AMERICAN INSTITUTE FOR CONTEMPORARY GERMAN STUDIES THE JOHNS HOPKINS UNIVERSITY

56

MAY 2017

A Geoeconomic Agenda: Transatlantic Strategy in an Age of Populism

BY PETER S. RASHISH

The U.S., Germany, and the European Union benefit from a high-standard, rules-based global economic order; "disruption" may produce innovation domestically, but it would be detrimental to transatlantic interests internationally.

Trade agreements can lift economic growth and advance a country's national security, but they should not be expected to take the place of domestic policies like workforce training and infrastructure investment.

The G20 Summit in Hamburg should commit itself to free trade while recognizing there is no single path to reach this goal, and endorse "economic resilience" as a way to ensure dynamic, sustainable, and inclusive growth.

The open, rules-based global economic order that for seventy years has provided a framework for unprecedented worldwide economic growth is under strain. Although all countries have become more prosperous and inequality between emerging and advanced economies has decreased, inequality within many richer countries has sharpened. An economic populism has arisen on both sides of the Atlantic that is laying the blame for this turn of events on the institutions, agreements, and norms that are at the heart of the liberal economic order. As a result, identifying new ideas and narratives about the importance of international economic engagement for the United States, Germany, and the European Union has moved to center stage.

The Sovereignty Illusion

The populist critique of the current international economic system comes in many guises. On the right—in both the United States and Europe—the most benign expression of this populism is that the global economic order is self-governing, so not requiring any investment of political capital; it comes "rent-free." Arguments are also heard that this order is unnecessary because national laws are sufficient to guarantee prosperity, what could be called the sovereignty illusion. A more radical form of right-wing populism asserts that the global economic order is contrary to the national interest; one short hand for this sentiment would be "China wins, the U.S. loses."

While the populist left shares some of these concerns, what distinguishes its critique is the notion that there is a lack of justice in the current liberal order—that existing economic rules benefit corporations and financial institutions rather than the average citizen. This idea was behind much of the opposition in Germany and other parts of the European Union to the Transatlantic Trade and Investment Partnership (TTIP), the U.S.-EU trade negotiation launched in 2013 and that is now on hold. Beyond purely economic concerns, on both the left and the right what has failed to find an echo is the idea that trade agreements and institutions can promote broader transatlantic security through the orderly, high-standard, and rules-based international economic system they support.

The importance of narrative. *Populist politicians have shown great skill in capturing the public's imagination through the power of narrative. Ideas that seem to make sense at first glance—the Brexit slogan of "Taking Back Control" from the EU, or candidate Trump's "America First"—and that are simple to remember can displace more complex arguments from experts who stand accused of failing to communicate persuasively the policies they champion. Defenders of the liberal economic order would benefit from framing their political communication to engage not only voters' analytical capabilities, but also their instinctive mind. The use of analogies may help. Chinese president Xi Jinping's comment that "pursuing protectionism is like locking oneself in a dark room" is one example (if not always actual Chinese trade policy practices). The "bicycle theory" of trade liberalization—if it doesn't keep moving forward the global economy will fall off and have an accident—is another.*

This economic populism is not just a set of slogans. Whether it is the Brexit vote in the UK to leave the European Union in June 2016, the U.S. presidential election last November, or the strong showing by economic populists of all stripes in the recent presidential election in France, considerable portions of the electorate in major liberal democracies appear willing to use their votes to try to throw overboard the existing economic order in the hope that politicians from outside the mainstream will devise something better…somehow.

Managing Expectations

While it is true that "disruption" may produce innovation domestically, extending that concept to the international economy would be detrimental to transatlantic interests. Less ordered global economic arrangements, where the World Trade Organization and the scores of existing bilateral and regional free trade agreements would no longer set and enforce rules (rules that are largely of U.S. and European inspiration), and where individual countries would have the freedom to raise tariffs and impose other barriers at will, would not benefit the U.S., Germany, and other open economies based on the rule of law. Rather, in this sort of anarchical global economy which populists seem to long for, it is state-capitalist countries like China and Russia—which are less democratically accountable and so have more freedom to act—that would be most able to assert their interests.

In an age of populism, what kind of strategy can the U.S, Germany, and its European partners pursue that will produce strong and equitable long-term growth within a global economic order that promotes their national interests and reflects their principles?

