# Global Trade in the Trump Era: Where are We Headed?

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JUNE 19, 2019

# Introduction

You have seen the headlines from candidate and President Trump:

“There are people who wish I wouldn’t refer to China as our enemy. But that’s exactly what they are. They have destroyed entire industries by utilizing low-wage workers, cost us tens of thousands of jobs, spied on our businesses, stolen our technology, and have manipulated and devalued their currency, which makes importing our goods more expensive – and sometimes, impossible.” 2015

“The Trans-Pacific Partnership is another disaster done and pushed by special interests…” June 2016

"NAFTA is the worst trade deal maybe ever signed anywhere, but certainly ever signed in this country," September 2016

“Trade wars are good and easy to win.” March 2018

# Introduction: major trade policy announcements

US withdraws from TPP (January 2017).

Administration announces a study of the sources of bilateral trade deficits and effects of unfair trade practices (May 2017).

US, Mexico and Canada renegotiate NAFTA (August 2017 – November 2018); awaiting Congressional approval.

Administration threatens to withdraw from KORUS agreement and renegotiates (September 2017 – March 2018).

Section 232 (National Security) steel and aluminum tariffs announced (March 2018).

US investment-review body (CFIUS) intervenes more to block technology-based acquisitions, such as Broadcomm-Qualcomm (March 2018).

US bans purchases by US firms from Huawei (and others) and bans sales of high-technology components to Huawei (and others) without approval (May 2019).

# Introduction: major trade policy announcements

Administration announces an intention to impose tariffs on $60 billion of Chinese imports under Section 301 regarding China's restrictions on investment, ownership, and intellectual property (March 2018); trade war is launched.

May 2019: US side claims China is reneging on its commitments and threatens to impose 25% tariffs on all Chinese goods. The stock market reacts badly.

May 2019: Trump Administration threatens accelerating tariffs on all Mexican imports unless they take action to stem refugee migration. The stock market reacts really badly to this "weaponization" of tariffs.

And behind all that: a threat to use 232 again to impose 25% tariffs on all automobile imports.

# Incoherence?

For economists it is hard to see any real strategic vision or plan in the actual implementation of trade policy:

Why give up on the TPP, which was better for US economic interests than the “magnificent” new NAFTA?

Why impose across-the-board steel and aluminum tariffs, which just anger our allies and promise to destroy more jobs than they create? And they open the door for all countries to use national security exceptions.

Why impose tariffs on all Mexican imports in a strange and unprecedented linkage to immigration policy? And it does not treat the causes of the migration, just the symptoms.

Why take on China unilaterally? Surely sustained multilateral pressure would be more effective, while sharing the burden.

And there are fundamental misunderstandings of economics:

- The sources of bilateral trade deficits.
- Foreign exporters “pay” the costs of US tariffs, when really US users and consumers do.
- Somehow tariffs encourage growth rather than serve as taxes that raise costs.

# Trump trade policy principles

What is this new approach to trade? It can seem chaotic but (my opinion) it seems to revolve around several "America first" pillars.

1. National security interests take precedence over trade relations.

2. US manufacturing and mining workers have paid too much of the burden of globalization and need protection.
   - Corollary: To shorten supply chains by bringing assembly operations back to the US is a goal, not a cost.

3. It is better to return to the use of "managed trade" in key sectors than "rules-based trade".

4. Competition for technological leadership is about both national security and future market shares in leading industries.
   - Corollary: China is engaged in mercantilist technological industrial policy and must be confronted. "Made in China 2025".

