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Explaining Trumpism as a Structural US Problem: New Insights and Transatlantic Plus Global Economic Perspectives

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Summary

The 2016 US presidential election resulted in the populist Donald Trump becoming the 45th President of the United States. While many observers assume that this reflects a transitory phase of populism in the US, a closer analysis suggests that there will be a structural populist threat for the US, the West and the world economy. There is survey evidence that US voters consider the inequality which has emerged in the US over many years as unacceptable. At the same time the Lindh-McCall survey results show that the relative majority of US voters expect that big companies rather than government will correct this inequality. This is illusory and wishful thinking and will serve to create continued voter frustration for the lower half of households – this refers to the poorer half of US households – and populism could indeed expand on the basis of such frustration for many years to come. The main drivers of rising inequality in the US, namely ICT expansion, financial globalization and the rise of China's exports will continue in the medium term so that US voters' frustration is a structural problem that cannot easily be remedied and that has consequences for transatlantic and global economic relations as well as security policy implications. While the decline of the income share for the lower half of income earners in Western Europe has been rather modest in 1981-2015, the decline of that share in the US has been dramatic, namely from 20% to 13%. The EU is nevertheless threatened by US populism since its political representatives are trying to export their ideology and approach to Italy and other Western continental EU countries. In the UK, a subtle populism is already becoming more apparent under the heading of BREXIT. If the EU27 could defend the model of the Social Market Economy and export this system to Asia and Africa while joining political forces with ASEAN – and possibly China – to defend the multilateral economic order, European impulses could help to contain US populism.

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Prof. Welfens has testified before the US Senate, the German Parliament, the European Parliament, the IMF, the UN etc.

On BREXIT analysis see Welfens, An Accidental BREXIT (2017, presented at Georgetown University, Washington DC, on Sept. 12 and at University College London on Dec. 6, 2017; German edition: BREXIT aus Versehen, 2016, 65 K downloads in one year for English/German edition)

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EIIW Discussion Paper 253

Table of Contents

List of Figures

List of Tables

1. Introduction

The winning of the US presidential election by Donald Trump in 2016 marks a populist president reaching the political pinnacle in the world's leading economy and military power. Populist as defined in the present analysis means that the government (US Administration) implements rather radical policy measures, tries to undermine the constitution, is generally very opportunistic in terms of policy – and thus unreliable for foreign partners – and uses anti-immigration and nationalist rhetoric plus implements a protectionist trade policy and adopts an anti-multilateral foreign policy agenda aiming at weakening International Organizations. "New Nationalism" could be a summary heading for this populism to the extent that it reflects all the ingredients of the traditional European nationalism of the 1920s and the 1930s, but it also has a digital communication and destabilization agenda where the Internet is a crucial new element of this populist approach. Digital populism often pushes news/information which has no basis in reality but rather reflects and reinforces the prejudices already common amongst part of the less educated strata of society. Stories made up by leading government actors are used to undermine the confidence of society and of voters, respectively, into the constitution and the established leading parties and institutions.

Over the course of its history, the US has had several populist presidents and now with the election of Donald Trump has another such president. Naturally, the question arises of how Trump could win the election to begin with? In the subsequent analysis, a new answer is offered to this question. Moreover, arguments are presented that Trumpism – the type of populism which is key to Trump's election and subsequent presidency – represents a structural US policy problem with challenges for many years to come. This in turn must have considerable consequences in Europe, Asia and the world economy.

Among the many contributions to the analysis of the Trump Administration and Trump's victory of 2016, one may point to several interesting books:

- In "How Democracies Die", LEVITSKY/ZIBLATT (2018) show how unstable democracy in some Western countries – many Latin American, Asian and European countries - can be. The destruction of democracy often has its origins not in external forces or from within via a collapse of support for democracy amongst voters, rather democracy is usually attacked by government or the respective president him/herself who have often risen to power via the democratic system itself. A destruction of political institutions, the freedom of the press and populist policies which promise advantages for broad strata of voters is a typical element in most cases. The Trump Administration is considered as being on the brink of authoritarian behavior for which the authors have four indicators (pp. 65-67): "(1) Rejection of (or weak commitment to) democratic rules of the game. (2) Denial of the legitimacy of political opponents, (3) Toleration or encouragement of violence, (4) Readiness to curtail civil liberties of opponents, including media." A crucial element of authoritarian rule is also that the president tries to directly utilize federal authorities, for example the tax authorities or the secret service (CIA), in order to put pressure on political opponents – this destroys the neutrality of major institutions which in a system shaped by the rule of law should not be weaponized on behalf of the president of the day. In Turkey and Russia such problems exist– and now, under President Trump, it is partly also a reality in the US. The authors clearly argue that giving up political forbearance and respect for political opponents has been part of the weakening of the informal rules of the political system over many years; with President Trump accelerating the process that initially was started by the rather radical Tea Party movement within the Republican Party.

- Barry Eichengreen's study on "The Populist Temptation" (EICHENGREEN, 2018a) is an interesting contribution in which he looks at some historical episodes of populism in the US and highlights some of the key problems with Trumpism and US populism, respectively. He points out that globalization and technological progress do not come at zero cost, giving the example of President John F. Kennedy who having been authorized to cut import tariffs by 50% in 1962 (via the Trade Expansion Act) developed programs for the retraining of workers and job search assistance "and exceptional income support to workers displaced by foreign trade, enlisting the support of union leaders for the trade expansion bill". Eichengreen argues that many politicians of the early 21st century have not yet made this connection: "a failure of courage …or a simple failure of logic." One may add that investing in the training/retraining of unskilled workers might not have a lower social rate of return than the training/retraining of skilled workers as research for the Netherlands (FOUARGE/SCHILS/DE GRIP, 2013) shows. While unskilled workers have certain motivation problems to enroll in training/retraining programs, there are no good arguments to expect that only the training of skilled workers would bring considerable economic benefits. If economic globalization means that there is an acceleration of product innovation cycles, it is clear that there should be skilled worker retraining in firms facing global competition – many leading US and EU firms are indeed implementing such programs. Eichengreen also emphasizes the view of Trump in his Phoenix speech on immigration – during the 2016 presidential campaign – in which Trump as a presidential candidate argued that a high share of social policy benefits was flowing to immigrants who often exploited the system of social policy payments and thus that this should be a reason to fight against immigration as well as social policy expansion. This conjecture is not correct as analyses of US social policy have shown. The principle of populist propaganda is to relentlessly repeat fictitious claims about reality until a majority of the public accepts the propaganda conjectures as a new reality.
- POLLACK/SCHWEIKHART (2017) have argued that the traditional media – including newspapers and TV stations – underestimated the popularity of Donald Trump in the presidential campaign. Trump's strategy to present one key topic every month and his digital campaign as well as a high number of meetings with supporters in many cities nation-wide worked, while that of Hillary Clinton was not successful.

While it is true that Trump has obtained votes from all strata of the economy, it is also clear that his rival Hillary Clinton obtained a rather low share of votes among those with an income level of less than $30,000 (BBC, 2016): Obama had 63% support from this group compared with 35% of votes for Mitt Romney – Hillary Clinton achieved 53% support, Donald Trump 41%; 51% of voters with a high school diploma supported Donald Trump, while Hillary Clinton obtained 45% support. Voters with a high school diploma might have been concerned about the risk of declining income shares for the median household (or the lower 50% of the income pyramid) in the US.

If Trumpism is a transitory US phenomenon, then there is not much reason for the main international partners of the US – and indeed international organizations – to make broad policy adjustments or to develop new strategies. However, it will be argued subsequently that the long run increase in US inequality, in combination with particular US voters' views and the ongoing triple drivers of inequality, namely ICT expansion, globalization and China's strong export growth, amount to a structural Trumpism problem: A strong populist political force has emerged in the US for reasons that are not difficult to understand. There is no easy way to defeat this populism – although in the end, maybe after a decade or so, the majority of voters might have come to understand that US populism cannot deliver the results which they had been promised; Trump's politics are deeply contradictory in the sphere of economic policy sphere as well as in the field of climate policy; it ignores scientific advice on a broad scale and thus is itself in contradiction with US political traditions and the "higher common sense" (if one may refer to scientific analysis with this expression). The following section looks into a new explanation of Trumpism and the elements presented clearly imply that even if President Trump would lose the next election, Trumpism/US populism is not over. If, however, Trumpism is a structural challenge for Europe, Asia and other regions of the world economy, the adequate policy reactions look quite different than in the case of a Trumpism being a transitory phenomenon.

As regards economists' views on populism, a useful definition was formulated by the authors DORNBUSCH/EDWARDS (1991) in their paper "The Macroeconomics of Populism in Latin America": Populism means to focus on income redistribution, while de-emphasizing the risk to broad economic stability from large medium-term increases in real government spending, inflationary financing of government programs and policy interventions which override the adjustments of markets.

2. Inequality, US Survey Results and Economic Analysis: The Case for Structural Trumpism

Since the 1960s, more and more countries have opened up to international trade and trade barriers across countries have reduced due to the negotiations in the various rounds of World Trade Organization (WTO) discussions aimed at trade liberalization. The WTO is an important international organization and is intended to help avoid international trade conflicts; and to peacefully solve conflicts and help reducing tariffs plus other trade impediments worldwide. The WTO, together with the International Monetary Fund (IMF) and the Bank for International Settlements (BIS), stand for leading global international organizations. Trade globalization will bring about international economic convergence of per capita income – in line with the logic of the Heckscher-Ohlin theorem which is based on trade, the assumption of availability of the same technology in the home country and in the foreign country. This theorem says that countries will specialize according to comparative advantage so that countries relatively richly endowed with capital (including machinery and equipment, as is the case of the US or the EU) will mainly produce and export capital-intensive goods – say automobiles – while countries which are relatively richly endowed with labor (say Bangladesh) will produce and export goods which are labor intensive to produce, say textiles. The capital-labor ratio is a good indicator of a country's relative endowment with capital and labor, respectively. China opened up for trade in 1978 and it became a member country of the WTO only in 2001. The Heckscher-Ohlin approach is without international factor mobility, say the mobility of labor and capital for example. However, in reality, a high degree of international capital mobility has characterized the world economy (here, leaving out China) since the 1970s. Moreover, trade globalization is combined with other forces, such as foreign direct investment (FDI), the expansion of the global information & communication technologies (ICTs) or international migration. Rising trade and capital flows have raised average per capita income worldwide, at the same time in many countries per capita income dispersion has increased. There could be more downward movements towards poverty than there has been upward mobility from lower strata or there could be high levels of immigration of rather poor people. In the era of modern globalization there has been both trade liberalization and outward foreign direct investment from most OECD countries as well as inward foreign direct investment flows. Inward FDI typically brings an international technology transfer which raises labor and capital productivity in the respective host country.

In a nutshell, the main dynamics of rising inequality in the US and some other OECD countries can be summarized as follows: ICT/robotics reinforce the income share of capital, partly through the ability of many ICT-related products to be sold as differentiated products and also in the context of high digital innovation dynamics in combination with network effects – as emphasized by WELFENS (2002). To the extent that information & communication technology facilitates perfect – or broad – price differentiation in digital markets and related markets, the quantity will not differ from the standard competitive market model in which the intersection of the demand curve and the supply curve (marginal cost curve) determine the equilibrium point. However, the average price (p_1) is now above the competitive uniform price (p_0) and hence profits are higher (see graph in the Appendix 1). This clearly raises the profit rate in the respective sector and the overall share of profits in gross domestic product (the overall value of newly produced goods and services) – the mirror side is the fall of the wage income share. Moreover, digital markets are often characterized by economies of scale and network effects. Both phenomena are raising market power in the respective sector and therefore the mark-up rate on costs and hence, again, the profit rate will increase.

The digital expansion will continue for many years to come as will financial globalization; the latter until major countries will impose barriers to international capital flows. Financial globalization means lower real interest rates and this will benefit households with a decent labor income – read: skilled labor – and households who already possess considerable wealth and thus can offer banks the collateral which is often required to get large loans. Unskilled workers are the losers of these digital and financial globalization dynamics – and workers indeed have often been exploited by the anti-competitive bundling of loans and payment protection insurance sold by banks. The latter means unfair financial globalization and could simply be remedied via national or international competition policy that should impose unbundling requirements; but even in Germany such bundling continues all the time which is much in contrast to the United Kingdom where this was banned in 2011. Biased technological progress also plays a role in favor of skilled workers; in the labor markets of almost all countries the increasing use of ICT/ICT capital raises the relative demand for skilled labor. This aspect indeed is emphasized in the empirical findings auf JAUMOTTE ET AL. (2008).

Economic globalization, in the sense of trade globalization, contributes to the economic catching-up of the South and international economic convergence, but financial globalization is in favor of skilled workers and biased ICT-based technological progress raises the relative demand for skilled labor so that the ratio of wages of skilled workers to those of unskilled workers is raised in almost every country – as emphasized in JAUMOTTE ET AL. (2008). Through FDI globalization – and rising international portfolio investment – globalization also brings an effective reduction of capital income taxation as shown by FOELLMI/MARTINEZ (2017) for the case of Switzerland and most of the increase of the top 1% income earners was explained by individuals having foreign income sources. Income accruing from abroad is taxed at lower effective rates than domestic income sources and a risk premium on income from abroad could also play a role here.

A final key driver of rising wage inequality within industrialized countries, according to an OECD study, is China (see BREEMERSCH/DAMIJAN/KONINGS, 2017) whose strong export growth has been remarkable since about 1985. China's exports have contributed to wage polarization in the US and other industrialized countries – the middle income class is facing a new challenge as medium-paid jobs are eliminated by the export dynamics and the structural export pattern, respectively. China's exports have undermined the position of US firms in certain sectors and brought about an acceleration of US structural change (AUTOR/DORN/HANSON, 2016). The fact that China, as a big economy and major exporter in key sectors, brings about declining relative goods prices for those sectors where Chinese firms have started to export large quantities to the world economy, implies massive potential downward wage pressure in the respective OECD sectors. In Western EU countries with a broad human capital basis and broad retraining programs, firms facing import competition from China could resort to product innovation as a means to avoid declining market shares and export unit values; however, in the US – and in the UK – the retraining expenditures per person unemployed traditionally were low (Germany's figure is quadruple that of the UK and also much higher than in the US).

In Germany, wage dispersion did not increase much if one ignores the special aspect of German unification and new inequality – but higher per capita income – in East Germany (the former socialist German Democratic Republic. Germany strongly benefitted from China's economic expansion and the associated growth impulses in Asia which all resulted in higher exports of German machinery and equipment). Falling real minimum wages over time could also play a role for rising inequality in the US and the declining union density in the US is a phenomenon observed in 1980-2016 (EICHENGREEN, 2018a).

