The Post-American World Economy

Globalization in the Trump Era

By Adam S. Posen

In the aftermath of World War II, the United States set about building a global, rules-based economic order. At the heart of that order, it put the liberal values of free trade and the rule of law. Over the next seven decades, the order, backed by U.S. power and bolstered by its growing legitimacy among other countries, prevented most economic disputes from escalating into mutually destructive trade wars, let alone military conflict. That allowed even the smallest and poorest countries to develop their social and economic potential without having to worry about predation by stronger neighbors. By taking much of the fear out of the global economy, the U.S.-led order allowed market decisions to be driven by business, not bullying.

Today, that order is under threat. U.S. President Donald Trump has rejected the idea that the world’s economies all benefit when they play by the rules. Instead, he has decided that putting “America first” means withdrawing from supposedly bad deals, on which he believes the system is based. So far, Trump has failed to follow through on his most destructive ideas. But the damage has already begun to show. His administration has hobbled the World Trade Organization, encouraged China and other autocratic regimes to lean on their smaller neighbors for economic loyalty, undercut agreements on tax evasion and climate change, and pushed even major U.S. allies to negotiate free-trade and cross-border investment deals without the United States.

If the United States continues its retreat from economic leadership, it will impose serious pain on the rest of the world—and on itself. Unless the Trump administration chooses to launch a full-blown trade war, the consequences will not come immediately. But a sustained U.S. withdrawal will inevitably make economic growth slower and less certain. The resulting disorder will
make the economic well-being of people around the world more vulnerable to political predation and conflict than it has been in decades.

One of the great lessons of economic history is that bullying is bad for prosperity. Good institutions—the rule of law, clear property rights, stable means of exchange, efficient tax collection, the provision of public goods, checks on official corruption—are the fundamental prerequisites for sustained economic growth. The benefits of such institutions should not be oversold. They do not lead inexorably to prosperity or democratic freedom. But without them, long-term saving and investment, which form the backbone of growth, cannot be maintained.

The U.S.-led postwar order extended these kinds of institutions to the international economic sphere, at least in part. The best way to think about the rules-based order is as a club that promotes a common set of beliefs to which its members adhere: the ability to export to, import from, and invest in markets around the world should not be determined by military power or alliance structures; other countries’ economic growth should be welcomed, not treated as a threat; property rights should be secure from invasion, expropriation, or theft; and technical knowledge should flow freely, subject to the enforcement of patents and trademarks. Together, these values provide the basis for sustained investment and business relationships, as well as household income growth.

The club offers some shared facilities, for which dues are collected. These start with the institutions founded at the Bretton Woods Conference in 1944—the International Monetary Fund (IMF), the World Bank, and what became the World Trade Organization (WTO)—but go far beyond them. The order maintains common systems for settling transactions, converting currencies, invoicing in widely accepted units, and applying tariffs and customs rules. It also establishes forums where experts can meet to discuss specialized topics and groups that set international standards, such as ICANN (the Internet Corporation for Assigned Names and Numbers). Critically, the club’s facilities now include frameworks for settling international commercial disputes.
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The club includes some mutual insurance against both man-made and natural disasters. In part, this takes the form of development assistance and emergency aid, which flow disproportionately to poorer members. But it also involves cooperation in the face of financial crises or economic depression, both of which can spread if the entire community does not work together to fix problems, even if they initially affect only one member. The liquidity provided by the U.S. Federal Reserve in emergencies is essential to such financial firefighting.

The club analogy is not perfect. Although the members are nation-states, underlying each state are millions of people, households, and businesses. These, not the states’ rulers, are the ultimate beneficiaries of the global economic order. That is what gives the liberal order its ethical weight.

LEADING FROM THE MIDDLE

All these attributes are in large part the result of U.S. leadership. But if the United States chairs the club, that does not mean it can issue commands or demand loyalty. Washington cannot force a state to become a member; it can only make membership more attractive than remaining outside the club. Nor can it easily restrict what a member government does within its own country or in areas outside of the order’s agreed values, short of issuing a credible threat to kick that country out of the system. But if such threats come too often or seem too arbitrary, then other members will fear for their own status and band together to resist U.S. pressure. Finally, the United States can collect club dues only to the degree that members think that membership is worth it and that others are paying roughly their fair share.

This reality contradicts the widespread but misguided belief that the United States provides global public goods while others free-ride, let alone Trump’s view that the global system has played American voters for fools. In reality, the United States supplies by itself only two essential aspects of the economic order. First, Washington extends an umbrella of security guarantees and
nuclear deterrence over U.S. allies. Second, the U.S. military ensures free navigation of the seas and airspace for commerce, subject to some international rules that are largely set by the United States. Both of these are classic public goods in that one actor, the United States, provides them, and can do so essentially on its own, and every country benefits, whether or not it contributes.