Perhaps the key to making such a strategy a success is first to manage expectations. Whether it is trade agreements like NAFTA or international organizations like the WTO, the global economic order needs to be judged against a reasonable yardstick. International trade agreements (and the institutions that adjudicate and enforce them) can raise the overall level of prosperity of a country by opening up export opportunities, lowering the cost of both consumer goods and imported inputs that producers cannot find domestically, and providing fair and productivity-enhancing competition to existing firms. These agreements will create jobs and raise wages in export-oriented sectors, but some workers exposed to foreign competition could lose their jobs.

While trade agreements can also help to ensure a level playing field between workers from advanced and emerging economies, they should not be viewed as a tool to fight unemployment, remedy income inequality, or guarantee the existence of a particular industrial sector or individual firm. No trade agreement—whether multilateral, regional, or bilateral—can do that. But neither would pulling out of such agreements.

Getting the Division of Labor Right

If governments want to create more jobs, foster economic equality, and strengthen particular sectors of the economy like advanced manufacturing, the answers do not lie in international economic policy, whether one marked by cooperative engagement, nationalism, or isolationism. It is instead domestic policies like apprenticeships, training programs, and other active labor market policies that help workers adapt to change, modernizing infrastructure, universal K-12 STEM education, and fiscal and monetary policies that promote savings and investment that will accomplish these national policy goals. Some of these domestic policies (investment in education and infrastructure for example) will require considerable financial outlays that may not be as easy to sell politically as measures like tax cuts or farm subsidies. Yet if governments put off being frank with their voting public, and fail to communicate the necessary division of labor between domestic policies and trade policies, populism will only grow.

With a better public understanding of the role of trade policy, revived negotiations of the Transatlantic Trade and Investment Partnership (TTIP) could provide the right basis for a strategy to help promote U.S. and European prosperity and security. There are a number of areas where neither WTO rules nor the rules in existing bilateral or regional trade agreements have kept up with changes in the real economy. Whether, as former president Barack Obama declared, "if we don't write trade rules, China will," or rather no new rules will be written at all, the U.S., the EU, and like-minded economies across Latin America and Asia would suffer.

Two of the most important areas for new and common transatlantic approaches are the digital economy and the role of state-owned enterprises. While there are real differences between the U.S. and the EU on data privacy, there is a paucity of rules governing international trade in digital services, which are also playing an increasing role in traditional manufacturing via the Internet of Things/Industry 4.0. A focus on e-commerce and the web-based economy would moreover have the virtue of attracting the attention and support of Millennials, for whom the openness promoted by globalization and the Internet is second nature and something seen more as an opportunity than a threat.

The growing role of China's state-owned and state-directed companies in the international economy is giving rise to concern in both the U.S. and Europe that the transatlantic economic model based on the primacy of private economic actors could, in the long run, come under threat. As a start, the U.S. and the EU could commit in TTIP to a single definition of the term "market economy" and a shared treatment of state-owned enterprises. They could also aim to harmonize as closely as possible their approaches to screening foreign direct investment. Additionally, they could lead a joint economic diplomacy campaign to convince other liberal economies with which they both have strong trading relationships—Japan, Canada, the four countries of the Pacific Alliance (Chile, Colombia, Mexico, and Peru), Argentina, and Brazil—to adopt similar policies.

The G20 Opportunity

A resurrected Transatlantic Trade and Investment Partnership may still be several months and even years away, as the Trump administration takes the time to establish its trade negotiation priorities and new governments in France and Germany assess their own international economic policies. As for the WTO, while it can count the Trade Facilitation Agreement that entered into force earlier this year as an accomplishment in the area of market access (particularly for developing countries), the sheer diversity of its membership in terms of both economic models and levels of development has created roadblocks to agreeing on binding new rules under its auspices.

If both negotiated agreements like TTIP and institutions like the WTO are not yet ripe for advancing U.S., German, and EU strategic economic interests, there is another layer of international economic engagement that may hold promise. The G20, which is under the presidency of Germany in 2017 and whose summit will take place in Hamburg July 7-8, brings together the world's largest economies and came to prominence for its role after the global financial crisis in 2008. During a time of great international economic policy activism—for instance, while the Obama administration was negotiating TTIP and the Trans-Pacific Partnership simultaneously—the G20 is less necessary, in part because it is an essentially advisory body that cannot commit its members to take policy action.

But at a time of economic populism in some quarters, and a degree of wariness about entangling commitments even among some traditional internationalists, the G20's weaknesses could become its strengths. During the German presidency, and in 2018 when the liberal, outward-looking Argentine government under President Mauricio Macri takes the G20 reins, there is an opportunity to rally its members around four key ideas.

