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The New Economics

How the U.S. and Its Allies Are Rewriting the Rules on Spending and Trade

By Felicia Wong

Amid the arduous fight in Congress over President Joe Biden's economic agenda, it is easy to lose sight of a more important development: the dramatic shift in economic thinking now taking place not only in the United States but also among many of its allies and partners. In its ambitious economic plan, the Biden administration is doing more than trying to push through a large-scale stimulus. It is also departing from a long-dominant neoliberal consensus—including the position of the Democratic Party itself for much of the past few decades—in favor of a sweeping new vision for economic growth based on privileging work over wealth and planet over profit. In doing so, the administration is moving in tandem with new and recently reelected governments in Canada, Germany, and Japan that are pursuing expansive policies aimed at tackling inequality and decarbonizing the economy.

Meanwhile, leaders in France, Italy, and the United Kingdom are moving in a similar direction, using the levers of state power to promote human welfare and green industries. Many of these leaders are also using the power of EU and national institutions to tame and tax the digital monopolies that are increasingly wreaking havoc with democracies worldwide. Indeed, for the last six years and especially since the pandemic began, leaders and

policymakers in many developed democracies have concluded that deeper structural reforms are necessary to counter the right-wing populism that brought former U.S. President Donald Trump and other political figures to power.

The broad international convergence around a new economic framework is significant, because for decades, there has been a similar convergence in the opposite direction: international policymakers privileged trade openness and volume above all, seeking to deregulate markets and support the market-oriented rules of the World Trade Organization (WTO). This was the so-called Washington consensus, the approach that was formulated in the 1980s based on the neoliberal ideas of privatization and deregulation. Now, the Biden administration and like-minded governments are rethinking that approach in favor of policies that seek to bring new standards to international trade and to use public investment to address issues such as income inequality.

Many of these ideas are only beginning to gain traction, and some face strong political headwinds. Even as Biden has succeeded in getting a historic $1.2 trillion infrastructure bill, he has had to make significant compromises in the negotiations for his even larger social spending package, the Build Back Better bill. But this momentary setback is not a ceding of the vision. Of far greater significance is that such legislation is now under discussion at all. For in its size and ambition, it suggests how far the U.S. administration has already come in embracing an entirely new understanding of how the

government can play a crucial role in not only the domestic but also the international economy—an approach that offers powerful new tools for addressing some of today's greatest challenges.

THE POPULIST BLOWBACK

Among the drivers of Biden's economic vision has been the recognition by his policy team that decades of trade liberalization have caused real harm to the electorate. Popular discontent with trade policy was one of the crucial dynamics of the 2016 presidential campaign. By taking a populist stance against the trade agreements that had long dominated international policy, Trump was able to exploit the inconsistency between the campaign statements of his opponent, Hillary Clinton—who said she was against the Trans-Pacific Partnership trade deal—and the position of the Obama administration—which had waged an aggressive campaign to enact the TPP. Trump's victory and his administration's hostility to trade deals broke the long-standing bipartisan consensus on trade, and the lesson was not lost on Biden. The new administration, although it has departed from many Trump-era policies, has continued to move away from trade expansion itself as a primary goal of economic policy. Biden's economic advisers have made clear that the United States will not pursue the TPP or any other trade agreement, for that matter, until Congress passes major new domestic spending legislation and international negotiators rewrite trade rules to include protections for workers and the environment.

Among the measures Biden officials have proposed for reshaping the international trade regime are restrictions on imports of carbon-intensive steel and aluminum; a loosening of intellectual property rules that protect corporate patents in order to better fight pandemics; and prioritizing goods produced domestically with domestic supply chains. Such efforts to control the social effects of trade run directly counter to the dominant approach pursued in Washington for decades, which sought to encourage unrestricted international commerce. The Biden team's efforts coincide with similar economic policies—such as the European Green Deal—that other governments are carrying out to combat climate change, fight international corporate monopolies, and enforce international tax rules.