# Trump trade policy principles

5. The US can negotiate better bilateral trade agreements (including in Asia) than regional deals.

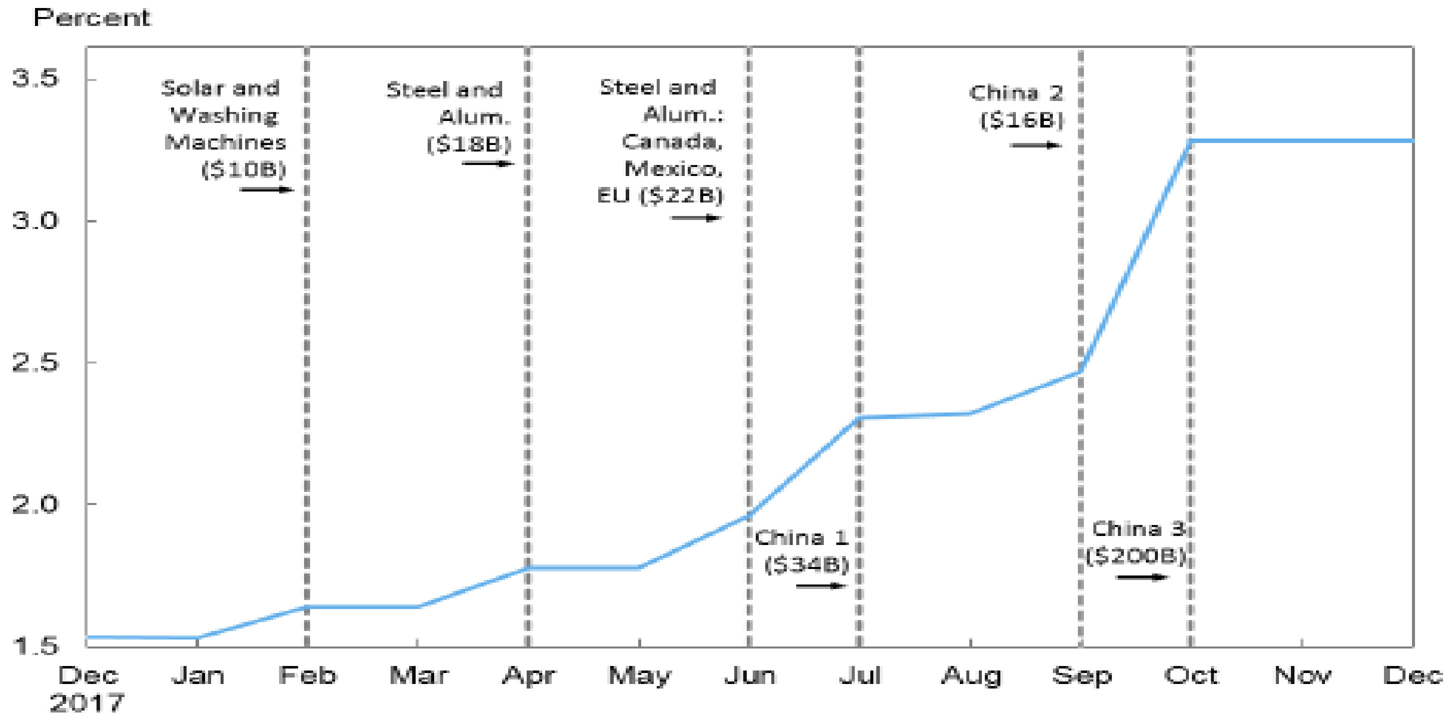
6. Trade agreements and the multilateral system (WTO) place too many constraints on US policymaking and not enough on countries that do not follow the rules (especially China).

7. And far from being constrained by the rules, unilateral tariffs are the key tool in pushing foreign governments to change policy.  Sanctions may remain useful micro policies but tariffs are seen as macro enforcers.

# Economic effects

The average US tariff rate across all merchandise imports more than doubled by the end of 2018. (chart). If additional tariffs on China go forward and automobile tariffs are imposed the average rate likely will exceed 6 percent, the highest among developed OECD countries.

**Figure 1: Average Tariff Rates**




Source: US Census Bureau; USTR; USITC; authors' calculations.

# Economic effects: steel tariffs

What effects are we seeing on the US economy?

***Steel Tariffs***

1. Current estimates are that the steel tariffs might raise production-worker employment in that sector by a maximum of 20,000 to 25,000 over several years (compared to 154,000 in 2017).

These estimates assume the additional US output will increase hiring at unchanged rates of jobs per ton of output. But early evidence suggests that we are seeing a lower marginal hiring rate and higher marginal investment in automation. We might expect a maximum job growth of 15,000.

2. Contrast that with a likely loss of 45,000 to 50,000 production-worker jobs in downstream sectors. We can expect around 2 or 3 jobs lost per job created in steel.

Caveat: these are static computations with full employment and unchanged real wages. A tariff-induced recession would raise net job losses.

