

The flag and the republic: the US in 2018

By Jonathan Wood



Think about the US as two countries: one is the global superpower, with its indispensable diplomacy, military deployments, cultural dominance, and dense trade and financial relations; the other is the local republic, mostly consumed by daily life, where jobs, health, family and heritage are most important. Especially since the global financial crisis, so-called “pocketbook issues” routinely top international affairs in the US’s hierarchy of concerns. Remember: the republic, not the superpower, elects the government.

In 2018, the relationship between superpower and republic will pivot around trade and investment. The shift in US trade policy over the last year from multilateral agreements to bilateral deals has irritated allies and inspired geopolitical rivals. Now, more assertive nationalism in trade relations also poses potential risks to the strongest US economy in nearly 20 years. Trade disruption in 2018 could easily have political ramifications at the midterm elections in November.

Power is global

US grand strategy since the end of the Second World War, and especially in the post-Cold War era, involved exporting political, economic and cultural values against the backdrop of overwhelming military power. Globalisation signalled this strategy’s success, but also made it increasingly diffuse, difficult and costly to sustain. Emerging markets, some maturing into rising regional and global powers, naturally had different ideas about national interest and global governance. As a result, a set of new regional power realities is percolating through international relations, in which the US is still an important but no longer a decisive player.

To illustrate, in 1980, when it started to successfully muscle rising power Japan into more favourable trade relations, the US was by far the world’s largest economy (in purchasing power parity (PPP) terms) and top trade partner of Japan – as well as Brazil, India, the Philippines, South Africa, South Korea and many other smaller economies.

By 2016, however, China had surpassed the US as the largest economy in PPP terms and become the largest trade partner of each of those countries, as well as Germany, Indonesia, Saudi Arabia, Vietnam – one gets the picture. US trade with these countries has also grown and remains significant – it’s often the #2 trade partner – but is increasingly vulnerable to geopolitical hedging strategies (see table).

Among major economies, Canada and Mexico are still dominated by trade with the US through the North American Free Trade Agreement (NAFTA). However, negotiations to preserve the pact are increasingly fragile, and the risk of failure in 2018 has

Fig.1 ▶ Top trade partners of Group of 20 (G20) countries

	1980		2016	
	#1	#2	#1	#2
Argentina	US	Brazil	Brazil	China
Australia	Japan	US	China	Japan
Brazil	US	Germany	China	US
Canada	US	Japan	US	China
China	Japan	US	US	Japan
Germany	France	Italy	France	US
France	Germany	Italy	Germany	Japan
UK	Germany	US	Germany	US
Indonesia	Japan	US	China	Japan
India	US	Japan	China	US
Italy	Germany	France	Germany	France
Japan	US	Saudi Arabia	China	US
South Korea	US	Japan	China	US
Mexico	US	Japan	United States	China
Saudi Arabia	Japan	US	China	US
Turkey	Germany	US	Germany	China
US	Canada	Japan	China	Canada
South Africa	US	Germany	China	Germany

increased. As a result, both are hedging their bets by strengthening ties with Europe and reviving the Trans-Pacific Partnership (TPP), a pillar of Barack Obama’s “Asia pivot” that presidential candidate Hillary Clinton abandoned and President Donald Trump scuppered as almost his first act in office.

