Explaining the Triumph of Trump’s Economic Recklessness

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The Trump administration’s economic policy is a strange cocktail: one part populist trade protectionism and industrial interventionism; one part classic Republican tax cuts skewed to the rich and industry-friendly deregulation; and one part Keynesian fiscal and monetary stimulus. But it's the Keynesian part that delivers the kick.

PARIS – Since he was elected US president, Donald Trump has done almost everything standard economic wisdom regards as heresy. He has erected trade barriers and stoked uncertainty with threats of further tariffs. He has blackmailed private businesses. He has eased prudential standards for banks. He has time and again attacked the Federal Reserve for policy not to his liking. He increased the budget deficit even as the economy was nearing full capacity. On a policymaker’s Don’t Do list, Trump ticks many more boxes than any other post-war US president.

And yet the US economy's longest expansion on record continues. Inflation is low and stable. Unemployment is at a 50-year trough. The unemployment rate for African-Americans is the lowest ever recorded. People who had left the labor market are returning and finding jobs. And wages at the bottom of the distribution are now rising at 4% per year, notably faster than average. On a voter's economic wish list, Trump ticks more boxes than most of his predecessors.

The political question everybody is speculating about is whether this economic performance will win Trump a second term. But the equally important (and related) economic question is whether it will teach governments worldwide that reckless initiatives beat analysis-based economic policies. If it does, expertise will be ridiculed and international policy institutions will lose whatever credibility they still have. Independent central banks may well become chapels of a forgotten cult. Populists of all guises will feel emboldened.

Some, like Joseph E. Stiglitz, regard Trump's achievements as an illusion. It is true that the picture is not entirely rosy. If anything, the trade deficit has increased. Distressed areas have not recovered. Inequality is still appalling. But this is no reason to overlook the positives. Assessment, rather than denial, is needed to shed light on what is happening.

The Trump administration's economic policy is a strange cocktail: one part populist trade protectionism and industrial interventionism; one part classic Republican tax cuts skewed to the rich and industry-friendly deregulation; and one part Keynesian fiscal and monetary stimulus. The question that must be addressed is what in the economic outcomes can be attributed to each of these ingredients.

Trump's populist agenda is very much geared toward America's industrial heartland. Trade protection is supposed to make US manufacturing competitive again, at least on the domestic market, while companies are being instructed to invest at home rather than abroad. Yet the share of manufacturing in GDP is still two percentage points below its level prior to the 2008 financial crisis, and 900,000 manufacturing jobs have been lost.

True, Trump continues pushing. The US-China "phase one" trade agreement commits the Chinese to a near-doubling of imports of US manufactured goods by 2021. But, as Chad Bown of the Peterson Institute for International Economics has pointed out, the target is unrealistic. And there is no evidence of a Trump-engineered industrial revival.

The main aim of the Trump administration's tax policy is to spur growth by cutting the statutory corporate rate from 35% to 21%, while broadening the tax base. It is complemented by what Trump describes as the most ambitious deregulation campaign in history, but, by his own admission, anti-red-tape measures started kicking in only recently, so they cannot account for the economic results.

In a careful collaborative analysis, Harvard's Robert J. Barro, a Republican-inclined economist, and Jason Furman, also of Harvard and a chair of President Barack Obama's Council of Economic Advisers, provide a numerical assessment of the impact of the corporate tax reform. Their conclusion is that lowering the cost of capital is a long-run positive, but that its immediate impact on GDP growth is less than 0.15 percentage point per year: a minor contribution to current economic performance. At any rate, relatively weak investment growth suggests that lower corporate taxes are not driving the expansion.

What we are left with, then, is the Keynesian explanation: fiscal and monetary support are the main factors behind the length and the strength of the expansion. On the fiscal side, the combination of tax cuts and spending increases may have boosted GDP some 2% since 2017. On the monetary side, the Fed changed course in 2019 and reversed some of the interest-rate hikes it had put in place earlier to stem inflationary risks. Finally, multiple increases in state and local minimum wages have brought the effective minimum wage to some $12 per hour (66% higher than the federal minimum, unchanged under Trump), lifting low incomes and making the late expansion more inclusive.

So, the main reason for persistent growth and record employment in the United States is neither trade policy and industrial interventions, nor corporate tax cuts and deregulation, but rather demand stimulus. There was nothing certain about this result. In its summer 2017 assessment of the US, the International Monetary Fund estimated that the economy was close to full employment, supported monetary tightening, and warned against rising public debt.

Whatever the motivation, to stimulate an economy in which unemployment was already below 5% was an experiment. It presupposed trust in the benefits of a "high-pressure economy" where tight labor markets attract people left behind and help create new capacity. It supposed a certain indifference to fiscal deficits. And it required risk-taking on the part of the Fed, which was accused of bowing to political pressure but actually fulfilled its mandate by testing the limits of the expansion. The experiment has worked – at least so far.

Overall, the lesson from Trump's apparent economic success is not that recklessness and economic nationalism should guide policies. It is that in a low-inflation, low-interest-rate environment, the room for expansionary policies is larger than usually thought; that such an environment calls for bold policymaking, rather than the usual coyness; and that policy can spur economic inclusiveness.

Of course, voters' ability to assign causes to outcomes is limited. So, unfortunately, this may not be the lesson they will learn.