Forbes

Leadership / # Economy

We All Should Worry About Trump's 'Divide And Conquer' Trade Policy

Harry G. Broadman, CONTRIBUTOR

I advise, speak and write on global markets and business strategy. FULL BIO

Opinions expressed by Forbes Contributors aretheir own.

June 30, 2018 @ 8:20 PM

With every passing day it's getting increasingly difficult to not overstate the potentially profound corrosive effects on the opportunities and risks for continued growth in the U.S. and across the globe of the Trump Administration's handling of international economic policy. As in his campaign, the President has been successfully—at least to date—pursuing a divide and conquer strategy domestically and internationally to try to achieve his goals. The result is an absence of a robust set of checks and balances to ensure that the best economic interests of the U.S. and the world will be served.

The state of affairs is a triple whammy of divisiveness at home and abroad: the overarching *direction and content* of many of Trump's policies is pitting firms in one sector against those in another, and business interests against consumers and workers--a strategy that will serve to distort and shrink the size of the economic pie, not one towards enhancing overall prosperity; the White House's *policy-making process* of "America-go-it alone" on a bilateral basis is out of whack with both the actual multinational production structure of world markets and the companion long-standing multilateral protocol of teaming up with friendly countries through existing international alliances (for which the U.S. was the chief architect) to smooth out bad conduct by national actors who don't play by global rules; and the seemingly moment-by-moment upheavals, in-fighting and reversals of the Administration's stance on the economy is generating *unprecedented policy uncertainty,* which is only serving to destabilize long-term investment incentives (running counter to the objectives of the White House's earlier push for cutting corporate tax rates).

The unmistakable substance of the Administration's economic policy—echoing of course, Trump's slogan of "making America great again"—is one of both significant protectionism and castigating those outside of the United States as the primary source of any woes evident in the domestic economy.

It's fundamentally counterproductive for Trump to ignore that there is in fact plenty of blame to be had at home if he truly wants to achieve his stated objectives. And, finger-pointing at foreigners, no matter how well it might sell at rallies or on television, distracts attention from where it needs to be focused.

As a case in point, it's hard to fathom that our nation's dilapidated infrastructure, which, as I've argued in this space before, is *the* Achilles Heel of the vibrancy, productivity and sustainability of the U.S. economy, is foreign-born. Rectifying this problem is a classic domestic "public good" challenge. Rising to such an occasion would be emblematic of sorely needed American leadership. In the economic sphere, it's arguable you couldn't find a better example. Frankly, for generations, no-one at the top of our nation, whether in

Washington, at the state level, or in the C-suite or boardroom, has dealt with it in any systematic fashion—that is, thrown down the gauntlet and dared to muscle up the necessary fiscal resources.

As a result, our dwindling infrastructure assets erode every day on Trump's watch. You would think a real estate businessman born and bred in New York City would readily, if not intuitively, get this. And, that our captains of industry would collectively prevail upon him, since the survival of our large internal market, which breathes life into their firms, is at stake. Yet, to date, the President has paid only lip service to this issue and is using public spending on activities that engender far lower public, if not private, rates of return.

But between the President's public bullying of iconic American companies (from Harley Davidson to Nordstrom to Amazon) for their autonomous commercial decisions, and the refusal of business leaders last year to continue participating in the White House "business advisory councils" in light of public outcry over the President's failure to condemn white supremacists behavior in Charlottesville, there are scant few CEOs who want to confront directly the president on where he should place his priorities in the national interest.

About the closest one might get are recent comments by the leaders of Exxon Mobil and Chevron, two of the world's largest energy companies, that they worry a trade conflict between the United States and other nations could destabilize the global economy.

The most recent polls by national business associations of aggregated responses by executives responding to perception-based surveys about their future *expectations,* rather than data-driven assessments of *operational decisions* they've actually undertaken, generally convey a qualified upbeat economic outlook for the U.S. economy. Critically, such data were collected *prior* to the very aggressive scaling up of Trump's trade actions beginning in mid-June.

For example, the Business Roundtable's 2018 second quarter CEO Economic Outlook Survey (covering 130+ CEOs) indicates a modest drop in expected sales, capital spending and hiring over the next six months—the first decline in these indices in nearly two years—but the overall index remains above its recent historical average. However, about 90% of the surveyed CEOs responded that reduced U.S. economic growth was a moderate or serious risk associated with global trade frictions.

The National Association of Manufacturers (NAM) poll for the second quarter of 2018 covered 560+ executives of varying sized firms. NAM reports that its survey reveals an "astounding 95.1 percent of manufacturers registered a positive outlook for their company, the highest level recorded in the survey's 20-year history. Additionally, expected growth for investments, hiring and wages is reaching historic highs." Not surprisingly, President Trump tweeted these results. Curiously, however, the historical trend of the NAM survey data from 2016 as presented in its report shows a far more nuanced picture. Its Outlook Manufacturing Index rose sharply in the fourth quarter of 2016—when Donald Trump won the election—but has largely plateaued throughout 2017 and 2018 (to date).

As is the case with almost all countries, forces abroad are also major economic threats to the domestic economy. To say that China today epitomizes this point—not just vis a vis the U.S. but many economies—is an understatement.

Tariffs are potent instruments to counteract protectionist behavior, and I have little problem supporting their use when called for. But—as anyone who has been awake the last few months surely has learned—the imposition of tariffs creates winners and losers among different strands of domestic businesses: think U.S. aluminum producers compared to U.S. aluminum extruders. And, almost all consumers will pay more for the affected products they buy. In some cases, however, these are costs we as a nation may well be willing to bear as a whole.