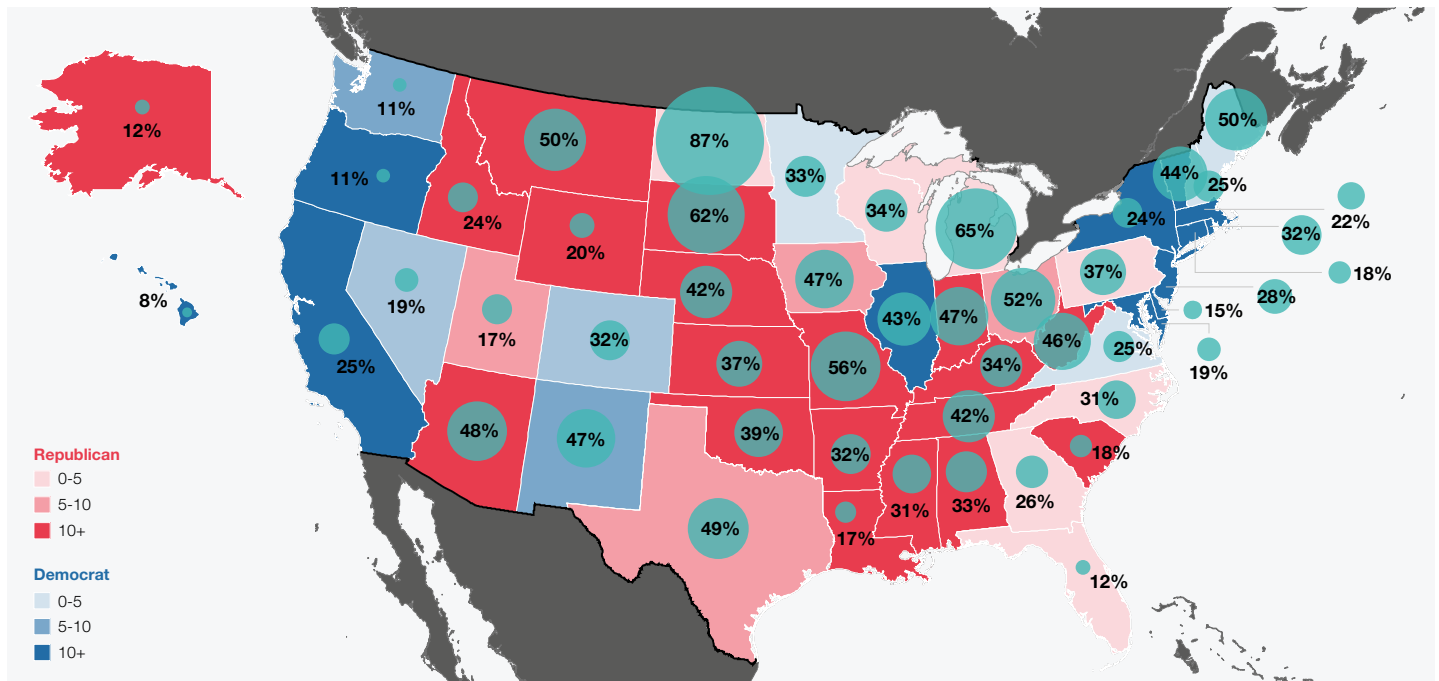
US energy, agricultural and manufacturing industries dependent on NAFTA trade have fewer immediate options; any scramble for new export markets would inevitably weaken, not strengthen, their trade leverage. Many of the US states most reliant on NAFTA trade also voted heavily for Trump (see map, below).

On top of the natural shift in global trade relations, US trade priorities have repeatedly conflicted with national security imperatives. Take North Korea: the administration declined to label China a currency manipulator, and briefly delayed a planned investigation into alleged intellectual property violations, to encourage China to “do something significant” on North Korea.

Trump also initiated a dispute with South Korea over the costs of deploying Terminal High Altitude Area Defense (THAAD) interceptors, and repeatedly indicated his intention to renegotiate or withdraw from the US-South Korea Free Trade Agreement (KORUS). These actions are incentivising South Korea’s long-term strategy of reducing strategic reliance on the US and developing home-grown alternatives to US military technology. Japan is also back in the trade relations crosshairs, even as the US military relies on Japanese bases and pitches billions in ballistic missile defence and other weapons systems. (In addition to reviving the TPP, and in the footsteps of Canada, Japan is now finalising a major trade agreement and strategic partnership with the EU.)

Long-running trans-Atlantic trade negotiations are in deep freeze, and the America First posture – on trade, climate change, Iran, NATO, the World Trade Organization (WTO), the Israeli/Palestinian conflict and other issues – has generated friction in the historic alliance between the US and Europe. Germany, France and other member states are beginning to articulate more independent, third-way geopolitics, including deepening ties with China and other rising powers. Trade will always help bind trans-Atlantic relations, but is clearly no longer as sticky as it used to be.

Fig.2 ▶ Presidential election margin and total exports to Canada and Mexico by state, 2016



Politics is local

While the superpower US confronts a multipolar geopolitical reality, the underlying republic is also undergoing fundamental change. Even as national political dramas continue to dominate the headlines, the much-used maxim that “all politics is local” is set to become relevant in 2018.