In fact, when it comes to the rest of the order’s institutions and benefits, the United States has often been the one free-riding in recent years. It has frequently failed to pay its dues to international organizations on time, as others do. It has spent a far smaller share of its GDP on aid than other wealthy countries. It has failed to respond adequately to climate change, even as other countries have begun to shift toward greener growth. It has behaved irresponsibly by excessively deregulating its financial system and its mortgage market, despite pressuring other countries to curtail their own growth for the sake of stability.

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This reality is the opposite of the concern voiced by Trump’s “America first” slogan. The United States has been given a pass on many responsibilities precisely because it leads the system and other countries want it to keep doing so.

So far, the benefits of U.S. leadership have been large enough that other countries are willing to ignore a certain amount of hypocrisy. But at some point, if the United States goes from occasional free-riding to ostentatiously violating the rules, the system itself will be imperiled. The United States has to want to lead, and the other members have to want it to do so.

Thus, U.S. leadership is not the inevitable result of the relative size of the U.S. economy and the U.S. military. Over the last 70 years, it has persisted even as the share of the world economy made up by the U.S. economy has shrunk from 50 percent to 25 percent. Policymakers should not fear that
China or the EU will replace Washington as the global economic leader as their economies surpass that of the United States. So long as the U.S. economy remains very large (which it will) and at the technological frontier (which it probably will), and the United States maintains its commitment to globally attractive values, the country will be capable of remaining the leader.

It is a tribute to the appeal of the liberal rules-based order—and to Washington’s ability to position itself as at least better than the alternative—that U.S. leadership has retained such indulgent support.

DO THEY REALLY MEAN IT?

Washington’s retreat will not immediately send the world into recession. Unless the Trump administration decides to mount an actual trade war with China or Mexico, it may not even do any obvious harm over the next year or two. This is partly because even major economic policies take time to affect economies as a whole. It is also because the global economy is in the midst of an extremely broad and balanced recovery. That breadth makes the current expansion the most resilient of any since at least the 1980s. All the engines of the world economy are running well, mostly without overreliance on debt in either the private or the public sector.

Other countries are also mostly taking a wait-and-see approach to Trump’s threats to the global economic system. The administration’s National Security Strategy, which was released in December, challenges almost all the fundamental aspects of the United States’ global role and the values that the country has professed for the last 70 years. It breaks down the wall between economics and national security and explicitly commits the U.S. government to bilateral bullying instead of enforcing and obeying the rules. Advancing what it calls “principled realism,” the strategy promises to “integrate all elements of America’s national power—political, economic, and military.” The United States will “pursue bilateral trade agreements” rather than broad ones, a recipe for economic coercion rather than cooperation.

Some skepticism over the Trump administration’s course is justified, since past administrations have rarely followed any stated strategy consistently. What is more, even if the document does reflect Trump’s intentions, a number of factors—the midterm elections later this year, unexpected
developments from the ongoing investigations into possible coordination between the Trump campaign and the Russian government, pushback from Congress, even reasoned persuasion by the president’s economic advisers and world leaders—could stop the administration from following this mistaken path.

If that strategy really does guide U.S. policy, however, then it will do serious harm. The United States would restrict access to its market in a variety of arbitrary ways, by blocking foreign investment, withdrawing from trade agreements, imposing “buy American” restrictions on government purchases, and politicizing financial supervision and access to international payments systems. Inevitably, given greater political discretion over the economy, some U.S. politicians will demand payments, perhaps even bribes, from companies for proceeding with normal commercial transactions. All but the last already occur to some limited degree, but successive U.S. administrations since World War II have pushed against these tendencies at home and abroad. Reversing that approach would hurt the United States’ economic productivity and its citizens’ purchasing power. At least as important, it wouldn’t stop there. Adopting such policies would encourage autocrats to follow suit and even democratic allies to retaliate in kind.

Finally, the extent of the damage will depend on how willing and able other governments are to uphold the values and structures of the current system: China and the EU, primarily, but also other major economies that have long supported the rules-based order, such as Australia, Canada, Japan, and Mexico. In all likelihood, there will be no immediate disaster, because the system offers benefits to members who voluntarily comply with its rules. Even without the United States, almost all the other members of the order still publicly subscribe to its stated values: open markets, equal treatment of all members for economic purposes, and the peaceful settlement of disputes.

