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The political economy of Donald Trump

Meghnad Desai



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Desai holds a BA and MA in Economics from Mumbai University and obtained his Ph.D. at the University of Pennsylvania. In 2008, he was awarded the Padma Bhushan Award, the third-highest civilian award in the Republic of India.

Desai has authored or edited 20 books, has written over 200 articles for academic journals, and contributes to newspapers across the UK and India. Recent books include *Hubris: Why Economists Failed to Predict the Crisis and How to Avoid the Next One*; *Marx's Revenge: The Resurgence of Capitalism and Death of Statist Socialism*; *Nehru's Hero: Dilip Kumar in the Life of India*; *Development and Nationhood: Essays in the Political Economy of South Asia*; *Rethinking Islamism: The Ideology of the New Terror*; and *The Rediscovery of India*. Recent articles for the OMFIF Commentary series include 'The future: neither paradise nor perdition'; 'Rexit in India'; and 'Europe's fragmentation effect'.

His research interests include economics, international political economy, economic history, South Asian studies and globalisation.

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Disturbing but electable

David Marsh

Donald Trump would not be a particularly palatable US president, but he is far from improbable. Trump is unusual and, in many ways, disturbing, but he is electable. Many White House incumbents over the past half-century have been mould-breaking: consider Eisenhower, Nixon, Carter, Reagan, Clinton and Obama. A wealthy right-wing tycoon embodying outlandish language and maverick political views cannot be said to fall completely outside the spectrum of 227 years of US presidential history. Judged by the dry statistics of gender, but not on her experience of high administrative office, Hillary Clinton is also an outlier.

In an age when many voters (not just in America) feel betrayed by the political class, Trump's position as the first nominee since Eisenhower in 1952 not to have held elective office may stand him in good stead. As a result of eight years of sub-standard growth since the financial crisis, the economic 'hollowing out' of Middle America and a series of US foreign policy setbacks, the political world has come to dislike and distrust insiders. Trump's economic policies, conventionally termed unconventional, may be a trump card. It is useful and necessary to put them under the microscope. As our two US experts, Desmond Lachman and Marsha Vande Berg, point out in their forewords, Trump's policy stance, as outlined so far, embody many inconsistencies and risks, for the US and the world. Both are less optimistic than Meghnad Desai on what Trump's economic consequences would be.

Confirming his outsider status in his own party, those boycotting the Republican convention in Cleveland on 18-21 July include the two living former GOP presidents, George Bush senior and junior, as well as the last two nominees, Mitt Romney and John McCain. Trump's choice of Mike Pence, the Indiana governor, from the conservative side of the Republican spectrum, as his vice-presidential running mate is an attempt to span an ideological divide with the Republican establishment, but the effort is not guaranteed to succeed.

That is not the only the gap the candidate has to bridge. Trump's stance on many issues has incited suspicions and intrigue from around the globe, stretching from the world's No.2 economy, China, to the Middle East, Russia and Europe. Yet undoubtedly, if elected, Trump would not be out of place in a roster of red-meat political supremos that includes the leaders of Japan, Russia, China, India and Turkey.

A principal Trump call to arms has centred on renewal of America's faded infrastructure as part of a programme of economic regeneration. With world interest rates at unprecedentedly low or negative levels, the time may be ripe for America to use its credit standing and the dollar's international supremacy to finance a campaign of internal revitalisation. Under a somewhat perverse law of reserve currency status, geopolitical tensions that a Trump presidency might incite could propel fresh 'safe haven' inflows into the dollar that would support an infrastructure drive, modelled perhaps on the Eisenhower years. Trump the businessman, Trump the politician and Trump the social engineer may spring some surprising synergies.

David Marsh is Managing Director of OMFIF.



Trump may bring some rough years

Desmond Lachman, American Enterprise Institute

Meghnad Desai's illuminating report on Donald Trump's political economy is most welcome and timely. It helps us understand Trump's appeal to a large part of the US electorate. And it sheds light on where the US economy might be headed and what the implications of a Trump presidency might be for the global economy.

Were Trump to assume the presidency on 20 January, he would be doing so at a highly challenging time for the global economy. While the US economy might then still be in relatively good health, the rest of the world will certainly not be. A sclerotic European economy will still be coping with the shock of the UK vote to leave the European Union. Japan will again be flirting with recession and deflation. China will be struggling with the process of transforming itself away from an investment- and export-led growth model that has run its course. Major emerging market economies like Brazil and Russia will still be coping with low international commodity prices.

Desai provides us with an informed review of those economic policies where Trump has been most controversial and which are most relevant to the US and the global economy. These include his desire to curb immigration, to have a wall built on the US-Mexico border, and to renegotiate trade deals, especially with China, on more favourable terms for the US. The report includes a review of Trump's unorthodox views on US government debt, the budget deficit, and the dollar.

Reviewing Trump's economic policy pronouncements, Desai is very much more sanguine than I am about the economic consequences of a Trump presidency for the US and globally. He takes comfort from Trump's cautiousness so far about articulating a complete and consistent economic philosophy. And he seeks solace from the numerous occasions in US history where unorthodox economic policies have defied the experts' dire predictions and been successful.

My primary economic concern about a Trump presidency is that it would come at a time when the world economy is still drowning in debt and characterised by all too many fault lines. The last thing the global economy needs is an inconsistent and inexperienced pair of hands heightening investor uncertainty.

The world economy is crying out for US leadership. It must avoid a return to beggar-thy-neighbour policies. It would be singularly unhelpful to have the world's most important economy led by someone who prides himself on his confrontational and belligerent style.

If Trump becomes president, I will be hoping against hope that Desai's optimism proves justified. If it does not, the US and the global economy should brace themselves for a very rough few years.

Desmond Lachman is a Resident Fellow at the American Enterprise Institute. He was formerly a Deputy Director in the International Monetary Fund's Policy Development and Review Department and Chief Emerging Market Economic Strategist at Salomon Smith Barney.



Risks for global economy

Marsha Vande Berg, Stanford University

Donald Trump may win the battle for the White House, but if his campaign is an accurate measure of his presidential preferences, a Trump presidency will produce few, if any, solutions to keeping the US economy out of a recessionary danger zone. Indeed, his presidency could put at risk America's role as leader of the global economy.

A Trump White House is likely to have only limited ability to accomplish two difficult objectives: achieving political alignment with a gridlocked Congress and a polarised American electorate, and navigating a dynamic and changing global economy. If Trump is declared the winner in November, the real-estate businessman and reality TV host turned politician will have to close the books on a presidential campaign unprecedented in its vitriol and polarisation. After his swearing-in on 20 January, he would probably face a divided Congress, with the Democrats back in control of the US Senate and any number of estranged Republicans running a GOP-dominated House.

The global economy will start to reflect uncertainties about the void that is created by an absent America, as it tilts inward toward protectionism, particularly with its largest trading partners, China and Mexico. Cautious long-term investors will recalibrate their global portfolios to reflect these new uncertainties. A Trump leadership would seem to espouse just one consistent ideology, namely a nativist view about immigration. The election campaign has exposed the country's polarisation and fears, but failed to unearth answers to these problems.

