

# A Deep Look at the Dark Side of the Trump Trade Doctrine

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*"Donald Trump has pledged to renegotiate every one of these bad trade deals according to the principles of the Trump Trade Doctrine, i.e., any deal must increase the GDP growth rate, decrease the trade deficit, and strengthen the U.S. manufacturing base." <sup>1</sup>*

After listening to President-elect Trump's campaign rhetoric and reading this quote from a recent position piece written by senior advisors on his transition team, it is hard not to come to the conclusion that the Trump Trade Doctrine is the beginning of an attack on globalization and free trade. If that is the case, the implications are quite wide-ranging. Globalization is partly responsible for high corporate profit margins in the U.S.; it has depressed inflation through competition; and, it has lifted hundreds of millions of people out of poverty in developing countries.

Most investors have focused on the economic and financial implications of the Trump administration's agenda for domestic tax cuts, choosing to ignore the protectionist tendencies in his trade policy or believing that the Republican-dominated Congress will not support such measures. Some may take reassurance from Trump's more conciliatory public appearances—a contrast to his pre-election rhetoric. Others may believe that the administration's main preoccupation will be enforcing existing agreements rather than replacing them with new, protectionist trade policies. The evidence suggests otherwise. The risk is that the market is underestimating what has so far been an unwavering protectionist stance on how the United States should approach trade with other countries, and especially with China. It is the key risk factor that could end the bull market in equities underway since 2008.

The Trump Trade Doctrine was described in a 31-page document, "Scoring the Trump Economic Plan," written in September by two of the president-elect's advisers. One of the authors is the current nominee for Secretary of Commerce, Wilbur Ross, a well-known global private equity investor. The other author is Peter Navarro, a business professor at the University of California-Irvine and a recognized hawk on trade relations with China. Navarro was recently appointed by Trump to lead the newly formed White House National Trade Council. The latter's purpose, among other things, is to advise the President on trade negotiations.

The document provides a helpful framework for contextualizing the president-elect's flurry of often confusing, hair-trigger Twitter tweets. What is clear from this essay is that the overall Trump economic plan—at least as outlined by these two advisers—is beholden to no particular economic ideology. Most investors have focused on the new administration's supply-side tendencies, as reflected in its proposals for corporate and middle class tax cuts and deregulation. At the other end of the spectrum, the use of social media as a bully pulpit to shame companies into refraining from outsourcing or leaving the country is the kind of industrial policy usually associated with banana republics.

Nor is there any particular trade theory or economic philosophy implicit or explicit in the Trump Trade Doctrine. Instead, there are a number of principles—some eye-popping—which appear to guide the president-elect's approach to trade policy:

1. Trade friend or foe? The Trump Trade Doctrine takes the line that a country is a trade foe if it runs a trade surplus with the U.S. and a trade friend if it runs a bilateral trade deficit. The embedded principle is that bilateral trade between the U.S. and another country should be roughly in balance over long periods of time if the trade agreement has been negotiated properly (page 15, "Scoring the Trump Economic Plan"). If it is not, the agreement is a bad trade deal, or the other country is a cheater and is stealing jobs from America, according to the doctrine. By this standard, China, Mexico, and Germany are all trade foes.
2. Defining the impact of currency manipulation. Managed or manipulated currencies are flagged by the

Trump Trade Doctrine as one of the big factors in the failure to achieve better trade balance. Dismissive of what they call "textbook promises of the gains from trade," Ross and Navarro quickly zero in on China's pegged currency as the prime example of currency manipulation. They argue that the dollar should weaken and the yuan strengthen because the U.S. runs a trade deficit with China. The authors go on to the EU Economic and Monetary Union as another case in point. Germany's large trade surplus with the U.S. is unfair, even though the euro freely floats, because the Germans benefit from a currency that is more reflective of Europe's weaker members.