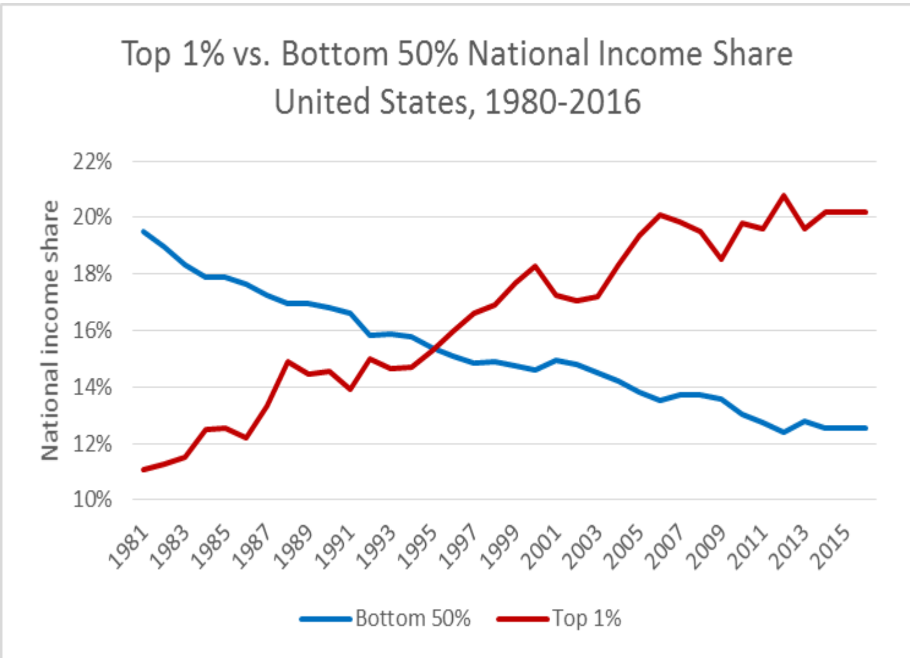
One should point out that the lower half of US income earners suffered a decline in national income share from 20% in 1981 to about 13% in 2015 (see Figure 1; for Western Europe, see Appendix 3) and the overlap of digitalization, relatively rising outward US foreign direct investment and growing global exports from China should all contribute to an ongoing medium trend of rising US inequality. In Western Europe, the share of the lower half of income earners in national income has not reduced much over the same period, only from about 22% to about 20% in 2015. These US inequality dynamics explain, together with findings from surveys in the US, the rise of populism in the US:

- The majority of US survey respondents hold the view that there is a problem with the rise of inequality (while they think that hard work is a basis for upward income mobility), but the preferred remedy of the relative majority is that large firms should bring about adequate changes here - see LINDH/McCALL (2018). It is also noteworthy that government intervention for reducing inequality has no majority support amongst US voters. The findings of LINDH/McCALL may be interpreted in a compact summary: This is an illusory view of the US public; in a shareholder economy of the US-type, one cannot expect that major stock market-quoted companies would somehow willingly reduce the remuneration of top managers or increase the salaries of unskilled workers considerably. Incidentally, it should be noted that US problems in parts of the tradables sector is related not to US imports from China in certain sectors but to China's rising exports to all importing countries and falling world market prices, respectively. Thus, if the Trump Administration imposes import tariffs on Chinese goods, this will not raise world market prices of the relevant goods considered, on the contrary it will reduce the world market price (net of import tariffs);
- the strong contradiction between seeing a rising inequality problem and the inability/ideological unwillingness of the US to extend income redistribution and social policies, respectively, is a guarantee for continued voter frustration on the part of the poor strata – in the short and longer term. Hence populist presidents who promise to improve the situation of the "forgotten men and women" (to use the words of Donald Trump in the presidential campaign of 2016) could become a rather long-term phenomenon in the US; along with broad import protectionism and anti-multilateralist policies, mostly to demonstrate to voters a level of international political activism and to have a scapegoat for populist policies which do not work;
- US populist policy leaders will try to export populism to Europe, Latin America and Asia. By pushing for bilateralism and populism in other countries, the Trump Administration will destabilize the world economy and contribute to new international conflicts as well as declining global prosperity. The US indeed could destabilize the EU and Trump's support for BREXIT during his campaign in 2016 was a first step in this direction (Trump's proposal for Nigel Farage, the head of the populist Anti-EU party UKIP, to be appointed the new UK ambassador to the US is one example of the strange new policy ideas from the populist US). Thus the US is likely to contribute to new security problems in other parts of the world.
- This populism problem of the US could continue until voters understand that the populist promises are vain; this problem of the inability of populism to deliver was also visible in the 1920s and 1930s in parts of Europe (even longer in autocratic Spain and Portugal; in Germany and Austria until the end of World War II). The initial expansion stage of populism is characterized by great promises and often religious or strong ideological (nationalistic/patriotic) elements, the second stage is one of partial implementation and anti-internationalism – or anti-globalism as explained on September 25, 2018, in Trump's speech before the UN; the final stage is one of growing internal contradictions and national or international conflicts. The inability of the Trump Administration to deliver a consistent trade policy is part and parcel of the populist radical beginning of Trump's presidency. As Donald Trump could replace only about three-quarters of the political appointees of his predecessor President Obama, the Trump Administration also suffers from a dangerous lack of competence in key fields. In the case of an international economic crisis, the IMF staff would likely not really know with whom they should cooperate in the Treasury – there are literally many positions which have not been

filled after the Obama presidency - and the inconsistent US trade policy under President Trump partly reflects a lack of several dozen economic experts in the Department of Commerce. It is interesting to read a paper from the Office of the US Trade Representative that looks into the welfare effects of US tariff policy and clearly finds that long run economic effects on the US are negative (KIM/SHIKHER, 2017). To some extent, Trump's Administration is reminiscent of Goethe's sorcerer's apprentice – the top expert is not at home and the apprentice tries to apply all kind of witchcraft incantations which he had observed previously, but as he does not understand the analytical basis of his interventions, what he only succeeds in doing is flooding the building: Until, finally, the Master Sorcerer comes home and puts everything back to order and the default modus returns (see the first lines of the poem in the Appendix 4).

- One cannot rule out that a future US Administration would decide to adopt more of an EU Social Market Economy system which – with income redistribution and social policies – is not a natural reform for the US entrenched in a traditional policy of limited government intervention and a rather restricted social policy; the latter might partly reflect the status of a globally leading immigration country where voters are afraid that overly generous social policies could attract too many immigrants. That the US might face a serious challenge is visible in the field of health insurance where the expenditures in the United States - relative to gross domestic product - are roughly twice as high as in Germany/France/the UK, while life expectancy is about 2.5 years lower in the US. Per capita consumption in Western EU countries, disregarding health care expenditures and taking into account the value of longer vacations in these countries (compared to the US), is roughly as high as in the US. The 20% transatlantic standard of living gap of the Western EU countries, as shown in the statistics, vanishes almost completely.

Figure 1: Top 1% vs. Bottom 50% National Income* Share, United States, 1980-2016

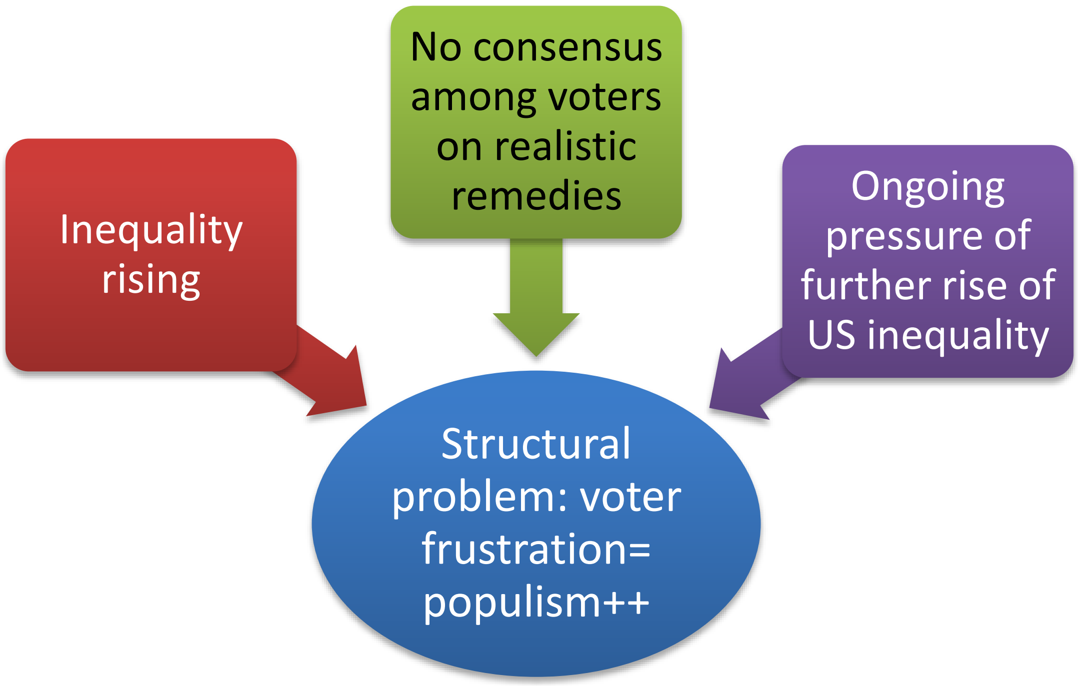


Source: Own representation based on data available from the World Inequality Database (market income), https://wid.world *Note: Share of national income refers to pre-tax incomes.

The increasing capital share in OECD countries and the rising skill wage premia in all countries stimulate South-North migration which, in turn, could reinforce xenophobic and populist policies in some countries, particularly if countries face a refugee wave. The political confusion of refugees and immigrants is part of declining political rationality in parts of the Western world. The rising potential inequality faced in many countries in the North and in the South could be reduced by adequate redistribution policy plus social policies, education policy and new retraining schemes that should include digital formats that are ubiquitous, efficient and based on the mobile Internet. Experience from the Netherlands shows that the retraining of unskilled workers does not have a lower rate of educational return than retraining of skilled workers, however, the motivation of unskilled workers seems to be generally weaker than that of skilled workers. International organizations should play a considerable role in helping to collect relevant data and organize benchmarking.

At the bottom line, the explanation for Trump's victory and expansion of Trumpism/populism in the US can thus be summarized rather easily (see Figure 2).

Figure 2: Structural Populism Problem in the US

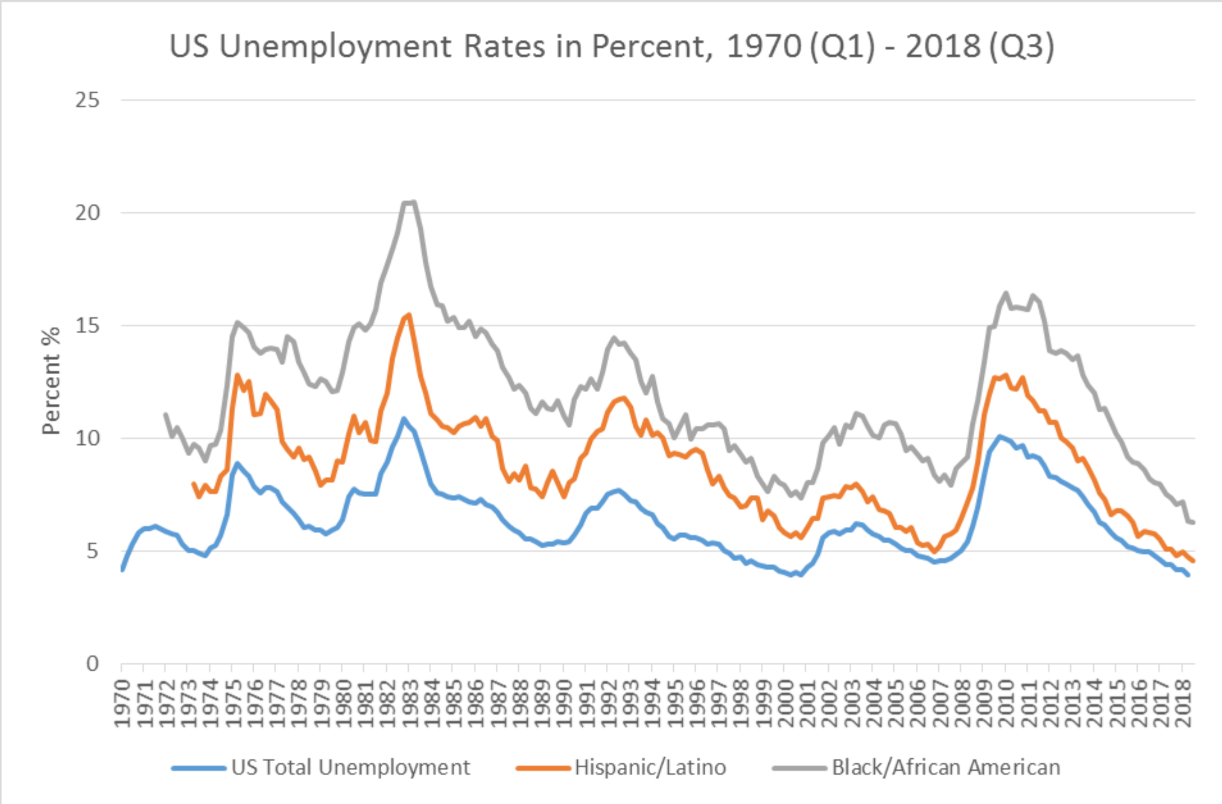


Source: Own representation

As long as voters' frustration about the contradiction of increased income inequality and no changes brought about in this field continue, populism will have an easy political game in the US.

As regards Trump's economic policy in 2016/17, one may expect that his tax reforms of 2016 (Tax Cuts and Jobs Act: TCJA) – with lower income tax rates and reduced corporate tax rates – will bring about higher economic growth for several years and not only reduced unemployment rates but indeed higher employment rates that bring the US back to the employment ratio before the banking crisis 2007-09 (BURDA, 2018): The US in summer 2018 still had below average capacity utilization (78 which leaves some room to the critical 85 level) and unemployment figures for all ethnic groups were at historical lows (see Fig. 4). Trump's mixture of demand-side stimulus and supply-side stimulus seems to have worked to some extent and new jobs were created both by big companies as well as by small and medium enterprises; annualized growth rates of real GDP in the second and third quarter were close to 4%, obviously stimulated by an expansionary fiscal policy, including higher military expenditures, higher consumption and higher investment. The latter seems to benefit from a higher level of patents and ICT capital investment growth which raises productivity. The high public debt-GDP ratio, however, could quickly become a problem as rising interest rates in 2018/19 will raise the debt burden of government (with rather short maturities of government bonds in the US compared to Germany and France).

Figure 3: US Unemployment Rates* (Total, Hispanic/Latino, Black/African American), 1970-2018



Source: Own representation based on data available from FRED (Federal Reserve Economic Data), St. Louis Federal Reserve, *Unemployment ratio, aged 15-64, quarterly and seasonally adjusted.

When one would ask the US Council of Economic Advisers about the main driver of higher US economic growth, the answer of Chairman Hassett – a tax expert – is that higher growth in 2018/19 in the US is mainly reflecting a lower capital cost (a 1% decline of capital cost raises investment by about 1%) and this in turn reflects corporate tax reforms; and US corporate tax reforms even have positive spillover effects to Europe. Chairman

Hassett explained his view in broad terms in August 2018 in a speech in Tokyo at the Japan Center for Economic Research (HASSETT, 2018):

"The evolution of recent forecast revisions is quite revealing, and consistent with the tax act having a large effect on growth expectations. If one looks, for example, at the Blue Chip consensus forecast for four-quarter real GDP growth in 2018 and 2019, it was roughly flat throughout most of 2017, as media coverage of the legislative prospects for the Administration's economic agenda was generally pessimistic. Consensus forecasts through November 2017 were therefore low—2.3 to 2.4 percent in 2018 and 2.1 percent in 2019.

Since November, however, we've seen steady upward revisions in private forecasts. As of last month, the Blue Chip consensus forecast is now for 2018 growth of 2.9 percent, and 2019 growth of 2.3 percent, upward revisions of 0.6 and 0.2 percentage point since the tax act was passed. Official forecasts revisions suggest an even bigger bump. In its last forecast before the tax bill was passed, the Congressional Budget Office projected growth of 2.0 and 1.5 percent in 2018 and 2019. That has now been revised up substantially—to 3.3 and 2.4 percent, respectively. In other words, the CBO now projects growth to be more than a percentage point higher, on average, over the next two years than they did a year ago. In addition, over the same timeframe, the CBO revised up its forecast of the effect of economic growth on projected corporate income tax receipts over the 2018-2027 period by $476 billion, which exceeds the CBO's own $409 billion static score of the TCJA...

In April, the International Monetary Fund released its April 2018 World Economic Outlook (WEO). Global growth for 2018 was revised up 0.2 percentage point from its October WEO release to 3.9 percent year-over-year. The IMF attributes roughly half of the global growth revision to changes in U.S. fiscal policy. When honing in on the United States, the IMF's April 2018 update to its October 2017 World Economic Outlook revised up its growth forecast by 0.6 percentage point from October to 2.9 percent year-over-year. According to the IMF, one reason for this upward revision is the macroeconomic effects stemming from the Tax Cuts and Jobs Act passed in December.

The IMF's April upwards revision to its October global growth forecast in the wake of the passage of the TCJA follows the OECD's own March upwards revision to its November global growth forecast. For the U.S., its 2018 outlook increased by 0.4 percentage point to 2.9 percent and its 2019 outlook increased by 0.7 percentage point to 2.8 percent. And the OECD's March Economic Outlook cited as one of the "key factors behind the upward revision to global growth prospects in 2018 and 2019" the "tax reductions . . . announced in the last three months."I note in passing that these revisions are almost exactly what our analysis from last year implied they would be once the bill passes.

As for global growth, CEA's own, very preliminary in-house analysis finds that exogenous tax changes in the world's largest economy may have surprisingly large effects on global growth, suggesting the recent rise in growth expectations around the world is more the result of fiscal developments in the United States than the other way around. Applying the Romer & Romer exogenous tax shock series to a global vector autoregressive model indicates that a 1 percent cut in U.S. taxes as a fraction of GDP raises growth in the European Union and Rest of the World by almost 1 percent in the year immediately following, with a peak impact of over 1 percent after 2 years. While wide error bands *suggest that we shouldn't attach much weight to these point estimates, the important result is that we can reject the null hypothesis of no effect with 95 percent confidence.*

Though the mechanisms relating exogenous U.S. tax changes to global growth remain an open and, I believe, fascinating question for our ongoing work, the magnitude of the effect strongly suggests they extend far beyond the arithmetic relationship implied by the U.S. share of global GDP. Our own intuition is that other countries often learn from U.S. success, and respond to first-moves by 25 percent of the world economy with adoption of similar policies.

But don't just believe the forecasts. You can already see the effects emerging in the data. Growth of business fixed investment rose every quarter of 2017 to average 6.3 percent for the year, according to data from the Bureau of Economic Analysis, up from just 0.7 percent in 2016. In the first quarter of 2018, it jumped again, to 10.4 percent. Growth of equipment investment jumped to 11.6 percent in 2017:Q4 and 5.8 percent in 2018:Q1, thanks largely to the tax law's allowance for full expensing of equipment investment retroactively to September 2017.