At home, Trump's campaign prerogatives will add to the uncertainty. An important campaign promise has been to overhaul the byzantine US tax code, shrinking the tax brackets to four and with those earning under \$25,000 individually and \$50,000 as a couple paying no taxes. The Washington-based Committee for a Responsible Federal Budget has estimated this initiative would cost American taxpayers by adding \$12tn to the national debt.

The Trump campaign counters that the double-digit, trillion dollar estimates are overstated and, anyway, the tax plan that was rolled out with fanfare last September and published on the campaign website is now being revised and 'finalised'. Even if the campaign pares the plan's cost (by reducing the top tax bracket to 28% instead of 25% and keeping the capital gains tax at 15% across all income levels), it's still not clear who really benefits. This is not likely to be an optimal measure of success for a newly elected administration.

The GOP Platform reflects Trump's anti-globalisation stance and his approach to US foreign and economic policy that gives priority to American interests. 'We need better negotiated trade agreements that put America first,' states the platform, before turning combative and threatening America's withdrawal from its role as global leader. 'We cannot allow foreign governments to limit American access to their markets while stealing our designs, patents, brands, know-how and technology.'

Why is this significant? Today, exports and imports are more than 30% of US GDP – up from under 10% in the immediate post-war era. This contribution to GDP will be at risk. The US Commerce Department estimates that US exports are worth \$2.3tn and directly support 11.7m jobs. More than 300,000 businesses export their goods or services, 98% of which are smaller enterprises with fewer than 500 employees.

A Trump White House agenda will not stop at its efforts to restructure the tax code and erect a firewall between the US economy and the 'undesirable' influences from abroad, whether they be immigrants or aggressive developing economies intent on driving for greater global market share. If elected, Donald Trump will push further and harder. His success or failure rests on his ability to convince a majority that his objectives are more than the rant of a single-minded maverick. Coming months will show whether Trump becomes part of America's bid to redefine itself in the early 21st century – or whether he leaves that effort to others who appear, on paper at least, to be better prepared for the task.

Marsha Vande Berg is a Distinguished Career Fellow at Stanford University.

1 TRUMP THE UNORTHODOX: A FIGURE WHO SURPRISES

Donald Trump will be the Republican nominee for the 2016 US presidential election. He has come this far fighting, or perhaps disregarding, widespread disbelief, as well as undisguised contempt on the part of the elite of both main US parties and almost the entire liberal community. But he won the primaries and has caught the imagination of millions of people, garnering their votes.

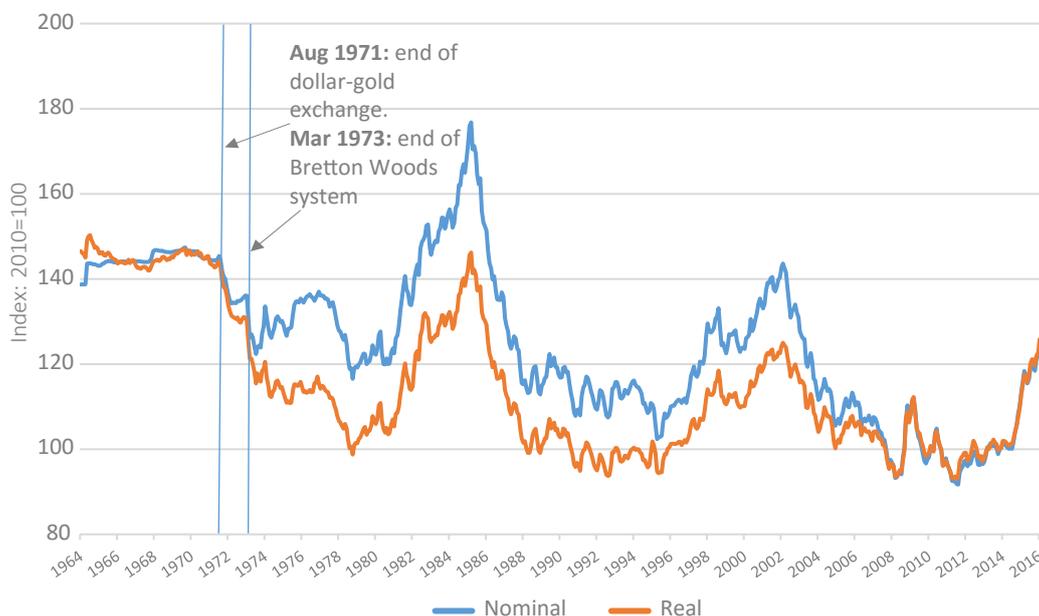
Let us move a step on and imagine that Trump wins the election and takes over from Barack Obama in 2017. What sort of president would he make? More particularly, what will his economic policy be? How will he be able to fulfil the many promises he has made? Here again, dire predictions are being made about the economic consequences of a Trump presidency. Most commentators see him going on a fruitless journey, promising the moon and not even delivering cheese.

This report explores the possible outcomes of the unorthodoxy of Trump's economic thinking and asks whether he may surprise us. After all, odious political views have coexisted with successful unorthodox economics in the past. During the Great Depression of the 1920s and 1930s, European fascist parties in Germany and Italy were the first and very successful Keynesians.

Trump has been careful not to articulate a complete and consistent economic philosophy. Tactically this is shrewd – he is a moving target and difficult for his critics to shoot at. He is not a fool as many say he is. Nor is he confused or self-contradictory. His is a studied stance intended to sow confusion in the minds of his opponents. Trump has made promises to create jobs, restrict immigration, build a wall along the US-Mexico border, and reverse the 'drain' caused by trade, particularly in respect of China.

The Republican nominee is a mercantilist and a protectionist. (This is a hallowed American tradition: until the end of the second world war the US was a protectionist nation.) He has said things financial market experts view as beyond the pale, such as reneging on debt and talking down the dollar. But memories are short. Most people believe a strong dollar has been a permanent feature of US economic policy. But they forget the volatility in the dollar's value in the two decades after the US exit from the dollar exchange standard in August 1971 (see Chart 1), which ended the Bretton Woods system and inaugurated flexible exchange rate markets. As John Connally, Richard Nixon's Treasury secretary, told European leaders, 'The dollar is our currency and your problem.'

Chart 1: Dollar's fluctuations after end of Bretton Woods
Real and nominal trade-weighted exchange rate indices, 1964-2016



Source: BIS

Trump's cavalier stance on public debt

Trump has been cavalier in his statements about debt – as to its size, buying back and/or reneging on it; about trade – US repudiation of its international obligations; about immigration and the expulsion of illegal immigrants; and about renouncing Obama's policy on the environment. He has been rude about Muslims, Mexicans, Hispanics more broadly, and women.

This sort of right-wing populism is not new. But it has rarely had popular resonance to the extent that Trump has provided it with. Previous right wing presidential candidates such as George Wallace in 1968 were anti-black Americans, given that Hispanics and Mexicans then had a negligible presence in the US. Easy contradictions can be pointed out in Trump's rhetoric. But there is much agreement about the malaise that has given him a willing audience.