3. The wealth of nations. Mercantilism runs deep throughout the Trump Trade Doctrine, in both directions. The document chastises China for engaging in massive dumping of select industrial products below cost. At the same time, the doctrine views manufacturing jobs as superior to service sector jobs in providing higher wages and downstream industrial multiplier effects. Noting the portion of manufacturing jobs in Germany and Japan, the new administration wants to focus on bringing manufacturing jobs back to the U.S., listing as priorities sectors like aerospace, biomedical equipment, chemicals, computer chips, electronics, engines, motor vehicles, pharmaceuticals, railroad rolling stock, robotics, 3-D printing, resins, ship building, and more. Its focus on trade policy in achieving this outcome will be to insure against unfair trade practices like undervalued currencies and the availability of illegal export subsidies.
4. Leveling the playing field through tax relief. A key principle of the Trump Trade Doctrine is the conviction that the World Trade Organization (WTO) treats the U.S. income tax system unfairly. The U.S. is one of the few countries in the WTO without a value-added tax or VAT system. The doctrine adopts the stance that the absence of a U.S. VAT system effectively creates backdoor tariffs that block American exports and promotes indirect subsidies that encourage foreign penetration of U.S. markets. Foreign exports into the U.S. market get a VAT rebate relief. Yet U.S. exports into foreign markets must pay the VAT and those exporters receive no relief on any U.S. income taxes paid. This taxation inequality is unfair according to the doctrine.
5. Calling out the usual suspects. Lastly, the Trump Trade Doctrine does not mince words in calling out a global trading order riddled with trade cheaters, singling out China as the worst trade cheater in the world. The doctrine accepts that ending the cheating means that import prices likely will be higher than if no disciplinary action is taken. But, this implied loss of real purchasing power will be more than offset by the employment and real income gains for those sectors which stand to gain from import substitution.

## A Doctrine with More Questions Than Answers

These "principles" beg some obvious questions. Are there no reasons for a sustained trade imbalance other than unfair trade practices? What should the trade balance be between two economies with a fair bilateral trade treaty but with dramatically different domestic savings rates? What consideration is there in the Trump Trade Doctrine for the U.S. dollar's role as the de-facto global reserve currency? The Chinese currency is still nearly 20% higher against the dollar than it was 10 years ago. How is it that China finds itself selling reserves to contain downward market pressure on the renminbi despite a trade surplus? Beyond these hypothetical questions are questions of a more practical nature. Where are the trade schools and training programs that the U.S. will need to support a workforce capable of providing the skills required by the manufacturing industries that the administration wants to reinvigorate? How will the administration factor in the rapid pace of technological change in discerning the impact of trade policy on job creation in manufacturing? How does a VAT in any country discriminate against the U.S. as long as it applies to both domestic goods as well as foreign-sourced goods from all countries? At the same time, different U.S. states impose varying sales taxes, which is not much different from the VAT differentials that exist across members of the WTO.

These questions are moot. The important point is that the new administration is already moving forward to implement policies designed to address the principles of the Trump Trade Doctrine.

- ▣ It is very clear from the calculus contained in the Ross-Navarro paper that funds raised from trade reform are expected to provide a significant portion of the funding for the proposed U.S. tax cuts.
- ▣ In addition, the new administration wants to expand the mandate of the Secretary of Commerce to include functions currently administered by the office of the U.S. Trade Representative. The obvious goal is more direct influence on trade policy. The newly formed White House National Trade Council is another step in this direction.
- ▣ Similarly, soon-to-be Chief of Staff Reince Priebus has given the nod to one of the fiscal ideas floated by

the Ryan-Brady plan of a border-adjusted corporate tax. Positioned as an adjustment in border tax, it amounts to a tax on imports. How currencies react and/or other countries would respond does not take much imagination. The tendency would be for foreign currencies to fall by the amount of the import tax, implying no gain to the U.S. from import substitution. But a stronger dollar would make U.S. exports less competitive. Alternatively, countries could respond with offsetting import taxes of their own, provoking a global trade war.

At the heart of the doctrine, there is a seething belligerence toward China. How the administration resolves trade issues with China may be more important than the issues themselves. In many ways, the structure of the world economy hangs on the unique relationship forged between America and China—the world's two most important economies. There is a lot to lose for everyone if trade policy becomes reactionary.

Looking at the net impact of these proposals, the border tax and negotiations with China on trade could be as defining a series of developments for this administration as any domestic tax cuts. So far, the market has only focused on the latter. However, the former could easily trigger a trade war. And, history has shown that protectionism is the stuff that kills bull markets.

<sup>1</sup>*Scoring the Trump Economic Plan: Trade, Regulatory, & Energy Policy Impacts*, Peter Navarro and Wilbur Ross, [www.donaldjtrump.com](http://www.donaldjtrump.com), September 29, 2016

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