Business investment in structures and intellectual property has also surged—up 16.2 percent in Q1 for structures, and 13.2 percent for intellectual property. In Q1, private fixed investment as a share of GDP was in fact the highest it has been since the first quarter of 2008. Consistent with that evident trend shift, composite planned capital expenditure indices from Morgan Stanley and Goldman Sachs have been hitting record or near-record highs.

All of this is, ultimately, good news for American workers. The burden of corporate taxation is disproportionately born by labor, and it is born by labor through a long-run investment channel that results in fewer establishments, fewer factories and plants, less equipment, and at the end of the day less employment, fewer hours, lower productivity, and thus lower wages. So when we reduce the corporate tax burden, as we've just done, in the long-run we expect labor to enjoy a disproportionate share of that relief, through increased investment, a higher target capital stock, higher capital per worker, and thus higher productivity and wages. It's therefore exciting to see in the 2018 data effects that are consistent on this point with top articles published in the Journal of Political Economy, American Economic Review, and American Economic Journal in just the past year.

An equally exciting challenge moving forward will be to identify the relative velocities of adjustment to a positive tax shock as we have just experienced. Consistent with Le Chatelier's Principle, liquid capital markets may respond instantaneously by reallocating capital from mature, cash-rich firms to more dynamic, cash-constrained firms, whereas labor and physical capital market responses may be subject to longer time horizons.

But in any event, I would say that right now the fundamentals of the American economy are looking strong, with improved supply-side potential."

The tax reform of the Trump Administration seems to have worked, not least since many US multinational companies have started to transfer cumulated profits abroad to the United States and the headquarter company, respectively. While the change in tax rates seems to have had an expansionary effect both on the supply side – through higher investment and more innovations – and the demand side, the impulses from US monetary policy, i.e. the switch to higher interest rates, is growth-dampening. The IMF's World Economic Outlook from October 2018 is not so optimistic for the US growth in the medium term (IMF, 2018b; see Appendix 2).

Rising US interest rates will be a challenge to many emerging economies. If certain emerging economies such as Brazil, Argentina, Turkey, Pakistan, India and other countries should face problems in capital markets and indeed international market confidence problems, the US and the Eurozone will record high capital inflows reflecting safe haven effects. The UK could also benefit from high capital inflows, but in the case of BREXIT the safe haven quality of the UK could be diminished. A side-effect of high capital inflows will be an appreciation of the currency – hence the US trade balance deficit and the US current account deficit could worsen and this in turn could make the Trump Administration even more protectionist than in 2017/18.

It should be clear that US protectionism will face retaliation from China and other countries so that global economic growth would be impaired. A serious risk is that President Trump could impose high import tariffs on more and more exports of China – up to the full $500 billion of Chinese exports which go to the US. Since China cannot fully retaliate on the trade side – with US exports to China standing for a bit less than half the amount of Chinese exports to the United States – China's government is likely to consider restrictions in the field of US foreign direct investment or the international transfer of profits of US firms. This, in turn, could undermine confidence in global foreign direct investment and would damage also European and Japanese as well as Korean foreign direct investment interests in China.

President Trump can be expected to continue his massive – and often rather spontaneous - twitter activities which are designed to influence the US voters and the global public, respectively. This generates considerable nervousness in the global public in a period of international trade conflicts. Stock markets in China already have suffered reduced stock price indices in late 2018 as a consequence of the US-China trade conflict. To the extent that the relative fall of China's stock market index is an impulse for lower investment by Chinese firms in China, the Chinese government has a tendency to rely on expansionary monetary policy and also expansionary fiscal policy – as long as there is still room to maneuver. If, however, China's GDP growth is impaired considerable by the US-Sino trade conflict, this has negative consequences around the world. The IMF in a Staff Report for an Article IV Report on China (IMF, 2015) has indicated that the implementation of suggested IMF reforms in China would not only raise China's output, but there would be a global impact indeed: On average, the per capita income outside China would be raised by $100 - more in countries that are rather close to China and thus have relatively more trade with China and a smaller amount in more distant European and Latin American countries.

Populism and the Internet

The re-emergence of populism is linked to the expansion of the Internet. There are several important characteristics of the Internet which are relevant here:

- The marginal cost of using the Internet for private users is close to zero, falling absolute equipment and mobile digital services prices make the Internet a platform for everybody. This leads to a myriad of complaints and groups aimed at sharing the dissatisfaction of users – all kinds of strange views get hundreds of thousands of supporters on Facebook and in other social networks which means that the public has become quite fragmented. The traditional political parties are often passive compared to anti-elite populist parties (e.g. in Germany, the *Alternative für Deutschland* AfD (translation: Alternative for Germany) has more Facebook followers than the CDU – a conservative party – and the social-democratic SPD combined).

- The ranking algorithms of search engines are such that extreme headlines make it rather easily to the top of, for example Google, search returns. The fact that many Internet services are apparently free for users – read: They actually are provided via cross-subsidization or a based on financing through advertising – have brought about very low quality standards on the Internet; part of the global Internet is full of fake news and the aforementioned algorithms invite extreme policy groups to conquer the digital political world. For example, in Germany a member of the populist right-wing AfD pushes fake information/news in the Internet, often under extreme headlines, so that political radicalism is spread through the Internet which in turn undermines democracy: Democracy needs the respect of the competing party leaders amongst themselves, but if the political messages are (almost) all radical and extreme, the ability to generate mutual respect among political leaders will be low. It is also no surprise that US President Trump uses the Internet with his twitter account very intensively.

Modern populism is an anti-elite project in Western market economies. Market economies are based on prices, competition and the rule of law. The Internet is largely the contrary of the traditional trio of market economy, democracy and the rule of law: On the Internet there is no direct role of prices for digital services, in very many cases the price is zero. This undermines the quality of information content on the Internet. There is an almost total lack of digital data property rights in Europe and the US – from a traditional Western legal perspective, property rights for data are not a clear concept. The effective payment in the digital world with one's own data or data links to friends is strange for a market economy, it is a hidden payment where private households often have no idea about the market value of the data they are giving away for free. This opaque world is a global digital world where the rule of law is partly very weak: There are competing governments trying to impose their own respective rules which often means that there are no effective rules. The Internet is a quasi-socialist world and it has many of the contradictions of the socialist system. The present Internet has many characteristics that could destroy both democracy and the market economy in the long run.

3. Protectionist US Policy and Expansionary Fiscal Policy in 2017/2018: Ongoing Contradictions

Since Trump's inauguration speech the new US president has held strange economic views, including the perception – see the inauguration speech of January 2017 – that the economic situation of the US is quite weak. The key wording of Trump in the Inaugural Address was, with emphasis on his position against the elites, economic problems of the US and a desire for a new policy, reads as follows:

"The establishment protected itself, but not the citizens of our country…But for too many of our citizens, a different reality exists: Mothers and children trapped in poverty in our inner cities; rusted-out factories scattered like tombstones across the landscape of our nation; an education system, flush with cash, but which leaves our young and beautiful students deprived of knowledge… Every decision on trade, on taxes, on immigration, on foreign affairs, will be made to benefit American workers and American families."

In his presidential campaign of 2016, Trump had vowed to focus on America First and had emphasized how weak the US economy had become. The latter is an unusual assessment for a country which in 2016 was already heading towards full employment and had achieved considerable economic growth in 2015/16. As regards economic growth, the US President had promised in his campaign that the US would achieve 3% growth under his presidency, roughly a full percentage point above the long run US economic growth rate.

As with many Republican presidents before him, Trump started his presidency with higher expenditures and tax cuts so that the deficit-GDP ratio increased and the medium-term debt-GDP ratio could be expected to rise. With rising domestic demand the US imports of goods and services increased so that the current account-GDP ratio was raised so that the first years of the Trump presidency is not much different from first years of the Reagan presidency with its twin deficit problem.

In the end there are two key economic relations that will be critical for the US: (1) the first is the debt-GDP ratio whose long run ratio according to the Domar rule is given by the ratio of the government's structural deficit-GDP ratio (SDGDP) to the real economic trend growth rate ($g_{Y\#}$). In analogy to the Domar rule, long run foreign indebtedness relative to real gross domestic product (denoted here as FIGDP) is given by the ratio of the current account-GDP deficit ratio (CAGDP) to the output growth rate: FIGDP= CAGDP/$g_{Y\#}$. These formulas are crucial for both the United States as well as Japan and many other countries – exceeding critical thresholds of debt-GDP and of foreign indebtedness to GDP would bring about a declining rating of the government bonds of the respective country and thus a higher real interest rate spread.

The US administration has also complained that many countries of the EU have high merchandise balance surpluses via-à-vis the US – with Germany being the biggest EU goods export surplus country in this field. The aggressive US trade policy under Trump has been reinforced in June 2018 when at the beginning of the month he imposed US import tariffs on steel and aluminum products from NAFTA partner countries plus the EU; in mid-June, US import tariffs of 25% on Chinese exports of $50 billion were announced where China's government in turn announced quick retaliation tariffs which would, however, cover only about half this volume. The Trump Administration explained that a further $200 billion of Chinese goods were also earmarked for US import tariffs. This raises the question of why President Trump is so eager to start a global trade war, what his expectations are and what likely results are to be expected.

Donald Trump has been elected by many voters from the lower half of the US income pyramid who stood for 13% of national income in 2016; a stunning reduction of 8 percentage points vis-à-vis 1980, the year before President Reagan took office (in Western Europe, by contrast, the share of the lower half of the income pyramid has remained rather stable – minus 2 percentage points – over the period 1980-2016 – see Appendix 3). It seems that President Trump's populist political focus is largely on this group comprising the lower half of the income pyramid and that he thinks that an improvement of the merchandise trade balance would be the natural way to create more jobs in manufacturing industry. This is a strange bias in favor of industrial jobs as if services jobs would not be at least as good a source of income in the US (this view has a strange similarity to Karl Marx's obsession that the services sector does not represent value-added, only industry would do so). President Trump has emphasized in his speeches and tweets how unfair the US merchandise trade balance deficit of some 800 bill. $ per year allegedly is, but all these complaints are ill-placed since the goods and services trade balance is relevant in a "mechanical way" for explaining total job losses through international trade: This mechanical view means that one could calculate – at a given domestic productivity – how many jobs in the services or the manufacturing sector could be created if the net imports of goods and services would have been replaced by domestic production. For example, the study by LAWRENCE (2017) indicates that the trade balance deficit of the US in this sense corresponds to about 3.5 million US jobs. The economic view of international trade, however, is different to the mechanical view of laymen: With more trade (or more regional integration fostering overall trade; Trade creation in the regional integration club of the respective countries exceeds the trade diversion effects for the outsider countries – a traditional assumption), there is increasing international specialization and productivity growth in each trading partner country so that all countries benefit from trade.

Some of Trump's trade advisors have apparently told him that many jobs lost in the manufacturing industry of the US are reflecting rising US imports over time and economic globalization, respectively. As the research by LAWRENCE (2017) has shown, the decline of the US manufacturing industry has been a long-term phenomenon. One may add that the US has a strong services export (surplus) position so that many new jobs in the services sectors have been established in the US. However, it is remarkable that the manufacturing industry has created many well-paid jobs for unskilled workers in the US – while the share of such workers in the manufacturing industry has declined over time, it still provided many well-paid jobs for unskilled workers. The US, however, has not been strong in active labor market policies over decades so that global structural change in the context of Asian economies' rising exports of goods and services has slowed down the wage growth in the US, particularly of unskilled workers.

A regards the US, France, Germany, the UK and Italy, it seem that domestic value-added shares in gross total exports have experienced a declining trend over time which, of course, reflects economic globalization; namely in the sense that increasingly intermediate products are imported which in turn contributes to enhanced international competitiveness. This means that US import tariffs could considerably undermine international competitiveness in an indirect way.

From the beginning of his presidency, Trump has started to emphasize that the US has a very high merchandise trade balance deficit and that he wants to correct regional trade agreements such as those with Mexico and Canada, who together with the US form the North American Free Trade Agreement (NAFTA) area. Once President Trump had realized the tax reform in late 2016, designed under the auspices of Steven Mnuchin and Gary Cohn, the US Administration has turned towards the $ 800 bill. merchandise trade deficit and to attack the many countries which have a bilateral goods trade balance surplus vis-à-vis the US; during his UK visit in July 2018, President Trump complained publicly about the EU’s bilateral merchandise trade balance surplus of about $ 150 billion vis-à-vis the US although this makes no economic sense at all. It seems that Gary Cohn, director of the National Economic Council from his appointment on January 20, 2017, until his resignation in April 2018 (to be replaced by Larry Kudlow on April 2), was not supportive of Trump’s new protectionist approach for the US and he considered Trump’s focus on the trade balance deficit to be inadequate (WOODWARD, 2018).

Using the threat of imposing import tariffs on steel and aluminum imports, the US Administration under Trump has tried to obtain more open market access to other countries; with special emphasis on China and the problems of illegal technology transfer from the US to China through various channels. On June 1, 2018, the US president has imposed a 25% import tariff on steel and a 10% import tariff on aluminum for exporters from Canada, Mexico and the EU; on China import tariffs of 25% of $ 50 bill. Chinese exports have been announced in mid-June 2018 – this will come under section 301 of the Trade Act which has rarely been used in the past, but this time it will be applied over a broad range of goods which the US Administration considers as standing for a violation of US intellectual property rights. The trade conflict with the EU comes under the heading of section 232 and thus refers to national security grounds.

A special case of trade conflict concerns the question of President Trump’s willingness to change the free trade agreement with the Republic of Korea. This treaty (“KORUS”) is of strategic importance for the US in the sense that this treaty is one key element in the strategic military cooperation between the United States and the Republic of Korea. Having troops stationed in South Korea – and advanced radar equipment to detect any potential attack from North Korea – is a key security interest of the US. Against this background it is all the more strange that President Trump seems to have considered an early end to the treaty in its current form and a renegotiating of KORUS; and Trump seems not to have been willing to listen much to his economic and chief military advisors (WOODWARD, 2018). The high US bilateral trade deficit with Korea ($18 billion in 2017) was a major driver behind Trump’s interest in renegotiating the KORUS. However, the outward stock of US foreign direct investment in Korea is high so that the US foreign production in Korea is effectively generating high profits which are transferred to US parent companies or are reinvested in Korea in order to generate higher future profits of US subsidiaries in Korea. The bilateral current account deficit of the US vis-à-vis the Republic of Korea is – relative to US GDP – smaller than the bilateral US merchandise trade deficit; a high US bilateral surplus in services exports to Korea is noticeable here. Moreover, a purely bilateral view that would want the US to have balanced trade balances with all major trading partner is nonsense and would artificially stop a significant share of trade and hence positive productivity and growth effects world-wide. If the global output is reduced by such a Trumpian push for the artificial equalization of trade balances, US exports of goods and services would be reduced, i.e. they would be smaller than otherwise. Finally, the US should have a permanent current account deficit-GDP ratio of at least 1% since otherwise a global dollar shortage would occur which impairs global trade, growth and prosperity: The US dollar is the foremost global reserve and transaction currency and it is only through a US current account deficit that the rest of the world, eager to hold dollar reserves in the respective central bank, can obtain additional dollars which they want to accumulate in parallel to a rising trade volume. Not many economic advisors around Trump understand this point: Lawrence B. Lindsey is obviously is one of those who do, while it is unclear whether or not Peter Navarro (an economist) or Secretary of Commerce Wilbur Ross understand International Economics.

According to WOODWARD (2018), Gary Cohn is said to have asked President Trump why he places such an emphasis on his view that the US should increase its manufacturing sector and export more merchandise goods; Trump's answer was that this had been his view for over 30 years upon which Cohn's retort was that for 15 years he had thought that he could pursue a professional baseball career, "but this did not mean that I was right". This 30 year old outdated policy blueprint could be part of a Trumpian economic policy disaster.

Two Inconsistent Views on the US International Trade Position

While the US-China trade conflict is a special case, the transatlantic trade conflict is of broader interest, not least since the deterioration of trade relations between the EU and the US have been reinforced by the failed Charlevoix G7 meeting in Canada on June 8-9, 2018. A day after signing the traditional G7 communiqué, the US President effectively retracted his signature on the document which had emphasized in point 4: "*We acknowledge that free, fair and mutually beneficial trade and investment, while creating reciprocal benefits, are key engines for growth and job creation. We recommit to the conclusions on trade of the Hamburg G20 Summit, in particular, we underline the crucial role of a rules-based international trading system and continue to fight protectionism. We note the importance of bilateral, regional and plurilateral agreements being open, transparent, inclusive and WTO-consistent, and commit to working to ensure they complement the multilateral trade agreements. We commit to modernize the WTO to make it more fair as soon as possible. We strive to reduce tariff barriers, non-tariff barriers and subsidies*."