The American middle classes have suffered in relative terms in the four decades since the first oil shock of 1973. These are the people who feel they have lost out from globalisation (which can be used as a portmanteau term for freer trade, liberal immigration policies, fiscal discipline in the matter of obeying the message of the bond markets, independent central banks, and the pursuit of inflation targeting as a central policy).

But here is the first contradiction. Since the deprived sections of the American middle class span white, black and Hispanic households, can Trump gain by focusing on white grievances and alienating black and Hispanic voters?

Normally one could summarise the Republicans' stance by saying that they favour lower income and corporation taxes, especially for the better-off; constantly worry about the size of the public debt and the budget deficit; and express anxiety over growth in public spending, especially entitlements for the less well-off.

Trump, however, has based his campaign on appealing to blue-collar manual workers and the growing number of unemployed in those regions dominated by failing manufacturing industries. He has railed against 'the system', including the large banks and international corporations, which has advocated and benefited from globalisation at the expense of American workers. He has shown hostility to international free trade and has advocated boosting public spending to counteract some of the impact on American workers.

This blurs the traditional distinction with the Democrats, who would like, but have been unable, to increase taxes on the rich and spend more on benefits. With Democratic primary contender Bernie Sanders' message having gained significant traction, the policy of the Democratic nominee (which, almost certainly, will be Hillary Clinton) may swing more to the left, against Wall Street (using that as a portmanteau term for corporate tax deductions, lax regulation, shunting the tax liability to tax havens abroad, high corporate salaries and bonuses).

2 BRITISH REFERENDUM BENEFITS FOR CANDIDATE TRUMP

The British decision to leave the European Union will help Trump in a number of ways. The right-wing populist and xenophobic thrust that was a feature of the UK Leave campaign is very much in his style.

He may enjoy the tough attitude towards globalisation and trade treaties. The idea that a nation should not be bound by previous commitments is his message too.

There is also confirmation of the Trump style of campaigning and presenting serious issues in simplified binary form. Liberal critics have sought to contrast his somewhat boorish approach to international relations with Europe's more subdued style of politics.

Now one of the oldest European polities has gone his way.

The shock of 'Brexit' has weakened sterling relative to the dollar. The uncertainty created by the UK decision is one of the factors dissuading the Federal Reserve from an immediate increase in interest rates. Bond yields have dropped to their lowest level in recent years.

Trump should benefit from this as his stance would be fiscally unorthodox, taking on debt and spending on infrastructure.

Even if the pound rallies moderately after the arrival of a new British prime minister, nervousness in sterling and bond markets may continue. Trump can use this to his advantage.

Theresa May, the new British prime minister who took office on 13 July, has appointed Boris Johnson, the larger-than-life former mayor of London, as foreign secretary. Johnson has frequently been compared to Trump in his demeanour, appeal to a cross-party spectrum and approach to national issues (including hostility to the EU). Like Trump, Johnson has ascended the political firmament in unlikely fashion – and is capable of springing surprises from a variety of directions.

3 THE MEN BEHIND TRUMP'S ECONOMIC POLICY



SAM CLOVIS policy director

Professor of economics at Morningside College, activist for the Tea party movement. Holds a Ph.D. in public administration from the University of Alabama. Responsible for shaping many campaign policies, involved in most of its domestic and foreign policy proposals. In 2014, ran for Republican nomination for Senate in Iowa and then as state treasurer.



LARRY KUDLOW economic adviser

Working with Trump on tax plan with Moore (see below). Syndicated television talk show, long history as a political commentator, first as a liberal and then a conservative. Columnist for a range of newspapers, and a distinguished scholar at the Mercatus Center of George Mason University, Virginia. Former Reagan administration official, chief economist at Bear Stearns.



ARTHUR LAFFER economic adviser

In campaign background, may re-emerge. Policy co-chairman, with Kudlow, of the Free Enterprise Fund: 'the pre-eminent lobbying force in Washington for the passage of legislation that will promote economic growth, lower taxes, and limited government'. Member of Reagan's Economic Policy Advisory Board in 1981-89.



PAUL MANAFORT campaign chairman and chief strategist

Senior partner in consulting firm Davis, Manafort, and Freedman. Largely responsible for messaging and communications. Gained control in April over expanded \$20m campaign budget, hiring decisions, advertising, and media strategy. Track record of advising Republican presidential contenders: Ford, Reagan, Bush senior and junior.



STEVEN MNUCHIN fundraiser

Heads campaign's fundraising as national finance chairman. Yale-educated banker, film producer and political fundraiser, former partner at Goldman Sachs. Set up hedge fund Dune Capital Management. Former chair of OneWest Group, formed from failed housing lender Indy Mac in 2009, sold to CIT Group in 2015.



STEPHEN MOORE economic adviser

Economics writer and political analyst. Working on Trump tax plan. Founded Club for Growth, a conservative organisation with a tax-cutting agenda, in 1999, president until 2004. Former member of Wall Street Journal editorial board, and a distinguished visiting fellow at the Heritage foundation, a conservative American think tank.

Other advisers with an economics, business or financial background include **Carter Page**, foreign policy adviser, who is founder and a managing partner of Global Energy Capital, and **George Papadopoulos**, senior policy and economic adviser to former Republican presidential contender Ben Carson. **John Mashburn**, campaign policy director, has worked on budget and appropriations bills in Congress. **Kent Gray**, Illinois state director, is a former executive assistant to the Illinois Comptroller. **Walter Curt** is former finance director of the Virginian Republican party. **Ed McMullen**, co-chair of the South Carolina campaign, formerly with Heritage Foundation.

4 BUSINESSMAN AS PRESIDENT

The first thing to remember about Donald Trump is that he is a businessman, and a very successful one. He has a hand in real estate, television, casinos and other entertainment products. He is the first business person (and seasoned television performer) to run for president and be a nominee of a major political party since the emergence of Ross Perot in 1992, a Texas businessman who ran as an independent and garnered 19% of the popular vote.

Other nominees and contestants may have made their money in business, but usually entered politics and competed for the presidency only some years after being successful in the business world. Mitt Romney, who contested the 2012 presidential election, worked in the management consultancy and private equity industries before entering politics in 1994. George H. W. Bush was an oil industry executive. Barry Goldwater, the Republican nominee in 1964, had a background in business, as did Wendell Wilkie, who ran against Franklin D. Roosevelt in 1940.

Trump has had no schooling in politics. He has been in the public eye for decades as a businessman and a public personality. The implication is that his economics may derive more from his daily experience and knowledge than other candidates, who require expert advice on economic issues. This has been clear in his very unorthodox attitude to debt. As a businessman who has amassed a fortune, he views debt not as a burden but as a tool for doing business.

Thus, while the economic programme of Paul Ryan, the speaker of the House of Representatives, has focused on tackling the size of the public debt above all else, Trump does not see debt in the same light. He knows that you have to end up richer than you started. If debt is necessary to achieve that goal, so be it. It is easy to deplore this attitude towards debt. Yet we have to remember that, since September 2008, many rules of orthodox finance have been broken.