That is why the official communique of the G-7 summit in Cornwall in June read so differently from those of past years. Instead of laments about "protectionism" and wait-and-see approaches to climate change (as was shown in the 2016 communique, the last before Trump took office), the 2021 statement openly acknowledges the unequal gains that have resulted from trade and sets specific goals to reduce carbon emissions industry by industry. The shift was also captured by the panel report "Global Economic Resilience" that I co-authored with experts from other G-7 countries and that was released in October. The report sets out to give a conceptual framework for what has been called the Cornwall consensus, a replacement for the Washington consensus.

REWRITING THE RULE BOOK

The G-7 report has several main points. First, trade liberalization should no longer be seen as an end in itself. Not only are tariffs already at historically low rates, but a growing body of economic research has shown that, since the 1990s, many of the trade agreements of the neoliberal era have not been particularly helpful and, in many cases, have been harmful to workers in the United States and abroad. Going forward, governments should focus less on trade agreements centered on tariff reduction per se and more on leveraging trade in the services of more robust regulatory standards, especially to encourage sustainable production. For example, the United States and the EU recently announced plans for the Global Arrangement on Sustainable Steel and Aluminum, which will keep dirty metals out of their markets and produce common ways to measure the embedded emissions in these industries. Notably, the agreement makes no reference to WTO rules or processes. Rather, the two trading giants staked out a common vision and invited the rest of the world to join them. Japan and the United Kingdom reportedly are inclined to do just that.

Existing international trade rules also tend to facilitate what Biden's chief trade representative, Katherine Tai, has called a "race to the bottom" by creating incentives for companies to lower standards to be more competitive. "This is part of the reason why, today, the WTO is considered by many as an institution that not only has no solutions to offer on environmental concerns, but is part of the problem," Tai remarked in April. To change this perception,

our G-7 panel report calls for trade negotiators to rewrite trade rules to address challenges such as pandemics and the climate crisis, not hinder nations' responses.

The Cornwall approach also calls on governments to invest more in what we call "high-quality future growth": supporting the energy transition, including public transportation infrastructure; high-quality education and training; and climate-focused research and development. This is a question of both scale and scope. The economist Nicholas Stern has argued that in order to tackle the climate crisis and put growth levels on a sustainable trajectory, countries need to increase public investment by two percent of national income above pre-pandemic levels, spending collectively at least $1 trillion every year between now and 2030. The point is to encourage investment that will help desired new sectors of the economy grow rather than focusing on immediate consumption. Indeed, declines in public investment help explain the supply chain woes now roiling ports and industrial production. For example, the EU's so-called Stability and Growth Pact requires keeping government budget deficits under three percent and overall government debt below 60 percent of GDP. As the economist Joseph Stiglitz has noted, this is onerous in normal times, unwise during business-cycle downturns, and outright lunacy in the face of the urgent, large-scale investments needed to fight climate change. COVID-19 forced the relaxation of those rules, and policymakers in France, Germany, and Italy have called for rethinking them going forward.

The corporate minimum tax upends more than a century of international tax rules.

Governments must also invest in specific policy directions. For example, scientists are developing many promising technologies to enable various industries to reduce carbon emissions more rapidly. But to put these technologies into widespread use, they need governments to create and backstop markets. By making large-scale investments in products such as green steel, governments can create markets, readying new innovations for large-scale private-sector investment. Governments can also make public investments in new technologies that firms can't or won't fund. And in both cases, governments can work with communities in and around the new industrial facilities to ensure that they share in the gains. The economist Mariana Mazzucato, a fellow co-author of the G-7 report, has described this approach as "mission-driven industrial policy."

