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## ▶▶ The global resurgence of economic nationalism: A looming threat for Canada

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### ▶▶ Introduction

A new strain of economic nationalism is reshaping policies in the world's two largest economies – the U.S. and China – and risks infecting the rest of us. This bout of nationalism coincides with profound structural changes in the global economy, a looming energy transition and intense strategic competition between America and China, making its future path highly uncertain and extremely difficult to navigate. It is an emerging risk to the global economy and Canada is not immune.

Donald Trump certainly did not invent economic nationalism, despite his claims to the contrary. The world has been through periodic bouts of economic nationalism over the last two centuries<sup>1</sup>, usually triggered by a perceived sense of inequity or loss of status by groups within a country or by a nation relative to its peers. Not surprisingly, shocks from transformative technologies, shifts in globalization and wars have reinforced these triggers.

As we witnessed during Trump's presidency, the rhetoric associated with economic nationalism is a narrative of failure by political leadership, elites and institutions to have addressed and remedied these perceived inequities. There is no unifying economic theory underlying economic nationalism. Nationalist policy advocates like Trump have typically railed against the constraints imposed by economic orthodoxy and globalization, while relying on a policy toolkit of protectionism and industrial policy, often combined with anti-immigration rhetoric and measures.

To understand the challenges Canada faces with this rise of economic nationalism, and the toolkit of possible policy responses, it is essential to recognize the context shaping today's geopolitical environment.

## ►► Rise of Neo-nationalism

A unique feature of today's neonationalism is the competition between the United States and China for economic, technological, diplomatic and military supremacy. Both are attempting to build walls around themselves and moats around the other. The goal of this competition is nothing less than global dominance in advanced technologies with dual uses – Artificial Intelligence, advanced computer chips, rare earth metals, battery technologies and EV supply chains. How current and future American and Chinese industrial and protectionist policies, with their national security and technology elements, will affect the global movement of goods and services should be a strategic focus for Canadian policy makers and business leaders.

While a Trump return to power would certainly turbo-charge economic nationalism in the United States, what makes the American embrace of it surprising is its widespread bipartisan support and public buy-in.

Indeed, President Biden is pursuing economic nationalist policies not unlike the Trump Administration but without the over-the-top rhetoric. The most articulate case for this fundamental pivot in American economic policy was made, tellingly, by the National Security Advisor, Jake Sullivan. In an April, 2023 speech, Sullivan cited four factors driving America's shift to a "modern industrial and innovation strategy":

- The hollowing out of America's industrial base with the globalization of supply chains;
- The geopolitical and security competition with China;
- The energy transition to respond to the climate change crisis;
- The challenge of inequality as gains from trade "failed to reach a lot of working people".

Most Republican leaders in Congress today would sign on to three of these four factors. The Sullivan speech is revealing for how the Biden Administration sees the case for more government intervention. It questions whether markets always allocate capital productively and efficiently when viewed from a national rather than a corporate perspective. Here, they view global supply chains, often anchored in China, as one culprit and point to the loss of American advanced manufacturing capacity and jobs as a prime example of its consequences. They believe American workers and firms were left behind by unfair Chinese trade practices. Republicans use similar language.

Lost in this bipartisan rhetoric is the fact that American consumers were big winners from the lower prices of goods made possible by global supply chains. They also conveniently ignore many studies demonstrating that technology has disrupted the American workplace as much as trade, particularly for workers with middling educations and jobs in low value-added industries,

exacerbated by the failure of successive American governments to implement effective retraining and reskilling programs in response to accelerating technological change and globalization.

Economic nationalism is not a team sport, and it is rife with the potential for unintended consequences. The U.S. economic nationalism playbook is decidedly expansive. It includes the retention of many Trump era protectionist measures by the Biden Administration including expanded America First policies and a broader use of tariffs and sanctions. The U.S. has legislated the mis-named Inflation Reduction Act, with its enormous industrial subsidies, as well as the Chips for Science Act with its massive support for advanced technology. There are also new restrictions on technology transfers and investments related to China and a broadening of national security over-rides on technology and trade which can, counter-intuitively, affect close allies like Canada.

## ►► Deglobalization is a Reality

A clear consequence of today's economic nationalism is fragmentation. Deglobalization is no longer a threat but a reality as geo-economic blocs form and harden: trade growth is weakening as tariffs grow; foreign investment is curtailed as sanctions expand; digitalization is splintering as China, US and EU establish quite different sets of digital rules; payment systems are diverging as China and Russia challenge the dominance of the US dollar; and global institutions are withering under big power rivalry.

