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The Trade Routes Not Taken

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In escalating tariffs, Donald Trump is treading a dangerous and high-stakes path. Tariffs lock out foreign competition, but they also punish consumers with higher prices, disrupt global supply chains, infuriate allies, and impair economic growth. To Trump, though, these are mere bumps in the road to the free-trade ideal that he outlined at the conclusion of the G7 meeting last month in Canada: “No tariffs, no barriers, that’s the way it should be—and no subsidies.”

Raising tariffs in order to eliminate them might sound like nonsense, yet it is a tactic that Trump is employing with increasing vigor. In the last few months, he has imposed tariffs on steel and aluminum, hit China with tariffs on a range of consumer and industrial products, and proposed new tariffs on foreign cars and automotive parts. High tariffs, the theory goes, will give Trump more leverage in negotiations. So far, though, the tariffs have led to retaliation, not concessions.

Trump’s actions are evoking fears of a global trade war. The president’s tariffs are often compared to the economically disastrous 1930 Smoot-Hawley tariffs, which nearly doubled the average U.S. tariff rate to 20 percent. Most economists and historians believe Smoot-Hawley exacerbated the economic problems of the Great Depression—the bank collapses, the stock-market implosion, the restrictive monetary policies—while prompting other countries to retaliate and thereby slowing trade.

While often described as unprecedented, the Trump tariffs are just a more prominent and larger-scale version of trade disputes that have cropped up often over the years. A 1994 study from the Peterson Institute for International Economics looked at 72 cases of threatened U.S. trade sanctions from the 1970s to the early 1990s—including such riveting sagas as disputes with Europe over oilseeds and conflict with Japan over citrus and beef—and found that tariff threats succeeded less than half the time. They were more likely to succeed when the foreign country depended on the United States to buy its goods, the study found, a rare condition today.

“There have been times in the past, back to the Nixon administration, where the United States has sought one-sided trade concessions where we say we are going to get more trade and balance things out,” says Mac Destler, a University of Maryland professor who studies American trade policy. “In those cases, we have sometimes gotten something, sometimes not.”

Some of our trading partners have made proposals to try to avoid the new tariffs, but not always to the administration’s satisfaction. China offered to buy more U.S. goods to stave off new tariffs. Germany proposed to scrap the E.U.'s 10 percent tariff on American autos in exchange for our dropping a 2.5 percent tax on European cars and holding off on Trump's threats to impose an added 25 percent duty. Argentina, Brazil, and South Korea successfully negotiated to avoid the steel tariffs by agreeing to limit their exports.

Yet for the threats to have power, some of these tariffs will have to be lasting, and as retaliatory measures increase, all sides will feel the economic pain. The Trump administration believes that other countries have more to lose and will be quicker to offer concessions. Proposed U.S. auto tariffs, for instance, could chop Canadian auto production in half and plunge the province of Ontario into recession, economists from the Canadian Imperial Bank of Commerce suggested in a July research note entitled "A Sword of Damocles." Yet there are consequences here, too. An analysis last month by the Tax Foundation predicted that if all the proposed tariffs and countertariffs were implemented, they would shave about half a point off U.S. growth and lead to the loss of more than 300,000 U.S. jobs—offsetting about a quarter of the gains from last year's tax cuts.

"The pain would be felt broadly," says Scott Lincicome, an international-trade lawyer and adjunct scholar at the free-market Cato Institute. "They might hurt more, but we'd still have a gaping flesh wound." And although other countries might have more to lose, foreign leaders might be tempted to continue the trade fights because standing up to Trump is politically popular abroad.

The safer approach to opening markets for U.S. companies is to rely on the institutions and tools that have repeatedly reduced trade barriers over the last seven decades. It might be less headline-grabbing than tweeting about unfair trade deals and tariff threats, but the strategy has historically been effective. "Tariffs and tariff threats tend not to work, but there are tons of areas that are ripe for the picking that have been proven over the years to create reciprocal market opening," notes Lincicome.