Finally, governments need to overhaul how top earners and corporations are taxed and regulated. Between 1995 and 2020, the share of global GDP controlled by the top 0.00001 percent tripled, giving the highest earners extraordinary influence on economic policy. Lobbied by corporations and the superrich, governments have often looked the other way as tax avoidance ballooned. Meanwhile, monopoly and monopsony power—when a single employer such as Amazon dominates a product or labor market—has spread in many areas of the economy, harming consumers and workers alike. The economist Thomas Philippon, another co-author of the G-7 report, has found

that decreased competition in many industries now costs the typical U.S. household more than $5,000 a year. This is at a time when nearly 40 percent of households struggle to pay for an unexpected $400 expense.

The historic international agreement this fall to establish a 15 percent minimum tax on corporate profits is a step in the right direction. For the first time, more than 130 countries have pledged to adhere to a global floor on tax rates. The largest and most profitable firms will enjoy less discretion over where they are taxed, as countries move closer to what is known as "<u>formulary apportionment"—requiring corporations to allocate their worldwide income to the jurisdictions where their sales, assets, and payrolls are most concentrated</u>. This approach will help workers by ensuring that public funds are available for socially beneficial projects, such as education or paid leave, and by generally helping restore the balance of power between labor and capital. Upending more than a century of international tax rules, the corporate minimum tax shows that large-scale change is possible and achievable.

There is much more to be done, however. As recent investigative reporting on what have been dubbed the "Pandora Papers" has shown, at least five U.S. states have become major offshore havens for international wealth, shielding the assets of national and global elites from public scrutiny and financial accountability. Biden, who spent 36 years as a senator from one such haven, Delaware, could take a strong stand by ending the practice. The president has already taken important steps to limit the power of

monopolies, issuing an executive order to promote competition in the economy and putting antitrust experts, such as Lina Khan and Tim Wu, in key administration positions. But the administration still needs to figure out how to deal with Facebook and other dominant technology companies that do not charge user fees but nonetheless wield enormous political and economic power through their broad control of digital media. European governments are further ahead on this type of regulation, so this is an area in which the United States is playing catch-up.

DEMOCRACY'S BEST DEFENSE

In the United States and many other countries, the elements of a robust new political economic agenda are in place. Yet translating the new approach into new rules will require confronting the vestiges of corporate capture, when large private sector interests gain sway over government policy, a phenomenon that just in the last few months has impeded ambitious efforts to keep the cost of medicines down. In the United States, powerful interests in Washington have resisted the Biden administration's effort to enable Medicare to negotiate drug prices to make them more affordable, and the German government has opposed relaxing WTO intellectual property rules to facilitate global vaccine access.

The Cornwall consensus has challenged rich countries to adopt a new economic worldview in which the state can use its power to limit corporate influence and offer new protections for workers and the environment. To the surprise of many American progressives, the current occupants of the U.S.

executive branch agree. In politics, business, and everyday life, there are many signs that the dominance of neoliberal ideas is waning—but proponents of the Cornwall consensus have much work to do to convince both powerful interests and the public to embrace their thinking. There are significant obstacles to putting the new ideas into practice, including not only the difficulties of the legislative process but also the threat of right-wing populism in the United States and elsewhere, which seeks to provide its own, inward-turning and often nativist alternative to the status quo. The appeal of a more nihilistic, less racially and religiously inclusive populism has only grown in the last five years and has gained ground in major political parties in many countries.

The resurgence of forces that seek to undermine democracy also shows how urgently a more inclusive economic vision is needed. As new social science research that reviewed over 100 countries across many decades has shown, democracies have been able to build popular support for their institutions, but only when they are successful at delivering economic growth, stability, and public goods. This brings to mind one of U.S. President Franklin D. Roosevelt's fireside chat observations in 1938: "Democracy has disappeared in several other great nations—not because the people of those nations disliked democracy, but because they had grown tired of unemployment and insecurity, of seeing their children hungry while they sat helpless in the face of government confusion and government weakness through lack of leadership in government." A similar risk exists today. Governments must

show they can act individually and together for the public good. No less than the future of democracy may be at stake.