If one considers Trump's trade policy, one may emphasize that the US President not only refused in January 2017 to send the Trans-Pacific Partnership Treaty – involving the US and 11 partner countries, including Japan and Australia – to the US Congress for approval, he also decided not to continue negotiations on the Transatlantic Trade and Investment Partnership (TTIP) with the EU; on top of that he blocked the (re-) election of judges to the World Trade Organization's appellate body so that the WTO's dispute settlement mechanism will be dead as of summer 2019. The IMF's Article IV Report on the US (IMF, 2018a) which is dated June 14, 2018, notes under the heading Trade Policy: "The U.S. maintains a very open trade regime. Over the years, this has supported U.S. growth and job creation and helped raise living standards. U.S. leadership on trade has encouraged a range of countries to open their own trade regime, removing tariff and nontariff barriers. There is also broad agreement that the global economy needs to be able to rely on an open, fair, and rules-based international trade system."

It is strange that the IMF publishes an Article IV report which partly makes claim which conflict with the reality of the US under the Trump Administration and seems to ignore the Trump messages before and immediately after the G7 Canada meeting. The US under Trump is for bilateralism and is, much in contrast to the six decade of US policy before, not in favor of multilateralism. The Trump Administration is also an exception, as noted by the IMF in its report, in that it deviates from the rule not to implement in an economic upswing an expansionary strong pro-cyclical policy (the IMF notes "The combined effect of the administration's tax and spending policy will cause the federal government deficit to exceed 4.5 percent of GDP by 1919. This is nearly double what the deficit was just 3 years ago. Such a strongly pro-cyclical fiscal policy is quite rate in the U.S. context and has not been seen since the Johnson administration in the 1960s"). The IMF indicates that the experts expect the US current account deficit-GDP ratio to increase from 2.4% in 2017 to a peak of 3.6% in 2020 and 3% in 2023.

It is difficult to understand why the US President Trump has publicly and repeatedly complained about the enormous goods trade balance: The US merchandise trade deficit in 2016 was about 4% of GDP, the US goods and services trade deficit was 2.7% of GDP, so that the services trade balance of the US had a surplus of about 1.3% of GDP and the US current account deficit was 2.4% of GDP – the latter is the goods and services balances plus the primary income balance (mainly dividends of US firms abroad, net of dividends of foreign subsidiaries in the US plus other net factor income from abroad) plus unilateral international transfers (e.g. payments to the UN and other international organizations). An improvement of the trade balance could help to generate full employment and, from this perspective, one might understand President Trump's complaining about the big merchandise trade balance deficit of the US; however, the US had already achieved full employment at the beginning of 2018. Hence complaining about the US merchandise trade deficit is absurd and that US President Trump is repeating this complaint is a tragic aspect of his presidency since in the US, Trump has many of the world's best trade economists, yet he does not seem to listen to them in any way. Here one can see a key element of populism: The invention of own pseudo-scientific laws, and in Trump's case this concerns climate change analysis as well as international economics (Turkey's President Erdogan is a related case in the wishful thinking of a populist president, as in July 2018 he announced that the high inflation rate in Turkey could be reduced by the Turkish central bank reducing the central bank interest rate which is economic nonsense).

The current account deficit position of 2.4% of the US in 2016 and 2017 is not dramatic since the US with the dollar as the leading global reserve currency can finance 1% of imports – relative to GDP – effectively for free since the US profits from foreign central banks' holding US $ reserves which are so large (and the difference between the interest rate paid by the US and the world capital market is so big) that this generates for the US the equivalent of 1% of US GDP. Hence the effective current account deficit-GDP ratio of 1.4% in 2016 and 2017 is not a problem if one assumes that the US has a long run growth rate of real output of 2%. The implication would be a long run steady state foreign indebtedness of the US – relative to GDP – that would be 70% and with an interest rate the US has to pay, say 1.95%, the net interest payments of the US would be 1.4% of GDP so that the current account situation is rather stable. It is, however, obvious that Trump's fiscal policy contributes to raising the current account deficit-GDP ratio in the medium term as emphasized by the IMF, but for this development US partner countries should not be blamed.

Can the US benefit from protectionism in the sense that it will improve the trade balance? The analysis of KIM/SHIKHER (2017) is quite interesting although it ignores the foreign direct investment (FDI) effects that could have shed additional light on the issue – and both inward FDI as well as outward FDI are important in the case of the US. The authors consider a three country model (USA, China, ROW) with goods and bonds markets.

Particularly they analyze the case that the US imposes a 10% import tariff on China or on all countries (read: China and Rest of the World). The rise of US tariffs improves the trade balance in the short run, but not in the long run. Both savings and investment decline in the US, but the initial fall in US investment exceeds the fall in savings. The main effects of the above equilibrium model considered are:

- In the US more domestic products are consumed;
- trade diversion occurs in some cases;
- in sectors facing US import tariff and hence reduced US consumption imports, the producer price abroad will fall so that there is a relative increase of US goods prices which impairs US exports;
- the production of non-tradable goods will increase;
- the trade balance records a slight and temporary improvement;
- the magnitude of the trade balance improvement is rather small;
- for the US there are welfare losses, while foreign countries enjoy welfare gains.

Thus one may have considerable doubts about the aggressive trade policy of President Trump. Moreover, there is risk of an accelerating global trade war which will depress global real income growth so that the export growth of the US could reduce. Taking into account US outward FDI capital stock, it is also clear that US profits from subsidiaries will reduce.

As regards the adjustment of current account imbalances, OBSTFELD/ROGOFF (2005) have emphasized that changes in the price ratio of tradable goods to non-tradable goods are twice as important for trade balance adjustment than a change of the real exchange rate. A basic requirement is to combine a real devaluation with a relative fall in non-tradables prices in countries with a current account deficit: With the relative non-tradables prices falling, there is reduced incentive to produce non-tradables and hence there will be an increasing excess supply in the tradable sector in the future. Conversely, countries with a current account surplus should face an appreciation and a rise in the non-tradable price: The latter is particularly relevant for a country like Germany that has a high structural current account surplus; the Eurozone also seems to stand for a structural account surplus (and in particular for a surplus vis-à-vis the US). From this perspective, rising public investment and rising wages in the Eurozone could be one starting point to raise the price ratio of non-tradables to tradables – more empirical research is needed.

What Is the Problem with Globalization?

US President Trump is not a supporter of economic globalization. His view is that globalization is to the disadvantage of the US and key strata of the US society, respectively. What does economic theory say about trade liberalization, which has been so impressive in the context of China which opened up its economy for trade in 1978 and a few years later – within an initially regionally limited framework – for the foreign direct investment of multinational companies? Do we have the analytical building blocks that help us to understand US/EU-China trade and investment dynamics; and do we understand the US-Mexico trade and foreign direct investment dynamics – with trade between the US, Canada and Mexico liberalized through a renewed NAFTA (renewed within a somewhat different framework in October 2018 under the Trump Administration)?:

- Trade globalization in a competitive two-country model – with competition in both countries and no international factor mobility (hence no international labor mobility and no foreign direct investment, i.e. multinational companies investing abroad) – is good for both countries involved. The traditional simplified textbook model is to assume that there are two factors of production, namely labor (L) and capital (K), and that there are two different goods (one is capital intensive in production, say an automotive sector or production of machinery; the other is labor intensive in production, say textiles). Both countries benefit from trade liberalization and free trade will help the poorer country – with the smaller capital intensity (ratio K/L) – in particular: There will be a catching-up process and wages will increase relative to the remuneration rate of capital, namely the real interest rate (nominal interest rate minus inflation rate). In the end, trade brings about the equalization of wages and the real interest rate. The country with the rather high endowment ratio K/L will experience an increase of that sector which is capital intensive in production, so in the relatively rich country the automotive sector will expand and cars will be exported. The wage in the relatively poor country will increase and in the long run the international wage gap will have been eliminated by trade. In every trade theory textbook this comes under the heading of the Heckscher-Ohlin approach, named after two Swedish economists who developed the key arguments in the 1930s.
- The Stolper-Samuelson theorem indicates what will happen with relative remuneration in a simple textbook model with two countries, two goods and two production factors (say skilled labor which may be dubbed human capital – so we use a kind of analogy to capital K – and unskilled labor). If the relative price of a tradable good i is (exogenously) increased in a world with free trade, one can show that the relative factor price of that production factor will be raised which is used relatively intensively in the production of the respective good. If opening up of the US/EU and China for trade in the 1980s – China opened up in 1978, but it took several years to witness clear economic effects in both countries – raised the price of machinery relative to textiles – the remuneration of US/EU skilled workers, intensively used in the production of machinery in the US/EU was bound to relatively increase while the wage of unskilled workers, intensively used in textile production, would fall in the US/EU. RODRIK (2018) has referred to some US-related issues of populism and globalization in the context of international trade theory and he has also pointed out that the welfare loss from import tariffs is usually a squared function of the import tariff rate. Both countries, namely China and the synthetic country "USEU" involved in the liberalization of trade would benefit "on average", but the wages of unskilled workers would fall in the US and in the EU. Governments in EU countries plus Switzerland/Norway would offer special public funding for the retraining of unemployed workers and even of workers with a job. In the US on the other hand, little compensation or support would be offered by government to the unemployed or to unskilled workers with reduced wages. US government spending on training/retraining is typically close to or below 0.03% of GDP, which is less than 1/25th of the respective share in Denmark and even only about 1/10th of the value for Switzerland or most western continental EU countries. Is this wise?

Table 1: Public Expenditure on Labor Market Programs (Training) in Selected Countries in Percent of GDP

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Denmark	0.52	0.49	0.42	0.37	0.35	0.46	0.68	0.64	0.61	0.60	0.59	0.60	0.53
Germany	0.44	0.38	0.35	0.30	0.30	0.35	0.27	0.25	0.22	0.22	0.21	0.20	0.19
Switzerland	0.28	0.26	0.21	0.17	0.15	0.18	0.20	0.17	0.16	0.17	0.17	0.18	0.19
UK	0.03	0.02	0.01	0.01	0.01	0.02	0.02	0.01					
USA	0.05	0.05	0.04	0.04	0.07	0.05	0.04	0.04	0.04	0.04	0.03	0.03	0.03

Source: Own representation of data available from the OECD

- A useful approach in trade theory is the analysis of the link between relative availability of production and output structure (the so-called Rybczynski theorem): An exogenous increase in the endowment of a production factor j – given relative goods prices – will lead to higher output of that good which is using the more abundant factor relatively intensively. Output of the other good will fall in absolute terms. Example: Refugees are coming to country 1, then the production of those goods which are relatively labor intensive will increase. Another example: Consider an accidental digital knowledge leak in country 1 so that many firms in the relatively poor country 2 can strongly upgrade their own knowledge basis: In this case the production of knowledge-intensive goods in country 2 will increase, that of goods that are rather labor-intensive will fall in absolute terms.
- While the Heckscher-Ohlin approach and the other two approaches assume that there is no international factor mobility, one may consider the McDougall theorem which deals with international factor mobility: Subsequently, the country pair to be considered could be Mexico and the US. In a world with free capital flows, the opening up of two countries – including free capital movements – will have the following consequences: World gross domestic product will increase, where both countries will gain. The relatively labor abundant country (here Mexico) will attract capital inflows which will contribute to rising real wage rates (labor will benefit not only for this reason but also because of an internal redistribution effect between capital and labor). The capital rich source country of foreign direct investment – the source country of investment abroad (the US) - will record a higher income for capital owners who benefit from the rise in world real interest and profit rates, respectively.

What is wrong in reality in Mexico? While about $8 billion per year in outward US foreign direct investment went to Mexico over almost a decade, the wages of unskilled workers in Mexico hardly increased. The main reason for this is that Mexico's economic order is strange and allows powerful trade unions to "sell workplaces" at a given wage rate to foreign companies willing to set up a new factory in Mexico – the trade union representatives receive some bribery payment from the foreign multinational company to make this happen and to thus avoid the normal real wage increase in an economy with much foreign direct investment inflows and no corruption (a recent publication, GANDOLFI/HALLIDAY/ROBERTSON (2017) on US-Mexican economic links ignored this strange role of Mexican trade unions and thus came up with strange conclusions). For more than a decade, powerful Mexican trade unions have prevented the normal result of foreign direct investment inflows from occurring, i.e. a rise of the wages of workers in

Mexico on a broad scale, thus the Mexican immigration pressure on the US has remained abnormally high. With roughly $90 billion invested by US multinational companies in Mexico, the wages there should have massively increased and high wage growth normally reduces the incentive for outward migration.

4. Impact on the US and Transatlantic Policy Aspects

If populism should be a medium- or even long-term phenomenon in the US, this would bode ill for transatlantic and global economic relations. The key to protectionism is nationalist and protectionist behavior. Thus more than seven decades of US international political commitment in foreign policy could be reversed; political and military alliances led by the US could disintegrate, a lack of leadership could become a major problem in many policy fields at the international and global level, respectively. This will undermine international and political stability which, in turn, will raise transaction costs and risks for trade and international investment. Hence trade growth rates and growth rates for foreign direct investment will fall so that global output growth will decline. If the US displays a lack of leadership and political orientation, some countries in Latin America could become destabilized – in addition to Venezuela where it was mainly President Maduro's chaotic and contradictory policies which have destabilized the country economically. The Trump Administration has also cut its financial allocation to the Palestinian territories which could destabilize the Middle East. The fact that China decided to cancel the proposed Sino-US trade negotiation talks in late September 2018 is a signal that the Trump Administration is heading towards some new form of isolationism. China will seek a reorientation of its main trade focus and could try to seek closer economic relations with ASEAN, Japan and the EU. Economically, the EU makes limited sense to the extent that the EU is far away from China – transportation costs are relatively high when compared to the ASEAN countries. However, the quality segments offered by China in the US and the prices fetched there by Chinese exporters cannot be obtained in ASEAN. Such high prices could be obtained in Western EU countries whose per capita income (corrected for health care expenditures) is almost as high as that of the US. Significantly higher Chinese exports to the EU27 could be possible not only via ship transportation but also via a more intensive use of the railway network connecting China and Western Europe. Russia is an important transit country and both the EU and China could only hope to exchange more goods over international railway networks if there is adequate investment in modernizing the railway infrastructure between China and Germany/France and if political relations with Russia are improved in an EU-Russia context. This, however, would bring up the issue of Ukraine again and it is unclear whether EU countries and Russia could achieve a solution here – without a strong involvement of the US. A populist policy of the US will most likely not deliver any international contribution to stabilizing any region or country of the world economy without calling for the EU/China to pay a price for any US involvement useful in the process.

The protectionist and anti-multilateralist Trump policy will certainly not be supportive of EU integration and this is a major policy change compared to 1945-2016. President

Eisenhower welcomed Jean Monnet, the President of the European Coal and Steel Community (ECSC: created in 1952 by Germany, France, Italy, Netherlands, Belgium and Luxembourg) in Washington DC in 1953 and he had a clear conviction that European economic integration could help rebuilding Europe faster and also build a bloc of countries that could be useful in the Cold War with the Soviet Union. From a French perspective, the creation of the ECSC should bring sectoral economic integration, but also joint political control over Germany and critical military sectors at that time. The institutions that had been created were precursors of the EU institutions created in 1957 – the EU then actually had the name of European Economic Community. Once the US is neutral to the EU integration or even openly hostile, Europe will face increasing challenges and even disintegration pressures spurred on by a populist-driven, and Trump supported, BREXIT.

5. EU Reform Problems and the Rise of Populism in Europe

Modern European integration started in 1952 with the creation of the European Coal and Steel Community (ECSC) by Germany, France, Italy, Belgium, the Netherlands and Luxembourg, followed in 1957 by the creation of the European Union (or European Economic Community as it was called then). Overcoming nationalism and removing import tariffs in regional trade as well as reinforcing economic convergence across countries and fostering peace and prosperity were the goals of the EU. EU integration was firmly supported by the US between 1950 and 2016. This support ended with the Trump Administration – with Donald Trump underlining during his presidential campaign in 2016 how much he supported BREXIT and that he expected further X-EXIT decisions in the EU28. In the pro-BREXIT campaign, the proposed exit from the EU was supported by arguments that EU membership meant a lack of political autonomy, an inability to control immigration from EU countries, too much bureaucratic EU power and also the squandering of UK taxpayers' money (WELFENS, 2017). The European consensus about EU integration was fractured 2016 in Europe and new populist forces are gaining ground in many EU countries since then. The Euro Crisis brought a populist majority in Greece, namely based on a coalition of a party from the far left and a populist party from the right-wing, while in Italy a strong right-wing Lega Nord Party and the rather left-oriented populist Five Star Movement (founded by comedian Beppe Grillo) created a coalition government in summer 2018.