When politicians demand loyalty over objectivity and suppress findings they do not like, they legitimate tactics that were once the preserve of autocrats.
Some of the shift away from U.S. economic leadership predates the Trump administration. Since the global financial crisis, widespread disdain has emerged for the excesses of turbocharged Anglo-American financialized capitalism, especially its unfettered speculative flows and unchecked accumulation of private wealth. In many countries, this backlash has led to greater tolerance for state-owned enterprises (reinforced by China’s example of state-led growth), the protection of special interests from trade competition, and the promotion of companies with their headquarters in their home country as national champions. All of these can have positive effects in moderation, but the current trend is likely to go too far without the restraint that comes when the United States enforces the rules. Even under the Obama administration, the United States was slow to put new issues, such as women’s empowerment, refugee resettlement, Internet privacy, and environmental concerns, on the international agenda. Yet the best way to deal with these issues would be to bring other countries’ concerns about the United States’ errors to a discussion at the G-20. For other countries to give up on U.S. leadership, let alone for the United States itself to abandon the system, would only worsen these problems.

The most immediate response to the Trump administration’s retreat has come on trade. The prospect of the United States’ withdrawal from the global trading system has spurred several large economies to conclude bilateral or regional trade agreements. In the past year, the EU has all but concluded substantive trade deals with Canada, Japan, Singapore, and Vietnam, and it has accelerated negotiations with Mexico and the South American trading bloc Mercosur. With surprising speed, the 11 nations remaining in the Trans-Pacific Partnership after the United States withdrew in early 2017 have moved forward with much of the agreement, with Australia and Japan taking the lead. Regional trade talks in Asia and Africa involving China and negotiations among Latin American countries have also gained pace; although these types of negotiations tend to result in lower-quality agreements that would allow only limited liberalization and resolve few regulatory issues, they will divert trade from elsewhere, including the United States.

The Trump administration has begun attacking international institutions from NATO to the UN. By blocking the appointment of new trade-dispute judges
to sit on the WTO’s seven-member appellate body, the administration is preventing the WTO from functioning normally. Here, the rest of the world has been slower to respond. A few world leaders, such as Argentine President Mauricio Macri, who defended the WTO at the organization’s biennial meeting in December, have spoken out. Canada has filed a WTO case against the many unilateral trade measures the Trump administration is pursuing, which may set a precedent for action by other countries. But most have remained silent, possibly because they do not wish to provoke Trump into directly withdrawing from or further attacking the organization.

Some nontrade aspects of the liberal rules-based order can continue to function in the absence of U.S. leadership. Most institutions and forums will not work as well, or as consistently, or as adaptably, but they will persist. The systems that allow international financial cooperation have been largely spared from attack so far, in part because of the Federal Reserve’s legal independence. Yet without U.S. leadership, even these regimes will be vulnerable to future economic shocks. In the event of a major downturn, large countries will likely fail to act together if the United States does not contribute. The system is not designed to withstand a full-on assault by Washington. If Trump wants to tear down the order, it will be difficult for other countries to limit the damage.

**BEGGAR-THY-NEIGHBOR**

Left-wing critics of the U.S.-led liberal economic order often argue that the system encourages countries to race to the bottom, exploiting poorer populations along the way. This criticism has particular merit when it comes to environmental protections and labor rights, areas in which the United States does not do enough domestically and so lowers global standards. But until recently, a combination of peer pressure and formal agreements encouraged by the United States had increasingly limited the extent to which countries undercut one another. Over the last decade, international efforts, led in part by the Obama administration working through the G-20, had begun to rein in two of the most pernicious beggar-thy-neighbor policies, currency manipulation and the creation of tax havens.

If the U.S. government walks away from its leadership role, this picture will change dramatically. Today, tax competition largely takes the form of
constructive pressure to bring rates and coverage somewhat in line with those of comparable economies. The United States, along with some other countries, is disadvantaged under the current system, but only international cooperation has a hope of plugging the holes rather than just driving every country’s revenues down. If the United States tries unilaterally to use its tax code to attract corporate headquarters away from other countries, the incentives to race to the bottom by allowing tax evasion will strengthen. The tax bill signed by Trump in December has many complex provisions, but overall, it appears to privilege domestic production in a way likely to both reduce economic efficiency and promote tax conflict internationally.

More broadly, either opportunistic multinational companies will pit countries against one another as governments compete to attract jobs or countries will designate national champions that will demand protection and subsidies. Either way, companies’ shareholders will capture more of national incomes, shifting resources away from individual taxpayers and workers and shrinking governments’ abilities to deal with social issues and invest in long-term projects. Beggar-thy-neighbor policies will beggar everyone.

