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Trump's Balance-of-Payments War on Mexico, and the Whole World

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The Road to Chaos

The 1940s saw a series of movies with Bing Crosby and Bob Hope, starting with the *Road to Singapore* in 1940. The plot was always similar. Bing and Bob, two fast-talking con men or song-and-dance partners, would find themselves in a scrape in some country, and Bing would get out of it by selling Bob as a slave (Morocco in 1942, where Bing promises to buy him back) or committing him to be sacrificed in some pagan ceremony, and so forth. Bob always goes along with the plan, and there's always a happy Hollywood ending where they escape together – with Bing always getting the girl.

In the past few years we have seen a series of similar diplomatic stagings with the United States and Germany (standing in for Europe as a whole). We could call it the *Road to Chaos*. The United States has sold out Germany by destroying Nord Stream, with Germany's Chancellor Olaf Scholtz (the hapless Bob Hope character) going along with it, and with

European Commission President Ursula von der Lehen tplaying the part of Dorothy Lamour (the girl, being Bing's prize in the Hollywood *Road* movies) demanding that all Europe increase its NATO military spending beyond Biden's demand for 2% to Trump's escalation to 5%. To top matters, Europe is to impose sanctions on trade with Russia and China, obliging them to relocate their leading industries in the United States.

So, unlike the movies, this will not end with the United States rushing in to save gullible Germany. Instead, Germany and Europe as a whole will become sacrificial offerings in our desperate but futile effort to save the US Empire. While Germany may not immediately end up with an emigrating and shrinking population like Ukraine, its industrial destruction is well under way.

Trump told the Davos Economic Forum January 23: "My message to every business in the world is very simple: Come make your product in America and we will give you among the lowest taxes of any nation on earth." Otherwise, if they continue to try and produce at home or in other countries, their products will be charged tariff rates at Trump's threatened 20%.

To Germany this means (my paraphrase): "Sorry your energy prices have quadrupled. Come to America and get them at almost as low a price as you were paying Russia before your elected leaders let us cut Nord Stream off."

The great question is how many other countries will be as quiescent as Germany as Trump changes the rules of the game – America's Rules-Based Order. At what point will a critical mass be achieved that changes the world order as a whole?

Can there be a Hollywood ending to the coming chaos? The answer is No, and that the key is to be found in the balance-of-payments effect of Trump's threatened tariffs and trade sanctions. Neither Trump nor his economic advisors understand what damage their policy is threatening to cause by radically unbalancing the balance of payments and exchange rates throughout the world, making a financial rupture inevitable.

The balance-of-payments and exchange-rate constraint on Trump's tariff aggression

The first two countries that Trump threatened were America's NAFTA partners, Mexico and Canada. Against both countries Trump has threatened to raise U.S. tariffs on imports from them by 20% if they do not obey his policy demands.

He has threatened Mexico in two ways. First of all is his immigration program of exporting illegal immigrants and permitting short-term work permits for seasonal Mexican labor to work in agriculture and household services. He has suggested deporting the Latin American immigration wave to Mexico, on the ground that most have come to America via the Mexican border along the Rio Grande. This threatens to impose an enormous social-welfare overhead on Mexico, which has no wall on its own southern border.

There also is a strong balance-of-payments cost to Mexico, and indeed to other countries whose citizens have sought work in the United States. A major source of dollars for these countries has been money remitted by workers who send what they can afford back to their families. This is an important source of dollars for families in Latin American, Asian and other countries. Deporting immigrants will remove a substantial source of revenue that has been supporting the exchange rates of their currencies vis-à-vis the dollar.

Imposing a 20% tariff or other trade barriers on Mexico and other countries would be a fatal blow to their exchange rates by reducing the export trade that U.S. policy promoted starting under President Carter to promote an outsourcing of U.S. employment by using Mexican labor to keep down U.S. wage rates. The creation of NAFTA under Bill Clinton led to a long line of maquiladora assembly plants just south of the US/Mexican border, employing low-wage Mexican labor on assembly lines set up by U.S. companies to save labor costs. Tariffs would abruptly deprive Mexico of the dollars received to pay pesos to this labor force, and also would raise costs for their U.S. parent companies.