Bankrupt banks and financial institutions have been bailed out using taxpayers' money while the ruling politicians have eschewed a sufficient fiscal boost to the economy to benefit the excluded middle. Federal actions such as the 2008 Troubled Asset Relief Programme (to acquire 'toxic' assets and equity from beleaguered financial institutions) have channelled money to the few but denied it to the many. The deprived middle classes have seen rules being broken and the guilty being rewarded rather than punished.

Quantitative easing may now be sold as merely an enhanced version of open market operations, but it has broken all the previous rules in its extent and scope (see Chart 2). Monetarists told us that monetising public borrowing was unsound and could lead to inflation.

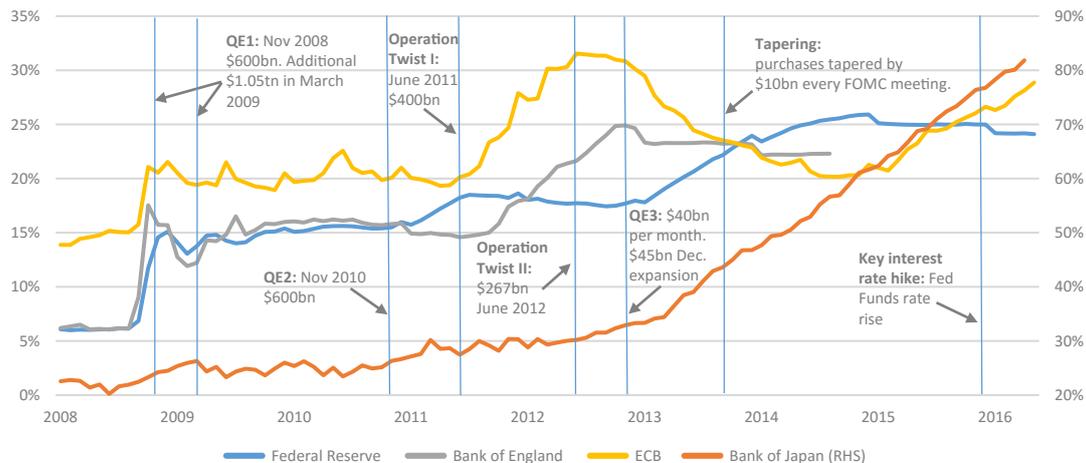
In the US and the UK, not to mention Japan, central bankers have been printing money with scant regard to previous rules and orthodoxies. There has been little response in terms of inflation. The Federal Reserve and Bank of England have taken interest rates to near zero, while the European Central Bank and Bank of Japan have driven them into negative territory. The main beneficiaries of these policies have been asset owners and large borrowers, including big companies, who still refuse to invest but profit from the availability of cheap credit to increase their asset values. 'Joe public' has got nothing out of this departure from orthodoxy, hailed as innovation.

If Trump takes the view that he wants to borrow to create jobs with infrastructure investment, it would be hard to mount too strong or moralistic a protest. The long recession has heightened income inequalities. Bank and corporate bonuses have soared; wage income has not. Trump could argue that orthodoxy has much to answer for. His critics have also displayed amnesia about American history. We are told how, ever since Alexander Hamilton was Treasury secretary in the late 18th century, financial probity has been the rule for the US. This is fanciful history.

Critics need to revisit the period between the destruction of the Second Bank of the United States by Andrew Jackson, then president, in September 1833, and the creation of the Fed 80 years later.

Chart 2: QE boosts central bank balance sheets

Assets of key central banks, % of GDP, 2008-16



Source: IMF, Federal Reserve Economic Database, OMFIF calculations

The politics of American credit

Throughout the 19th century, American credit abroad was not sound. The battle over joining the gold standard after the American civil war, particularly the struggle of farmers who suffered from the resulting deflation as against the East Coast corporations, has planted a permanent distrust of banks and bankers in the American political psyche.

More recently, in 1971, the US unilaterally reneged on a promise to buy gold at \$35 an ounce, destroying the Bretton Woods system of monetary management. The US has a dubious record in terms of financial responsibility and Trump has many precedents to cite.

Trump is pragmatic about trade. Like any businessman, he would like a captive market, even though he may mouth platitudes about competition. He wants to capture as many of the gains from trade as possible. If this requires trade restrictions or exchange rate devaluation, then he would not be against using these instruments.

Again, what matters to him is not dogma but success – the bottom line. Trump does not agree with the argument that free trade leads to mutual advantage for both parties and is optimal for each. More to the point his core supporters do not agree with this view either. It has not been part of their life experience.

This may be for cogent economic reasons – the 1973 oil price shock, the migration of manufacturing abroad in search of cheap labour, a strong dollar. But Trump and his core support cannot accept that they should be helpless as a result of external factors. Their instinct is to use the levers of political power to regain control.

Again, while free trade is 'first best' and freer trade is better than protection, practice has always departed from theory. US and European Union protection of their respective agricultural sectors generates much resentment in emerging economies. The Doha Round of World Trade Organisation talks aimed at lowering trade barriers has been stuck for years because of developed country resistance to developing countries demanding similar protection for their farmers.

At least this is what Xi Jinping, China's president, and Narendra Modi, the Indian prime minister, tell the US. Now Trump complains about China not playing by the rules. But this is just a sign that the US is no longer as dominant in international trade – in manufacturing at least – as it was in the 1960s and 1970s. Even the EU has complained about the US in the Transatlantic Trade and Investment Partnership negotiations.

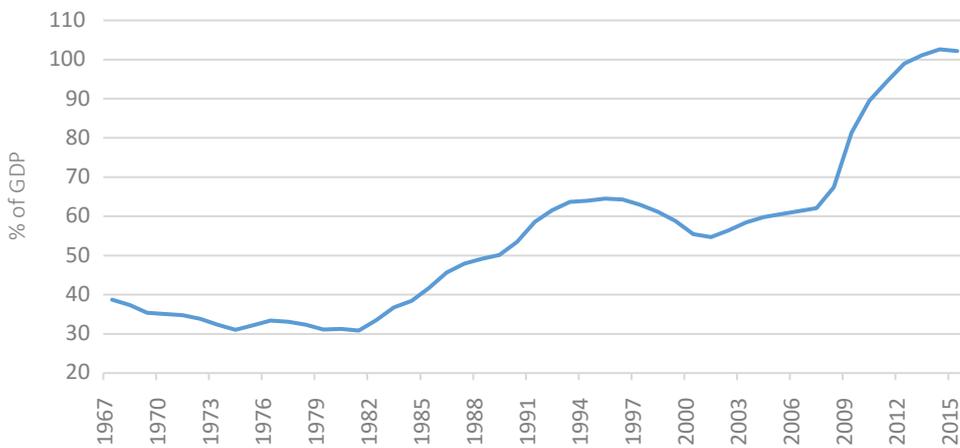
5 THE POLITICS OF AMERICAN DEFICITS

Despite the homilies about budget deficits, in practice both Democrats and Republicans have presided over deficits. Ronald Reagan, viewed as a paragon of Republican virtue, in the 1980s spent money in an almost Keynesian fashion, running a deficit in each of his eight years in office.

