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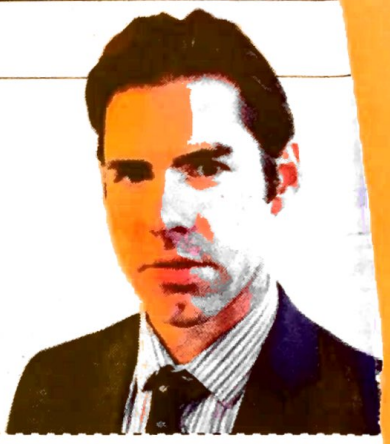

Beware the playground bully who is set on calling the world's tune

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The election of Donald Trump was like dropping a large rock into a small pond. A strangely bouffant, hyper-kinetic, trigger-happy kind of rock but a rock that makes waves nonetheless. The ripples from his decisions will fan out across the world, knocking other countries off balance and forcing a reaction. Few nations will escape being engulfed, least of all the UK.

At least it is becoming clear what President Trump meant when he declared at his inauguration: "From this day forward, it's going to be only America first, America first." He wants to bend the world to America's will. Policy will be defined by simple economic nationalism, a short-termist distortion of what is in America's best interest, and it will be up to the rest of the planet to respond. Global trade, tax and financial regulation will all be rocked before the year is out.

One way of understanding Mr Trump is through the prism of game theory. In the Prisoner's Dilemma, two crooks are interrogated separately and can either stay quiet or drop their mate in it. The best outcome is for both to remain silent but, in doing so, each risks the other pinning the whole crime on them. The worst outcome is for both to betray the other.

Erik Britton, of Fathom Consulting, reckons President Trump views the US as the "honourable" prisoner who has repeatedly been done over. China (and Mexico and Canada and Germany and pretty much everyone, it seems) is the bad crook. In the real world, that means Beijing has broken global trade rules by subsidising industries such as steel, nicking intellectual property and manipulating the yuan to gain an advantage.

President Trump has decided he's had enough and is threatening to "betray" China by declaring it a currency manipulator and imposing crippling tariffs. In game theory, the outcome from that strategy is binary. Either he scares Beijing sufficiently to pull it into line, or the tariffs go up and everyone loses.

America's trump card, so to speak, is its size. Countries don't square up to the world's biggest economy without expecting a thrashing. For the new president, though, the US has been too gentle for too long. The time has come to be the playground bully.

For economic policy, "America first" means divide and rule. Bullying only succeeds if the others can't gang up on you, which explains why President Trump tore up the Trans Pacific Partnership and plans to renegotiate the North American Free Trade Agreement. Multilateralism diminishes America's strength. It is no accident that Washington is talking to Mexico and Canada separately over Nafta. The president likes bi-lateral negotiations because America gets to dictate the terms.

This bull-headedness is less about isolationism than reshaping the world through brute force. America cannot be isolationist like North Korea, after all. It is too big. Its actions have global repercussions that, because nobody can ignore them, have the power to change everything.

President Trump's "border tax" is a case in point. The policy, which is being championed by senior Republicans and would be the most radical overhaul of corporation tax in generations, has two defining features. First, all costs, including investment, can be offset against profits. Second, the current system of taxing exports and not imports would be reversed.

Essentially, companies would pay tax on their US cashflow. It's complicated, but the idea is to move the locus of tax from the country of production to the country of sale, turning corporation tax on profits into a consumption levy like VAT. Others describe it as a "tax on abormal profits". Either way, it would both end the debt-bias in the current system by eliminating interest rate relief and deter tax avoidance by making it pointless for big business to shift profits around the world.

That's all incredibly good, except for one thing. As the economists who developed the idea admit, the border tax only works if everyone adopts it. By striking out alone, the US would become a giant tax haven. Companies would relocate to America because every penny of investment spending would count against taxable income. Under corporation tax norms, only a small portion does. A border tax would kill Ireland's economic model.

Another problem is the import tax element, which critics say breaches global trade rules. Supporters answer that the rules don't matter because, by the time the US is dragged into the dock, the rest of the world would have signed up to the border tax. "If they didn't, they'd be dead," one official said privately this week. It's diplomacy at gunpoint.

A similar story can be told about bank regulation. The president has promised to roll back Dodd-Frank, the US version of global reforms agreed after the 2008 crisis. There is talk of loosening capital requirements and scrapping the Volker Rule that bans casino-like proprietary trading.

If the US does relax regulation, will Europe and the UK follow? At the moment both adamantly oppose looser standards, but the lobbying by banks that fear US rivals will eat them for lunch has not begun. The last time America deregulated, under Bill Clinton, Britain and Europe swiftly followed suit, with disastrous results.

As for that free trade deal with the UK that President Trump has promised? He has also pledged to lower US environmental and safety standards. How will that square with the Tory manifesto commitment to "push for high animal welfare standards to be incorporated into international trade agreements"? Moreover, the president objects to trade deals that leave the US a net importer. Yet, that's the current state of affairs, acccording to UK data. Why would the bully play nice specially for Britain?

For the moment, the waves from President Trump's election have yet to hit land. So far, the White House has refrained from accusing China of currency manipulation. The border tax may be the exchequer centrepiece but it is not official policy yet (partly because it would be inflationary and, for that reason, may struggle to win enough Republican support in Congress). Dodd-Frank reforms have still to be detailed.

On economic policy at least, there is an eerie calm. Just don't expect it to last.