Another goal of the postwar liberal order was to give the governments of developing countries a voice. Global governance has never been truly equal; the United States and other major countries have always played a dominant role. And deadlock often stymies institutions in which all member countries have an equal vote, such as at the WTO. But the IMF, the World Bank, and other multilateral development institutions have generally applied consistent criteria across countries when apportioning lending and aid, authorized by their collective membership.

In contrast, in a world in which national security links and bilateral relationships displace general rules and multilateral institutions, aid and crisis financing will grow increasingly politicized. Whether a developing country gets access to financing might come to depend on whether it sits inside a major country’s sphere of influence and is willing to accept (or unable to resist) political domination by that country. The IMF and the World Bank will remain, but without backing from rich countries, they will likely not be able to counterbalance this kind of politicization in large parts of the world.

To avoid facing such political pressures, many emerging-market countries will make renewed attempts to hedge against situations in which they need
assistance by keeping larger currency reserves, even if that comes at the cost of domestic investment. They will also try to secure patrons who will promise them relatively unconditional assistance when it is needed. With those promises in hand, countries will have less need of help from international institutions and thus will be more willing to keep international monitors out of their decisions. This combination will make financial crises more frequent and, by interfering with international cleanup efforts, more likely to do lasting political and economic damage. The division between middle-income countries and countries that remain poor will grow even starker as inconsistencies in the system will hurt the poorest and smallest countries the most.

THE POST-REALITY ECONOMY

Less obvious but no less destructive effects of the U.S. withdrawal from economic leadership will come on the macroeconomic side. These have begun with recent efforts to compromise economic statistics. The United States has always taken pride in the fact that it relies on independent agencies to report data about its economy. That has allowed it to press other countries to disclose information properly and promptly, given rise to a set of definitions and techniques to help them do so, and created the basis for formal agreements on economic surveillance among technocrats. Objective, standardized economic data allow policymakers to adjust their policies based on more than gut feelings or salesmanship. The Organization for Economic Cooperation and Development and the IMF, with strong support from the United States, help develop and maintain this statistical regime; their regular reports on member countries’ policies and performance give voters and investors independent expert assessments to consider.

Yet over the past year, British and U.S. politicians have begun to disparage their own technocrats’ findings. In London, government ministers have dismissed official agencies’ skeptical analyses of Brexit, and in Washington, Republican members of Congress have rejected legally required assessments of legislation by the Congressional Budget Office and the Joint Committee on Taxation. In some cases, they have even attempted to prevent analyses and data from being released to the public. Politicians will always present numbers in a rosy light and push back against criticism, often with some justification. But when they demand loyalty over objectivity and suppress findings they do not like, they legitimate tactics that were once the preserve
of autocrats. Other self-interested politicians will follow this lead. It is impossible to put a number on the damage this could do by allowing wrong-headed policies, distorting and deterring investment by raising uncertainty, and reducing the ability of publics to hold their governments accountable.

As the United States turns away from the liberal rules-based order and economic decisions grow more intertwined with political power, uncertainty will rise and returns on investment will fall. Governments will work to trap investment at home, either to create domestic jobs or to fund a corrupt political system. Those efforts will always come at an economic cost. If they did not, governments would not have to prevent money from flowing abroad. Policies that restrict foreigners’ ability to invest in a particular country are more of a mixed bag. Limits on some kinds of foreign investment can help prevent destabilizing surges of capital into and out of economies. But such policies can easily go too far since foreign direct investment brings a wide range of benefits for advanced and developing economies alike.

If governments begin to restrict capital flows, investors will find it harder to diversify their investments across the global economy. That will expose households and businesses to greater losses from volatility within their particular country or region. Laws that make it more difficult for households to get their savings into or out of an economy will reduce the level of investment and shift it toward more liquid assets, such as cash and government bonds. Worthwhile business ventures will struggle to raise capital.

Wealthy but aging societies in Europe, North America, and Northeast Asia need to invest in growing emerging-market countries to sustain their retirement incomes. Emerging economies need investment from wealthier countries to build roads, bridges, and hospitals; develop Internet and other communications networks; and train doctors, teachers, and other professionals. But if politicians and national security threats interfere with investment between countries or among different sectors of the economy, that win-win exchange will become more tenuous, leaving both retirees and workers around the world worse off.

TRADE ON

The international free-trade regime forms the most visible—and the most reviled—aspect of the postwar economic order. But it is here that U.S.
withdrawal might actually do the least harm. The United States is more dispensable to the rules-based trading regime than it is in other economic spheres, and the other major trading countries are responding to U.S. withdrawal by deepening their own trade agreements. International trade has persisted throughout recorded human history, even when some global economies have left the system (as China did from the mid-fifteenth century to the mid-eighteenth century, Japan did from the mid-seventeenth century to the mid-nineteenth century, and the Soviet Union did throughout its existence). Trade can be limited, but never completely squelched.