The country's debt to GDP ratio, which had fallen to 31% by 1974, had reached 50% by the end of Reagan's presidency and rose above 60% in 1992 (see Chart 3). With further deficits under George H. Bush and Bill Clinton, it peaked at 65% in 1996, subsequently declining to 55% in Clinton's second term.

Chart 3: US government debt deepening over time

Debt to GDP ratio, annual, 1967-2015

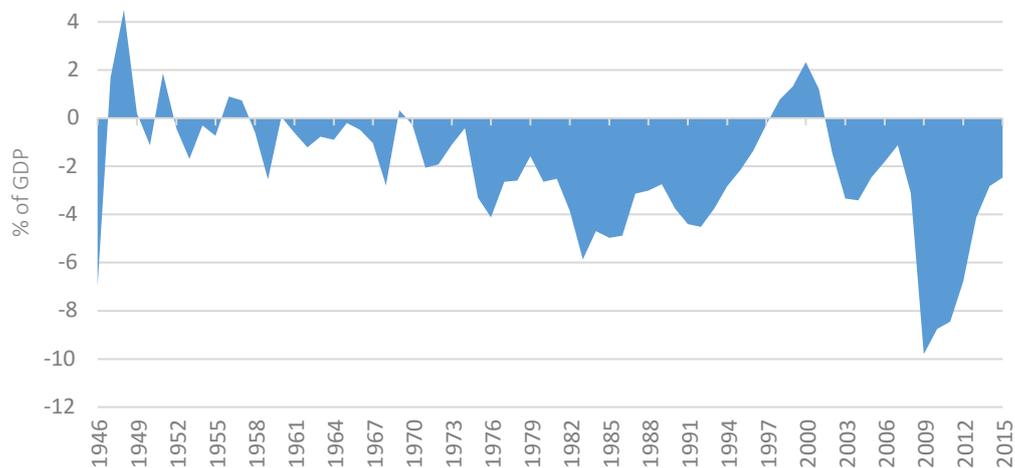


Sources: Federal Reserve Bank of St. Louis, US Office of Management and Budget

George W. Bush ran a budget deficit in each of his eight years as president. The debt to GDP ratio was 67% in 2008. Then, as has happened in other countries, output growth reversed and debt continued to rise. The debt to GDP ratio rose steadily from 67% in 2008 to 101% in 2013 after the 2008-09 recession, and was around 102% in 2014 and 2015.

Chart 4: US budget deficit persistent over time

Federal budget balance, 1946-2015



Source: Federal Reserve Bank of St. Louis, US Office of Management and Budget

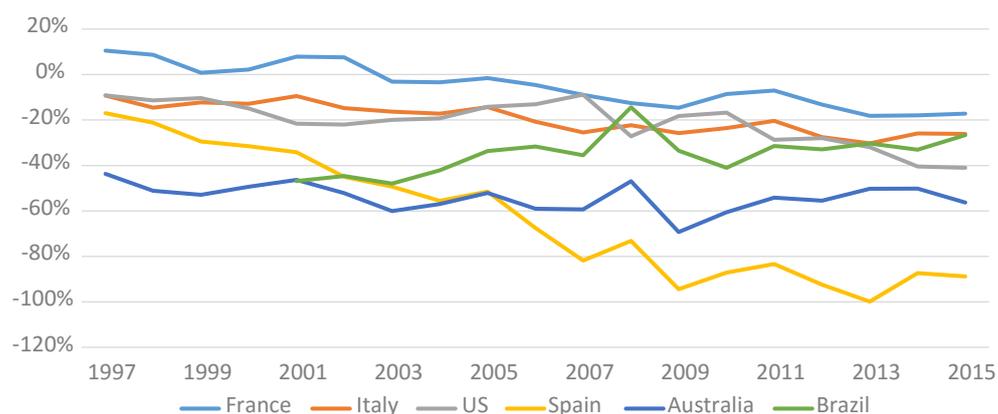
The long tradition of raising public debt

The US budget has been in surplus in only 12 years since 1946 – four years under Harry S. Truman (1947-49, 1951); three years under Eisenhower (1956-57, 1960), and four years under Clinton (1998-2001). The only other year in which the country ran a surplus was 1969, Nixon’s first year in office (see Chart 4).

Trump would not be the first US president to run a deficit and increase debt. All he would need is a pliant Congress. Republicans attribute the deficit during the Reagan years to winning the Cold War, and the Bush deficit to the September 2001 attacks on New York and Washington (and the subsequent war on terror). Trump has to find a headline-grabbing theme for his deficits. He will then be in good and safe company.

Chart 5: Rising foreign liabilities for world’s largest debtor economies

Net international investment positions, 1997-2015, % of GDP



Source: IMF, Eurostat, OMFIF calculations

The US has run a persistent current account deficit for more than 20 years, rapidly increasing its net foreign debt. At end-2015 US liabilities were almost \$7.36tn, equal to 41% of GDP (see Chart 5). This has risen from under \$800bn, or 9% of GDP, in 1997. Countries with large external debts and/or current account deficits should, in theory, face downward pressure on their currencies and rising costs of borrowing, encouraging them to adapt their monetary, fiscal and regulatory policies and ultimately rebalance domestic and foreign demand.

America’s stable and attractive domestic financial and political environment and deep liquid markets, however, have meant the US has been able to draw in reserves, investments and other sources of long- and short-term capital from around the world. Along with its role as the main reserve currency-issuing country, these factors make the US a special case, allowing it to borrow heavily, at cheaper rates, while maintaining a strong currency.

Chart 6: US is the world’s largest debtor economy

Net international investment position of the largest debtor countries, 2014-15

	Largest debtor economies			
	NIIP (\$bn)		NIIP (% of GDP)	
	2015	2014	2015	2014
US	-7,357	-7,020	-41	-40.5
Spain	-1,065	-1,208	-88.8	-87.3
Brazil	-799	-723	-26.6	-50.1
Australia	-689	-553	-56.3	-25.9
Italy	-475	-799	-26.2	-33.1
France	-416	-508	-17.2	-17.9

Source: IMF, Eurostat, OMFIF calculations



Trumponomics' unchallenged contradictions

A devil-may-care approach to unpredictable campaign

Reginald Dale, Center for Strategic and International Studies

There are two difficulties in deciphering Trumponomics. First, when Donald Trump utters a contentious soundbite, few people ever ask him a follow-up question – not journalists, nor, earlier, his rivals for the Republican nomination. Among the reasons are the distaste of American political reporters for economics and competitors' fear of alienating voters by attacking Trump's slogans.

Thus Trump constantly charges China with 'killing' America by currency manipulation. But he is never asked about the broader effects of the weaker dollar he seeks. He threatens crushing tariffs on companies moving to Mexico, but nobody asks him, 'Under what authority?', or 'How will you get that through the World Trade Organisation – or even the necessary due process in America?'

