



It's Time for a Course Correction in the Trade War

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May 16, 2019

President Donald Trump and his supporters often tell us that he is fundamentally a free trader. The current trade war with China, they say, is simply the small price we must pay now for a world of much freer trade tomorrow, when all governments lower their trade barriers in fear of Trump's hard-bargaining techniques.

Let's see what markets have to say about that. After the president tweeted a couple weeks ago that tariffs against China would go up within five days if Beijing didn't agree to his demands, markets dived. Stocks plunged once again on Friday morning, after the 25% tariff on \$200 billion in Chinese exports to the United States became reality. Stock prices rose later that day after presidential tweets suggested that trade talks were going well. But the market took another hit on Monday after China announced retaliatory moves, including tariffs increased to as much as 25% on \$60 billion of U.S. imports to China.

Markets aren't immune to being pulled and pushed by emotions, yet overall, they're smarter than any one politician or administration. Markets reflect expectations of the future health of the economy. And what they're telling us now, strongly and clearly, is that they're uncertain about the economy's ability to sustain a long trade war with China. That's true even if, by some measures, China is getting hit harder than we are. The great interconnectedness of our economies means that if China "loses," we do, too — and vice versa.

If the markets really believed that the Trump trade war would eventually make global trade freer, then with each U.S. move, the markets should go up. The fact that they go down upon news of a U.S. escalation in the trade war means that markets expect trade to, for a significant time, become and remain less free.

It's understandable. Investors don't know how long this belligerence will last. They don't know which goods will be targeted for retaliation or how high the new duties will go on either side. And markets don't know if or how this fight will spread to other countries.

Also, let's not forget that our fight with China isn't the only trade war Trump is waging. We have no idea if the United States-Mexico-Canada Agreement will ever be implemented. Will anything happen with Europe and Japan? Meanwhile, other countries are forming trade alliances among themselves, leaving the United States more and more isolated.

This drama could go on for a long time. It's one thing if Beijing agrees to change its trade policies as part of a multilateral agreement that it enters voluntarily. But it's a whole other political game when the United States demands unilaterally — much like a bully — that Beijing must change its behavior. The Chinese government is unlikely to cave on issues of sovereignty. And being an authoritarian government, China could hold on for quite a while, even if this trade war hurts the Chinese people more than it hurts Americans.

It's time for another route. There's no doubt that we would all, including the Chinese people, benefit from a change in the Chinese government's behavior on trade and state subsidies. But tariffs on top of other tariffs isn't the answer. The U.S. government should drop the duties on China and our other trading partners and rejoin the Trans-Pacific Partnership Agreement.

From there, a strong alliance could form to induce change in China with the aggressive use of the World Trade Organization. Those skeptical of the WTO's ability to help with China should check out a Cato Institute report from last year titled: "Disciplining China's Trade Practices at the WTO: How WTO Complaints Can Help Make China More Market-Oriented." The authors demonstrate that "China does a reasonably good job of complying with WTO complaints brought against it."

Trump's strategy was never going to be a winning one. If ever we needed a reminder that trade wars are neither good nor easy to win, this is it. If ever we needed evidence that the president might not know what he's doing and he's poorly advised on these matters, again, this is it. Unfortunately, we all suffer from these self-inflicted wounds. But, please, spare us the nonsense that this trade war is part of a grand scheme to make global trade much freer.