Traditionally in Western Europe, France, Northern Italy and parts of Belgium have experienced populist parties. Since 2016 – basically after the refugee wave and Chancellor Merkel's poorly prepared decision to open Germany's borders in late August 2015 – populism is a strong new political current also in Germany. In many EU countries, part of this populist surge has emerged as a reaction to the Transatlantic Banking Crisis and all the government rescue funding for bank; guarantees of banks' bonds placement are, however, often confused with actual funding at taxpayers' expense. In Germany, the Merkel governments did not do enough to explain how rather limited the actual costs of rescuing banking in the end really were. In Germany, and many Western EU countries, including the UK, there emerged a widespread perception in 2008-2010 that governments that had argued that there was no money in the budget for social policies would offer almost unlimited resources to bail out the wealthy owners of banks.

As regards populism in Germany, the expansion of the *Alternative für Deutschland* (AfD) party as a right-wing political force in the German federal parliament and in the parliaments of the federal states (the "*Länder"*) is a serious challenge for political stability in Germany and the EU. As regards digital networks, it seems that AfD activists are very strong in the diffusion of fake news with sensational, "click bait", titles. Research from the Bertelsmann Foundation on the digital activities of right-wing groups have suggested that a significant share of FAZ digital readers are closely linked to the AfD (HOFFMAN, 2014).

In Germany, the creation of the populist AfD was initially motivated by the concerns of some economists and journalists that the Euro Crisis would cost the German taxpayer tens of billions of euro; this is a perception that often has been propagated by the Frankfurter Allgemeine Zeitung, a leading national newspaper with an Economics section that has been anti-Euro since 1999. That newspaper has a Sunday edition, the Frankfurter Allgemeine Sonntagszeitung, where the chief economic journalist – he has no formal education in Economics or Business (he has a major in Literature, Catholic Religion and Philosophy) – compared the European Central Bank with a Nazi bank created during the Second World War with a seat in Vienna. One of the leading creators of the AfD was himself a former journalist of the Frankfurter Allgemeine Zeitung and its current leader, Mr. Gauland, served for a few years after the reunification of Germany as an editor of a newspaper in Potsdam (in the former East Germany) which was owned by the Frankfurter Allgemeine Zeitung.

In March 2015, opinion polls showed the expected voters' share of the populist AfD in national elections at around 5% which is the critical threshold for national elections in Germany, after the year with the refugee wave the AfD was often close to 10% and in October 2018 in some opinion polls the AfD was even narrowly ahead of the Social Democratic Party which had fallen below 20%. Opinion polls in the former German Democratic Republic, i.e. East Germany, put the AfD in some states ahead of all other parties in autumn 2018. In Saxony, which partly is a geographical center for openly anti-immigrant/nationalist groups (such as Pegida) or sometimes even fascist political groups, the AfD won a relative majority of votes in Germany's national elections. By mid-2018, the AfD has been established in all 16 state parliaments in Germany. Its leaders openly support Trump's views in many ways: Nationalism, protectionism and anti-immigrant as well as anti-Muslim slogans are part of this ideology.

According to a study by VEHRKAMP/WRATIL (2017) for the Bertelsmann Foundation support for populism is strong in the right-wing spectrum as well as in the political center; and it is noteworthy that a large share of supporters of populism in Germany have low formal skills and fairly low per capita income. Among non-voters, populism is mainly on the right-wing of the political spectrum in Germany.

On October 6, 2018, the head of the AfD and leader of the AfD faction in the German Parliament explained in an op-ed in the Frankfurter Allgemeine Zeitung ("Why Does it Have to Be Populism?") what the key motives for AfD support are and what the core of its ideology is – ignoring the more radical right-wing views in eastern Germany. Gauland argues that Donald Trump is the symbol of modern populism and when he, Gauland, is asking himself, how populism re-emerged he gives the following answer (translation by Paul Welfens):

"In the course of globalization, after the end of the East-West (Cold War: added by PW) conflict, a new urban elite has been created…people from business, the political sphere and the entertainment & culture sector are part of it – and above all the new species of digital employees dealing with information. This globalized class is active in internationally active companies, in organizations such as the UN, the media, start-up companies, NGOs, in the foundations of the parties and their management; and since they are controlling the information flows, they shape society in the field of culture and politics. Their members usually speak English fluently and when they are changing jobs they move from Berlin to London or Singapore...This milieu does not mix with others and strives to be "colourful". The consequence is that the linkages of this new elite to their respective home country is weak. In their elitist parallel society they consider themselves to be citizens of the world. The rain, which hits the home countries, is not felt by them. They dream about One World and the global republic. Against this globalist class there are two heterogeneous groups that have forged an alliance within the AfD: On the one hand, a bourgeois strata which economically includes the SME-group which could not easily relocate production to India; on the other hand, rather the normal simple people whose jobs often pay so miserably or indeed no longer exist…Those are the groups that assign a value to the homeland, a unique value as such, and they will be the first to lose the homeland because immigrants move into their milieu…Through all western societies there is now such a divide today. It was greatly deepened when billions and billions of taxpayers' money was suddenly mobilized to bail out banks and to finance ailing European countries and to pay for hundred thousands of immigrants. This constellation called for a radical opposition. Such opposition could have been from the right or from the left, but it naturally was populist. Populism means: Anti-establishment…Nobody should counter this view with childish platitudes such as "we should not be protectionist". But a man like Donald Trump has been elected because he had promised his fellow countrymen that he would shelter them from international wage dumping as well as against illegal mass immigration… Globalization looks much better for those in a penthouse than for those in subsidized housing.

The egoism of globalization actors is not any better than the private interests of those emphasizing factionalism; but the globalization supporters have more at stake. We are about, following the orders of the globalization elite, to put at risk much of what makes our country and our continent worthwhile to live in: Internal peace, the rule of law, social security, equal rights for men and women, the freedom of expression and the freedom of religion. With one expression: Our liberal way of living, that is, our homeland. Once this homeland is gone it will never come back again."

In a nutshell, this is a romantic but illusory view which expresses many fears and considers international entrepreneurship as undesirable (and this is the view of a man who has visited Venice often and admired the city the powerful and prosperous historical past of which is based on clever institutions, industrious people and international commerce). One may respond to the Gauland views with several points:

- The right-wing groups within the AfD – which might have been a majority in this party in 2018 – are radical, xenophobic and aggressive against other groups, including journalists. They have no respect for the rule of law and the rights of minorities, they partly seem to be willing to use violence in public – and to threaten violence in letters or mails – and in doing so they destroy internal peace; they hinder their opponents with all kinds of interventions from expression of their view: The AfD partly stands for suppressing the freedom to express publicly one's own view and the freedom of religion obviously should not be extended to Muslim citizens in Germany. This is just the opposite of what the AfD-boss has argued. Mr. Gauland has difficulties accepting that a German music composer can live for decades in California, successfully composing film music, and then say: Even if I am not living in Germany, my music always has this German element. Vice versa, if a US composer would live in Germany and say his music is still linked to his US-American roots, why should this be a problem for people in Germany or Europe; and if this composer and musician would be like Cat Stevens, later converting to Islam, and continuing to write or compose songs under a new name: What problem should this be for Germans or Western Europeans? It is also clear that once the AfD would be in power, the AfD would want to limit all kinds of freedoms. Mr. Gauland has a romantic, anti-realist attitude – as if the world would be best if all countries of the world were closed economies (sounds like Europe in the 10th century when life was miserable in most parts of Europe if the weather had been unfavorable in the first half of the year). When Gauland refers to Trump and all the wonderful promises Trump had made to his voters it is simply obvious that Gauland has confidence in Mr. Trump whose economic views are full of contradictions and who is rarely willing to listen to economic advisers or experts, respectively. Mr. Gauland's ideas are largely wishful thinking, he has no idea what answer Germany or the EU should give to the historical rise of China. His romantic and illusory agenda suggests that Germany should get back power from the EU and then with its new political autonomy it should adopt legislation that would be more in the interest of the Germans. For a country that represents 3% of the world economy, the idea of giving up EU integration and the role of the EU as the institution which is responsible for negotiating free trade agreements as well as international investment (a role the EU has since the Treaty of Lisbon) is unconvincing. In a world economy in which the US's real income will continue to rise – not least due to population growth, part of which is from immigration – and in which China is about to pass the economic power of the US, it would be a strange situation for Germany alone to later have to strike trade deals with the US and China; at the same time, Russia, the UK and France would put pressure on Germany to join a military and economic cooperation treaty; and then Germany and Europe would be back to the political instabilities of the 1890s and the decades thereafter. Germany, Italy, Spain, Greece and Portugal stand for aging societies – with a rapidly ageing workforce and this means a decline of productivity and output growth - after 2025, much in contrast to France and the UK.

- Mr. Gauland's view consists of a romantic non-realism and shows a wish to live in a situation reminiscent of the 17th century – before the Industrial Revolution and the Cobden-Chevalier Treaty of 1860 between the UK and France (and subsequent free trade agreements among individual European countries). Mr. Gauland has the view of a dreamed up world with a global, high flying, jet-setting group of managers and other elite people who work for a few years in this country or in that country – and this is considered to be bad. First, most top managers live abroad for only for a limited time and living abroad, learning and coming back home was already a reality for some entrepreneurs and bankers in the Hanseatic League – i.e. a network of interconnected trading cities - in Europe in the period 1150 to 1650. Consider

Erasmus van Rotterdam (*1466 in Rotterdam, † in 1536 in Basel) who lived and published in the Netherlands, England, France, Germany (Freiburg), Italy and Switzerland. His was a critical mind with a broad communication network in Europe, part of his philosophy was quite critical about abuses in the Roman Catholic Church and he advocated tolerance. According to Gauland, such a man is representative of an international elite and should not be accepted – what a strange idea. It was not just scholars either, many young craftsmen used to learn their trade in various countries during the Middle Ages. The big foe of the AfD leader Gauland are the people working in information & communication technology; Gauland is afraid of technological progress, but then he argues that the poor people would not benefit from globalization. However, the digital revolution has helped to create new companies and new jobs, in many cases they stand for higher productivity and hence higher wages. In the Middle Ages, Mr. Gauland would have been suspicious about libraries and universities (they had libraries) which effectively were the stores of information and knowledge at that time. Mr. Gauland seems to be a person who is afraid of innovations and structural change. He argues that small and medium enterprises cannot easily relocate production abroad – compared to big companies. And rather immobile people of relatively limited skills would be the first victims of immigration, just as the SMEs would face a strong bankruptcy risk from globalization. Why would anybody be a victim of immigration? The US, Canada and some other countries, including Israel, the Netherlands and Germany, show that immigration can generate significant economic benefits for a large majority of the population.

- As regards the economic impact of globalization, one may state this: Due to trade globalization, the import prices of many daily products fall which raises the real income of all strata of society. The share of the lower half of income earners in Western Europe witnessed a small decline between 1981 and 2015: From 22% to 20% (see Appendix 3); however, the US is different since there the share of that group fell from 20% to 13% in that period (see Figure 1). It is certainly true that many people in eastern Germany are dissatisfied with economic dynamics and a continued wage gap between the former West Germany and the former German Democratic Republic, but in real terms the East-West income gap is rather small since local prices in eastern Germany in some regions are much lower than in western Germany. One may also point out that the state of Brandenburg's (formerly in East Germany) household income is close to that of Bremen (in the former West Germany). The gap between the average per capita income in Germany and the poorest two states in East Germany, namely Mecklenburg-Vorpommern and Saxony, was about €500 in 2017 (the average monthly household income was €2,700 in Germany).

It is interesting to consider part of a Mussolini speech of 1927 in which he emphasized some key populist views that were relevant at the time and possibly would be embraced – sooner or later - by many populists in Italy (or France or Germany) in 2018 and beyond (translation PW, based on the quote in BLOM, P. (2014; p. 345):

"The current situation is as follows: In a decadent Europe, weakened by its vices, perverted by exotic habits, in a delirium which tries to realize the dreams of a social-democratic humanitarianism, the only vital principle is that of a fascist Italy. Europe has lost its faith. It does not assign relevance to religious values and is worshipping only money, the individual and the collective instinct for survival. It is chasing only pleasure

and seeks a peaceful life. Fascist Italy – Catholic, disciplined, belligerent – will be able to dominate Europe if it can defend its physical and moral health.”

As regards Germany, the rise of populism should be mitigated in eastern Germany where populism often goes along with Nazi propaganda, the dissemination of anti-Jewish attitudes and violent political behavior. Improvements in education in the eastern federal states of Germany could be a useful element, but an attempt of government to relocate some of the top 100 companies to the former territory of the German Democratic Republic would also be useful. One should not exclude that the federal government in Berlin would, for example, relocate the seat of the Deutsche Post AG to eastern Germany. Then at least one of West Germany’s leading 100 companies would have been relocated to eastern Germany. The German government should improve its economic policy and could also try to support the expansion of part of the information and communication technologies in eastern Germany. The questionable arguments contained in the party program of the AfD are partly strange and should sharply be refuted. For example, there is the question of nuclear energy generation which the AfD wants to maintain; they consider the phasing out of this form of energy by 2021 – on the basis of a decision of the Merkel government - to be inadequate. This in turn is also a doubtful view of the party’s vice-chair Alice Weidel who should know that no insurance company is willing to provide full liability insurance for nuclear power plants; the minimum liability insurance of € 2.5 billion in Germany would be just about 1/1000th of the cost a very serious accident in a nuclear power plant would entail. In a market economy, nuclear power should obviously have no future as the risks are too big to be covered by private insurance. Mrs. Weidel has often argued that more referenda should be a key element of German politics. However, one can have many doubts about a system of monthly referenda in Germany or France, just as in Switzerland. An emphasis on referenda in politics serves mainly to encourage a more emotionally-based, short-term oriented policy and this will hardly be rational.

Populism is on the rise in Europe since the Transatlantic Banking Crisis of 2007-09, the Euro crisis of 2010-2015 and the UK’s pro-Brexit majority at the EU referendum of 2016. The latter in itself is a sign of populism. The Transatlantic Banking Crisis was shocking in the US and Europe since the enormous rescue funds offered and mobilized by various governments for banks facing a major crisis in the banking system suggested that taxpayers’ money could be relatively easily mobilized on a grand scale for banks and big private investors while for the needs of the poor strata and ordinary people in the middle class – concerning better education or support for retraining, for example – the budget funds allocated were quite modest. For Germany’s taxpayers, the cost of banking crisis ex post were put at an estimated € 30 billion for the federal government plus a somewhat smaller amount for the German states (DEUTSCHE BUNDESTAG, 2018; SCHOLZ, 2018): This figure for the cumulated contributions in the years 2008-2018 corresponds to about 2% of Germany’s annual Gross Domestic Product (GDP). On top of this come other costs in the form of fines paid by German banks – mainly in the US – for ignoring regulations and for other misconduct that could stand for another 0.5% of Germany’s annual GDP.

Moreover, Germany’s banking sector has had a system over many years which has imposed unfair costs on private households taking loans (this system still exists today!): Typically the borrower was pushed by banks to also take out payment protection insurance (PPI) from the same bank which offered the original loan – such costly bundling to the disadvantage of private borrowers had been criticized in the UK by the competition authorities and since 2011 such bundling has actually been banned in the United Kingdom. The German government did not act in a setting with similar problems. Instead it commissioned a study from the *Institut für Finanzdienstleistungen* (iff) and the *Zentrum für Europäische Wirtschaftsforschung* (ZEW) which argued that the situation in the field of interest rates on overdrafts and also the interest rate setting for private households – including the bundling problem – was considered to be part of a normal competitive situation. It is questionable whether Germany's federal government should have awarded the tender for such a study to the ZEW since the ZEW compiles a monthly economic sentiment indicator on the basis of survey data collected from bankers and other representatives of the financial market community (hence there is a conflict of interest in a study the title of which is "A study on interest rates on overdrafts and instalment loans"; how could the ZEW write a critical analysis pointing to more than doubtful bundling in the credit market?). The ZEW published as a co-author (iff/ZEW, 2012) a study that had neither an adequate theoretical basis nor adequate methodology – the whole study is not state-of-the art and even ignored the question of relevant markets; the claim that overdraft interest rates in Germany are largely the result of effective competition in credit markets is wrong. Any professional economic analysis would have come to the conclusion that overdraft interest rates in Germany, much higher than those in the Netherlands, Austria and many other EU countries, were incompatible with competitive markets; and that the bundling of loans and PPI should have been banned (it is this artificial anti-competitive bundling in credit markets that brings about the strangely high overdraft interest rates). A rough estimate of losses imposed by this strange situation on households buying PPI and loans indicates that €4 billion should be repaid to bank customers - cumulated over a decade, roughly 1.3% of annual GDP. Once ordinary people and workers, respectively, finally understand that they have been treated quite unfairly by the German government and banks, respectively, and that consumer protection has for almost a decade been weaker than in the UK in loan markets, this could further undermine the trust of voters in the Grand Coalition in the German Bundestag; although one may point out that not a single party in parliament in Berlin has raised public doubts about the inadequate iff/ZEW study.

