CRUX

Trump's trade wars are incoherent, angry, and misguided

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The U.S. Constitution vests authority in Congress to collect duties and to "regulate commerce with foreign nations." But over the course of the 20th century, Congress delegated some of that authority to the president through legislation. Although the purpose was, ultimately, to facilitate the process of reducing tariffs, President Donald Trump has systematically weaponized a few statutes to serve a small-minded, protectionist, "America First" trade policy.

Since taking office, Trump has misappropriated his authority to launch six investigations under three seldom-invoked trade laws. Five of those investigations have led to the president imposing or announcing tariffs on imports of more than 1,500 products (steel, aluminum, washing machines, solar-panel components, and, mostly, Chinese technology products) valued at about US$100 billion. A new investigation into whether imports of automobiles and parts constitute a national-security threat could lead to sanctions on another US$300 billion of imports. Taking into consideration the likelihood of commensurate retaliation against American exporters, US$800 billion of U.S. trade – or about 20 percent of total U.S. trade in goods – could be ensnared in a trade war by year's end. And that assumes no new cases or an escalating tit-for-tat.

The last 13 presidents of the United States – going back to Franklin D. Roosevelt, who signed into law the watershed Reciprocal Trade Agreements Act in 1934 – considered trade to be mutually beneficial for their fostering of economic growth and good relations among nations. Those presidents aimed to avoid trade wars and committed their administrations to reducing barriers, respecting the rules, and supporting the institutions of trade.

Trump sees the world differently. He has departed from more than 80 years of U.S. trade policy continuity, charting a new and deeply troubling course. Although Trump is not the first president to blame foreign trade practices for problems real and imagined, he may be the first to believe that protectionism is essential to making America great. He is certainly the only head of state ever to tweet that "trade wars are good, and easy to win." Trump's trade policy is motivated by a toxic blend of ignorance, petulance and nationalist grievance.

Keeping the Wrong Kind of Score

More than anything else, economic fallacies inform this president's trade views. Unlike his predecessors, he sees trade not as a win-win proposition, but as a zero-sum game with distinct winners and losers. Exports are Team America's points; imports are the foreign teams' points; the trade account is the scoreboard. Since the board shows a large overall deficit, and many bilateral deficits with individual countries, the U.S. is losing at trade – and it's losing because Trump's predecessors were bad negotiators and because the foreign teams cheat. But in those U.S. trade deficits, Trump also sees leverage.

Countries registering surpluses, Trump reckons, are more dependent upon the U.S. market than U.S. exporters are on theirs, making the threat of tariffs – even trade wars – an effective and powerful tool to compel foreign governments to cave in to his demands. Yet, so far, there has been very little acquiescence to those demands. Under the threat of steel tariffs and U.S. withdrawal from their bilateral trade agreement, South Korea opted to put out the fire by agreeing to limit its exports of steel and raise its quota on imports of U.S. automobiles. Other countries with economic heft, however, are fighting back.

In any case, while it might be true that the U.S. would be less weakened than other countries by a trade war – after all, the U.S. economy depends less on trade than almost every other country: imports plus exports account for 27 percent of U.S. gross domestic product compared to a world average of 53 percent – the damage to the U.S. economy would be considerable nonetheless. Cavalierly inviting a trade war because U.S. "casualties" would be lighter than, for example, China's or Europe's, betrays a worrying absence of understanding of how trade and the global economy really work.

Most global trade is in intermediate goods – the purchases of producers, who have decentralized and diversified their operations to improve efficiencies, reduce costs and compete more effectively. Whereas in the 20th century, most of a company's production and assembly took place in one location, often under one roof, the factory floor has since broken through those walls and now spans borders and oceans. Taxing imports today is akin to erecting a wall through the center of that 20th century assembly line, impeding production and raising costs in similar fashion. That helps explain the preponderance of opposition among U.S. manufacturers to Trump's trade tack. U.S. tariffs raise their costs, and the resulting retaliation from foreign governments will reduce their export revenues, squeezing profits from both ends.

