POLICY Brief

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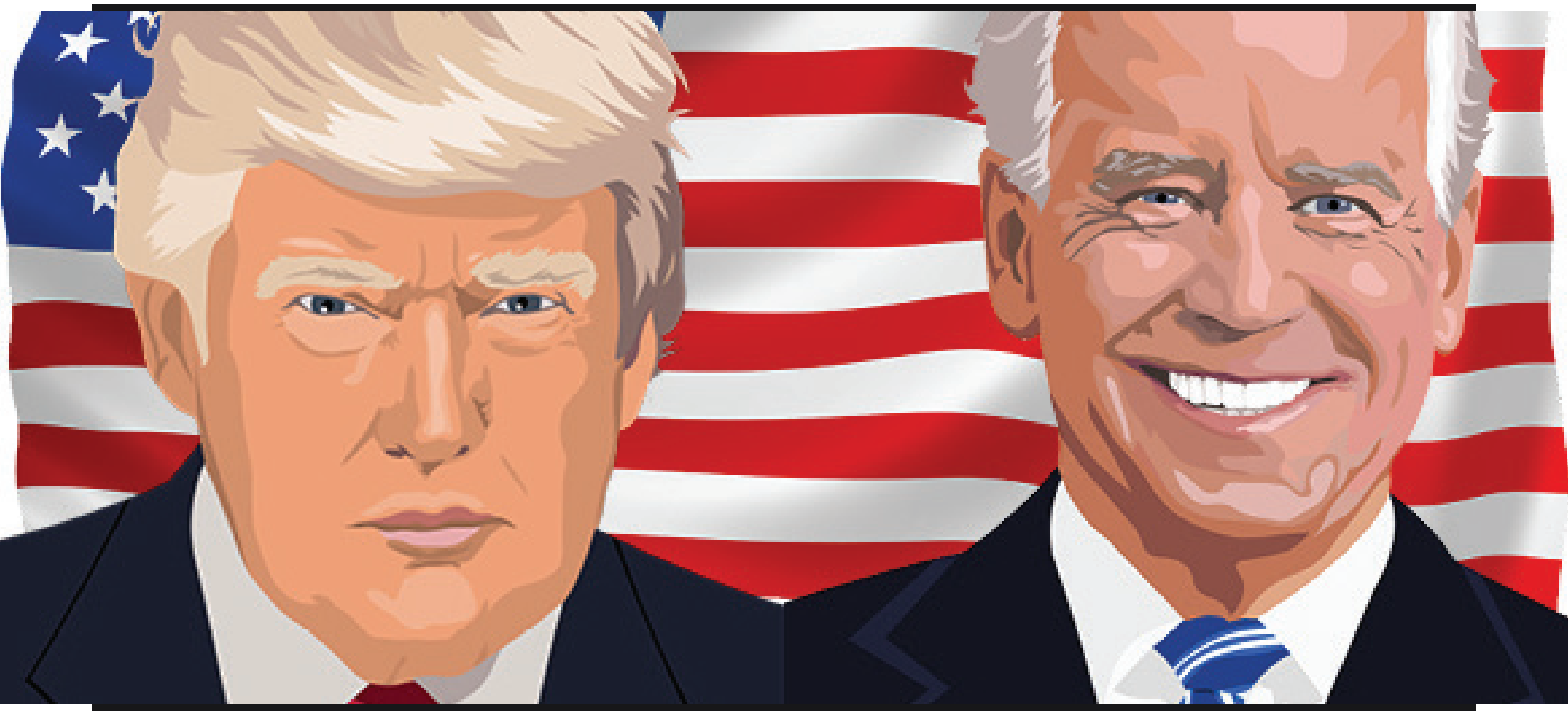

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Whether it's Trump or Biden, there will be no "Return to Normalcy"

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The United States is the midst of a profound paradigm shift, both economically and politically. Donald Trump is as much a consequence of that shift as its cause. With that shift, many Canadian assumptions about what it means to be dealing with a Democratic or a Republican Administration are coming apart at the seams. It may be comforting to think of the past four years as an aberration, but even a Biden presidency is unlikely to signal a return to the old normal.

