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*Trump and Globalisation: Will the retreat from open trade damage global development?*

I want to talk today about whether developments—especially in America with the election of Donald Trump, but more generally in the political culture of the developed world—will get in the way of what, in the 21<sup>st</sup> century, has been a rather promising period of economic development in the developing world. In fact, for broad-based development across the whole world, we haven't had a better time than the 21<sup>st</sup> century so far.

We've seen quite a significant reduction in inequality in global incomes as the very large number of people in China have seen rapid increases in their living standards since 2005. Real wages in China are growing consistently in the range of 5-10 per cent and are accumulating into an historic increase in living standards. But not only in China.

Through the other large Asian countries, we've seen a period of successful growth. India, which got onto a higher growth path in 1991, has done better in the 21<sup>st</sup> century on average. While it's been less spectacular than China, it's been a consistent. Indonesia had a big transition at the end of last century with the transition to democracy, the collapse of the military regime. There were lots of questions about what the implications of that would be for economic development, but it's managed to implement a successful economic strategy under democracy, with reasonably strong economic growth.

Vietnam, on the whole, is a good development story. Thailand also, until the recent problems with its political institutions. The Philippines is doing much better, again with some question marks about recent political developments.

But the 21<sup>st</sup> century has been a very good period for overall Asian development, which is critically important for Australia and is very important for the world because more than half the world's people live in Asia.

But some of those developments in Asia—now that they've become so large—China in particular, but China and India and other developing countries in Asia, are so large in the world economy that their continued growth has put downward pressure on the living standards of ordinary people in the developed world, which has not been corrected by countervailing domestic economic policies in those countries.

The 21<sup>st</sup> century has been different from the early postwar period, where rapid economic growth was associated with the expansion of the welfare state and highly progressive taxation systems. More recently we've had a corrosion of welfare state interventions and a retreat from the progressive taxation of capital, which has compounded the effects of the rapid growth in exports from big Asian developing countries and contributed to downward pressure on living standards in the developed countries.

That's part of the background to the rise of resistance to globalisation that's been manifested in the rise of figures like Donald Trump in the America and Theresa May out of the Brexit event in Britain. Obviously May is very different from Trump, but Brexit reflected a lot of those pressures against globalisation. And then there is the kaleidoscope of reactions against international exchange in continental Europe.

Globalisation—expanding trade in goods and services, large-scale movements of capital, the international movement of ideas and learning about institutions that work, has been very important part of the development story of the 21st century.

If we were able to continue the beneficent processes of what's been happening in much of the developing world so far then we could look forward to a future—not within my lifetime, but certainly within the lifetime of our grandchildren—in which most people on earth could enjoy living standards similar to those that we have.

Certainly, just about all the people—not quite all—of Asia are on trajectories of development that are consistent with that sort of outcome. It's really only in parts of Africa and in the developing countries closest to Australia—the arc of instability between Timor, through the island of Guinea, and towards Fiji—that have not shared in that process at all.

One does not have to reflect for long to be aware of the wonderful possibilities of such a world. Amongst other things, it would mean that open trade and exchange would not be associated with the unwanted movement of people as a result of economic distress. It would not be associated with downward pressure on living standards in developed countries. It would be a world in which smooth-functioning democracies would be more secure. So it is a world worth working for. But it's a world which depends on the international movement of goods and services, ideas, institutions, capital and, to a lesser extent, people.

Let's focus on the 21<sup>st</sup> century. For the first 7 to 8 years, they were good years for the developed countries as well as the big developing countries. But there was a bit of illusion in that. Especially in the English-speaking countries and Spain—in particular in the United States, Britain, Ireland and Spain. Some underlying weaknesses were obscured by an extraordinary housing and consumption boom funded by debt. That was unsustainable, and like unsustainable things it did not last forever and it ended in the great crash of 2008.

Amongst the underlying problems through the developed world, from early this century, we saw a marked decline in productivity growth in all of the developed countries. It's got steadily worse, until in recent years it's the slowest productivity growth in the countries that were enjoying modern economic growth and productivity growth since it all began in Britain in the end of the 18<sup>th</sup> century.

