Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

By: Michael Spence

The long-term effects of Trump's policies will be only partly reversible

To call the current global economic environment "uncertain" grossly understates the confusion that has taken hold in recent months, and especially since US President Donald Trump introduced his "Liberation Day" tariffs in early April.

He paused them almost immediately, after capital markets – especially US bond markets – were thrown into turmoil.

But no one, except perhaps some administration insiders, knows whether Trump will reactivate the tariffs – suspended for 90 days as affected countries attempt to negotiate new bilateral trade agreements with the United States – sometime this summer, or replace them with a series of negotiated arrangements with trading partners.

Nonetheless, we can predict some of the effects Trump's policies will have on the US and global economies.

Short-term consequences

Some short-term consequences are already unavoidable. Some areas of the US will face shortages of imported goods, especially from Asian countries. More broadly, aggregate demand is likely to be depressed, as virtually every economic actor – including firms, investors, and households – takes a "wait-and-see" approach to investment and consumption.

Welcome as it is, the China-US agreement to suspend prohibitive tariffs for 90 days does not fully resolve the uncertainty.

But Trump's tariffs do not necessarily spell immediate disaster for the US. After all, the US economy is not particularly exposed to trade: including services, imports amount to only about 14% of GDP, and exports slightly over 11%.

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Moreover, the Trump administration's deregulation agenda, if pursued effectively, could spur growth by unlocking a wave of domestic investment in a wide range of sectors, as well as infrastructure.

The rest of the world, too, might be able to avoid the worst effects of Trump's tariffs in the short term. At 25% of global GDP, America's economy is large enough to cause widespread disruptions, with some countries and regions more vulnerable than others.

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The International Monetary Fund echoes this assessment, predicting that Trump's tariffs will have the largest impact on growth in the US (-0.9%), followed by Canada and China (-0.6%), then Japan (-0.5%).

The IMF also predicts a 0.5% loss for the United Kingdom, but this does not account for the newly announced US-UK framework trade agreement. Finally, continental Europe's major economies are expected to face losses of 0.3% or less. Not ideal, but not fatal.

The longer-term effects

The longer-term effects of Trump's tariff policy are probably larger – and more predictable. Whatever its flaws, the US was regarded for decades as a reliable global actor, whether in trade and finance or foreign policy and security. No more.

With political leaders, policymakers, and businesses now convinced that the US cannot be counted on, they are updating their strategies for resilience and security.

Europe is already increasing its defense spending sharply in response to the Trump administration's evident indifference to the security of long-standing US allies.

Many economies will also diversify trade away from the US. For example, as Canada negotiates revisions to the US-Mexico-Canada Agreement – which Trump hailed as a great victory of his first presidency, but now wants to change – it will also move to broaden its trade and investment linkages, and reduce internal barriers to trade. Such diversification efforts will fundamentally alter the structure of the global economy.

The long-term stability of the US economy and financial system are also at risk, as the Trump administration weakens their institutional underpinnings.

These include a commitment to capital-account openness and to price and fiscal stability; a US Federal Reserve that is not subject to short-term political pressures; and a legal and regulatory system that applies rules and adjudicates disputes fairly for foreign and domestic actors alike.

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If this trend continues, foreign investment flows may be diverted away from the US – precisely the opposite of Trump's stated goal.

In yet another potential blow to America's long-term prospects, top scientific and technological talent might be motivated to go elsewhere, owing to the Trump administration's defunding of basic and applied research in science and technology as part of their tense relations with universities over what they perceive as left-wing bias.

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Global governance

Yet another area where the Trump administration's policies will have long-term effects is global governance. To be sure, multilateral institutions and frameworks were facing a much-needed revamp well before Trump came on the political scene.

But whereas Trump might be happy to scrap them altogether in favor of bilateral dealmaking, leaders of the other developed economies, as well as virtually all emerging economies, remain committed to a practical and adaptive version of multilateral engagement, at least in principle.

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This means that efforts to build a new, more complex multilateralism – which addresses sustainability, digital trade and trade in services, and the intersection between economic policy and national security – will continue, only with little input from the US.

Instead, the EU and the major emerging economies, especially China, will lead the way. Given Asian economies' dependence on trade with China, such co-sponsorship is essential to prevent the global trading system from fracturing into largely regional blocs.

America's prominent role in Asian security arrangements will complicate this process. But it will not prevent the multilateral system from evolving – or US influence from declining. This loss of influence will persist, even if the US later decides to return to the fold.

As the Trump administration sows confusion and uncertainty, it is understandable that short-term disruptions attract a lot of attention. But the longer-term effects of some of the Trump administration's policies are likely to be more significant and far-reaching – and they will probably be only partly reversible.

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