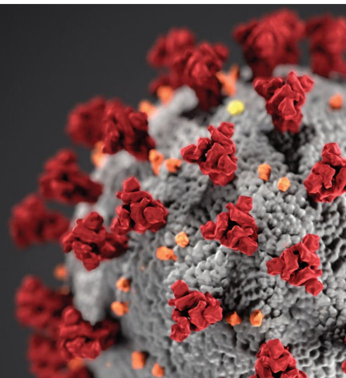
Consider economic policy: The economic damage of the coronavirus pandemic has upended the global economic system, and just as importantly, cast out 40 years of neoliberal orthodoxy that has dominated the industrialized world. COVID-19 has accelerated a process that was well underway before the pandemic hit, spreading beyond U.S.-China-EU trade negotiations and into the world's 50 largest economies. As much as many defenders of the old order lament this trend[1], it is as significant a shift as the dawn of the World Trade Organization (WTO) that ushered in the global trade era.

Economists, politicians, and leading pundits are often tempted to see new economic patterns through the prisms of the past; we are therefore likely to hear that we're back in an era of 19th-century mercantilism, or 1970s-style stagflation[2]. But that misses the moment—the motives are different, and so are the outcomes.

What we are experiencing is the realization by state planners of developed countries that new technologies enable a rapid ability to expand or initiate new and profitable production capacity closer to or inside their own markets. The cost savings in transport, packaging and security and benefits to regional neighbors and these countries' domestic workforces will increasingly compete with the price of goods produced through the current internationalized

COVID-19 SERIES: FROM CRISIS TO RECOVERY

This issue of *JSGS Policy Brief* is part of a series dedicated to exploring and providing evidence-based analysis, policy ideas, recommendations and research conclusions on the various dimensions of the pandemic, as it relates here in Canada and internationally.



trade system. U.S. national politicians from President Trump to Joe Biden are increasingly being joined by a growing chorus of European and Asian politicians who see the long-term domestic political benefit of supporting this transition.

Forget about the "new world order."[3] Offshoring and global supply chains are out, regional and local production is in. Market fundamentalism is passé, regulation is the norm. National security considerations supersede untrammeled foreign investment flows. Public health is now more valuable than just-in-time supply systems. Stockpiling, and industrial capacity suddenly make more sense, which may have future implications in the recently revived antitrust debate[4] in the US. Supply chain managers in industrial companies will be busy studying alternative sources that are more local. They may trade efficiency for robustness.

One of the biggest casualties of the current order is the breakdown of "Chimerica," the decades-old nexus between the US and Chinese economies, along with other leading countries' partnerships with Chinese manufacturing. That is likely to be accompanied by the rise of regional trade blocs—notably in Asia, the Americas and the European Union—as several countries increasingly come to recognize the inherent vulnerabilities associated with supply chains dispersed among too many far-flung parts around the globe.

The Rise of Economic Nationalism

The reinvigoration of the North American trade bloc via the USMCA is likely to represent the template, regardless of whether Trump or Biden is in office. Over the past 40 years, the kind of overt economic regionalization embodied in the new treaty, especially as it has pertained to domestic manufacturing capabilities, has generally been eschewed by the United States, at least until the ascension of Donald Trump to the White House. That is all changing. Economic nationalism, once considered part of a bygone era, is reviving. In part, this is a product of the fact that as global hegemon, the U.S. used to be able to dominate global institutions (such as the IMF or WTO) and shape them toward American national interests. But when necessary, national security considerations have intervened.

Consider Sematech, a government-industry consortium created in the 1980s to successfully revitalize the American semiconductor industry, after the Pentagon deemed this to be a strategically key industry that should not leave the US exposed to the vagaries of foreign manufacturers. The Sematech consortium has represented a great success in national industrial planning, as it enabled the United States to re-establish its global dominance in high end semiconductor production and design. That kind of partnership between the state and the private sector is likely to manifest itself more in the future.

Today, formulating a sensible economic nationalist response also entails examining why American companies went offshore in the first place, and under what different conditions would they have stayed, or are likely to return. Research and development tax credits on their own are unlikely to induce the requisite shift (as these can easily be matched by the recipient investment country's government). The state can and must drive this redomiciling process in other ways: via local content requirements (LCRs), tariffs, quotas and/or government procurement local sourcing requirements. And with a $750bn plus budget, the US military will likely play a role here, as it ponders disruptions from overseas supply sources.

National security considerations in the semiconductor industry have again revived in the wake of the Trump administration's growing dispute with Chinese 5G telecommunications equipment maker Huawei. As in other parts of the world, the U.S. government is working to limit the Chinese telecoms equipment manufacturer's international access to global markets. The Commerce Department has now mandated that all semiconductor chip manufacturers using U.S. equipment, IP, or design software will require a license before shipping to Huawei. This decision has forced the world's biggest chipmaker—Taiwan Semiconductor Manufacturing Company (TSMC)—to stop taking fresh orders from Huawei, as it uses U.S. equipment in its own manufacturing processes. Clearly, this will have implications for Canada as well, given how the high-profile case against Meng Wanzhou,[5] daughter of Huawei's CEO, has inextricably drawn Ottawa into this dispute.