The result of these two Trump policies would be a plunge in Mexico's source of dollars. This will force Mexico to make a choice: If it passively accepts these terms, the peso's currency exchange rate will depreciate. This will make imports (priced in dollars on a worldwide level) more expensive in peso terms, leading to a substantial jump in domestic inflation. Alternatively, Mexico can put its economy first and say that the trade and payments disruption caused by Trump's tariff action prevents it from paying its dollar-debts to bondholders.

In 1982, Mexico's default on its tesobono bonds denominated in dollars triggered the Latin America debt bomb of defaults. Trump's acts looks like he's forcing a replay. In that case, Mexico's countervailing response would be to suspend payment on its US-dollar bonds.

This could have far-reaching effects, because many other Latin American and Global South countries are experiencing a similar squeeze in their balance of international trade and payments. The dollar's exchange rate already has been soaring against their currencies as a result of the Federal Reserve raising interest rates, attracting investment funds from Europe and other countries. A rising dollar means rising import prices for oil and raw materials denominated in dollars.

Canada faces a similar balance-of-payments squeeze. Its counterpart to Mexico's maquiladora plants are its auto-parts plants in Windsor, across the river from Detroit. In the

1970s the two countries agreed on the Auto Pact allocating what assembly plants would work on in their joint production of U.S. autos and trucks.

Well, “agreed” may not be the appropriate verb. I was in Ottawa at the time, and government officials were very resentful at being assigned the short end of the auto deal. But it is still going today, fifty years later, and remains a major contributor to Canada’s trade balance and hence the exchange rate of its dollar, which already has been falling against that of the United States.

Of course, Canada is no Mexico. The thought of it suspending payment on its dollar bonds is unthinkable in a country run largely by its banks and financial interests. But the political consequences will be felt throughout Canadian politics. There will be an anti-American feeling (always bubbling under the surface in Canada) that should end Trump’s fantasy of making Canada the 51st state.

The implicit moral foundations of international economic order

There is a basic illusory moral principle at work in Trump’s tariff and trade threats, and it underlies the broad narrative by which the United States has sought to rationalize its unipolar domination of the world economy. That principle is the illusion of reciprocity supporting a mutual distribution of benefits and growth – and in the American vocabulary it is wrapped together with democratic values and patter talk about free markets promising automatic stabilizers under the U.S.-sponsored international system.

The principles of reciprocity and stability were central to the economic arguments by John Maynard Keynes during the debate in the late 1920s over U.S. insistence that its European wartime allies pay heavy debts for arms bought from the United States before its formal entry into the war. The Allies agreed to pay by imposing German reparations to shift the cost onto the war’s loser. But the demands by the United States on its European allies, and in turn by them on Germany, were far beyond the ability to be met.

The fundamental problem, Keynes explained, was that the United States was raising its tariffs against Germany in response to its currency depreciating, and then imposed the Smoot-Hawley tariff against the rest of the world. That prevented Germany from earning the hard currency to pay the allies, and for them to pay America.

To make the international financial system of debt service work, Keynes pointed out, a creditor nation has an obligation to provide debtor countries with the opportunity to raise the money to pay by exporting to the creditor nation. Otherwise, there will be currency collapse and crippling austerity for debtors. This basic principle should be at the heart of any design for how the international economy should be organized with checks and balances to prevent such collapse.

Opponents of Keynes – the French anti-German monetarist Jacques Rueff, and the neoclassical trade advocate Bertil Ohlin – repeated the same argument that David Ricardo laid out in his 1809-1810 testimony before Britain's Bullion Committee. He claimed that paying foreign debts automatically creates a balance in international payments. This junk-economic theory provided a logic that remains the basic IMF austerity model today.

According to this theory's fantasy, when paying debt service lowers prices and wages in the debt-paying country, that will increase its exports by making them less costly to foreigners. And supposedly, the receipt of debt service by creditor nations will be monetized to raise its own prices (the Quantity Theory of Money), reducing its exports. This price shift is supposed to continue until the debtor country suffering a monetary outflow and austerity is able to export enough to afford to pay its foreign creditors.

But the United States did not permit foreign imports to compete with its own producers. And for debtors, the price of monetary austerity was not more competitive export production but economic disruption and chaos. Ricardo's model and U.S. neoclassical theory was simply an excuse for hard-line creditor policy. Structural adjustments or austerity have been devastating to the economies and governments on which it has been imposed. Austerity reduces productivity and output.