If government is so negligent even in organizing a study on consumer protection in a key field, it is clear that this risks contributing to nurturing populism (in 2012 it was the German Federal Ministry for Food, Agriculture and Consumer Protection that was in charge of commissioning this study). Reforms in the field of consumer loans and real estate loans should not only be considered in Germany, but also in Spain, Italy, Poland, France and many other EU countries.

French populism to some extent has had a left-wing communist side on the one hand, on the other side there is the right-wing Front National which is a classical populist party; it has a party program that is anti-immigration, nationalist and protectionist (under the heading of "intelligent protectionism" which is largely a contradiction in terms). With Macron and his En Marche movement winning the presidential elections and the parliamentary elections in France in 2016, the expansion of French populist parties seems to have ended for some years, but if Macron's reforms should not work in economic and political terms, there is a risk that the populist, right-wing party could win the next presidential and parliamentary elections. Whether or not Macron's reforms will be successful depends to a certain extent on cooperation with Germany's government in key fields. Germany's Merkel-led government, however, seems to be rather weak: In early 2017 Merkel's attempt to start a new coalition, namely of the conservative CDU combined with the Green Party and the FDP (a liberal party), collapsed. Instead, the next Grand Coalition formed a government in 2017 which did not have many new ideas for reforms in Germany and the EU.

Populist forces are strongly active in Eastern European EU countries, including in Hungary and Poland where conservative/right-wing populist parties are part of the government. Since July 2018, Italy has had a government comprised of two populist parties: The right-wing Lega Nord and the left-wing Five Star Movement have created a government under the premiership of Giuseppe Conte, a professor of law. Eliminating the pension reforms which had been enacted under the government of Mario Monti – undertaken to restore the confidence of international investors in Italian government bonds in the midst of the Euro Crisis – was one of the main policy decisions taken in autumn 2018. The implication is a budget deficit-GDP ratio of 2.4% in the medium term if one is to believe the Italian government's own planning. Italian interest rates have increased considerably in September and October 2018 after the government's refusal to adopt a budget with an implied deficit-GDP ratio of less than 2%. The Italian government debt is 130% of national income. This means that an increase of the interest rate by 0.5% would cost government 0.65% of GDP in the long run in the form of higher interest payments. The structural deficit-GDP ratio of Italy would rise from about 1.5% of GDP in 2017 to a bit more than 2% in the long run which, along with a trend growth rate of 1%, implies that the debt-GDP ratio would be 200% in the long run. This is unsustainable for Italy and would bring about the next Euro Crisis which would primarily be an Italian debt crisis that would also go along with an Italian banking crisis – the latter would happen because Italian banks hold large stocks of Italian government bonds and fear that there could be a haircut on Italian government bonds (similar to the haircut on Greek bonds in the Euro Crisis 2010-2015) could trigger a run on Italian banks and would lead to the European Stability Mechanism (ESM) helping Italy within the framework of a conditional support program.

It is unclear how such a political path to instability in Italy would end: For Italy itself and for other Eurozone countries. France and Germany could try to support a broad Italian reform program, but this would require that Italy has a reform-minded government. One may point out that any Italian bonds market crisis will have major spillover effects on former Euro Crisis countries, including Greece, Portugal and Spain, which would make the bill for overcoming an Italian government bond market crisis rather large. Italy's populist government began with a phase of announcements of what it intended to do better than previous governments – this usually boiled down to the government proposing higher expenditures without clear ideas of how to avoid the next Italian government bond crisis. The only major advantage that Italy has with respect to the large Italian bond market is that Italy does not have much foreign indebtedness. Any government haircut of Italian debt in the context of a bond market crisis effectively means that Italians banks, firms or individuals who are holding Italian government bonds would face considerable wealth losses.

Could there be similarities between an Italian debt crisis and the Greek crisis of 2010-2018? Neither Germany nor France, nor indeed the UK nor the US, would want that Chinese investors buy large parts of Italy's infrastructure as has happened in Greece in the course of the Greek crisis. At least it is conceivable that Germany and France would try to help Italy to get EU funding for implementing a broadly accepted Italian reform program designed to generate more output growth. For years, the European Commission has emphasized that Italy's productivity growth and output growth rates are too small, but neither the German nor the French governments have understood that a lack of EU support for Italian reforms, for example the Monti government reforms, would in the end destabilize not only Italy but potentially the whole Eurozone and the EU, respectively.

There is not much doubt that the Trump Administration will try to encourage populism in Italy. The populist Conte government in turn is eager to reinforce cooperation with the US where the hope is that this could reinforce Italian firms' position in the US on the one hand, on the other hand Italy's populist government will find it easier to defend its agenda in Europe if it has support from the US. A populist US policy stance might encourage a more protectionist Italian policy attitude. As China has become a major investor in Italy one might, however, witness that Italy could become more exposed to the US-Sino trade conflicts in the medium term.

Trumpism and BREXIT

US populism under the Trump Administration is a political approach that is not unfolding alone in the Western world. Interestingly, the UK, has also adopted a partly populist policy under the heading of BREXIT – with an anti-immigration focus in the Brexiteers' campaign for the EU referendum in 2016. The first visit of the newly elected Prime Minister, Theresa May, was to the US where she was welcomed by US president Trump in Washington DC who signalled that the US would support the UK's BREXIT course and that an envisaged free trade agreement US-UK should be feasibly achievable relatively quickly. Formally, this is possible only once the UK is no longer an EU member country, since the European Commission is the body responsible for negotiating a free trade agreement on behalf of all EU countries; the EU is a customs union which has common import tariffs for all its member countries.

Even during the presidential campaign, President Trump had already argued that he would support BREXIT and that he was expecting to see more examples of disintegration in the EU. This was a historical about-face with respect to the US foreign and economic policies which had been supportive of EU integration since the early 1950s. There are several questions related to BREXIT and the US:

- To what extent is BREXIT a negative impulse for the global financial center of London and what are the effects on the US and New York, respectively.
- The UK post-BREXIT will want to pursue a Global Britain approach – as explained by the May Government (HM GOVT., 2017). This means that the UK would like to conclude many new free trade agreements, for example with India, China, the US, New Zealand, Canada and Australia. Global Britain means that the UK, facing weaker access to the EU single market post-BREXIT – with slightly more than 45% of UK exports going to the EU27 in the referendums year of 2016 – would seek to promote high trade growth opportunities in other parts of the world economy. Such agreements could possibly be realized within a few years, most likely in the case of the US, Canada, New Zealand and Australia. However, if there would be a conflict between the UK and the US – or in the case of a UK-India free trade agreement, with India – the United Kingdom would normally want to rely on

the World Trade Organization (WTO). The UK itself is too small, about 2.7% of global income in 2017 (based on purchasing power parity figures) to solve trade conflicts on a quasi-bilateral basis; rather the UK would want to rely on a multilateral World Trade Organization solution. This organization, however, is facing the problem that its dispute settlement mechanism will collapse in 2019 as the US is blocking the election of new judges for the appellate body and this means that the Trump Administration officially supports BREXIT, on one hand, but is undermining the UK's future trade policy orientation through weakening of the WTO, on the other. Some judges are retiring in that court in 2019 and below a minimum number of judges the appellate body cannot work. The trade policy course of many countries might already start to change, embracing a more protectionist attitude, once countries start to anticipate that the WTO dispute settlement mechanism is not working (on the WTO see PAYOSOVA/HUFBAUER/SCHOTT, 2018). Hence the post-UK trade policy is facing a potential conflict with the US Administration if it should continue a protectionist and anti-multilateral policy.

- The UK will face problems in the sense that EU membership – according to empirical analyses (see WELFENS/BAIER, 2018 for foreign direct investment aspects; EICHENGREEN, 2018b, for portfolio investment) – reinforces the country's attractiveness for international investors. Once the UK leaves the European Union – with the overall impact then determined by how sharp, in economic terms, BREXIT will be as an economic separation between the EU and the UK – capital inflows to the UK will decline. This would cause a strong depreciation of the Pound and thus higher UK inflation rates: Instead of the 1-2% in the years immediately prior to 2016, an inflation rate of 3-5% could characterize the UK in the decade after 2016. The UK will not want to face declining capital inflows, in particular in relation to lower greenfield foreign direct investment inflows – i.e. the creation of new firms and production capacity, respectively, by foreign investors - and lower portfolio capital flows would be a problem. The UK government is likely to further reduce corporate tax rates and also to adopt a deregulation of banks in order to minimize net capital outflows and to raise gross capital inflows post-BREXIT. Lowering corporate tax rates in the UK will bring new political tensions with the EU which already faces downward adjustment pressure from the Trump corporate tax reforms of 2017. With the UK and the US both reducing corporate tax rates, these two countries will create global pressure for lower corporate taxation and thereby will contribute to growing income inequality. The already increased income shares of capital owners will further increase and in a mirror perspective the income shares of workers will fall. While the UK is smaller than the US in economic terms, there is no doubt that BREXIT will affect the EU countries as well as other countries negatively not only through direct economic effects, but also via the UK policy-induced side-effects of BREXIT which matter significantly. If the UK and the United States would pursue a parallel banking deregulation policy this is likely to be an impulse for a future international banking crisis: The two globally leading banking centers, that is London and New York, would put strong pressure on the Eurozone and the EU27 to also adopt new deregulation of banking and this would bring western OECD countries largely back to a pre-2007 situation in the long run.

- BREXIT also means that the representation of European countries in leading international organizations, including the Bretton Woods organizations, is bound to face some marginal adjustment (EICHENGREEN, 2018b). The changes in these organizations and other financial institutions could partly be considerable, for example in the context of G20/Financial Stability Board rules (FSB rules come under the heading of the Bank for International Settlements). The G20/FSB initiatives to move standardized derivative contracts into central clearinghouses could be undermined; the European Central Bank wants to have control over Euro-denominated derivatives clearing, but new regulations that would effectively mean pressure on London-based dominant clearinghouses to move business to the Eurozone is likely to bring a lower degree of liquidity to this field of financial markets and efficiency losses also can be expected.

BREXIT will economically weaken the UK in general and the City of London, the UK's financial center, in particular. As new EU passporting rules for UK banks cannot be expected, part of the London financial services will be relocated to the US, part of those services will also be relocated to EU27 countries as banking foreign direct investment outflows from the UK will go, for example, to France, Germany and Ireland as well as a few other EU countries. For the Eurozone this could mean some problems in the form of lower interest rates in safe haven countries, such as Germany and France, while Italy – facing for 10-year government bond spread of 3 percent vis-à-vis Germany – with its populist government and a rather high deficit-GDP ratio (planned deficits are 2.4 percent for three consecutive years) could come under considerable pressure from financial markets; not least because the Italian debt ratio is slightly above 130% in 2018. If the UK and the US continue to reduce corporate tax rates, the Eurozone countries would face strong pressure to also reduce corporate tax rates and this in turn could raise the deficit ratio of Italy. One should, however, not rule out that Italy's expansionary fiscal policy – with only the cutting of tax rates for small firms being a supply-side impulse – will not generate much additional growth. The long run government debt-GDP ratio is determined, according to the Domar rule, by the ratio of the trend deficit-GDP ratio to the real long run growth rate of gross domestic product. If the Italian trend growth rate would be 1.5% and the deficit-GDP ratio were 2%, the long run debt-GDP ratio would be 133.3%. This is fairly high and could be manageable if the share of foreign indebtedness of Italy would remain rather low which in turn requires that Italy has a long run current account surplus – or a rather modest current account deficit-GDP ratio. It is not so surprising that Italy's electorate have finally voted for radical populist parties, on both the left and the right of the political spectrum: For 20 years, Italy has suffered from a stagnating real per capita disposable household income, between roughly 1995 and 2015 there was a very long stagnation period for Italian real household income.

6. Policy Conclusions for China

China's political leadership had been impressed by the Western world's winning of the Cold War and the demise of the socialist system in 1990/91. The historical political psychology in China is to admire an economically and technologically dominant country so that China after 1991 wanted to reinforce its co-operation with the West in the 1990s – and indeed this strategy continued until the US Banking Crisis of 2008. Only then did the Chinese government become more interested in reinforcing its co-operation with the EU.

In addition, the plans for “One Belt, One Road” – a new Silk Road – favored EU countries and possibly countries in Asia and Africa. Part of the new maritime Silk Road would be based on existing and new ports in Asia and the maritime Silk Road naturally allowed to reinforce trade relations with Africa where China and Chinese firms, respectively, bought large areas of land and also became major investors. In Africa, the main rivals were France and the UK plus the US. The United Kingdom and France have a long colonial history in Africa and parts of Asia.

China’s leadership has understood in 2018 that the country will be quite vulnerable to US protectionism under Trump. The strategy of the Trump Administration to push China in various ways – temporarily denying access to US chip technology – and progressively raise import tariffs, in addition to import tariffs on steel and aluminium, is bound to encourage China seek a political reorientation; less cooperation with the US. For China, the US was an admired partner before its banking crisis of 2007-09 but in the course of that crisis the US lost part of its global leadership position. China must seek some form of co-operation with Russia for practical security reasons and both countries have a joint interest in not allowing a reunification of Korea. For China, the strategic disadvantages and the psychological defeat would be too obvious, while for Russia the strategic perspectives of having the US military establish a foothold in the northern part of a reunified Korea are also undesirable. As regards economic cooperation, Russia is not a leading global partner. Clearly, the EU could play such a role provided that EU integration remains on course and no further BREXIT cases would follow; this disintegration impetus, however, is precisely what the Trump Administration is aiming at. It is not unfair to say that Trump as a political layman – before being sworn in as US President in January 2017 – has no broad strategic understanding of international economic relations and of the role of International Organizations. He is apparently convinced that nationalism, sometimes dubbed patriotism, should be the natural policy orientation of the US and all other countries. The last time this view was shared by the leading countries of Europe was in the late 19th century and there is not much doubt that a new global wave of populist nationalism would sooner or later lead to new international conflicts, possibly including military conflicts.

China’s political and economic relations are shaped by the interest in getting access to the EU single market and – since the start of the Trump presidency - by using the EU as potential counterweight to the US. The earlier Chinese approach to the EU, under the heading “16+1”, which was viewed critically by the EU Commission, is likely to get a lower priority ranking in Beijing in the medium term. China’s main interest is in building a strong economic and political bridge to the EU27 which, however, it views as having been weakened through BREXIT. The UK, once separated from the EU27, could rapidly become a simple target for China. With the UK facing reduced medium-term economic prospects post-BREXIT, China has two new options:

- Through a Sino-UK free trade agreement, the UK would increasingly become dependent on China in economic terms in the long run as China’s output growth rate is expected to exceed that of the US for at least two more decades. The conditions for Chinese market access to the UK should be rather favorable for China as the UK is economically and politically weakened through BREXIT; its economic weight is 1/5th of the EU28 so that China will get much better conditions for UK market access than would have been the case if China had concluded an agreement with the EU28. While one may not exclude that a populist US administration might want to discourage a UK-Sino free trade agreement for strategic reasons, the strong interest of the UK to raise economic growth through more trade with China seems likely to be the overriding influence in the long run.

- With the strong real Pound depreciation in the course of BREXIT, Chinese firms (often state-owned enterprises) face rather favorable conditions for taking over British firms. The economic influence of China would thereby increase strongly in the medium term. Chinese firms could be eager to buy both industrial firms as well as service providers in the UK and also to expand its investment in the infrastructure sector. Electricity generation, transportation and other fields are of particular interest for China.
- British universities will offer better conditions to students from Asia in the future as studying in the UK has become less attractive for EU27 students as well as for students from OECD partner countries post-BREXIT. With political relations between the US and China weakening, China has already to some extent signalled in summer 2018 that fewer Chinese students would study at US universities in the future.

The EU and China might see each other as rivals in Africa, but the regional foreign direct investment differentiation is broad enough in that region that EU and Chinese relations should not stumble over new fields of conflicts there. Finally, the EU will need the support of China to maintain the multilateral trading system. The combination of the EU, ASEAN, Mercosur, ECOWAS, China and some other countries could be strong enough to maintain a multilateral system. There is, however, the risk that the Trump Administration transforms the global system step-by-step into a managed, US-dominated system based on bilateralism. Japan which had been hesitant to negotiate with the US about a possible free trade agreement – the hope was rather to get the US on board as a signatory to the Trans-Pacific Partnership (TPP) agreement – has in October 2018 accepted to indeed start bilateral Japan-US talks.

With the US providing the nuclear umbrella for so many countries in Asia, it was easy to push Korea to accept a revised trade agreement and along the same logic Japan and other countries could follow suit. The Trump Administration, however, will hardly be in a position to undermine the ASEAN group which itself is successful in its economic development and which is certainly a preferred new partner of China. With US-China trade relations worsening under the Trump Administration, Chinese firms have started to strongly raise foreign direct investment in ASEAN as the management of those firms hopes to be able to export from ASEAN countries to the US without serious impediment. This will become an indirect challenge for EU countries and EU foreign investors, respectively, which had so far held the leading position in the field of foreign direct investment in ASEAN. At the bottom line, one may expect that Chinese firms will be pushed by the Sino-US trade war to accelerate the creation of Asian production networks. This is a process that is facilitated by modern digital technologies as the ADB (2014) has shown in its analysis. Since China itself is a strong player in digital innovations, one may expect that China's Asian production networks will indeed expand at an accelerated pace. With more technology-intensive and knowledge-intensive Chinese production established in ASEAN, China's economic and political influence in this region is bound to increase. The presence of ethnic Chinese groups in Singapore, Malaysia and some other ASEAN countries could reinforce this Chinese networking. One may, however, argue that the free market-oriented Chinese bankers of Singapore – whose parent families fled from China in the 1960s – do not share the ideological views of the Chinese government.