In 2017, U.S. goods imports totaled US$2.2 trillion – of which US$1.1 trillion were purchases of raw materials, intermediate goods and capital equipment – and U.S. goods exports totaled US$1.5 trillion. If Trump were to impose, for example, a 10 percent across-the-board tariff on all imports, producer costs would rise by roughly US$110 billion (or 10 percent of US$1.1 trillion). Commensurate retaliation abroad would reduce U.S. export revenues by roughly US$150 billion (or 10 percent of US$1.5 trillion). Together, the increased costs and reduced revenue would amount to a US$260 billion reduction in manufacturing-sector profits. Last year, the U.S. manufacturing sector's profits were US$550 billion, so a 10 percent import levy alone could end up cutting profits nearly in half. When Trump claims that protectionism will revitalize manufacturing and bring back jobs, one can only wonder where he thinks the investment will come from without the profits his tariffs will chase away.

False and Misleading

Trump's trade policy is driven by misleading statistics and the fallacious narrative that trade destroyed U.S. manufacturing. Trump pines for the days when U.S. industry was unrivaled in the world, accounting for a larger share of the U.S. economy, and employing a significant chunk of the labor force. Manufacturing's share of the U.S. economy peaked in 1953 at 28.1 percent and has been on a downward trajectory ever since. In 2017, that share was only 11.6 percent of GDP.

But in 1953, U.S. manufacturing's value-added amounted to US$110 billion, whereas in 2017, it reached a record high of US$2.24 trillion. A sector that today produces more than six times the value in real terms than it produced when it was of much greater significance to the U.S. economy can hardly be described as declining. The sector employs about two-thirds the number of workers as it did at its peak of 19.4 million in 1979, but that reflects massive increases in output per worker, which is attributable primarily to the adoption of new technologies.

Trump seems to believe that manufacturing is the only part of the economy that matters – or the only part of the economy, full stop. When citing trade balances, the president and his advisors simply ignore U.S. services, where the U.S. is most competitive and growing fastest. It's as if Google and Amazon, financial services and insurance companies, tourism and intellectual property licensing don't exist. Last year, U.S. services exports amounted to US$800 billion and generated a US$250 billion trade surplus.

For a nation whose consumers spend twice as much on services than on goods, and where 90 percent of the workforce is employed outside the manufacturing sector, the obsession with manufacturing is misplaced. But even Trump's concerns about manufacturing are reserved for just a few heavy industries, such as steel and automobiles. He fails to recognize – or at least his policies fail to reflect – the diversity of industries within manufacturing, many of which are worried about the pain from Trump's steel and aluminum tariffs. For every US$1 that steel producers add to GDP, steel users add US$29; for every one job in steel production, there are 46 in steel-using industries. While Trump wants credit for "protecting" the steel industry with a 25 percent import tariff, he and his advisers downplay the adverse impact on steel-consuming producers.

Incoherent Uncertainty

Although it's difficult to discern any coherent trade-policy strategy, the administration's incoherent strategy seems to be to intentionally foment a climate of uncertainty. Some suggest the policy dissonance is intended to distract the public from the president's mounting domestic legal and ethical woes, but the persistent noise may be conducive to the administration's goal of repatriating global supply chains.

Trump has sought to deter U.S. companies from investing abroad. His tweet-shaming of U.S. firms that were considering establishing assembly operations in Mexico, and his threats of 35 percent taxes on re-importation into the U.S. dissuaded a few from moving forward with their plans. Trump's repeated threats to withdraw the U.S. from the North American Free Trade Agreement; his insistence that any revised NAFTA agreement should require that products contain more U.S. content to qualify for preferential treatment; and his demand for a five-year sunset clause under which NAFTA would automatically terminate unless the parties affirmatively agree to extend its terms are all designed to create uncertainty. Why?