In 1944 when Keynes was trying to resist U.S. demand for foreign trade and monetary subservience at the Bretton Woods conference, he proposed the bancor, an intergovernmental balance-of-payments arrangement calling for chronic creditor nations (namely, the United States) to lose their accumulation of financial claims on debtor countries (such as Britain would become). That would be the price to be paid to prevent the international financial order from polarizing the world between creditor and debtor countries. Creditors had to enable debtors to pay, or lose their financial claims for payment.

Keynes, as noted above, also emphasized that if creditors want to be paid, they have to import from the debtor countries to provide them with the ability to pay.

This was a profoundly moral policy, and it had an additional benefit of making economic sense. It would enable both parties to prosper instead of having one creditor nation prosper while debtor countries succumbed to austerity preventing them from investing in modernizing and developing their economies by raising social spending and living standards.

Under Donald Trump the United States is violating that principle. There is no Keynesian bancor-type arrangement in place, but there are the harsh America-first realities of its unipolar diplomacy. If Mexico is to save its economy from being plunged into austerity, price inflation, unemployment and social chaos, it will have to suspend its payments on foreign debts denominated in dollars.

The same principle applies to other Global South countries. And if they act together, they have a moral position to create a realistic and even inevitable narrative of the preconditions for any stable international economic order to function.

Circumstances thus are forcing the world to break away from the U.S.-centered financial order. The U.S. dollar's exchange rate is going to soar in the short term as a result of Trump blocking imports with tariffs and trade sanctions. This exchange-rate shift will squeeze foreign countries owing dollar debts in the same way that Mexico and Canada are to be squeezed. To protect themselves, they must suspend dollar debt service.

This response to today's debt overhead is not based on the concept of Odious Debts. It goes beyond the critique that many of these debts and their terms of payment were not in the interest of the countries on which these debts were imposed on in the first place. It goes beyond the criticism that lenders must have some responsibility for judging the ability of their debtors to pay – or suffer financial losses if they have not done so.

The political problem of the world's overhang of dollar debts is that the United States is acting in a way that prevents debtor countries from earning the money to pay foreign debts denominated in US dollars. U.S. policy thus poses a threat to all creditors denominating their debts in dollars, by making these debts practically unpayable without destroying their own economies.

The U.S. policy assumption that other countries will not respond to U.S. economic aggression

Does Trump really know what he's doing? Or is his careening policy simply causing collateral damage for other countries? I think that what's at work is a deep and basic internal contradiction of U.S. policy, similar to that of U.S. diplomacy in the 1920s. When Trump promised his voters that the United States must be the "winner" in any international trade or financial agreement, he is declaring economic war on the rest of the world.

Trump is telling the rest of the world that they must be losers – and accept the fact graciously in payment for the military protection that it provides the world in case Russia might invade Europe or China send its army into Taiwan, Japan or other countries. The fantasy is that Russia would have anything to gain in having to support a collapsing European economy, or that China decides to compete militarily instead of economically.

Hubris is at work in this dystopian fantasy. As the world's hegemon, U.S. diplomacy rarely takes account of how foreign countries will respond. The essence of its hubris is to simplistically assume that countries will passively submit to U.S. actions with no blowback. That has been a realistic assumption for countries like Germany, or those with similar U.S. client politicians in office.

But what is happening today is system-wide in character. In 1931 there was finally a moratorium declared on Inter-Ally debts and German reparations. But that was two years after the 1929 stock market crash and the earlier hyperinflations in Germany and France. Along similar lines the 1980s saw Latin American debts written down by Brady bonds. In both cases international finance was the key to the system's overall political and military breakdown, because the world economy had become self-destructively financialized. Something similar seems inevitable today. Any workable alternative involves creating a new world economic system.

U.S. domestic politics is equally unstable. Trump's America First political theater that got him elected may get his gang unseated as the contradictions and consequences of their operating philosophy are recognized and replaced. His tariff policy will accelerate U.S. price inflation and, even more fatally, cause chaos in U.S. and foreign financial markets. Supply chains will be disrupted, interrupting U.S. exports of everything from aircraft to information technology. And other countries will find themselves obliged to make their economies no longer dependent on U.S. exports or dollar credit.

And perhaps in the long-term view this would not be a bad thing. The problem is in the short run as supply chains, trade patterns and dependency are replaced as part of the new geopolitical economic order that U.S. policy is forcing other countries to develop.

