries whose exports to the US include a high percentage of high-value-added goods in their GDP, and countries in which manufacturing accounts for a big share of national production and which have a big surplus in trade with the US. China accounts for about half of the US trade deficit in absolute terms, followed by Japan, Germany, and Mexico. Judging by trade statistics, Trump’s protectionist policy will also affect Canada, some EU countries, Brazil, South Korea, Turkey, and Russia.

A trade war would also harm the US economy. According to Moody’s analysis of a potential trade war, the introduction of a 45 per cent customs tariff on imports from China and a 35 per cent tariff on imports from Mexico would increase the overall cost of imports by 15 per cent, pushing up prices in the country by about 3 per cent (at the peak, i.e., 18 months after an import tariff hike). As a result, American exports in real terms would drop by \$85 billion.

The European Union could retaliate by raising its tariffs for American goods within two months. The EU has published a list of goods for which retaliatory tariffs may be imposed. It includes corn, orange juice, Harley Davidson motorcycles, and jeans. China could retaliate by raising duties on 128 types of American goods, and by slapping a symmetric 25 per cent duty on American cars, planes, petrochemicals and farm produce (106 items worth \$50 billion). Transatlantic China–US and Japan–US trade wars could become a reality. Many see a reduction in the trade deficit with China as the main aim of Trump’s trade war. According to the US Department of Commerce, the total trade deficit in 2017 stood at \$811 billion, of which 46 per cent in trade with China.

President Trump has signed a memorandum against China’s ‘economic aggression’ introducing 25 per cent duties amounting to \$60 billion on more

than 100 Chinese goods ranging from light industry products to electronics. The official pretext was the desire to penalize China for decades of stealing intellectual property from American corporations. The US Treasury Department has been ordered to develop restrictions on Chinese investments in American companies to protect strategic American technologies. Restrictions would apply to information and digital technologies, communications, cyber-physical systems, medical equipment, aerospace, machine building and machine equipment, electric vehicles, etc. The aim of these measures is not only to cut the record US trade deficit with China, but also to delay China's transition to Industry 4.0.

China's response may affect America's agriculture as well as consumer goods, technologies, services, and education. China may restrict the participation of American companies in its state procurement programme, including aircraft, which would deal a blow to Boeing. However, the biggest risk for the US in a trade war with China is possible competitive devaluation of the yuan, which has made big gains against the dollar in 2016–2017. Trade wars may develop into currency wars, with the EU, South Korea, and Latin American countries also weakening their currencies against the dollar.

Trade wars with the US may be particularly bad for Japan because it exports high-tech goods and has the second highest trade surplus with the US after China, a bigger surplus than Germany. The possibilities of weakening the yen are limited because of the big government debt and the current monetary policy of the Bank of Japan, all of which may deter Japan from a competitive devaluation in response to US actions.

By introducing tariffs on steel and aluminium, the US will renege on its obligations not only to the WTO, but also to NAFTA and disrupt value creation chains that took many years to build. It is easier to impose tariffs and erect barriers than consider issues in WTO dispute resolution body, especially since the US has itself done much to weaken the WTO. Some industry representatives in the countries that trade with the US believe that if exports plummet, it could lead to a market glut in the medium or long term, triggering a major economic crisis. Tariffs typically target manufacturing sectors, which account for 80 per cent of all international trade, whereas inside the US, manufacturing accounts for just 12 per cent of GDP, which gives the United States an advantage over China, Japan, and Germany.

The developing countries in general will be the biggest losers from a trade war since the slowdown of international trade causes the most harm to the exports and industrial production of developing countries.

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# The Outlook for Protectionism

In spite of Trump's tough rhetoric, the risk of a full-scale global trade war is not high so far. Jerome Powell, the head of the US Federal Reserve System, said after a meeting of the Open Market Committee that the Federal Reserve has left its economic forecast unchanged after the president announced trade tariffs on steel and aluminium and measures against Chinese goods. The monetary authorities are more concerned about the impact of Trump's tax reform on monetary policy. Asked whether a tax cut could deliver a 3 per cent sustained growth rate in the American economy, the target set by the Trump administration, Powell said it would require heavy lifting, that it would take a significant growth in labour productivity and greater workforce participation.

A serious escalation of a trade war in 2018–2019 is unlikely, the main risk for the world economy today being a U-turn in the credit cycle and the money supply by the Federal Reserve and other leading central banks in the world. So far, the US economy is linked with the other economies by a complicated global supply chain and mutual investments. America's foreign direct investments in China are five times China's investments in the US. The People's Bank of China is one of the biggest holders of US Treasury securities. Considering the financial interdependence of the economies, a trade war would be counter-productive. It is more likely that the Trump administration will be pressing China to buy more American goods and services. Europe, being a relatively closed economy, is better protected against global trade wars.