There's also been a tendency towards decline in business investment, not unrelated to the decline in productivity growth. Except for that episode at the end of the housing and consumption boom in the English-speaking countries and Spain, it was a tendency towards increased savings derived partly from the ageing of the population. Ageing itself seems to having an effect on the dynamism of the developed countries—of their economic systems.

The great crash took away the masking of that with debt-funded consumption and housing investment. Since then, the underlying problems have been clearer—low productivity growth, low business investment, relatively high savings, and difficulty in maintaining full employment, strong growth in employment and labour incomes.

Partly associated with all of those things, but also associated with big increases in imports from the Asian developing countries and also associated with the weakening of taxation systems in the developed countries and therefore a weakening of the fiscal basis of the welfare state, all of those things adding up to stagnation of incomes of ordinary people in the developed countries. It's worse in the United States than other places if you look over long periods. At the median level, wages in the United States are lower now than they were a generation ago (30 years ago). That's unprecedented in the history of modern economic development.

Alongside this stagnation of ordinary incomes, you have quite strong growth in high incomes, exacerbated by reductions in corporate taxation, reductions in progressive taxation on high incomes.

Globalisation itself, was often seen as a reason for reducing corporate taxation rates and taxation on high incomes. Whether or not that was a valid reason, it had the certain consequence of exacerbating the fiscal pressures on the welfare state, and the reduction of education, health, social security conditions led to further downward pressure on living standards of ordinary people.

Through this period, we also saw important deterioration of quality of the political culture of our democracies. A weakening of what I call the independent centre of our polity. The people who are interested in policy, talk about it and seek to influence it because they are concerned about the quality of policy in their country and not because they reflect some vested interest or partisan political interest.

This weakening of the independent centre and increasing capture of policymaking by vested interests has been important in most of the developed countries. I think it's gone further in the United States and Australia than in other democratic countries, and it's become quite an important source of deterioration in the quality of economic policy in the public interest. Over time, gradually, that leads to deterioration of economic performance—so that's part of the background to the stagnation of the living standards of ordinary people. In the developed world recently, especially since the financial crisis, we've had a reaction against globalisation, a reaction against trade and a reaction against international investment, especially from countries that are culturally dissimilar.

In some countries, we've had a reaction against movements of ideas and attempts to close down discussion of ideas that come from other places. Not so important yet in the developed world, but we have to watch where Trump takes us in the United States. There's been more resistance to international capital flows than there had been late last century. And straightforward protection against movements of goods and services really throughout the developed world, including in Australia.

Most obviously, there's been a reaction against the movement of people. Movements of people have been at a very high level through a lot of new channels in the 21<sup>st</sup> century. We've had a lot more international movement of people than we've ever had before, through tourism and short-term employment in other countries. Australia has perhaps been bigger in those processes than others.

There's been a big reaction against the movement of people—especially against the movement of unskilled labour. That's fed rather directly into the Brexit reactions in Britain and into the rise of Trump. I think we're seeing it in Australia with the rise of Hansen and a prime minister, who only a few years ago presided of the biggest immigration program we've ever seen, now talking about the need to substantially reduce immigration.

The big question is, is this retreat from globalisation just political froth? Will it pass? Or will it have substantial consequences for global development? Will it get in the road of the beneficent processes that were changing the world for the better?

On trade, we can see the retreat from globalisation in the numbers. Growth in international trade has slowed down, relative to growth of economic activity. It has been much slower recently—over the last decade and especially in the last few years—than at any earlier period since WWII. That is partly a reflection of the retreat into protectionist attitudes. With the election of Trump, we had the immediate withdrawal of the US from the Trans-Pacific Partnership (TPP). That, in itself, I don't see as a great blow to free trade because the TPP was not a free trading instrument. But the lines of division in the US polity over the TPP were between the supporters and the opponents of open trade. So it was certainly a political defeat for open trade, even if the TPP itself was not unambiguously favourable to free trade.

It is important as a marker, as a symbol of where the American polity is at at the moment. More important is the persistence of rhetoric around the new president of the United States about his wish to introduce protectionist measures—what he calls border adjustment measures—in one form or another. Even more worrying, but this was stronger in pre-election rhetoric than it is now, was talk of high discriminatory taxes, in particular on imports from China and Mexico.