China's efforts to reinforce its economic role in Asia partly are manifested in the One Belt One Road initiative: Building a new or modernized infrastructure transportation network – the new Silk Road(s) – could help to generate more trade and to reinforce China's political role in Asia. The Asian Infrastructure Investment Bank (AIIB), located in Beijing and to some extent dominated by China, offers favourable financing packages for various infrastructure projects in this context. One may note that the AIIB is one of the few international organizations in which China's government takes a rather active role. For China, this multilateral policy perspective is a rather new option for its foreign and commercial policy.

7. Policy Conclusions for International Organizations

President Trump's nationalistic policy orientation has an overlap with an established political current in the Republican Party to consider international organizations as doubtful institutions that cost taxpayers' money and could impair US policy autonomy. It is quite obvious that President Trump gives only weak support to international organizations. The US Administration under President Trump could pull out of major international organizations such as regional multilateral banks (e.g. the Asian Development Bank (ADB) or the European Bank for Reconstruction and Development (EBRD)) arguing that any such membership costs the US taxpayer a lot of money and generates uncertain benefits for the US – actually often delivering greater benefits for other countries involved rather than the US. For example, if the US would have a lower profile in the ADB, this would indirectly reinforce the role of Japan as the leading ADB country on the one hand; on the other hand, it would reinforce the role of the Asian Infrastructure Investment Bank (AIIB) - with its seat in Beijing. The US is not a member of the AIIB while many EU countries, including the UK, France and Germany are founding members. The idea that the US would gain from weakening the international organizations in which it mostly has a dominant role or could block major decisions is as unconvincing as the idea that the UK will gain international power by pulling out of the European Union (EU28 is roughly 5x the UK's economic weight alone).

Multilateralism means a rule-based international system with a crucial role for International Organizations that help to implement international law. In the words of the Secretary General of the WTO – as expressed in a speech in 2017 – multilateralism means "to make the small big and the big civilized". The idea is that big powers that have tied their hands to the rule of international law would be a fairer partner for the large group of small countries in the world than otherwise. In International Organizations the small countries have – as a joint group of countries – a voice in international economic policy. The role of small countries is enhanced if the countries are part of a regional trade integration club.

The bipolar order of the Cold War of 1944-1991 (the year when the Warsaw Pact and the Soviet Union dissolved) was one in which the world market economy was shaped by the

United States and its political and military allies. US leadership and the international organizations that had been created in 1944 (IMF/World Bank) and the following decades (e.g. GATT: 1947; WTO: 1995) have helped to achieve the international public good "free trade" and "financial stability". The OECD as an institution which helped to coordinate fiscal policy among industrialized countries – as did the G7 in an informal way – also played a role.

However, the system failed in preventing the Transatlantic Banking crisis of 2007-09; despite the fact that after the Asian crisis of 1997/98 the IMF had introduced the Financial Sector Assessment Program (FSAP) and despite the warnings of the Bank for International Settlements which since the 1970s has played a crucial role in designing rules for prudential supervision (the Basel Committee on Bank Supervision (BCBS) was created in 1974, the Basel Accord I rules for international banks were adopted in 1988, followed later by Basel II and Basel III). The system thus was augmented by an active G20 – with a first meeting in November 2008 on the Transatlantic Banking crisis - which brought China, India and other countries into a role of more shared international economic policy responsibility.

However, the G20 is a rather heterogeneous group in terms of per capita income of member countries and the size of the countries, involved. The list of promises enshrined in communiqués is long, but there is no clear track that the promises made were held – with the remarkable exception of the G20 Brisbane summit of 2014 when countries promised to increase real GDP by an extra 2% by 2019.

A key question is which alternative international regime would emerge once International Organizations have become rather unimportant, for example by the US bypassing these institutions; and what would be the economic and political consequences of such a development. It is most likely that a new grand power regime would be established – with the US, Russia and China being these grand powers and all other countries having to decide which of the grand powers they want to join as a political vassal. The South China Sea will become a major area of new conflict; with the UK and France also sending naval forces to the area although one cannot easily understand what is at stake there for these two European countries. For China, this is a new situation and it might have to accept some European military presence in the area since the key merchandise shipping routes between the EU and Asia will have to be protected by European countries. This will be all the more important as the EU-China and EU-ASEAN trade will grow in the long run, and since NATO is weakening so that Western European countries are less likely to rely on US military protection. A broader EU-China dialogue in all fields of policy would be useful and it is obvious that the EU will push China to remain a supporter of multilateralism. A major problem of China's international political role is that it has accumulated relatively limited experience in multilateralism over a very short time period, basically starting with WTO membership in 2011, followed by the new Chinese financial policy approach through the AIIB.

Multilateralism has been based on International Organizations as they were emerging in a small number in the late 19th century and in much greater number (and role) after 1944. Historical globalization of the 1860s to 1914 created a rapidly growing network of trade and international capital flows and at least in some fields – concerning, for example, postal service, telegraphy and patent protection – European countries plus the US and other countries joined forces to use international law and international organizations to facilitate the exchange of goods, knowledge and information. The leading country of the system was the UK which had lost its global economic leadership around 1900 – with the US becoming the No. 1 in the world economy, but there was no political ambition in the US to play a continued international political role beyond fending off European intervention in Latin America (with the Monroe Doctrine stating the willingness of the US not to accept European interference). The Democratic President Woodrow Wilson, who led the US into World War I and pushed for a new international order in which the League of Nations should play a major role, did not manage to convince the US Senate to follow his plan for this new order so that the US stayed outside. The UK was too weak to provide strong international leadership and Germany as well as Japan left the League of Nations in the 1930s. It was only in 1944 that the US adopted a new strategy and pushed for a multilateral order based on increasingly powerful International Organizations – a strategy that included support for EU integration; a strategy that ended in 2017 with Trump taking office. One may notice that part of the Republican Party stands for a rather isolationist international position and certainly for a deep mistrust in the role of International Organizations which are considered as being dominated by non-US countries and corrupt foreign governments that do not care much about efficient leadership and governance in international organizations.

Differentiated Economic Globalization

It was only in the early 1970s that the UN recognized that the world economic order did not have an institutional design and was not shaped by principles that would encourage the economic catching-up of the South vis-à-vis the North. Taking a look at the early 21st century one may emphasize that there has been much catching-up internationally since the 1970s in some parts of the world economy. This holds despite the fact that the UN was hardly successful in shaping a new world economic order. It was not so much changing institutions at the global level, but rather regional economic catching-up dynamics in Asian and Latin American newly industrialized countries (NICs) that helped to raise global growth for part of the world economy – with Asian NICs following Japan to some extent; and Asian NICs' export growth then contributed to worsening terms of trade of the socialist countries in Eastern Europe and the Soviet Union in the decades after 1970; until the Soviet Union and Eastern European socialist countries collapsed in 1989/90. In Eastern Europe, it took about two decades to organize broad and successful modernization of the post-socialist transition countries – with the European Union and the European Bank for Reconstruction and Development (EBRD) strongly contributing, as external forces, to the successful modernization of many countries. A revival of political nationalism went along with the post-socialist transformation in many countries of Eastern Europe which enjoyed the new found political freedom, namely to no longer be a vassal state of the Soviet Union which had disintegrated in 1991. In Hungary and Poland, in particular, a new nationalism became visible after 1991 and in these countries indeed populism also started to grow.

The role of international organizations has increased since the 1970s in some policy fields, however, it was not so much the global UN which oversaw the leading institutions, rather there was a strong role of the IMF and the World Trade Organization whose membership base could be widened not least after the collapse of the socialist countries. There was obviously a need for more international cooperation; with the US and the EU really pushing Eastern European countries to join the leading global institutions.

In 1974, the UN adopted an action program for a New International Economic Order: the UN stated (JAMES, 2002) that the present order has not allowed to achieve long term and stable economic dynamics. The gap between North and South is increasing, the present system was created before developing countries existed; the current system was considered as to be likely to reinforce economic disparities in the world. Key elements of UN proposals were (i): Support of producer organizations from Less Developed Countries; (ii) improving conditions for the transfer of financial resources to LDCs. In a special general assembly there was a debate about a UN Charter of economic rights and duties of member countries.

While the UN did not contribute much to international economic catching-up in the 1970s, it was more successful in pushing the topic of environmental modernization – with the Stockholm conference of 1972. The state of the environment became part of the policy approach of OECD countries and actually of most UN countries in the decades following; and even China, the new economic giant in the early 21st century, came on board for green modernization and signed the Paris Protocol designed to fight global warming. It was the US under President Trump which became the first OECD country that pulled out of the Paris Protocol. China itself had become part of the global market economy after opening up in 1978 and finally joining the World Trade Organization in 2001. However, China is not a small open economy whose opening up creates marginal adjustment burdens for its partner countries. For some of these countries, at least in some sectors, the strong growth of China's exports has created significant adjustment pressures.

The idea of solving international conflicts trough international law goes back to modern history, particularly to the German philosopher Immanuel Kant (1795) who wrote an influential booklet titled *Zum Ewigen Frieden*/Perpetual Peace: A Philosophical Sketch. He argued that this could be reached by responsible government in republics; treaties between countries would help to achieve perpetual peace and no secret clauses within peace treaties would be allowed. Woodrow Wilson, the US President who helped to create the League of Nations after World War I – although the US itself did not wish to participate as the vote in Congress showed – was clearly inspired by the thoughts of Kant who was convinced that a democratic country, a republic, would be very hesitant to go to war. The idea of Kant that peaceful cooperation among countries would be in the interest of all countries was shared by David Ricardo who emphasized that trade between countries was one element to reinforce peace. It is, however, obvious that only growing trade is a necessary condition for peace. At the same time there are clear arguments that declining trade intensity could undermine peace and raise the risk of war. Thus countries pushing for protectionism are not only causing negative welfare effects but also are likely to undermine peace in the long run.

For the majority of small countries in Asia, Europe, Latin America and Africa, the system of International Organizations and multilateralism is very valuable; as it was also for the US over decades. China seems to support multilateralism and the creation of the Asian Infrastructure Investment Bank– with its seat in Beijing – has been a key step towards a more multilateral (and also regional) approach in China. The US under Obama had adopted TPP in order to create an American-Asian regional integration network that should also establish a counter-balance to China, but Trump had quite different views; or he simply did not understand the logic of TPP and of TTIP. One should note that TTIP – and in a less pronounced way TPP – stand for deep integration approaches that generate benefits in the form of higher trade, higher FDI flows and an acceleration of innovation dynamics in the countries concerned (see on TTIP: JUNGMITTAG/WELFENS, 2016; the authors use a knowledge production function to analyze the key points of TTIP – and beyond this use a macro production function).

With President Trump, from the non-tradables sector, weakening multilateralism in many ways the question has to be raised: Wither multilateralism? The EU and China as well as ASEAN are three supporters of multilateralism. For China a serious leadership role in this context is quite unusual and it is not clear how strong China's role could be here. The EU27 will be weakened after BREXIT but it could join political and economic forces with the other regional single market in the world economy, namely ASEAN and push for a very broad cooperation and joint transregional liberalization, for example in the Mercosur-EU-ASEAN triangle. If one would include China in a reliable way, one could imagine that the trilateral regional integration club plus China could be strong enough to fend off Trump's bilateralism and his determination to bury International Organizations (not only is the WTO on his list for phasing-out, but the Trump Administration has also been very hesitant in 2017 to support the BIS, not to mention leaving the Paris Climate Convention in 2017 and leaving the UN Humanitarian Rights Convention in 2018). To fight international cooperation was a hallmark of the nationalism in Germany and Japan in the 1930s.

In the early 21st century digital modernization and global networking is crucial for all countries – possibly with the exception of North Korea. In the digital field, the ITU (Geneva) should play a more active role. One should not overlook opportunities to consider comparative regional integration analysis and to possibly develop interregional networking initiatives that could in principle lead in the end to a worldwide network of formal or informal co-operation. One can also identify particular successful policy reforms that could serve as a basis for encouraging reforms in other countries. Moreover, as digital expansion is a global phenomenon – as much as the problem of global warming which thus calls for UN activities in order to create a global public good, namely climate mitigation – one could also particularly consider certain fields of digital rule-setting with global relevance: For example, global competition policy and the provision of global data security; sufficient telecommunications network investment as well as digital innovation dynamics – often with positive international/global spillover effects – are important as is avoiding global negative international digital spillovers (the Internet-based diffusion of viruses or trojans) should be avoided. Millions of unsafe Internet W-Lan networks in hotels – with access offered to guests for free – are part of the problem; these unsafe W-Lan connections should be heavily taxed by all governments and countries which refuse to effectively forbid unsafe W-Lan-connections should face economic sanctions which could, however, be implemented only if all UN member countries would pay upfront a certain deposit into an escrow account of the UN. The World Bank's capacity building experience could be very helpful in building more safe digital networks around the world. Adequate immigration policy partly could help to contribute to North-South economic convergence.

8. International Policy Conclusions

If the largest OECD economy, the US, is facing a structural populism problem, one should not consider a national policy reform perspective alone due to the size of the United States and the many international spillover effects it would generate; some of them will come incidentally, others systematically through trade and investment mechanisms; plus those impulses that would stem from the ideological export of US populism. The latter means that the nationalist and protectionist policy approach of the US would find countries in Europe and elsewhere which are willing to imitate the US policy course and this is bound to create new conflicts within Europe and elsewhere. A US policy that is nationalist, protectionist, anti-immigration and anti-multilateralist would send strongly destabilizing signals to the world economic order; the new US approach and declining financial contributions to international organizations mean that the UN, the IMF, the World Bank, regional multilateral banks such as the Asian Development Bank and the EBRD in London, plus the Bank for International Settlements, the OECD and the ILO would be likely victims.

For the EU, a return back to nationalism and protectionism could not mean that the British emphasis on maintaining free trade would be the motto of most countries, but creating new and old groups of regional leadership and new political rivalries within Europe once the EU has been broken apart. Germany is likely to pursue some new “Mitteleuropa” strategy where it would assume the role of the regional center without any support. In such a new regime, some countries would gain relative power for a time where the UK would try to create a new network group with Scandinavian countries, Switzerland. France would most likely seek to create a Mediterranean influence group which could include Portugal, Spain, Italy and Greece.

Russia would again seek to exert a strong influence on countries in the Balkans and China would be a new actor in Europe, compared to the 19th century. China would have some influence on certain countries in Eastern Europe and the Balkans and thus could get into a conflict with Russia and potentially also with Germany following its new ‘Middle Europe’ policy. China would build on its relatively young 16+1 cooperation format which is an initiative with a focus on 11 Eastern European EU members plus five Balkan countries (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia and Slovenia). The main areas of cooperation envisaged in the 16+1 approach are infrastructure investment/transport, finance, science and education/culture. Within the framework of the initiative, China has emphasized three key areas for economic cooperation: Infrastructure, high technologies and green technologies. China would have to cooperate with Russia to a certain degree since all Western Europe-China trade transported by rail would pass through Russian territory. If there would be an intensifying US-Sino political and military rivalry, China would no longer want to put a clear priority in terms of commercial transportation on the maritime links between China and Western Europe – too great would be the potential threat to these transportation routes through areas dominated by US naval power. The rivalries emerging would be more complex than in the late 19th century which is known to have ended in World War I.

The key requirements for avoiding a remake of the 19th century in Europe is to maintain the process of European integration and to roll-back populism in the US. According to the analysis presented herein, the main driver of populism in the US is a structural contradiction between the perception of an increasingly uneven and unjust income distribution in the United States and the lack of effective remedies to deal with this situation. It is obvious that President Trump could generate some moral suasion pressure on some big companies, for example Amazon, to raise their lowest wage bracket – Amazon indeed raised the minimum wage paid in the US in October 2018 (and it also raised the minimum wage in the UK: With a top-up in London exceeding the new company-wide minimum wage in the rest of the UK). However, such selective policy intervention cannot replace what would be necessary to achieve a less unequal income and wealth distribution in the US. Adequate policy options could consider the following four aspects:

- The US Administration could create a rule on the transparency of remuneration of companies so that every company would have to publish the remuneration of top managers relative to the lowest wage bracket. Such information should be available on the Internet and must be based on data certified by the companies themselves. There is a risk that some companies could eliminate very low wage brackets and thus also eliminate poorly paid jobs, but this risk is rather modest and empirical evidence could then be a basis for final reforms here.
- The US might want to consider moving away from a pure shareholder economy to what is a stakeholder economy model; some form of workers' interest representation or of trade union influence would have to be considered.
- The US government could increase the federal minimum wage which is fairly low.
- The US government should not accept artificial wage limits as set in Mexico as a result of certain strange union practices which prevent wage increases in US subsidiaries. Other countries concluding free trade agreements should never accept artificial limits on factor remuneration in the host country – such limits run absolutely counter to the normal wage and adjustment dynamics which are usually observed in competitive economies (with rather limited corruption).
- The US should revert to supporting the OECD BEPS initiative which should help bringing about more equal and fair taxation across countries. The Trump tax reform has in effect been equivalent to weakening the BEPS initiative of the OECD.