How did we get to this point? An under-appreciated trigger for this rise in populism and nationalism was the 2008 global financial crisis. In the United States and other countries like the U.K., the financial crisis created a burst of public concern about inequality as banks and bankers were bailed out while many lower middle-income Americans lost their homes. Lost jobs were slow, if ever, to return, while new jobs, of which there were many, demanded very different skills and education.

This created a toxic brew of alienation, despair and loss of confidence in the government and elites who were in charge. Britain went the Brexit route, America elected Donald Trump president. Concerns about "illegal immigration" and whether the state is able to control its borders have further stoked nationalism and loss of confidence in government. Trust in government and the media has cratered, as the Edelman Global Trust Barometer makes clear. Indeed, Edelman argues that "distrust is now society's default emotion" in many western countries.

At the same time, the Chinese government saw the financial crisis as an unexpected weakness of western capitalism and its leadership. The long and humbling shadow of the Asian financial crisis was cast off and the Chinese leadership consciously started to play a more assertive role internationally, something Xi Jinping has pursued very aggressively during his presidency.

China became quite transparent in its industrial policy ambitions with its Made-in-China 2025 initiative – seeking global leadership in a number of advanced technologies while manipulating market access to further its economic aims and to coerce other countries. President Xi has fueled the fires of nationalism in China while further centralizing Party control over the Chinese economy and society.

In the “Global South”, resource nationalism is on the rise as rare earth metals essential to the energy transition become the new oil. Many emerging market economies have become part of a new “hedging middle” where a transactional approach to big power politics is replacing past alliances.

In the west, opportunistic demagogues like Nigel Farage in the U.K., Gert Wilders in the Netherlands, the Le Pens in France, Victor Orban in Hungary and Donald Trump in the United States have seized on this public angst to advocate for nationalist, protectionist, and anti-immigrant agendas – and with evident success. A President Trump 2.0 would be much more disruptive.

In unnerving recent speeches, Trump has signalled that he would be the world’s protectionist nightmare, mulling across-the-board tariffs of 10 per cent on all imports to the United States. The EU and UK would reciprocate, as would China, leading to shrinking global commerce and rising import costs for all countries. Add to this his utter disdain for rules and norms and institutions, whether they be American or international, and it is clear that the 2024 U.S presidential election will capture the world’s attention like no other.

So, what can Canada do? Being the world’s largest economy, American policy matters to everyone, and that is especially so for Canada which relies on the U.S. market for 75% of our exports. The enormous scale and scope of the new American subsidies is impacting friend and foe alike and causing countries near and far to consider whether to match them at great fiscal cost or lose out on attracting future investments.

## ▶▶ The Way Forward

What is clear is that a country like Canada cannot out-subsidize the United States, yet nor can it do nothing in the face of aggressive American and Chinese industrial policies. For Canada the recent ad hoc decision to match American subsidies to woo Volkswagen and Stellantis to establish new EV factories in Ontario at a cost of nearly \$30 billion has unclear long-term benefits to the Canadian taxpayer according to the Parliamentary Budget Officer and clear shorter-term costs as South Korean workers, not Canadians, will fill the jobs to build the facility.

While economic nationalism policies in the U.S, China and elsewhere present obvious challenges for Canadian policy makers and business leaders, the route forward has to be strategic not ad hoc in what we do, recognizing that the American focus on China means it will need allies to achieve its geopolitical aims. And be patient: remember the lessons of history that bouts of economic nationalism always run their course.

**First**, we have to pick our interventions strategically and surgically. Will a subsidy-enabled investment create a sustainable competitive advantage and nurture a cluster of related firms and technologies, or will it be a stand-alone facility whose lifespan is dictated by the duration of the subsidy? Does it build on national advantages such as scarce commodities, skilled talent, favourable business climate and intellectual property? Can it help achieve meta policy objectives such as tackling climate change? Does it enhance or restrict competition?

What will not work to the long-term advantage and prosperity of Canadians is a series of ad hoc financial supports to footloose multinational companies conducting global “subsidy auctions”. And, given that these are financed by government debt, they pass the burden of today’s decisions to future generations.



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**Second**, this is the time to double-down on strengthening national competitiveness – simpler, more effective regulations; efficient public services; strong education systems; modern infrastructure; clear fiscal anchors to manage debt and deficits and spending priorities; and reasonable taxes. Long term, these attributes of a competitive economy should be more important to firms in leading-edge sectors than subsidies. This is why the negative signals from the massive increases in government debt and spending in recent years in Canada, combined with our seeming inability to build things, make attracting foreign investment that much more difficult, and expensive.

While no one can out subsidize the U.S., it is not at all clear that the United States itself can sustain the cost of its new industrial policy for many years given the size of the fiscal deficits it entails, the inefficiencies it produces, and the sectoral conflicts it creates. A 2021 study by Hufbauer and Jung for the Peterson Institute<sup>2</sup> “scores” the success of various US industrial policies over the last 50 years as a guide to current US industrial policy efforts to “compete with China.”