# Economic effects: burden of tariffs

***Who pays for the tariffs?***

The President likes to say that foreign exporters “pay” the tariffs and the revenues generated are proof of a big US welfare gain.

But this is a major misunderstanding of how tariffs work.  Economists distinguish between:

The *incidence* of the tariff (who writes the check?), typically US importing companies; and

The *burden* of the tariff (net price effects).  In principle this could be split among:

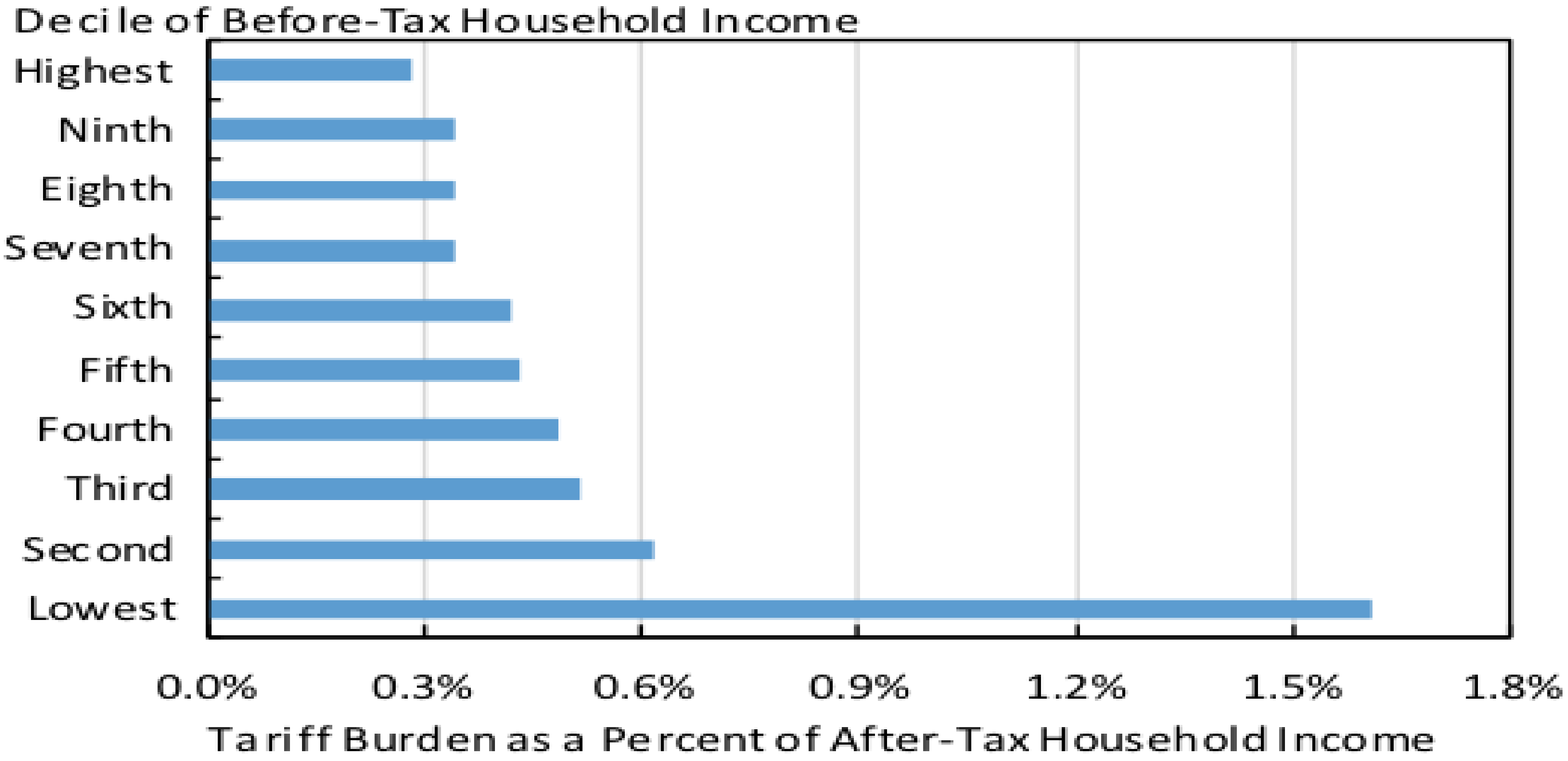
- Chinese exporters who may have to accept a lower FOB price.
- US importers and retailers who may absorb the tariff through lower profit margins for a while.
- US input purchasers and consumers if the tax increase is passed through to them.