U.S. withdrawal will still hurt. Countries have already begun to shift their trade flows, supply chains, and business relations away from the U.S. market. This process will only accelerate as the United States retreats. Although the U.S. economy’s sheer size will make it impossible for other countries to completely divert trade around it, that size will also worsen the global economic losses from the United States’ withdrawal.

If the United States entirely abandons the global free-trade system, the result will be a massive reduction in the size of global markets. That would leave consumers with less variety and worse quality in the products they buy, leave companies less able to take advantage of economies of scale, and leave countries more likely to diverge from the common technologies and standards that make modern life possible. Global competition would wither. The United States itself would suffer as companies pursued opportunities in places where new trade deals expanded markets and the politics were more favorable. Among the biggest losers would be Americans themselves, as they would soon pay more than they do now for almost everything and miss out on the new jobs and growth that would otherwise have come from the rise of developing economies.

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As the leader of the global economic order, the United States has, albeit insufficiently, pushed to enshrine tougher standards for anticorruption,
environmental protection, and human rights in major trade deals such as the Trans-Pacific Partnership. There is still room for improvement, but trade deals without the United States, especially those that include China but not the EU, will likely score far worse on all these counts. Even the EU may compromise more readily than before when it becomes the leading high-income economy in the global trading system. Without the United States to counterbalance it, Brussels will be tempted to sell out its values for economic gain. It may restrict the spread of biotechnologies and agricultural innovations, as many EU countries have an anti-science opposition to them; attempt to split up the Internet in order to advantage European companies in search, shopping, and social networking; and acquiesce to demands from Beijing to transfer militarily useful technology or recognize its territorial claims in return for preferential access to Chinese markets. The United States has sometimes failed to stand on principle on these matters, but U.S. leadership with European support remains the only way to make any progress on such issues. Otherwise, the incentives for each major economy will be to pander and compromise.

THE HOUSE THAT WE BUILT

The United States has at times failed to live up to its ideals as the leader of the liberal economic system. That failure has grown more frequent since 9/11, as many Americans have felt threatened by the growth of terrorism and the economic rise of China. That trend also reflects a recurrent nativism in the U.S. electorate and Congress that predates—and contributed to—Trump’s election. The United States has played too dominant a role in some areas of global economic discussion and been reluctant to allow other countries to help set the agenda, partly in an effort to pander to domestic nationalists by maintaining the symbolism of dominance. But far worse than a lackluster leader is one that abandons its role altogether or even works actively to subvert the system’s values. A return to bullying would only harm economic growth.
The United States’ motivation for building the postwar economic system was as much preventing conflict as promoting growth. In setting out the rules by which all members would conduct business, the architects of the system hoped to separate economic from military competition. U.S. withdrawal need not result in economic or physical wars, but it will raise the risk of stumbling into conflict by accident. Without agreed-on rules, even minor economic disputes have the potential to set off escalating counterattacks. If the norm of separation between economic and military confrontations breaks down, economic frictions, such as Chinese theft of intellectual property or restrictions on trade with a nuclear Iran or North Korea, could turn into outright conflict.

It is plausible that as the United States retreats and thereby weakens its economy, the Trump administration will blame the economic damage not on its own actions but on foreign governments, creating a self-perpetuating cycle of anger. When other major countries step forward to preserve the open economic order, or defend themselves against U.S. economic aggression, Washington may interpret that as an attack on U.S. primacy. The Trump administration might even misinterpret the current forbearance by China or the EU as a sign of weakness and an invitation to escalate confrontations.

Today, a smaller share of the world’s population than ever lives in poverty, and a larger share than ever lives a middle-class existence. This is not solely the result of China’s astonishing rise. In Chile, Ethiopia, India, Indonesia, South Korea, Vietnam, and the countries of the former Soviet Union, economic growth has brought hundreds of millions of people out of what amounted to subsistence or little better. This miracle took place without conquest or even much conflict, and with greater protections for private property and human rights than ever before. The liberal order constructed and led by the United States made such progress possible by giving countries, businesses, and individuals the opportunity to build their economic lives without fear of a foreign power taking away what they had made. That U.S. leadership has not, as some have charged, hurt the United States. The country’s rampant inequality and wage stagnation are largely the result of domestic political choices and failures. A world in which the United States ceases to lead—or, worse still, attacks—the system it built will be poorer, nastier, less fair, and more dangerous for everyone.