The second difficulty is that it's hard to tell whether he is being serious or making it up as he goes along – 'stream of consciousness economics', as one analyst put it. Trump doesn't seem to mind that his various policy pronouncements are contradictory or that his figures don't add up – a devil-may-care approach perhaps reinforced by his view that unpredictability is an asset.

Here are some of the contradictions and confusions of Trumponomics so far:

The deal: By constantly stressing his deal-making prowess, Trump suggests he sees international economic (and geopolitical) challenges as a giant global real-estate market that operates according to zero-sum rules – if China and Mexico 'win' by running trade surpluses with the US, America 'loses'. He seems to believe that trade surpluses represent income that governments can spend, for example in the case of Mexico by financing the great border wall he has promised. If not, he will simply confiscate a share of (particularly illegal) Mexican immigrants' remittances – a plan almost impossible to implement and liable to lengthy legal disputes.

Taxes: Trump says he is 'not necessarily a huge fan' of his own big tax-cutting plan, which he claims to have written himself last autumn. The plan featured huge tax cuts for the highest earners, but he has said he is open to tax increases for the rich. He claims his tax cuts would pay for themselves, by generating annual economic growth rates of up to 5% or 6% and eliminating unspecified tax loopholes and deductions – a claim dismissed as ridiculous by most economists.

Minimum wage: Having categorically stated in November that America could not compete with other countries if it raised the minimum wage, he now says he is open to it.

Tariffs: Trump has talked of imposing tariffs as high as 45% on Chinese goods, and lower rates on Mexico. But he has also hinted that these may be bargaining positions. He never seriously addresses the likelihood of retaliation or the consequences of the global trade war he risks unleashing.

National debt: Perhaps Trump's most outrageous pronouncement has been that he will eliminate America's \$19tn national debt over eight years, a highly unlikely outcome, not least because his tax cuts are estimated to cause revenue losses of around \$10tn over 10 years. There is no way he can come remotely close to this objective, particularly as he has vowed to leave massive budgetary entitlements like social security alone. He now says he means he will reduce 'a percentage' of the debt, and has experts working to halve the estimated \$10tn cost of his new taxes.

Some of these changes – such as on taxes and the minimum wage – are nudging Trump closer to the centre for the election, and perhaps we should not expect clarity. Trump's most enthusiastic supporters are not interested in arcane economic details. By enhancing his reputation for changing his mind, he is preparing the ground for further shifts and retreats. However, economists who never believed he would gain the Republican nomination and thought it would never come to this are devoting greater scrutiny to his plans. It would be nice if more of the media followed suit.

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6 TRUMP'S CHOICES

If Trump ran serial budget deficits or increased the debt, this would be the norm rather than the exception.

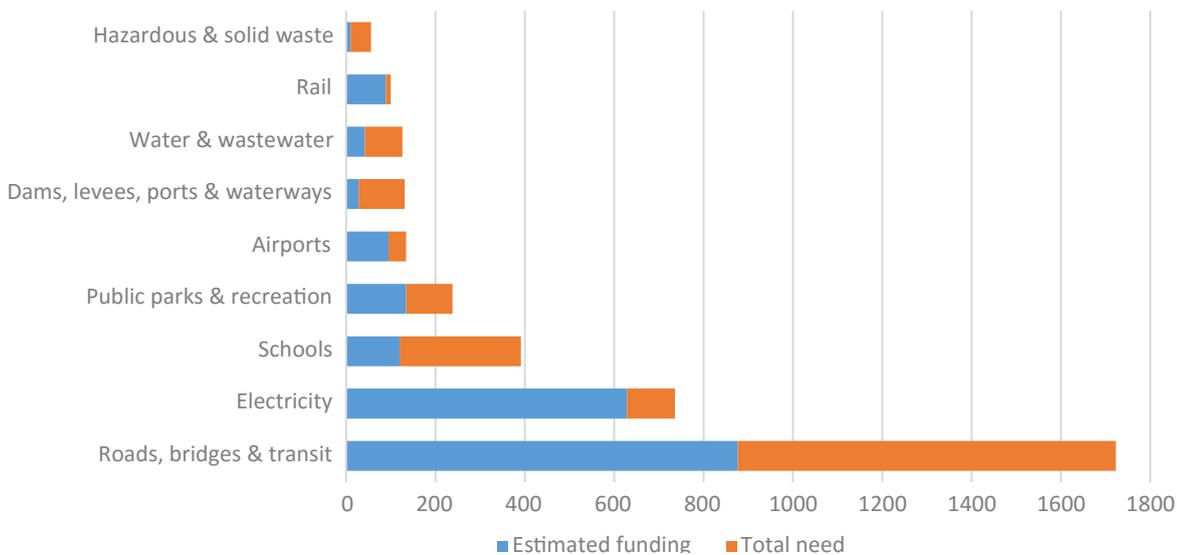
Of course, the key to keeping the debt to GDP ratio under control is to work on the denominator as much as restricting the numerator.

But it could be argued that the US has under-borrowed, if anything. The country's infrastructure is badly in need of repair, while its total infrastructure investment needs have been calculated at \$3.63tn. These needs include surface transport (almost \$2tn), waterways and port (\$131bn), electricity (\$736bn), and airports (\$134bn) (see Chart 7).

US infrastructure is old. There is some urgency here. The 2014 dirty water crisis in Michigan state, where high levels of lead were found in the drinking water, provides a painful reminder of infrastructure neglect.

Chart 7: US infrastructure faces funding shortage

Total allotted funds against total need, 2013-20, \$bn



Source: American Society of Civil Engineers

US wage stagnation

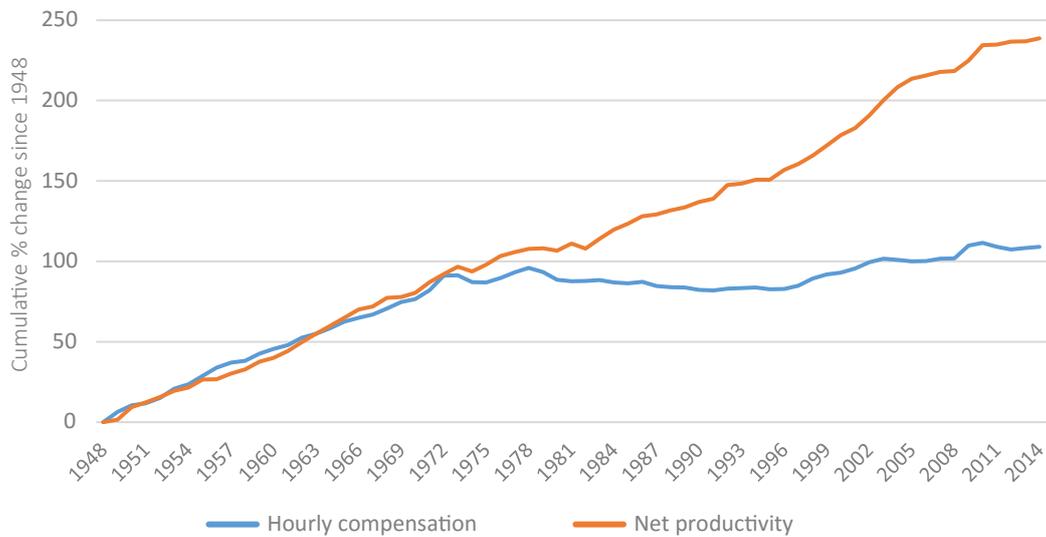
The other problem is flatness of wages (average hourly compensation of production/non-supervisory workers in the private sector) over the last 40 years.