We've recently heard very little about discriminatory high import details against China since the election—whether that's just a lull before the storm—or whether it does reflect some rethinking we can't be sure at this stage. On Mexico, we had a rather amusing incident—amusing if the whole thing wasn't so serious—when the Mexican president was due to meet Trump and the meeting was cancelled because, just before the meeting, Trump said that he'd be discussing with the president of Mexico how Mexico would pay for the wall. After the meeting the people around Trump were saying 'We'll make them pay for it by putting an import duty on Mexican goods' and the finance minister of Mexico said 'Well, you said you'd make us pay for it, but what you're now proposing is that American consumers of avocados and television sets will pay for it.' It was an apt and appropriate point.

We just don't know where this will end up. It may be that talk of border adjustment will end up wrapped up into something fairly benign. If it's part of a general taxation reform across the board, across all goods and services and not discriminatory against particular countries, then it may be benign.

I've come to the view that the Trump tax package is probably fairly benign for international trade. The Australian Business Council and the Australian Treasurer draw attention to the low tax rate, but it's not actually a reduction in taxation. It's a huge removal of deductions against taxation. The 15 per cent collected on a much bigger tax base will raise as much, and some members of the Congress say more, revenue than the current 35 per cent on a narrower base.

Amongst that package, apart from the denial of any deductions for payments of interest, which is a radical change in the income tax system, is a denial of any deductions for imports of goods and services. A car dealer who is importing cars from Japan or Korea, and importing a sedan for which they pay \$8,000 and sell for \$10,000—whereas they once would have paid a tax of 35 per cent on the differential, 35 per cent of \$2000, they won't get any deduction for the import. So they'll pay 15 per cent on the whole lot of the sales value.

That would be very disruptive of trade but over time, if it was simple and across the board, applied to everyone and everything, and associated with an exemption from income tax on receipts from exports, over time it would begin to have the economic effects of a uniform tariff associated with a uniform export subsidy. While that's a bit of a mess and there'd be rather large transition costs and problems, in the end it would not be systematically and strongly anti-trade.

If that's the way that Trump's congressional Republican colleagues can channel his interest in restrictions of trade, then it wouldn't be terribly damaging. It may force us all to move in a similar direction in our own tax systems which will have another set of consequences. It won't lead to a reduction in overall corporate taxation, therefore it won't lead to an increase in the US budget deficit. But we don't know that's the way it will go. That's the happiest of the possible outcomes.

There are other possibilities. There will be a big increase in the US budget deficit for other reasons—even if a reduction in corporate tax doesn't happen. We've just seen an announcement about a big increase in defence expenditure. They say they'll fund that through reductions in other expenditures. We'll wait and see.

If we look at similar increases in defence expenditure that were announced alongside commitments to reduce other expenditure in the Reagan and George W Bush administrations, then the reductions in expenditure didn't happen and the consequences were a big increase in the budget deficit.

An increase in the budget deficit has to be funded. It will be associated with capital inflow. Already in anticipation of increased budget deficits, you've got capital inflow and a big

increase in the US dollar exchange rate. That's already knocking on the head the modest reversal of the long-term decline in US manufacturing employment.

In the last 7 years, after 30 years of declining manufacturing employment, you had the beginnings of an increase in employment. The higher exchange rate has knocked that on the head. And the bigger Trump lets that budget deficit go, the higher the exchange rate will go and the more damage to US manufacturing employment. The people who elected him will get it in the neck, but that was always going to be the case.

The difficulties in trade, therefore, could come, not so much in the beginning, but once there is a feeling that things aren't working. A higher exchange rate, a larger trade deficit and stagnation in manufacturing employment after a period of slight growth will generate a reaction. I imagine that the president will blame everything except the actual causes of the problem and that may lead to a new set of pressures for a discriminatory trade measures against the countries that have trade surpluses with the United States.

I think the greater risk of big discriminatory trade interventions that really damage the international system, come then and not right at the beginning.

It's the effects on trade that will have the biggest influence on global development. While there are large humanitarian consequences of restricting the movement of people in distress, the global economic effects of that are not going to be large. The effect is more on American values and the quality of democracy rather than on the global economic system. Nor, in the case of the United States, will deliberate restrictions on investment from the rest of the world be terribly important. But the high real exchange rate, the capital inflow, will turn America into a country that absorbs more of the world's capital and that will mean less capital for investment elsewhere. If that went too far, that could be a downward point for global development. But it would have to go quite a long way to be significant.