Trump bases his attempt to tear up the existing linkages and reciprocity of international trade and finance on the assumption that in a chaotic grab-bag, America will come out on top. That confidence underlies his willingness to pull out today's geopolitical interconnections. He thinks that the U.S. economy is like a cosmic black hole, that is, a center of gravity able to pull all the world's money and economic surplus to itself. That is the explicit aim of America First. That is what makes Trump's program a declaration of economic war on the rest of the world. There is no longer a promise that the economic order sponsored by U.S. diplomacy will make other countries prosperous. The gains from trade and foreign investment are to be sent to and concentrated in America .

The problem goes beyond Trump. He is simply following what already has been implicit in U.S. policy since 1945. America's self-image is that it is the only economy in the world that can be thoroughly self-sufficient economically. It produces its own energy, and also its own food, and supplies these basic needs to other countries or has the ability to turn off the spigot. Most important, the United States is the only economy without the financial constraints that constrain other countries. America's debt is in its own currency, and there has been no limit on its ability to spend beyond its means by flooding the world with excess dollars, which other countries accept as their monetary reserves as if the dollar is still as good as gold. And underneath it all is the assumption that almost with a flick of the switch, the United States can become as industrially self-sufficient as it was in 1945. America is the world's Blanche duBois in Tennessee Williams' *Streetcar Named Desire*, living in the past while not aging well.

The American Empire's self-serving neoliberal narrative

To obtain foreign acquiescence in accepting an empire and living peacefully in it requires a soothing narrative to depict the empire as pulling everyone ahead. The aim is to distract other countries from resisting a system that actually is exploitative. First Britain and then the United States promoted the ideology of free-trade imperialism after their mercantilist and protectionist policies had given them a cost advantage over other countries, turning these countries into commercial and financial satellites.

Trump has pulled away this ideological curtain. Partly this is simply in recognition that it no longer can be maintained in the face of US/NATO foreign policy and its military and economic war against Russia and sanctions against trade with China, Russia, Iran and other BRICS members. It would be madness for other countries not to reject this system, now that its empowering narrative is false for all to see.

The question is, how will they be able to put themselves in a position to create an alternative world order? What is the likely trajectory?

Countries like Mexico really don't have much of a choice but to go it alone. Canada may succumb, letting its exchange rate fall and its domestic prices rise as its imports are denominated in "hard currency" dollars. But many Global South countries are in the same balance-of-payments squeeze as Mexico. And unless they have client elites like Argentina – its elite being themselves major holders of Argentina's dollar bonds – their political leaders will have to stop debt payments or suffer domestic austerity (deflation of the local economy) coupled with inflation of import prices as the exchange rates for their currencies buckle under the strains imposed by a rising U.S. dollar. They will have to suspend debt service or else be voted out of office.

Not many leading politicians have the leeway that Germany's Annalena Baerbock has of saying that her Green Party does not have to listen to what German voters say they want. Global South oligarchies may rely on U.S. support, but Germany is certainly an outlier when it comes to being willing to commit economic suicide out of loyalty to U.S. foreign policy without limit.

Suspending debt service is less destructive than continuing to succumb to the Trump-based America First order. What blocks that policy is political, along with a centrist fear of embarking on the major policy change necessary to avoid economic polarization and austerity.

Europe seems afraid to use the option of simply calling Trump's bluff, despite its being an empty threat that would be blocked by America's own vested interests among the Doner Class. Trump has stated that if it does not agree to spend 5% of its GDP on military arms (largely from the United States) and buy more US liquid natural gas (LNG) energy, he will impose tariffs of 20% on countries that resist. But if European leaders do not resist, the euro will fall perhaps by 10 or 20 percent. Domestic prices will rise, and national budgets will have to cut back social spending programs such as support for families to buy more expensive gas or electricity to heat and power their homes.

America's neoliberal leaders welcome this class-war phase of U.S. demands on foreign governments. U.S. diplomacy has been active in crippling the political leadership of former labor and social democratic parties in Europe and other countries so thoroughly that it no longer seems matter what voters want. That is what America's National Endowment Democracy is for, along with its mainstream media ownership and narrative. But what is being shaken up is not merely America's unipolar dominance of the West and its sphere of influence, but the worldwide structure of international trade and financial relations – and inevitably, military relations and alliances as well.

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Michael Hudson's new book, The Destiny of Civilization, will be published by CounterPunch Books next month.