Trump fears that trade agreements, which extend preferential access to the U.S. market, encourage investment diversion and outflows from the U.S. to the economies of its trade agreement partners. And he believes that by convincing the world that U.S. trade barriers could rise at any moment, foreign companies will want to hedge their bets by investing in the U.S. –

inside the tariff wall. It may sound cynical and self-defeating, but this kind of thinking permeates the strategy sessions of America First nationalists, who like to think the specter of President Ronald Reagan's threatened tariffs on automobiles induced Honda to build the first foreign automobile plant in the U.S. in 1982.

Either way, things have changed since then. The U.S. is still the world's top destination for foreign direct investment, but its share of the global stock of FDI has decreased from 39 percent to 17 percent during the first two decades of the 21st century. The determinants of investment are diverse and many, and the number of viable destinations competing for that investment has increased as countries have developed. Obviously, the size of the market is important, but so are many other factors, including ease of access to supply chains, respect for the rule of law, policy predictability, and certainty in the business and regulatory climate.

Trump is betting that by making policy less predictable and creating an environment of "regime uncertainty," investment will flow into the US. Not only is the success of that approach doubtful, but the objective itself – attracting investment – is at odds with the president's primary goal, which is to reduce the trade deficit. When Americans buy more goods and services from foreigners than they sell to them (trade deficit), then they also sell more assets to foreigners than they buy from them (capital surplus). Increasing inflows of investment and reducing the trade deficit cannot happen at the same time, hence the conclusion of policy incoherence.

Anger as Policy

A sense of grievance also permeates the America First narrative. Trump and several of his advisors see the U.S. as a benevolent giant, having selflessly provided the resources, security and generosity of spirit to rebuild Western Europe, East Asia and the rest of the free world after the Second World War. Under the U.S. security umbrella, the rest of the West took advantage of America's kindness, took more from the till than they put in, skirted the rules to obtain artificial advantages in certain industries, adopted policies to promote their own interests at the expense of the U.S. industrial base, became economic rivals and began to adopt views about foreign policy and geopolitics that weren't in lockstep with the U.S. government's. Or so the story goes.

Expectations that other governments will acquiesce to U.S. foreign and economic policy positions and accept the premise of American exceptionalism predominate this mindset. That the U.S. isn't treated with deference within the international trading system, especially by the World Trade Organization's Dispute Settlement Body, for its selfless leadership in establishing the rules and institutions of trade is an affront to Trump and his advisors. This premise is the well-spring of Trump's outrage in learning that Canada, Mexico, the European Union and China would even consider retaliating against the U.S. for imposing punitive tariffs on steel, aluminum and technology products.

The Trump administration's concerns about China's mercantilist industrial policies have some validity, but its approach to resolution has been an unmitigated disaster. The U.S. doesn't need China to agree to buy US$200 billion more U.S. exports per year. Reducing the bilateral trade deficit is a silly, misguided objective.

Instead, the U.S. should be pursuing deeper, enforceable commitments from China that it will operate within the letter and the spirit of the rules-based trading system. The way to do that is to stand shoulder-to-shoulder with like-minded governments and demonstrate to Beijing that certain behavior won't be tolerated. Instead, the Trump administration has done the opposite. It pulled out of the Trans-Pacific Partnership (TPP) trade accord, it picked fights with allies by hitting them with steel and aluminum tariffs, it transgressed WTO rules to impose sanctions unilaterally and it isolated the U.S. as an international scofflaw. These missteps must be reversed, if that's still possible.

Those who subscribe to Trump's points of view – that trade is an "Us versus Them" proposition – probably think that the president is doing the right thing in subverting the institutions of global trade and provoking trade wars. More sycophantic supporters consider Trump's strategy to be ingenious. Apologists who know better say that the president is merely fulfilling his campaign promises – and how refreshing is it that a politician is making good on his promises! All are complicit in the unenlightened, provocative and possibly unhinged trade policy that Trump has wrought.

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