Between 1973 and 2014, productivity grew by 72.2% and wages by 9.2%, according to the Washington-based Economic Policy Institute (see Chart 8). Only 15% of the additional growth generated since the 1970s has accrued to workers. The rest has contributed to corporate income.

This has been as much a redistribution induced by policies that have deregulated financial markets, lowered taxes and increased deductions for corporations as a result of competition from cheaper labour in emerging economies.

Chart 8: US wage growth has stagnated

Real hourly compensation against net productivity, 1948-2014



Source: Economic Policy Institute

The secret of Trump's appeal

Trump's core supporters want an unorthodox economic policy because the orthodox policy has not brought benefits to many middle-class voters who now feel alienated and disenfranchised. These supporters blame Washington because they see the malaise as the result of a deliberate policy choice, justified on the grounds of 'sound economics' or 'benefiting the wealth generators'. Sanders has concentrated on corporate privileges (Wall Street), while Trump has focused on creating jobs and shutting down foreign trade to help American workers.

Changing the climate of free and open trade may not be as easy as Trump thinks. International treaties cannot be changed or reneged on that easily. (The Paris climate agreement, which Trump has denounced, has built-in safeguards against unilateral withdrawal by any country.) But there may be a synergy in his desire for large infrastructure projects (such as the wall along the border with Mexico) and further tackling the US infrastructure deficit, a long neglected priority.

Members of Congress like spending the money that comes to their constituencies. 'Shovel-ready' projects could generate demand for workers lacking the education levels to take jobs in the services sector but who could take on manual jobs.

Of course, sentiment against the liberal globalisation orthodoxy has been rising around the world. We see the rise of right-wing nationalist parties in Europe, as well as anti-capitalist leftist extremist parties. It may be that, as in the past, the boom cycle of globalisation may yield to a rise of 'deglobalisation' as a result of the 2008-09 crisis and persistent low growth and deflation. If so, Trump will face less hostility internationally than many orthodox observers expect.



Challenging the infrastructure status quo

Private sector can play a greater role

Eugene Zhuchenko, Long-Term Infrastructure Investors Association

Rebuilding America's infrastructure has been one of Trump's key promises from the beginning of his presidential campaign. When he announced his presidential bid in June 2015 Trump said that, 'It will be done on time, on budget, way below cost, way below what anyone ever thought. I look at these roads being built all over the country and I say, "I could build these things for one-third." We have to rebuild our infrastructure: our bridges, our roadways, our airports.'

There is little doubt that US infrastructure is in acute need of a major overhaul and expansion. But the choice of financing options can have different economic and political implications. Most US infrastructure has been built with public funds, though the share of private funding has grown steadily over the last decade, albeit slowly. If the rate of infrastructure investment accelerates, the question arises of whether it will be driven by public spending or private investment.

Despite US public debt remaining above 102% of GDP in 2015, the low interest rate environment makes it cheap to increase public spending, in the short term at least. But aside from deciding on optimal gearing for the US (including the long-term implications), a Trump administration would have to weigh the efficiency of public spending on infrastructure. It is hard to expect public procurement to be able to 'build these things for one-third'.

Private investors and infrastructure operators have a much stronger efficiency record than governments, both in the US and globally. Yet private financing's share of US infrastructure stocks is no higher than 10-15%, according to various estimates, and primarily concentrated in energy assets. Procurement processes for public-private partnerships have been notoriously slow and plagued by last-minute cancellations. Only 10 states have been running relatively active PPP programmes, while one third of states have no PPP legislation at all.

The unorthodox way to revive infrastructure investment would simply be to remove legislative and procedural obstacles currently hindering private financing. A large and ever expanding club of private financiers are ready and willing – but currently unable – to increase their infrastructure exposure in the US more rapidly. Their primary funding sources are pension plans, insurance companies and sovereign funds, which provide 'patient' money and seek long-term, stable return in a low-risk setting. The US agencies would not have to look for those investors. They simply need to make more projects accessible to them.

Taking this path would require a certain political courage. First, the government would have to facilitate an expansion of the legislative base (particularly at the state level) and allow procurement processes to be simplified. The current system often requires investors to obtain an unprecedented set of approvals to start a project, even after winning it in a competitive tender.

Second, but perhaps most importantly, the government should help increase public awareness of the benefits flowing from private infrastructure concessions. People tend to complain about tolls on new roads, disruption from continuing construction and 'somebody getting rich' off what is meant to be public. This is what often ends up in the press. A bigger picture – greater value for money and faster implementation under private management, as well as financial returns being channelled into pension savings, for example – goes largely unnoticed.

Trump has positioned himself well to challenge the status quo. Let's see whether this generates a better reality for US infrastructure investment.

Eugene Zhuchenko is Executive Director of the Long-Term Infrastructure Investors Association.

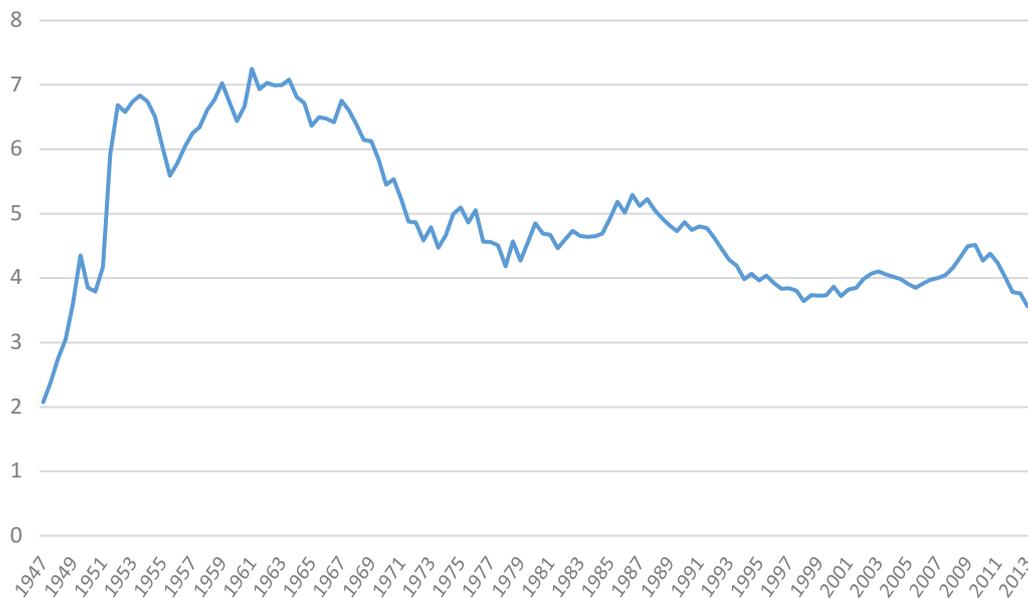
7 REVIVING INFRASTRUCTURE: LESSONS FROM EISENHOWER

A model for Trump to follow is Eisenhower's approach to infrastructure investment. The Interstate Highway System – the network of highways, turnpikes and motorways that still covers America – was built during the 1950s. Eisenhower initiated these projects in a sustained fashion. Arthur F. Burns was his chief economic adviser between 1953 and 1956, and went on to serve as chair of the Federal Reserve in the 1970s.