First, **the G20 should make the concept of "economic resilience" a long-term focus.** This concept, which the German presidency has already put at the forefront of its agenda, can help communicate that dynamic, sustainable, and inclusive growth requires a balance of international rules and cooperation on the one hand, and policy flexibility and national approaches on the other. The United States, for example, would become more resilient to technological change by investing in a skilled workforce. The European Union would increase its financial resilience by completing the banking and capital markets unions. Several European countries would increase their resilience to changes in global markets by making their labor or service markets more flexible, while the euro zone would boost its resilience to external shocks by reducing current account imbalances among its members.

Second, **the G20 should endorse a similar pluralism on trade and investment policy**. For the first time in the history of the G20, the March communiqué of the finance ministers meeting in Baden Baden did not include a commitment to "avoid all forms of protectionism," agreeing instead on "working to strengthen the contribution of trade to our economies." It is unclear whether the traditional language will be resurrected at the July summit. If not, one way forward would be for the G20 to distinguish clearly between means and ends: its members can declare that they are committed to free trade as an objective, while at the same time acknowledging that countries can choose their own paths to achieve this goal. The four largest G20 economies—the United States, the European Union, China, and Japan—all proclaim themselves to be in favor of free trade as long as it is fair, and should be able to agree on such an approach.

Third, **the G20 should also lend its support to the role of the World Trade Organization**, and call for its members to launch a review of its role and functioning at the WTO Ministerial meeting in December in Buenos Aires. Among other questions, the WTO should consider what the concept of "rules-based" trade means and if there is a common definition that all of its 164 members can agree upon. The G20 should also point to the importance of the WTO's dispute resolution process, which plays a unique and crucial role in enforcing the rules that underpin international economic order.

Finally, **the G20 summit should specifically address the importance of a skilled and adaptable workforce as a contribution to creating resilient economies**. As the pace of change accelerates, whether from trade and investment, immigration, climate events, or from technologies like robots and artificial intelligence, concerns about employability are also on the rise. Reasserting national sovereignty—what newly-elected French president Emmanuel Macron in a January 2017 speech at Berlin's Humboldt University called "the new magical thinking"—offers no lasting solutions to these inherently global phenomena. Nonetheless, the burden lies on public and private leadership in the U.S., Germany, and like-minded countries across Europe, Latin America, and Asia to demonstrate that policies inspired by their values and principles can still offer solutions seventy years after the creation of the current liberal economic order. The G20 summit can make clear that while economic openness has not been, and is unlikely to be, at the root of most labor market dislocation, the future of work in both emerging and advanced economies will remain its top-line concern.

__Do trade deficits matter?__ The United States has run a trade (or current account) deficit since the late 1970s, while Germany has had a surplus since the early 2000s. During these years, there has been no correlation between the trade balance and overall U.S. economic growth. Nonetheless, the Trump administration has made reducing bilateral deficits a key goal of its trade policy. Is this right? A trade deficit is a symptom that a country's domestic investment exceeds its saving rate. Starting with trade policy to fix what is essentially a fiscal problem would get it backwards. And since it is also a global problem, even if a bilateral deficit with one country were reduced, so long as the U.S. savings rate stays low, the deficit would re-emerge with another trading partner. Rather than focusing on reducing bilateral trade deficits, the U.S. administration should place a priority on strategic goals like writing new high-standard trade rules that can update and strengthen the liberal economic order.

Support for this publication is generously provided by the AICGS Business & Economics Program.

Peter Rashish is a Senior Fellow and Director of the Geoeconomics Project at AICGS.

In the face of growing challenges to an open, rules-based global economic order, there is a need to identify new ideas and narratives about the importance of international economic engagement for the United States, Germany, and the European Union. This Issue Brief, which is part of the AICGS Geoeconomics Project, sets the stage for the Institute's Annual Symposium in Berlin examining the role of fiscal, monetary, regulatory, and workforce policies in promoting strong and equitable U.S. and European economic growth, and the ways that regional and international trade agreements and institutions can advance U.S., German, and European economic interests and principles.

A Geoeconomic Agenda: Transatlantic Strategy in an Age of Populism

American Institute for Contemporary German Studies
JOHNS HOPKINS UNIVERSITY

1755 Massachusetts Ave., NW
Suite 700
Washington, D.C. 20036 – USA
T: (+1-202) 332-9312
E: info@aicgs.org
www.aicgs.org