One quite important question is whether, if the worst happens in America and the second stage of Trump responses involves serious restrictions on trade—genuinely protectionist measures—especially discriminatory measures, whether that will be large enough to seriously set back global development.

There are a lot of other things happening in the world and it may be that some of these can balance what's happening in America. China has used the opportunity of the retreat from globalisation under Trump to make a public point of going in the opposite direction—of committing itself more strongly to open trade. Xi Jinping paraded at the Davos meeting about his commitment to globalisation. If China becomes more open it could go quite a long way to offsetting a retreat to inward policies in the United States.

China's now a very big economy in the international system. The volume of Chinese trade is now substantially larger than the total volume of American trade. The volume of Chinese savings now available for investment in China or abroad is now as large as American and European savings put together. China remaining deeply engaged in the international economy can go quite a long way to offsetting an inward retreat in the United States. Some of the recent international institutional developments in China are specifically designed to make use of these sorts of opportunities—the Belt and Road initiative, the establishment of the Asian International Investment Bank, Chinese investment in infrastructure across Asia and East Africa is now large enough to make a significant

difference to development in many countries. Chinese import growth has been strong enough to make a significant impact on development in many countries. If China continues to take advantage of an inward lurch in the United States by going the opposite way, that could significantly offset the impact of developments in America.

For that to work in China, China will have to succeed in its articulated ambitions to become a more market-oriented, a more internationally oriented economy, and that's been a struggle in the last few years. Progress is ambiguous in that at the moment – on the whole they haven't made as much progress as is necessary in building the institutions of an internationally oriented market economy.

Some general points about what all this means for all of us in Western democracies. I think there are some lessons about the origins of the retreat from globalisation that we should all learn. It's very costly for us as well as for global development if others go the way of the US. There's pressures on all of us to do that and Australia has gone some way down that route. What can be done to shore up our defences against those developments?

I would not have once advocated this, but we've got to think about economising on globalisation. Making sure we stay open on the things that matter most, and being prepared to accommodate pressures for gradualism on other matters.

It was a step too far to start including in bilateral trade agreements and agreements like the Trans-Pacific Partnership (TPP)—measures that effectively agreed on compromise of domestic sovereignty on quite a lot of issues. That was a red button issue that led to reaction against international trade when it's not actually necessary for open international trade and investment.

In the immigration area in Australia—the country has maintained an extraordinarily large immigration program. It would be a mistake to think that there won't be a big reaction against that unless we do much better at investment in infrastructure to accommodate the huge increase in populations in Melbourne and Sydney.

And Australia has gone quite a long way in the 21st century in expanding immigration of a kind that does Australia the least good as a society. There's been a fundamental change in the culture of immigration in Australia. Once immigrants were accepted they were on a path to citizenship as soon as they arrived and they had incentives to share Australian values and aspirations from the time. But now a very large number of the people who come to Australia are, for an indefinite period, not on a path to Australian citizenship. For example, the large number of 457 visas and most recently the innovation of the 10-year granny visas for Chinese grandmothers to look after their grandchildren in school. They're temporary visas, not a path to citizenship. We've unnecessarily encouraged reaction against immigration by promoting a lot of areas of immigration that are of lesser value to Australia and which draw less commitment from the people living here to Australian values and society.

In the foreseeable future—and who knows what the failure of Trump policies will unleash in the United States—but at least in these earlier years, the retreat from globalisation associated with Trump is likely to have only a moderate influence on global development.

The impact will be greater on political relations around the world. There's no doubt that the Trump period has been associated with a decline in the prestige of democracy at a time when democracy is in a real contest with alternative political systems. The central-planning type of socialism associated with the former Soviet Union was dead and buried in the 20<sup>th</sup> century—the competition between political systems now is between authoritarian and democratic capitalism. Authoritarian capitalism is currently enjoying boom-time conditions.

The strength of Xi Jinping, of Putin, developments in Egypt, in Turkey, maybe in the Philippines and Thailand and elsewhere—means that this is not a time when we want democracy's prestige to fall in the international community. Rather than the purely economic outcomes, this will be the most important consequence of Trump's leadership.

Thank you.