These efforts are being mirrored at the legislative level. The U.S. Congress is taking concrete steps to bring semiconductor manufacturing back home, with the introduction of Senator Tom Cotton's new bill focusing on domestic production of semiconductors, titled the "American Foundries Act of 2020." It proposes spending up to $25 billion in three major categories: $15b for commercial microelectronics manufacturing, $5b for defense microelectronics grants, and a final $5b of R&D spending to secure U.S. leadership in microelectronics.

While not huge, the bill is notably bipartisan in scope: Cotton's proposed legislation has received significant bipartisan backing as evidenced by the co-sponsorship of Senators Chuck Schumer (D), Marco Rubio (R), Josh Hawley (R), Jack Reed (D), James Risch (R), Kirstin Gillibrand (D), Susan Collins (R), and Angus King (I).

Civilian or military-led, there is a cascade of new production in the United States—not the familiar announcements of new data centers, warehousing and logistics centers, but rather the production of high-tech goods and essential restoration of hard infrastructure that one might expect of a more self-reliant economy. These trends will continue regardless of who is in the White House.

Consider that Democratic Presidential nominee, Joe Biden has likewise unveiled a "Buy American" economic recovery plan,[6] calling for the U.S. government to spend $400 billion on American products and services to increase demand and $300 billion on research and development for new technologies. The proposal also calls for tighter enforcement of existing "made in America laws" to make it more difficult for companies to exploit loopholes.

The same policy attitude is now visible with regard to pharmaceuticals (as it is in other parts of the world, to the likely detriment of China and India). Senator Elizabeth Warren's introduction in July of her sweeping Pharmaceutical Supply Chain Defense and Enhancement Act demonstrates that the U.S. power establishment is beginning to reach a consensus on this issue—this is no longer the sole province of Trump's "America First" movement. "To defeat the current COVID-19 crisis and better equip the United States against future pandemics, we must boost our country's manufacturing capacity," Warren said[7], recasting the consequences of decades of policy to offshore American economic production as an "overreliance on foreign countries." Warren's warnings take on new force in light of Beijing's threat to restrict American access to medical supplies[8] in retaliation for intensifying U.S. regulations on Huawei.

Naturally, if the U.S. does this, it will reinforce the actions already undertaken in other parts of the world, which in turn will accelerate regionalization trends in trade. What is more striking in the US context is that this reassessment of the benefits of globalization is running in parallel with reconsideration of global institutions that have fostered and facilitated this drive in the first instance, institutions that the US played a major role in creating in the aftermath of World War II. The latest example is GOP Senator Josh Hawley's call for the abolition of the World Trade Organization, in recent a NY Times Op-ed[9].

It may not be necessary for the American government to go that far: Within the overall WTO treaty are the Trade-Related Investment Measures, or TRIMs for short. These must be abrogated if countries are serious about re-establishing domestic manufacturing capability. They are regulations that explicitly prohibit local content requirements, prioritization of domestic firms for public works procurement, foreign exchange restrictions (which are particularly important for emerging economies now totally reliant on dollar funding access by the U.S. Federal Reserve), and export restrictions.

But here's the key point: TRIMs are annexes[10] to the main WTO accord. Consequently, they can be abrogated without stepping outside the bounds of the main agreement itself, which means that eliminating them does not necessarily presage a return to some kind unregulated law of the jungle with respect to global trade. During the current pandemic, virtually all of these provisions, especially the export restrictions, have been routinely broken[11], as every nation has scrambled for vitally needed medical supplies. Yet the world's global trading system has not collapsed into a total free-for-all.

There is no reason to expect these trends to be abrogated, regardless of who occupies the White House next January. Expect to see fiscal packages heavily biased toward American companies. Either potential president will likely invoke national security exemptions in order to evade any restrictions within the existing WTO rules, much as Trump and other US presidents, such as Ronald Reagan, have done in the past pursuant to authority provided in Section 232 of the Trade Expansion Act of 1962.[12]

Likewise, future trade agreements are likely to diverge from classic free trade principles, toward managed forms of trade that emphasize domestic content rules. Part of the rationale is to ensure that adequate redundancy and resiliency are built into our economies (providing supply cushions to prevent inflationary supply shocks), even at the cost of "just in time" inventory accumulation practices (which have prioritized short term profitability at a cost of the kinds of supply shocks we are experiencing today). Trade, after all, is also a distributional issue, and one of the future goals of either Administration must be, to paraphrase former Treasury Secretary Lawrence Summers[13], to ensure that the overall economy works more for the benefit of "Detroit Man", and not exclusively for "Davos Man".

