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***China's emergence as an economic power helped fuel the rise of protectionist views on trade worldwide.***


CHAD CROWE

## We Are All Mercantilists Now

**By Greg Jensen**



Time magazine in 1965 published an article whose title quoted Milton Friedman: "We Are All Keynesians Now." Using fiscal deficits to manage business cycles—once an unorthodox idea—had become mainstream, driving market outcomes in the decades that followed.

When society's beliefs about the role of government shift, it affects investors. Philosophical shifts alter how people expect the government to respond to changes in economic conditions and determine to what extent policy drives economies. The rise of Keynesianism, for instance, became critical for understanding the global financial crisis and Covid shock.

For much of the post-World War II era, neoliberalism was the mainstream economic ideology. Countries lowered tariffs, integrated their economies and specialized according to areas of comparative advantage. The U.S. helped create global institutions, like the World Trade Organization, to enforce freer trade.

This system of global cooperation and robust institutions has been crumbling as China in particular, and other countries to varying degrees, has pushed the boundaries. With Donald Trump's election, the postwar economic order is poised to change for good.

It will be replaced by a quasimodern mercantilist system. The term "mercantilism," popularized in the 18th century, was used to describe economic policies of colonial powers that focused on managing the economy to build up state power.

Modern mercantilism today is built on four tenets: First, the state has a large role in orchestrating the economy to increase national wealth and strength. Second, trade balances are an important determinant of national wealth and strength, and trade deficits should be avoided. Third, industrial policy is used to promote self-reliance and defense. Fourth, national corporate champions are protected.

Mercantilist ideology is contagious. The postwar system of free trade relied on America's soft power and the general respect that many nations had for the system. But as countries defected and adopted mercantilist policies, the global system

lacked sufficient authority to stop them. Each time another country adopted mercantilist policies, it pushed others to react similarly.

China turned a slow drip into a death spiral. While many countries had pushed the boundaries before China did, its economic size and the effectiveness of its mercantilist policies broke the pre-existing order. Through currency management, public procurement, state subsidies, protectionism and other implicit subsidies, China has developed a range of leading industries, including electric vehicles, solar power, and batteries.

China's emergence as an economically powerful strategic competitor to the U.S. worries many in the free world. It has raised concerns about supply-chain dependencies, the lack of robust manufacturing, and an ailing defense industrial base. The political and social consequences of lost domestic manufacturing jobs are leading policymakers to second-guess whether cheaper consumer goods and a more market-efficient allocation of capital are worth it. Over the past eight years, the Trump and Biden administrations have chipped away at the WTO order— putting tariffs on Chinese imports, using export controls to limit China's access to advanced semiconductors, and pushing industrial policies like the Inflation Reduction Act and the Chips Act.

With China and the U.S. now in the mercantilist camp, pressure is growing for Europe to follow. The Continent is torn between its commitment to WTO principles and the need to respond to competitive threats.

French President Emmanuel Macron, who's pushing for a more independent Europe, had some sharp remarks following the U.S. election: "The world is made up of herbivores and carnivores. If we decide to remain herbivores, then the carnivores will win and we'll be a market for them."

Modern mercantilism will reshape the global economic order. Government policies will reduce the competitive pressures companies face, as their survival will be a matter of national interest. Tariffs, industrial policy and export controls will define a market for the kinds of companies the government wants to exist. The market's role in determining companies' success will diminish.

Countries that rely on rising, persistent trade surpluses to achieve growth are the most at risk in a mercantilist world, as the U.S.—the world's largest trade-deficit economy— becomes unwilling to absorb these surpluses. And retaliation to mercantilist policies is likely to extend beyond tariffs.

Countries with trade deficits will have the upper hand in trade wars because they will have more imports to tariff than their trading partners. Competing countries will likely respond with a range of measures. Retaliation could be explicit, such as China adding more companies to its Unreliable Entity List, which restricts investments in China and participation in China-related export activity. Or retaliation could be subtle, such as Europe intensifying antitrust efforts or digital service taxes that would affect large U.S. tech companies.

Capitalists have long worried that socialism would end the Reagan-Thatcher economic system. Instead, modern mercantilism is poised to strike the final blow. We are all mercantilists now, and the implications are profound and unavoidable.

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