Grassroots political activism and organisation have become less expensive and more influential in the age of social media, giving birth to the expression “netroots” (both for good and ill, as persistent concerns about electoral manipulation suggest). National party infrastructure still dominates, but no longer dictates, many political contests, especially since wealthy individuals started bankrolling preferred candidates.

Anecdotal, polling and voting evidence from the right-wing populist surge in 2016, as well as the left-wing reactionary “resistance” in 2017, indicates that local concerns often trumped national agendas. Factions across the political spectrum at least seem to agree on putting Washington, and by extension the superpower project, in its proper place.

More so than ever, understanding the ebb and flow of local-to-national politics and their complicated relationship with the superpower US is the primary navigational challenge for foreign companies operating in the country. We expect three issues to shape domestic politics in 2018:

First, Democrats are seeking to avenge the 2016 election with an anti-Trump wave that delivers control of the House of Representatives (lower house) and perhaps the Senate (upper house). The Democratic sweep in the 2017 off-year election was a clear warning shot: hostility to Trump, more than any policy plank, can drive candidate recruitment, voter enthusiasm and turnout, particularly in the purple suburbs. There’s little reason to expect the administration to change course, so this strategy – tying Republican candidates as closely to Trump personally and politically as possible – should still apply in November. And the opposition almost always gains ground at the midterms.

A supporter of Democratic U.S. Senatorial candidate, Doug Jones, during an election night gathering on December 12, 2017 in Birmingham, Alabama (Justin Sullivan/Getty Images)



But the Hill is steep: in the House, where all members are up for election, Democrats face a large numerical deficit and incumbents entrenched by partisan electoral districting. In the Senate, they must defend 25 seats to the Republicans' six (of which even fewer are potentially competitive). In addition, Democratic electoral success depends substantially on turnout: Trump may be galvanising, but midterm election turnout is traditionally 15%-20% below presidential years. Even a repeat of the off-year wave would barely crest that hurdle. Finally, the US economy is humming along, particularly in terms of employment and wages, which will be the single most important factor for the majority of voters come November.

Second, the Republican Party divide between populist and establishment factions will deepen. Whereas Democrats intend to run against Trump, Trump and his supporters – including situational religious conservative allies – appear to be running against the Republican establishment. Loyalty to Trump, his policies and his people is the apparent strategy for building a winning and durable populist coalition. But whatever the outcome of the midterms, it seems unlikely to resolve the strategic fault at the core of the Republican Party diagnosed after Obama's 2012 campaign, but present since immigration reform collapsed under the second president Bush: should Republicans solidify or expand their political base? A big loss, in particular, will be read both ways.

For now, the main problem for business is that Republican infighting has replaced partisanship as the foremost source of policy paralysis. Slender control of the Senate, combined with unified Democratic opposition, will continue to leave scant room for error. In 2018, tax reform notwithstanding, it may be enough simply to keep the lights on until November.

Finally, the midterms represent the last best chance for both parties to control state governments ahead of the critical 2020 decennial census. With federal politics mired in obstructionism and partisanship, much of the political action in the US has moved to the state and municipal levels. Thirty-six state governorships are up for election in 2018, and the Democratic Party will bet heavily on winning these state-wide offices, which might favour an anti-Trump campaign, to block partisan redistricting by largely Republican-controlled state legislatures in 2021.

If it ain't broke...

The strong US economy is good news for both the local republic and global superpower in 2018. At home, it will help vanquish the lingering ghosts of the Great Recession and potentially soften partisan political edges ahead of the midterm election. The economy

is likely to be a factor in favour of political continuity in the midterm elections.

Abroad, it will help restore US global confidence and credibility, supporting the administration's more assertive international posture. Yet preserving it is also one of the main reasons that disruptive geopolitical scenarios – from conflict with North Korea to withdrawal from NAFTA or the WTO – remain unlikely. Such scenarios would almost certainly be bad for voter pocketbooks ahead of the midterms.

Needless to say, the strong economy is enough of a boon for business to outweigh much of the daily cut and thrust of domestic politics and international relations. In 2018, companies can continue to count on a broadly deregulatory bent, shaped by executive authority and the court system rather than Congress; continued unease in overseas capitals at the domestic drivers of US foreign policy; and more political twists and turns than they can shake a stick at.



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