The re-establishment of stricter domestic content rules has already been expressed institutionally via the newly reconfigured United States-Mexico-Canada trade agreement (USMCA). Country of origin rules now specify that automobiles must have 75 percent of their components manufactured in Mexico, the US, or Canada to qualify for zero tariffs (up from 62.5 percent under NAFTA). That will likely be expanded to other areas and might require US or Canadian multinational firms to operate in foreign markets through local subsidiaries with local content preferences and local workforces. That is how it worked in the 1920s—Ford UK was a mostly local British company different from Ford USA but with shared profits. That may seem strange given recent practices, but it is not historically anomalous: during much of the post-1945 world, America emphasized free trade mostly in raw materials, but not finished goods. The US only adopted one-way "free trade" with its Asian and European allies later as a Cold War measure to accelerate their development and keep them firmly secured within the American orbit.

More localized production is also consistent with the Democrats' increased focus on a "Green New Deal", as it would also cut the cost of transport and contribute to the reduction in greenhouse gas emissions. Decentralized manufacturing would allow countries to secure critical supplies during crises such as an epidemic or a war.

Ironically, it is in foreign, not domestic, policy where the biggest differences between Trump and Biden manifest themselves. President Trump's foreign policies have been viewed as erratic and unpredictable by his foreign counterpoints, largely because he does not instinctively embrace the Atlanticism of his predecessors. Indeed, with his recent nomination of Colonel Douglas Macgregor as ambassador to Germany, Trump is implicitly questioning the future of cold war institutions, such as NATO. Macgregor himself has called NATO a "zombie"[14] and has long been a critic of the militarization of US foreign policy, while also calling for long needed cuts in the US defense expenditures. While President Trump himself has not gone that far, he has certainly proven himself to be less instinctively inclined to follow the historic patterns of US foreign policy dictates, especially in regard to his erstwhile NATO partners. It is also the case that in transforming itself into a global policeman, and a reckless one at that, NATO has contributed to the geopolitical disasters of Iraq, Libya and Syria, as well as hampering efforts by Trump to make peace with North Korea and come to a *modus vivendi* with Russia.

By contrast, while there has been considerable pushback to economic neoliberalism within the Democratic Party in recent years, thanks mainly to the candidacies of figures such as Bernie Sanders and Elizabeth Warren, along with the increasing popularity of economists like Stephanie Kelton,[15] the same cannot be said for its foreign policy. Democratic presidential nominee Joe Biden has evinced an openness to being "pushed left" on his social and economic plan, but on external affairs, he still mainly operates within the standard Washington foreign policy playbook. As the historian

David Sessions recently tweeted: "Basically nobody in liberal circles is taking seriously the consequences of the fact that the exiled cadre of the Republican Party are building a massive power base in the Democratic Party."

As American Conservative editor Kelley Beaucar Vlahos recently noted,[16] "Democratic interventionists and Blob careerists now [sit] at the right hand of [Biden]… like [Antony] Blinken, Nicholas Burns, Susan Rice, Samantha Power, and Michele Flournoy,[17] who has been touted as a possible Secretary of Defense. They would sooner drag the country back into Syria, as well as position aggressively against China if the military pushed hard enough, and there was a humanitarian reason to justify it." Nowhere in Biden's foreign policy ambit do we find mainstream figures warning about the dangers of a new cold war with Russia or the broader problems posed by America's overall propensity toward militarism. He ignores the fact that Trump's shattering of many existing shibboleths in foreign policy was one of the factors that helped get him elected in the first place.[18] These policies should be separated from the toxicity of Trump himself.

In that sense, a Biden presidency might represent a change in degree, but the magnitude of the economic challenges at home might ultimately entail a change of emphasis on priorities, even under a new Democratic regime. Trade issues, especially when concerning China, are increasingly being linked to national security issues by both parties, along with the exigencies of the coronavirus pandemic. Thus, both parties may ultimately decide to build on Trump's attempts to bring key supply chains back to the United States in order to ensure that strategic industries remain on home shores, even if this conflicts with the principles of free trade and non-interventionist government. In either case, a return to the old normal does not appear to be on the cards and America's historic allies such as Canada should recalibrate their calculations accordingly, no matter who occupies the White House next year.

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