A serious problem of the US Administration is the emphasis on bilateralism and indeed an anti-multilateralist policy agenda. The idea of President Trump to have an advantage for the US through bilateralism is an illusion on three counts:

- Seriously weakening and indeed destroying the system of International Organizations – with so many dominated or at least strongly influenced by the US – amounts to a high depreciation rate of organizational capital and institutional reputation which have facilitated the formation of expectations of market participants and politicians worldwide for decades (TILLY/WELFENS, 2000). Without such an institutional anchoring of the behaviour of countries and the expectations of firms and countries through international organizations, government actions in many countries could become less predictable and more radical, hence more conflict-prone.

- The world economy has been organized through regional organizations (e.g. the EU, ASEAN, Mercosur or the regional development banks, including the EBRD and the ADB) in groups of countries; such groups could also be identified with global organizations; and both regional and global organizations have been useful in solving international conflicts (e.g. in the field of trade). Each group has some internal leadership, be it formal or informal. The US influence at the global level has been predominantly based on US power itself, but also on generating political support of whole groups of countries rather easily – communication with the respective leadership was often quite helpful: Hence the US Administration saved many political resources through this strategy. A purely bilateralist policy would have to coax or push more or less all individual countries into supporting the US which is a costly process and which can easily lead to inconsistent actions as this approach is very complex and time-consuming.

US populism is likely to continue to be a major challenge for many years to come. It would be good if scientists could become more visible on the internet and if scientific institutions could better explain the key insights from their respective fields in order to reduce public confusion in the context of fake digital information and news.

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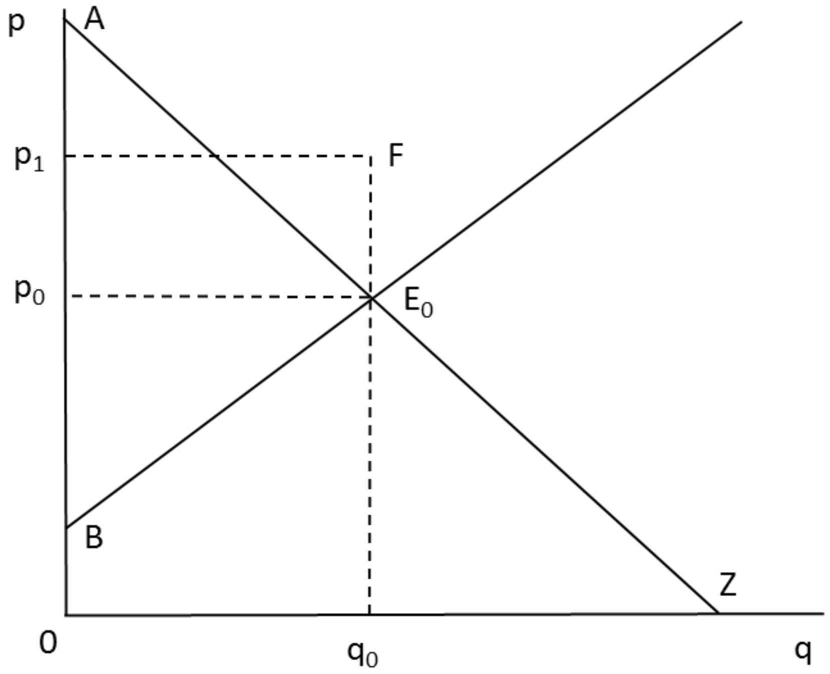
Appendix

Appendix 1: Full Price Discrimination* (Based on ICT)

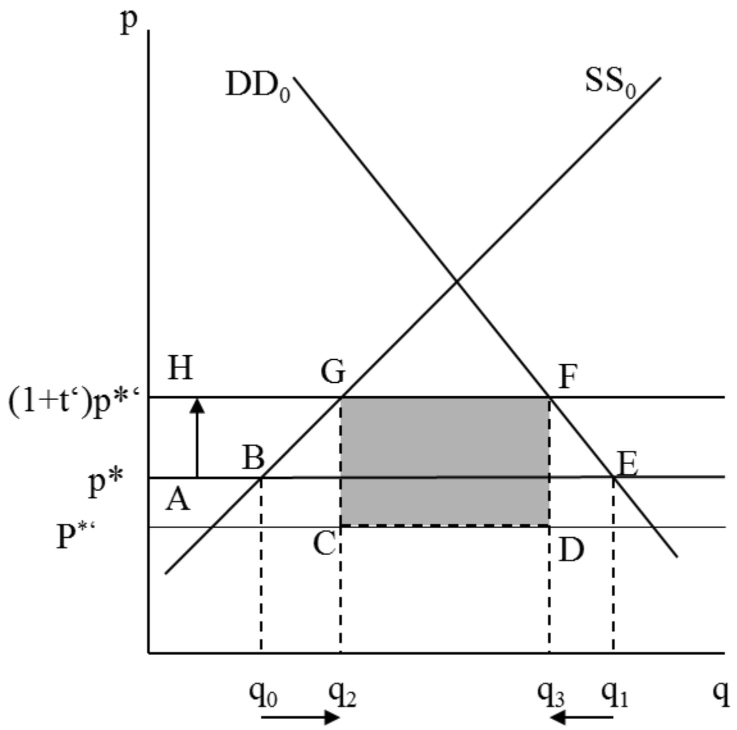


Source: Own representation. Note: * $\overline{Ap_1} = \frac{1}{2}\overline{Ap_0}$, initial profits p_0E_0B increase by area $p_1FE_0p_0$ which is equivalent to consumer surplus.

Welfare Loss from Taxation (and Import Tariffs)

Consider an import volume tariff rate t'. A simple partial equilibrium analysis will show now the tariff-ridden price p' and the net of tariff price p_1, the difference being t'; the marginal product curve k' is assumed to be given by k'= c>0. The consumer surplus is AEp_0, the producer surplus is OEp_0. It is assumed that the demand curve is q= a – b(p+t') where a and b are positive parameters. The tax-/tariff-induced welfare loss is the triangle EFG which can be calculated as 0.5 t'(q_0-q_1) = bct'^{2}/(2(b+c)) since the equilibrium net price is p= (a-bt')/(b+c) and the equilibrium quantity is q_1 = c(a-bt')/(b+c). The welfare loss is quadratic in the tax rate/import tariff rate. The welfare loss depends on the parameters b and c only. The higher c and b are, the higher the welfare loss is; high marginal costs and a low elasticity price sensitiveness of demand imply rather high welfare losses. The welfare loss would increase if the marginal cost parameter were a positive function of t' and lnt', respectively; this is rather likely since firms' allocation of time to avoid being taxed at tax rate t' will positively depend on t'. However, if government spends revenues t'q_1 in part on the promotion of process innovations in this sector, the welfare loss would be a bit smaller than indicated by the traditional (quadratic) formula above.

Figure 4: Taxation/Import Tariff (The Case of a Big Country)



Source: Own representation

If one assumes that there is a good imported by a large economy, the optimum tariff literature says that the optimum tariff is 1/ε where ε is the output elasticity and all goods, by assumption, are produced abroad. The optimum import tariff for a small economy is zero since the small country cannot affect world market prices by importing a lower quantity after imposing a tariff. There will always be a loss of consumer welfare that exceeds the tariff revenue. In the case of a big economy, there will be a reduction of the world market price so that part of the tariff revenue stands for a welfare gain that could be larger than the deadweight loss and this leads to the question of an optimal import tariff.

Now, let us assume that a share of the sectoral capital stock of the respective sector is φ. Then the optimum import tariff is no longer 1/ε, but is smaller: The new term is (1/ε)(1-φ’φ) where φ’ is a positive parameter in the range 0,1 (WELFENS, 2018). This reflects the fact that pushing down the world market price through an import tariff will reduce profits abroad – part of which are the profits of subsidiaries/firms abroad owned by investors from country 1.

Appendix 2: IMF World Economic Outlook, October 2018

The IMF's World Economic Outlook from October 2018 is not so optimistic for the US growth in the medium term – with some key insights explained in the subsequent Box (IMF, 2018b; p.19).

Box 1.2. Growth Outlook: Advanced Economies

Advanced economies are projected to expand by 2.4 percent in 2018 (a marginally faster pace than in 2017) and 2.1 percent in 2019. Growth in advanced economies is expected to decline to 1.7 percent in 2020 as the US tax cuts are partially reversed, and to 1.5 percent in the medium term as working-age population growth continues to slow.

• *Growth in the United States is expected to peak at 2.9 percent in 2018, supported by the procyclical fiscal stimulus after eight consecutive years of expansion and still-loose financial conditions (despite expected monetary tightening). Growth is expected to soften to 2.5 percent in 2019 (a downward revision of 0.2 percentage point relative to the April 2018 World Economic Outlook (WEO) due to the recently introduced trade measures) and to drop to 1.8 percent in 2020 as the fiscal stimulus begins to unwind. Strong domestic demand is projected to push the economy above full employment and increase imports and the current account deficit. Medium-term growth is forecast to temporarily decline below potential at 1.4 percent as the positive output gap is gradually closed.*

• *Growth is projected to remain strong in the euro area, but has been revised down by 0.4 percentage point to 2.0 percent for 2018, reflecting weaker-than-expected performance in the first half of the year. Growth is forecast to gradually slow further to 1.9 percent in 2019, 0.1 percentage point lower than the April forecast. Healthy consumer spending and job creation amid supportive monetary policy are expected to continue to provide strong aggregate demand, though at a moderating pace. Short-term profiles of country-specific growth rates vary. In France, growth is expected to moderate to 1.6 percent in 2018 and 2019, 0.5 (0.4) percentage point weaker than in the April 2018 WEO for 2018 (2019), reflecting softer external demand as well as lower outturns and high-frequency indicators in 2018. In Germany, growth was revised down to 1.9 percent in 2018 and 2019 (by 0.6 percentage point and 0.1 percentage point, respectively) because of a slowdown in exports and industrial production. Italy's growth forecast is also lower than in the April 2018 WEO, estimated at 1.2 percent for 2018 and 1 percent in 2019, because of the underlying deterioration in external and domestic demand and uncertainty about the new government's policy agenda. In Spain, growth is expected to be 2.7 percent in 2018 and 2.2 percent in 2019, which is a 0.1 percentage point decline relative to the April forecast for 2018, and no change for 2019. Medium-term growth in the euro area, projected at about 1.4 percent, is expected to be constrained by slow productivity growth and unfavorable demographics.*

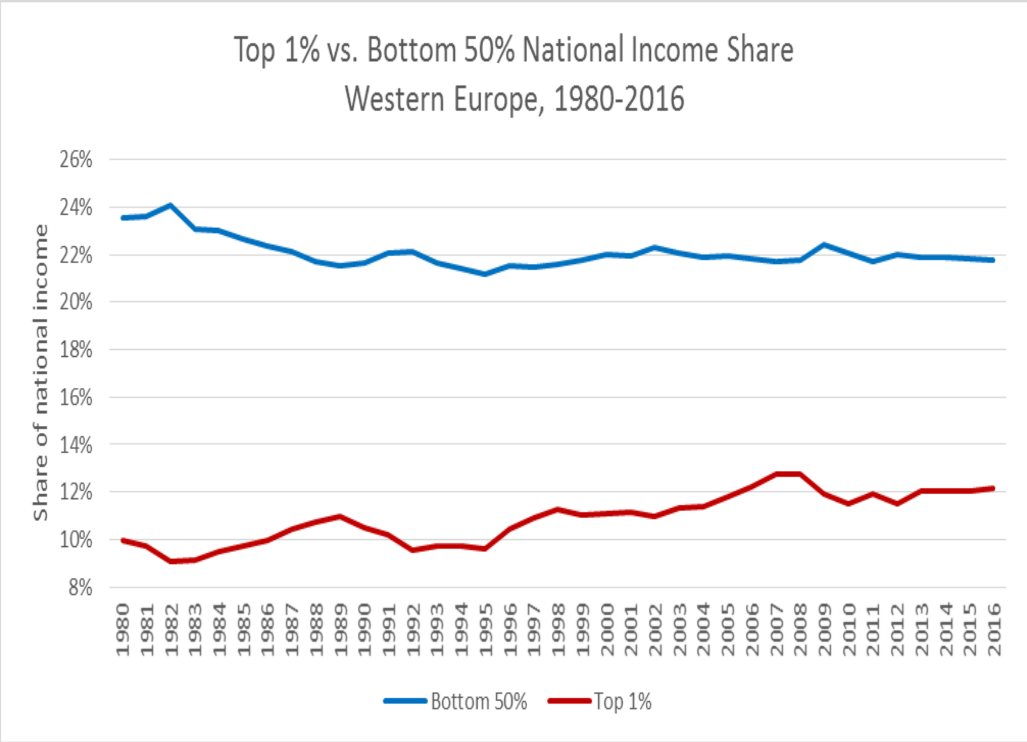
• *In the United Kingdom, growth is projected to slow to 1.4 percent in 2018 and 1.5 percent in 2019 (from 1.7 percent in 2017). This forecast represents a downward revision of 0.2 percentage point for 2018 relative to the April 2018 WEO, driven by weak growth in the first quarter of the year, partly due to weather-related factors. The medium-term growth forecast remains at 1.6 percent, weighed down by the anticipated higher barriers* *to trade following Brexit. (Assumptions regarding the Brexit outcome remain broadly unchanged relative to the April 2018 and October 2017 WEOs. Tariffs on trade with the European Union are expected to remain at zero, and nontariff costs will likely increase moderately.)*

• *Japan's growth is projected to moderate to 1.1 percent in 2018 (from a strong, above-trend outturn of 1.7 percent in 2017), before softening to 0.9 percent in 2019. The downward revision of 0.1 percentage point for 2018 relative to the April 2018 WEO is largely due to the contraction observed in the first quarter of 2018, and given the uptick in growth and domestic demand in the second quarter of 2018, this is likely to represent a temporary dip rather than the beginning of a turn in the cycle. Japan's medium-term prospects are impeded by unfavorable demographics and a trend decline in the labor force.*

• *Among other advanced economies, growth is projected to moderate in Canada to 2.1 percent in 2018 and 2.0 percent in 2019, and to exceed 3 percent in Australia in 2018, before declining to 2.8 percent in 2019. In Korea, growth is projected at 2.8 percent in 2018 and 2.6 percent in 2019. The downward revisions to the 2019 growth forecast for Australia and Korea relative to the April 2018 WEO partially reflect the negative effect of the recently introduced trade measures.*

Appendix 3: National Income Shares, Western Europe, 1980-2016

Figure 5: Top 1% vs. Bottom 50% National Income Share, Western Europe 1980-2016



Source: Own representation based on data available from the World Inequality Database, https://wid.world

Appendix 4: The Sorcerer's Apprentice (English version)

The Sorcerer's Apprentice (Original from Johann Wolfgang von Goethe, English version: Translation by PJJ Welfens)

President Donald Trump, quite unexperienced as a politician, has assumed full US executive political power in 2017 – after his election in 2016. He does not really know how best to use the partly magic power of the White House. Goethe's poems The Sorcerer's Apprentice summarizes the problem:

The old witchman
Left the house for now!
And his magic skills then
Should work for me somehow.
His words and deeds
I have memorized, the tricks
And as my spirit leads
Wonders happen by the clicks.
Highup! Highup
Considerable fields plus the hill
Would follow my will
Full of waterflows
In bowls and every cup
Look at my liquid shows.
Come here, my old broom!
Take old rags from the niche
You are my servant groom
Now you follow my wish.
Walk on two legs so free
On your top a head then.
Hurry up for me
With water in a can.

…
Stand still, stand still
As we enjoyed right from trough
All the water – it's enough
From your torrent's go.
But just I note like a huge bill:
Forgotten is the magic word, oh no.
…
Oh you devil from hell
You want the house to go under
As I see for every bell
So much water as evil wonder.
A horror broom so evil
Does not want to listen still
…
Too fluid running, many rivers
In this room, on all stairs wet choice

What a horror, currents - shivers.
My master, hear my voice.
Oh, there comes the master,
Sir, the problem is incredibly big.
The spirits which I called – disaster.
They should go, but all will stick.
“Fly back to the niche
Broom, broom!
All over, like doom.
You as witchcraft good or ill
Call to life from fiche
Only the old Master’s will.”

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