In the last 100 years, worldwide barriers to trade have fallen dramatically, generally through negotiations under the auspices of the General Agreement on Tariffs and Trade and the World Trade Organization (WTO). In 1947, for instance, the average worldwide tariff was 22 percent. Today, most developed countries have average tariffs in the single digits, including the United States (1.6 percent), the E.U. (1.6 percent), Canada (0.8 percent), and China (3.5 percent). Other barriers have fallen, too, although every country retains some protectionist measures such as industry subsidies, high tariffs on certain goods, and laws restricting foreign companies in certain sectors.

"The first and best way to negotiate market access in the form of lower tariffs and lower non-tariff barriers is through a multilateral trade round under the auspices of the WTO," says Raj Bhala, a professor of international law at the University of Kansas. The current negotiations, known as the Doha Round, started in 2001 but have stalled.

The Trump administration could also seek smaller, less comprehensive wins by using the WTO framework to negotiate agreements in specific sectors of the economy. If Trump is concerned about unfair treatment of the auto industry, for example, then why not lead negotiations that drop barriers to trading in autos? That's what happened in 1996 with an agreement on information technology. More recently, the Obama administration tried but failed to reach a comprehensive agreement on environmental products. Could a president who considers himself a master negotiator pull it off? We don't know, says Bhala, as "the Trump administration has not even tried."

Then there's the possibility of reaching an agreement with a small group of countries. Here again, Trump doesn't seem interested. He pulled out of the Trans-Pacific Partnership soon after taking office. It would have reduced tariffs on some 18,000 products across 12 countries that together make up 40 percent of world trade.

Trump says he prefers direct, bilateral agreements. Yet since taking office, the Trump administration has concluded just one such deal, with South Korea. Announced in March, it made mostly minor revisions to existing trade regulations, and a review by the free-trade Heritage Foundation found that the agreement "advanced several Obama Administration-era policies that do nothing to expand the freedom to trade for Americans."

In negotiating free-trade deals, Trump still has plenty to offer our partners without placing the threat of higher tariffs on the table. The United States already imposes tariffs and other substantial trade-restricting barriers on a wide range of products and services—from cheese, butter, sugar, and canned tuna to carpets and numerous industrial products. Our laws restrict foreign airlines and shipping companies. There's also the $20 billion the government spends annually on agriculture subsidies—left largely intact in House and Senate versions of the recent farm bill. All of these are ammunition for negotiating better trade deals.

One of the biggest problems for American companies in recent years has been that China, with its government subsidies and forced technology transfers, has failed to protect intellectual property. The answer here is less likely to be tariffs than unified global opposition. At a Weekly Standard summit in May, Trump budget director Mick Mulvaney expressed regret that the administration has not done more to gain international support against such Chinese practices: "We simply have not done a fair enough job of rallying our allies to join us in this so it's the world against China."

Another option is singling out for sanctions Chinese companies that have benefited from illicitly obtained technology. Again, the Trump administration has not pressed on that. In a parallel move, though, it did punish Chinese telecom company ZTE for illegally trading with Iran and North Korea, but eased the penalties after the Chinese government protested. U.S. law already calls for foreign products developed with stolen intellectual property to be banned. There have been about 30 such cases filed this year, though the numbers are on the rise.

"What the Trump administration could do is single out those Chinese companies which are benefiting from that kind of technology acquisition and really make life difficult for them," says Gary Hufbauer, a senior fellow with the Peterson Institute for International Economics. "The Trump administration could work with allies to boycott those particular firms in various ways, denying them financing and banking relationships, and not allowing them to export. To me, that would be much more targeted and appropriate to the legitimate objections than what Trump is now talking about."

The 164-member WTO also has dispute-resolution panels. Trump likes to say that the WTO is "a catastrophe" and unfair to the United States, but those panels have ruled in favor of U.S.

complaints 91 percent of the time. Pressing China on its violations and exposing it to the world as a trade scofflaw could be an effective tactic, especially since many of our allies share our concerns about Chinese policies. Instead, the Trump administration is blocking the appointment of new WTO judges, which could leave the panels unable to function by the end of the year.

The Trump administration has plenty of trade tools at its disposal—and most of them won't damage the economy.