We now have a series of studies that reach a consistent conclusion: tariffs imposed through the end of 2018 have been almost fully passed through in higher prices.  US firms paying for imported inputs and consumers are paying for the tax.

And there are additional costs to buyers as US prices of US competing goods go up.

We can expect this to get worse for households as tariffs are imposed on $300 billion or so of consumer goods from China (and perhaps automobiles).  Oxford Economics predicts that a “wider” tariff war (maximum product coverage plus retaliation) would cost the average household about $800 per year in additional taxes.

It’s worth noting that such tariffs are the most regressive form of tax there is.  Figure shows tariff costs by household income decile; 2015 data.



# Economic effects: what are we taxing?

***Are we really taxing Chinese exports?***

The tariffs on electronics are mostly levied on products assembled in China but sold in the US by their designers (Intel, Apple, Samsung, etc.). US value added is generally 50% of final imported value.

# Economic effects: reshoring

***Are tariffs likely to bring manufacturing back to the US in general?***

We have seen manufacturing supply chains get shorter and manufacturing output rise in the US, going back about 10 years. This was largely due to automation and robotics, which reduce the wage advantages of labor-abundant developing countries.

Tariff increases may reinforce that trend, but with disappointing employment effects, both due to increasing automation and the greater inefficiency of disrupted supply chains.

And industries with extensive offshoring (e.g., autos, electronics, apparel) will experience substantial costs if they have to invest in new facilities in other supply locations.

# Economic effects: growth

***Uncertainty and growth impacts***

Higher US tariff rates *per se* are often thought to have small effects because they affect a small proportion of US economic activity.  (A 25% tariff on all Chinese imports is about 0.8% of US GDP; adding a Chinese retaliatory 25% tariff on all US exports adds about 0.3%.)

But in the medium term investors face considerably higher uncertainty about the prospects for US trade policy.  Measured US “trade policy uncertainty” is higher by a factor of 4 now compared to 2016.

This is a heavy implicit tax on investment in trade-sensitive sectors and such investments are slowing rapidly.

IMF forecasts that the tariffs and policy uncertainty will reduce global GDP growth by about 0.5 percentage points in 2020.

# Economic effects: trade imbalance

***The US trade deficit***

The overall trade deficit just keeps getting larger.  It hit an all-time high of $891 billion in 2018 as US growth continued to drive imports higher.

The growing federal budget deficit also continues to raise the need for external financing, raising the current-account deficit.

And the deficit with China refuses to fall. It is averaging about $50 billion per month in 2019, as it did in 2018.

# Comments on US-China trade war

In short, the economics of this policy are proving difficult and getting worse, especially regarding China.

But maybe that's OK if all of the tariff pressure gets China to agree to really meaningful reforms. This belief seems nearly universal in Washington.

Is that likely?

- Any deal is likely to commit China to return to its pre-trade-war levels of purchases of soybeans and other products. Not much gain there.
- China is likely to agree to some significant tariff cuts in several industrial sectors (e.g., autos) and to permit more investment in everything but strategic sectors.
- China will agree to stop "stealing" intellectual property, because they have promised that many times.
- China is very unlikely to scale back on its high-tech industrial subsidies.
- The US wants the agreement to have an enforcement mechanism, by which it can re-impose tariffs unilaterally. That's a tough point for China to agree to.

My sense is that some kind of agreement will emerge but it will retain high US tariffs and quantitative limits on Chinese exports, another form of high-cost managed trade.

# Broader impacts

***The United States is quickly surrendering its leadership role in the global trading system.***

The withdrawal from TPP essentially isolates the US from integration in the Asia-Pacific region and is costly in terms of market access there.

Extensive use of unilateral tariffs (mostly WTO-illegal) has reduced the confidence of other governments in the stability of US trade policy.

It also raises an additional threat to the multilateral WTO system at a time when the system needs considerable reforms.  Other countries (EU, Canada, Japan, and China) are now taking the lead in that area.