America’s real challenge is the defence of democratic institutions

With much talk focusing on the likely outcomes of Trump’s protectionist economic policies, the security of America’s fundamental institutions has gone largely undiscussed. As Piroska Nagy-Mohacsi argues, however, this is where our greatest attention must go; and warns that in the context of a populist victory this presidential election, Americans must be cautious and vigilant in defending their political institutions.

Market reaction to what appears to be Trump's economic plan has been, in general, more positive than expected. Economists are more ambivalent, and some even believe that it can lead to a recession. But this debate is actually missing a key point. In the short run, the Trump package has the potential to generate more activity and accelerate growth. It certainly will not cause a recession, and this is for several reasons.

First, Trump promises to deliver a significant fiscal stimulus through a combination of large infrastructure projects and tax cuts. That should directly boost growth in the short to medium term. If selected and implemented correctly, with full transparency and respect of the legal rules, projects that result in better transportation and communication infrastructure on a large scale would not only boost demand during construction but also have the capacity to increase productivity over the medium term. Jump-starting infrastructure investment has been argued for years by top economist Larry Summers as the best way to counter post-crisis secular stagnation in a non-inflationary world.

Second, Trump will be able, in all likelihood, to obtain market finance for the stimulus. In this context one may claim that some monetary financing from the Fed may also help. It will generate some inflationary pressure, as employment is reaching capacity. But, in fact, this has been a persistent objective of central banks through their quantitative easing – an objective that has not been met by success.

Third, by easing the excessive burden laid on monetary policy to boost demand, the Fed may be able to normalise monetary policy faster and raise interest rates. The “policy mix” – the combination of monetary, fiscal and structural reforms policy – can finally become more balanced. Rising interest rates from ultra-low post-crisis levels will support small savers, pension funds and the insurance industry, easing pressures from low interest rates on them, thus helping financial stability.

Fourth, deregulation, another significant element of the emerging plan, can also have supply side effects, unless it ends up driven by vested interest. Given all these factors, no wonder markets have shown enthusiasm in the hopeful expectation that these components indeed work out well.

However, realism also requires to recognize that there are several issues that can actually limit the potential growth generation described above even in the short run.

First, a rush to tear up free trade agreements would have a negative effect on growth as it would certainly generate uncertainty and create investment risks (though again protectionism could, on the short term, increase jobs through income substitution).

Second, if institutional checks and balances are weakened, vested interest, favouritism and corruption would be bound to thrive. These are the usual reasons for which so many countries have produced in the past wasteful “white elephant” or large scale investment projects that do not enhance productivity. It is against that sort of misallocation that safeguards needs to be established.
Third, is not clear at this point how the emerging economic plan would sit with major constituents of the Trump vote. Fiscal stimulus runs against conservative republicans’ hate of large government and high public debt. Meanwhile, republicans loath protectionism and the regulation coming along with it. And rising inequality, an inevitable consequence of the planned tax cuts, will hurt the poor and less educated, another key Trump’s constituency. We will have to see in the coming months how priorities are hammered out among competing ideologies, vested interest, and reality on the ground.

All the above means that, in the whole, Trump’s economics is quite clear. It is a kind of populism that can deliver higher growth on the short-to-medium term. And at this juncture of the post-crisis economic cycle, the suggested fiscal stimulus with supply side reforms is something that may actually be desirable to pull economies out of post-crisis low-growth trap.

Therefore, the focus should not be economics. Trump critics should today hold the firepower because a much more serious threat could be in the horizon. What may have to be defended is the preservation of the basic pillars of democracy. The real threat does not come from the economic front but from the risk that the new administration may end up tampering with the institutions that provide the political and economic framework and ensure overall financial and political stability in America. It is well documented that populists and autocrats tend to target from the outset the fundamental democratic institutions, first and foremost the independence of the judiciary and the media. This is where the main concerns should lay.

Is this not an exaggerated concern in the world’s lead democracy? Sadly, it is not. We have seen recent successful efforts to extinguish media freedom and undermine judiciary independence by democratically elected governments not only in less mature democracies such as Russia, Turkey, or Venezuela, but also in two EU members Hungary and Poland (and the number may well grow further in the coming months). EU’s mature legal framework has been unable to sufficiently counter the attacks on democratic institutions.

Everything rests on just a few key beacons of democracy: upholding human rights, individual freedom (including that of minorities), the right to trial and many other basic civil rights, all can be directly affected by these institutions. Similarly, the independence of economic and political institutions, particularly those promoting competition and transparency, needs to be defended. Erosion of democratic institutions is too big a risk to ignore, even if this risk were to be smaller in the US than elsewhere.

Vigilance and systemic monitoring of any emerging threat to key political and economic institution in the US will have to be a priority at all levels of government: local, state and federal. This is the responsibility of the whole organized society. It is also the responsibility not only of Democrats, but also those disenchanted voters who genuinely want a better and more inclusive system that pays attention to their plight. Failing this, a paradox may arise: undermining institutions would increase perceived risks and deter investment, hurting the potential success of the growth plan.

Demagogue rhetoric plagued and poisoned the victor’s election campaign. It is not clear how much bigotry, misogyny, white supremacy and racism he has unleashed in the process, and the early record is worrying.

We should hope that basic tenets of American democracy will be upheld and protected from damaging political interference. But this cannot be left to be seen – action and vigilance are needed now. America should therefore focus on the most dangerous political risks to key institutions, rather than on economic short term policies, and organise to defend what is really crucial. As for the economic package itself, it might well work if growth trumps protectionism.

*Featured image credit: debaird. [CC BY-SA 2.0], via Wikimedia Commons*

*Please read our comments policy before commenting.*

*Note: This article gives the views of the author, and not the position of USApp—American Politics and Policy, nor of the London School of Economics.*
About the author

Piroska Nagy Mohacsi – London School of Economics

Piroska Nagy Mohacsi is Programme Director in the Institute of Global Affairs at the London School of Economics since September 2015. Previously she was Director at the Office of the Chief Economist of the European Bank for Reconstruction and Development (EBRD), overseeing the EBRD’s strategic directions in Emerging Europe, Central Asia and North Africa as well as key policy initiatives such as local capital market development, food security, health and climate change. Prior to EBRD, Piroska worked for the International Monetary Fund (IMF) between 1986 and 2008, with surveillance and policy advice and program responsibilities in Europe, Africa and Asia. While on leave from the IMF, she was lecturer at the Hebrew University of Jerusalem in 1996/97 and also worked at Fitch Ratings as Senior Adviser in 2003/4, covering Europe. She has published in the area of euro adoption in emerging Europe; financial stability issues; and fiscal policy reform, and she is the author of the book The Meltdown of the Russian State (Edgar Elgar, 2000).

∗ CC BY-NC 3.0 2015 LSE USAPP