Burns was a conservative and a compassionate person as far as his economic beliefs were concerned. He was not a Keynesian in respect of his economics, but his advice led to the best public capital spending years the US has enjoyed. Gross public investment peaked at around 7% per annum during the Eisenhower administration and has not reached those proportions since (see Chart 9).

Chart 9: US public investment declines after Eisenhower spurt

Gross government investment, % of GDP, 1947-2013



Source: US Bureau of Economic Analysis

Eisenhower did this while pursuing a prudent fiscal policy, bringing the debt to GDP ratio down to 53% in 1960 from 72.7% in 1952 (the last year of the Truman administration). Public works spending in these years exceeded that during Roosevelt's 1933-38 New Deal. These were also years of full employment (with a mild recession in 1957) and sustained growth, keeping tax revenues buoyant.

The 'baby boom' had given the US a young and growing population that placed few demands on health infrastructure. Welfare spending was modest and would remain so until Lyndon Johnson's 'Great Society', a series of programmes aimed at eliminating poverty and racial injustice. Income growth prevented the debt to GDP ratio from rising.

As an icon of prudent public finance, Eisenhower beats Reagan, Bush and the rest of Republican presidents hands down. He pioneered a public-private initiative in the way the Saint Lawrence Seaway – a network of locks, canals and channels linking the US and Canada – was financed.

Attracting sovereign funds to finance US infrastructure

Trump could initiate a second large-scale public capital spending programme by taking advantage of low interest rates and borrowing to meet the need. Following the Saint Lawrence Seaway example, he could even tap sovereign funds to finance his proposals. After all, the total infrastructure deficit, estimated at \$3.63tn, is just 19.6% of GDP.

A capital spending programme at 5% of GDP would amount to around \$900bn. This much could be borrowed as a sound principle of public finance. Sovereign funds as well as pension funds would be attracted if the US borrowed with long maturity, fixed coupon bonds. If sustained over four years, the borrowing would address the entire US infrastructure gap. It is difficult to estimate the number of jobs it would create, but it cannot be negligible.

If Trump undertook such a bold investment programme, he could meet most of the promises he has made without provoking a trade war with China. He may yet want to adopt an aggressive stance for the sake of popularity. But he may equally choose to live with a Congress that would not let him effect a major protectionist move.

8 WHAT TRUMP MAY ACHIEVE

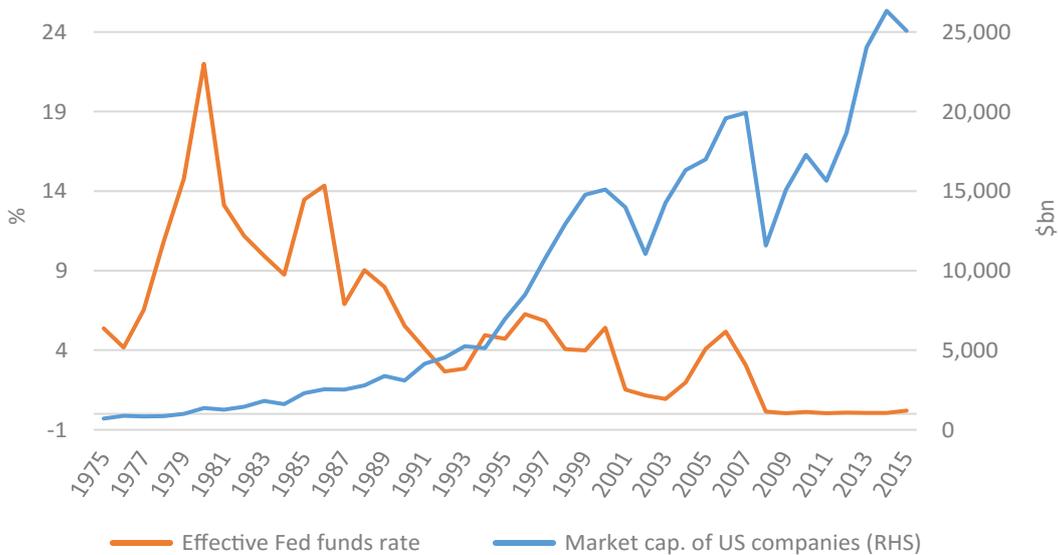
Tump is an unorthodox person in respect of his politics and is promising to be one in terms of his economics too.

There has been paralysis in the G7 and G20 international forums in terms of bold fiscal policy. There may have been a time to hold back on fiscal spending (as in the UK) immediately after the steep rise in the deficit and debt in the first few years following the financial crisis. Borrowing is defensible for investment purposes at all times.

Monetary policy – quantitative easing – took up the task of easing the pain of the recession and helped ‘zombie households’ and ‘zombie companies’ survive.

But following years of QE monetary policy has reached its limits. Negative interest rates have become the latest problem. Companies are using cheap money for share buybacks or other ways of pursuing asset bubbles (see Chart 10). Little of the money has been channelled into reviving the economy, raising wages or driving inflation back to the target level of 2%.

Chart 10: Low interest rate boost for asset prices
US stock market capitalisation against Fed funds rate, 1975-2015



Sources: Federal Reserve Economic Development, World Federation of Exchanges

In this climate, rather than seem helpless in the face of insurmountable problems, a bold unorthodox policy would remove obstacles to growth.

Technical progress – for example, artificial intelligence or driverless cars or robots – will only take care of the skilled when it comes to jobs. The many unskilled manual workers who used to enjoy a high and rising standard of living have lost out over the last 40 years. American unemployment rates remain low, but there is still much dissatisfaction over wages. Household debts have risen.

Capital spending will boost job growth

A bold policy of capital spending on infrastructure projects will increase the job opportunities precisely for those workers who need it and revive the economy. A policy of sustained capital spending will raise income and its growth rate.

These indirect/multiplier effects are difficult to estimate, but they can only be positive. This itself may reduce the debt to GDP ratio to a level lower than it would have been were the debt incurred because of a shortfall of tax revenues below current spending. If Trump adopts such a policy, he may yet turn out to be a Keynesian, despite himself.

Ultimately, an American president with an economic plan to enact requires a compliant Congress that accommodates budget proposals and provides the sought-after extension of the debt ceiling.

This depends on whether Trump has coat tails that will carry Republicans into the two houses and maintain the party's majority – and whether the Republicans themselves have an appetite for Trump's unorthodox policies. None of this is guaranteed. If Trump wins in November, those who fear his actions should pray for four years of legislative gridlock. This would not be a propitious outcome, for the US and the world – and we must hope that it is not the best on offer.

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