The introduction of import tariffs on steel and aluminium is unlikely to benefit the US given that these categories account for only 2 per cent of US imports while the steel and aluminium industries employ just 146,000 workers (less than 0.1 per cent of the total employment figure). The threat of a currency war will also hold back protectionist initiatives because that would hit not only trade, but also the global financial markets in which American funds and banks play a leading role. Tariffs could accelerate inflation, which would lead to higher credit rates and slow economic growth.

All the above suggests that in its tariff policy the Trump administration will confine itself to the measures already announced for the time being, and concentrate on erecting non-tariff barriers and financial market actions to reduce the supply of dollars for foreign trade. Monetary measures may turn

out to be more destructive for world trade and preferable for keeping America's rivals and adversaries at bay. Controlling its own technologies, which are also world technologies, and the establishment of technological barriers by the US for the products of its trade partners would have a bigger impact than import tariffs on steel and aluminium.

The US could focus on the sphere of services. In 2017, it exported \$778 billion worth of services and imported just \$534 billion worth, generating a surplus of \$244 billion. Royalties and license fees brought a profit of \$75 billion, transport services, \$55 billion and IT services, \$53 billion, and financial and insurance services, \$45 billion. Services account for 23 per cent of world trade and as the US is competitive in the world's services market, this could compensate for part of the trade deficit in consumer goods trade.

A \$600 billion reduction in the US Federal Reserve balance may cut money supply to external financial markets by \$3 trillion due to the multiplier effect. A rate hike could attract the trillions of dollars the US needs to finance the budget deficit by making the American bonds market attractive against the background of zero or negative rates in the EU and Japan. At the same time, it could wreak havoc in debt markets all over the world and trigger a financial crisis outside the US. Foreigners own 42 per cent of all US Treasury securities, but recent months have seen Chinese and Japanese investors and banks selling their treasury securities, and their share in the structure of the US debt market steadily declines.

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## Conclusions and Expectations

In 2017, the US accounted for 24.3 per cent of global GDP compared with almost a third (32.5 per cent) in 2000, a drop of a quarter over 17 years. That is a lot and the implications are dire. China rates second (14.8 per cent), the only other contender for hegemony in the foreseeable future. Given current growth rates, China will outstrip the US in terms of nominal GDP in the next decade. The US can no longer afford to meet all of its obligations in the world that it assumed a quarter century ago when it became the sole superpower.

American-style globalization has reached its natural limit and the main beneficiaries of world development are becoming China and Asia in general. The situation brings to mind the Thucydides Trap, that is, the inevitability

of a war between a hegemon power and a rising pretender to hegemony (the Ancient Greek historian Thucydides maintained that the Spartans started the Peloponnesian War in 431 BC out of fear for the rise of Athens). The world is witnessing growing neo-mercantilism, protectionism, and regionalization and is gradually returning to the situation of a hundred years ago, in some ways similar to the decade preceding the Second World War.

China will try to avoid an open conflict and will follow the ancient principle of 'confrontation in agreement' formulated by Guiguzi, a strategist and teacher of Zun Tzu, the author of *The Art of War*.

The United States will have to rely more on military power and its 700 military bases and camps all over the world. Globalization will be stopped by a series of military and trade conflicts in various regions of the world. The scramble for energy resources will also provoke conflicts at the regional and global levels. The beefing up of the military component in the US National Security Strategy indicates that America has almost run out of time for solving the problems that crop up and meeting new challenges in economic ways that have been habitual since the beginning of the 21st century.

Maintaining its influence through the exercise of soft power and buying the loyalty of allies is becoming too costly for the US, leading to global overstretch. America will try to fence itself off from the world and build up strength on its territory for a new leap that would enable it to preserve its superiority in the future and to ensure leadership in a new technological environment and Industry 4.0.

The problem facing the US is that Trump's plans do not envisage the financing of research on anything like the level of the Cold War era in the 20th century. Competition with China in engineering and science will soon be part of the agenda as much as competition in international trade is today. The US will try to derive maximum gain from the new global confrontation unless it goes too far and poses existential risks for the whole humanity.

In the foreseeable future, the return of production from the developing countries to the US will have a negative impact on world trade and will hurt its rivals. The United States may increase its share of world markets by increasing spending, including defence expenditures. The main task for the US today is to preserve its military-technological leadership. Part of the cost of maintaining its leadership will be shifted to its allies and satellites.

The tax reform will have a long-term positive effect on the economy, but negative consequences for the US budget. On the whole, the measures proposed by the Trump administration will help small and medium-sized businesses, which are largely oriented toward the domestic market, spur on economic growth in general by raising solvent demand and increasing investment. At the same time, they will increase demand for the dollar and corresponding pressure on foreign currencies, which will be converted into dollars because of a massive repatriation of offshore profits, thus increasing pressure on securities (mainly bonds), denominated in these currencies.

While Trumponomics is not guaranteed to succeed, Donald Trump is likely to make a difference and will certainly go down in history.



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 ValdaiClub

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[valdai@valdaiclub.com](mailto:valdai@valdaiclub.com)