But for this to be the case the national public policy argument for tariffs needs to be made compellingly. To date, the legal basis on which much of President Trump's trade actions have been taken has been the nearly blanket application of a seldom used portion of U.S. trade law, namely Section 232 of the Trade Expansion Act of 1962. Section 232 provides for Presidents to execute measures to "adjust" imports" in the interest of national security". One would hope that before a President appeals to such a standard there would be dispassionate, systematic, and *national* discussion of the extent to which a particular imported good or set of goods pose such a threat. Before one pulls out the heavy artillery, it's critical that there's confidence all around that the best alternative has been selected. Otherwise there's an appreciable risk of moral hazard—both at home and abroad.

Regrettably that has not been the process followed by this Administration, and it has gone so far as to apply Section 232 to literally our closest allies, such as Canada. The result is predictable: members of Congress—indeed a bipartisan group of Senators—has now introduced legislation to amend Section 232 that would require Presidents to get Congressional approval before invoking such a measure. To date the bill's sponsors have garnered the support of 51 national trade groups, including the U.S. Chamber of Commerce, as well as 222 state and local chambers of commerce.

But the challenge with China goes way beyond what tariffs might ever accomplish. Plain and simple, China is not a *bona fide* market economy, where, among other characteristics, prices function as the foundational mediators of the value of transactions. Thus, the imposition of a tariff—which, after all, places a surcharge on top of a price—will do little to generate the 'behind the border' changes in China's economy that are at the root of the that country's trade and investment challenges with the U.S. and much of the rest of the world. Think of it this way: it's counterproductive to erect additional stories on a building where the foundation is not structurally sound.

This is where Trump's U.S. go-it-alone approach with China and his fetish with the bilateral trade deficit are fundamentally perverse. Even if the U.S. had a trade surplus, tariffs won't cure the core challenge of China's conduct in international commerce. The fact is that Beijing is in violation of its 2001 Accession Agreement when it became a member of the WTO and it committed to implement reforms to

become a market economy. Doesn't the President recognize the vast majority of the 155 other members of the WTO see China the same way? Whatever happened to the logic of collective action?

Well, like the US business community, Trump has bullied many of the other WTO members, including threatening or already imposing tariffs on their products. As a result, even if he should ask for their help, it's not clear who would now come to his aid. The same can be said for the IMF and the World Bank—two other multilateral bodies who might be enlisted in some fashion to work with the U.S. vis a vis a China—and where, by dint of being the largest shareholder, the U.S. otherwise might have some weight.

Trump has a stunning knack for creating the most uncertainty in U.S. international economic policy any of us trade negotiation veterans can recall. Remember in May the issuance of the joint U.S.-China Agreement issued at the conclusion of talks in which the world's two largest economies called a temporary truce to their increasingly volatile trade war? The statement was beyond vague; it showed nothing concrete was decided in any shape or form.

Back in Beijing, the Chinese side, which has a well-honed unified trade policy strategy, declared—accurately—victory. In Washington, meanwhile, in-fighting among the U.S. negotiating team was in full-view. Indeed, there is no coherent stance within Team Trump vis a vis U.S. trade policy overall, and especially with respect to China. This could not have been better reflected by the fact that just after the release of the joint U.S.-China proclamation, two materially different official statements interpreting the Beijing-Washington "agreement" were issued: one by the Secretary of the Treasury and the other by the U.S. Trade Representative. That was a truly striking first-time event for any administration.

The government bond market—a far more reliable barometer of the prospects for economic growth than the stock market—seems to be increasingly paying attention. In this context, we economists are enamored of always keeping an eye on how the size of the gap between interest rates on bonds of differing maturities changes over time.

The pattern the magnitude of such changes traces out—the "yield curve"—indicates how much higher an interest rate the buyer of a long-term (say ten-year) bond will want for lending money over that length of time compared to the interest rate demanded by the buyer of short-term (say two-year) bond. When the long-term health of an economy is thought to be strong, the interest rate on a 10-year bond will be greater than that of the two-year bond to compensate the lender for the risk that prices of goods and services will increase over time as the economy expands, thus producing a "rising" yield curve.

When the gap between those two interest rates gets increasingly smaller—as it has been doing over the last few months—that's a signal that the prospects for continued growth are fading and thus long-term lenders are not as demanding about getting compensated for rising prices since they don't expect them down the road. In fact, today we are approaching a point where there could well be no gap between long-term and short-term rates on government bonds, resulting is a "flat" yield curve. This is due, on the one hand, to diminished expectations about future growth, and on the other hand, the Federal Reserve, worried about near-term inflationary pressures, raising its Federal Funds Rate, which affects short-term rates.

Should short-term interest rates actually become *greater* than long-term rates—an "inverted" yield curve—historically that has been the forerunner of a recession. There are elements of the current trend in the behavior of the bond market that increasingly suggest that could be the scenario that plays out.

The most recent data on U.S. GDP growth are also beginning to tell a cautionary tale. Whereas U.S. economic growth rose sharply from 1.2% in the first quarter of 2017 to 3.2% in mid-2017—no doubt helped by the cut in corporate tax rates in early 2017—it began to decline in the last quarter of 2017 to 2.9% and further downward to 2.0% in 2018's first quarter.

Even more challenging for the Administration is that growth in consumer spending, which accounts for more than two-thirds of U.S. economic activity significantly slowed from 4% in the fourth quarter of 2017 to 0.9% in the first quarter of 2018, which was the slowest pace since the second quarter of 2013.

One can only hope that the President and his economic team begin to see the writing on the wall. This is the time to take steps to ameliorate the conditions generating the dark clouds seemingly on the horizon. The divisiveness that has characterized the President's and his Administration's actions will make achieving that goal far more difficult than otherwise would be the case.

The biggest threat is that if we continue down the current path, the most precious commodity in economic policy-making and implementation—credibility with markets—will be at even greater risk than at present. Regaining such credibility will take many years, if not decades to achieve.