On the basis of their analysis, they make four key points:

- Industrial policy can save or create jobs but at a high cost;
- Import restrictions seldom pay off over the longer term;
- R&D and innovation policies have the best track record;
- Budget realities and private sector opposition to unlevel playing fields ultimately impose political limits to US industrial policies.

The **third** element relates to the American focus on China for geopolitical, security, technology, and economic reasons. In today's hyper-connected global markets, the U.S. cannot be successful acting alone – it needs allies and it needs natural resources. Here the EU, UK, Canada, Japan and South Korea can build collaborative alliances in return for being included within the American industrial policy sphere when it comes to nationalist restrictions and selected subsidies. An example, could be a “Team North America” approach to EV supply chains and production, creating an integrated and globally competitive sector, rather than a hodgepodge of local markets competing for subsidies.

**Fourth**, this is clearly the time to rethink our trade diversification strategy. Canada's approach over the last decade of signing lots of free trade agreements, and everywhere, has been largely ineffectual. The much-hyped Indo-Pacific trade strategy is in tatters with Canada at political loggerheads with both China and India. What is needed is a targeted diversification approach focussed on countries like Japan and South Korea in Asia, and Germany and others in the EU, that are equally unsettled by American and Chinese economic nationalism and where our economies are complementary. Somewhat paradoxically, we also need a full court press to protect our current trade access to the U.S. with the 2026 renewal of the USMCA looming, particularly in the event of Republican controlled Congress. Here the integration of our two economies is both the risk and our leverage.

And **fifth**, Canada is a laggard in defence spending, falling well short of our commitments to NATO and NORAD and lacking the capability to ensure Arctic security and sovereignty. This is well known in Washington and European capitals and, given the degree of global insecurity, it reduces our leverage on other issues including protectionist measures and exclusionary industrial policies. Becoming a valued security partner to the U.S. and NATO and spending the money and political capital to do so -- should be considered as a strategic response to today's neonationalism pressures. Indeed, in the event of a Trump 2.0 presidency, it would likely be linked to USMCA renewal and border fluidity.

Looking ahead, the resurgence of economic nationalism is unlikely to dissipate any time soon. The 2024 Presidential election is shaping up to be one of the most bitter and divisive in US history. China, which is more and more under the absolute control of President Xi, is doubling down on nationalism and geopolitical confrontation with the West. The EU and member states have to come to grips with the nature of their relations with China and how they respond to American industrial policy while the Russian invasion of Ukraine continues next door.

## ▶▶ A Public Policy Hippocratic Oath

Governments in countries like Canada should follow the Hippocratic oath for policy makers to “do as little harm as possible” and focus on preparing for the future. Those preparations should include, in addition to improving Canada's competitiveness, strong and sustained support for open markets, global institutions and rules-based trade – they are in everyone's best interests in a hyper-connected world whether nations always realize it or not.



The Honourable **Kevin Lynch** served as the Vice Chairman of BMO Financial Group from 2010 to 2020. Prior to that, he was a distinguished former public servant with 33 years of service with the Government of Canada, serving as Clerk of the Privy Council, Secretary to the Cabinet, Deputy Minister of Finance, Deputy Minister of Industry, as well as Executive Director for Canada at the International Monetary Fund. Dr. Lynch is the past Chancellor of the University of King's College, the past Chair of the Board of Governors of the University of Waterloo, a Senior Fellow of Massey College, and a Trustee of the Killam Trusts. Since retiring from government, he has written more than 250 policy Op Ed's and articles and speaks frequently at conferences in Canada and abroad.

## ▶▶ Endnotes

- (1) Marvin Suesse, *The Nationalist Dilemma*, Cambridge University Press, 2023
- (2) Gary Hufbauer and Euijin Jung, “Scoring 50 years of US industrial policy: 1970-2020”, Peterson Institute for International Economics, 2021

*People who are passionate about public policy know that the Province of Saskatchewan has pioneered some of Canada's major policy innovations. The two distinguished public servants after whom the school is named, Albert W. Johnson and Thomas K. Shoyama, used their practical and theoretical knowledge to challenge existing policies and practices, as well as to explore new policies and organizational forms. Earning the label, “the Greatest Generation,” they and their colleagues became part of a group of modernizers who saw government as a positive catalyst of change in post-war Canada. They created a legacy of achievement in public administration and professionalism in public service that remains a continuing inspiration for public servants in Saskatchewan and across the country. The Johnson Shoyama Graduate School of Public Policy is proud to carry on the tradition by educating students interested in and devoted to advancing public value.*

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