Trump's Assault on the Global Trading System

And Why Decoupling From China Will Change Everything

Chad P. Bown and Douglas A. Irwin

Donald Trump has been true to his word. After excoriating free trade while campaigning for the U.S. presidency, he has made economic nationalism a centerpiece of his agenda in office. His administration has pulled out of some trade deals, including the Trans-Pacific Partnership (TPP), and renegotiated others, including the North American Free Trade Agreement (NAFTA) and the U.S.-Korea Free Trade Agreement. Many of Trump's actions, such as the tariffs he has imposed on steel and aluminum, amount to overt protectionism and have hurt the U.S. economy. Others have had less obvious, but no less damaging, effects. By flouting international trade rules, the administration has diminished the country's standing in the world and led other governments to consider using the same tools to limit trade arbitrarily. It has taken deliberate steps to weaken the World Trade Organization (WTO)—some of which will permanently damage the multilateral trading system. And in its boldest move, it is trying to use trade policy to decouple the U.S. and Chinese economies.

A future U.S. administration that wants to chart a more traditional course on trade will be able to undo some of the damage and start repairing the United States' tattered reputation as a reliable trading partner. In some respects, however, there will be no going back. The Trump administration's attacks on the WTO and the expansive

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legal rationalizations it has given for many of its protectionist actions threaten to pull apart the unified global trading system. And on China, it has become clear that the administration is bent on severing, not fixing, the relationship. The separation of the world's two largest economies would trigger a global realignment. Other countries would be forced to choose between rival trade blocs. Even if Trump loses reelection in 2020, global trade will never be the same.

BATTLE LINES

The first two years of the Trump administration featured pitched battles between the so-called globalists (represented by Gary Cohn, then the director of the National Economic Council) and the nationalists (represented by the Trump advisers Steve Bannon and Peter Navarro). The president was instinctively a nationalist, but the globalists hoped to contain his impulses and encourage his attention-seeking need to strike flashy deals. They managed to slow the rollout of some new tariffs and prevent Trump from precipitously withdrawing from trade agreements.

But by mid-2018, the leading globalists had left the administration, and the nationalists—the president among them—were in command. Trump has a highly distorted view of international trade and international negotiations. Viewing trade as a zero-sum, win-lose game, he stresses one-time deals over ongoing relationships, enjoys the leverage created by tariffs, and relies on brinkmanship, escalation, and public threats over diplomacy. The president has made clear that he likes tariffs ("trade wars are good, and easy to win") and that he wants more of them ("I am a Tariff Man").

Although the thrust of U.S. policy over the past 70 years has been to pursue agreements to open up trade and reduce barriers, every president has for political purposes used protectionist measures to help certain industries. President Ronald Reagan, for example, capped imports to protect the automotive and steel industries during what was then the worst U.S. recession since the Great Depression. Trump, however, has enjoyed a period of strong economic growth, low unemployment, and a virtual absence of protectionist pressure from industry or labor. And yet his administration has imposed more tariffs than most of its predecessors.

Take steel. Although there is nothing unusual about steel (along with aluminum) receiving government protection—the industry maintains a permanent presence in Washington and has been an on-again, off-again beneficiary of trade restrictions since the Johnson administration—the scope of the protection provided and the manner in which the Trump administration gave it last year were unusual. In order to avoid administrative review by independent agencies such as the nonpartisan, quasi-judicial U.S. International Trade Commission, the White House dusted off Section 232 of the Trade Expansion Act of 1962. This Cold War statute gives the president the authority to impose restrictions on imports if the Commerce Department finds that they threaten to harm a domestic industry the government deems vital to national security.

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The Trump administration's national security case was weak. More than 70 percent of the steel consumed in the United States was produced domestically, the imported share was stable, and there was no threat of a surge. Most imports came from Canada, Germany, Japan, Mexico, and other allies, with only a small fraction coming from China and Russia, thanks to antidumping duties already in place on those countries. The number of jobs in the U.S. steel industry had been shrinking, but this was due more to advances in technology than falling production or imports. In the 1980s, for example, it took ten man-hours to produce a ton of steel; today, it takes just over one man-hour. Even the Defense Department was skeptical about the national security motivation.

Prior administrations refrained from invoking the national security rationale for fear that it could become an unchecked protectionist loophole and that other countries would abuse it. In a sign that those fears may come true, the Trump administration recently stood alongside Russia to argue that merely invoking national security is enough to defeat any WTO challenge to a trade barrier. This runs counter to 75 years of practice, as well as to what U.S. negotiators argued when they created the global trading system in the 1940s.

The Trump administration dismissed all those concerns. The president and leading officials desperately wanted to help the steel and aluminum industries. (It did not hurt that Wilbur Ross, the commerce secretary, and Robert Lighthizer, the U.S. trade representative, both used to work for the steel industry.) The administration also believed that its willingness to impose economic self-harm in the form of higher steel and aluminum prices for domestic manufacturers would send a strong signal to other countries about its commitment to economic nationalism.

Trump also went so far as to impose tariffs on steel and aluminum imports from Canada, something that even the domestic industry and labor unions opposed. Over the last 30 years, the U.S. steel and aluminum industries had transformed to become North American industries, with raw steel and aluminum flowing freely back and forth between Canadian and U.S. plants. The same union represents workers on both sides of the border. In addition to lacking an economic rationale, targeting Canada alienated a key ally and seemed to make no political sense, either.

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The administration also miscalculated the foreign blowback against the tariffs. "I don't believe there's any country in the world that will retaliate for the simple reason that we are the biggest and most lucrative market in the world," Navarro, the president's hawkish trade adviser, told Fox News in 2018, apparently unaware that other countries have trade hawks, too. Canada, China, Mexico, the European Union, and others all hit back hard, largely by slapping tariffs on U.S. agricultural exports. In effect, the administration jeopardized the welfare of 3.2 million American farmers to help 140,000 U.S. steel workers, a remarkable move given Trump's electoral reliance on Midwestern farm states.

If the aim was to fire a shot across the bow of U.S. trading partners, the tariffs worked. Foreign governments were suddenly on alert that the United States was willing to abandon the established norms of trade policy. The White House has insisted that "economic security is national security." Yet defining security so broadly opens the door to unrestricted protectionism. And so when, in mid-2018, the Trump administration made yet another national security case for tariffs, this time on automobiles—imports of which dwarf those of steel and aluminum combined by a factor of seven—the fear abroad reached a new level. Although the administration recently announced that it was delaying any new auto tariffs, the threat remains. The consequences of imposing such a large tax on a major household

Tariff Man: an anti-Trump billboard in Guangzhou, China, August 2018

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item, in the sure knowledge that there would be swift and heavy foreign retaliation, may be staying the administration's hand.

The president's enthusiasm for tariff threats has even spilled over to issues beyond trade. In May, Trump suddenly demanded that Mexico stop the flow of immigrants into the United States or risk facing new, across-the-board tariffs of 25 percent. As long as Trump is in office, no country—even one that has just negotiated a trade agreement with the United States—can be confident that it won't be a target.

POINTLESS RENEGOTIATIONS

On the 2016 campaign trail, Trump complained that NAFTA was "the worst trade deal ever," a theme he has continued in office. His advisers talked him out of simply withdrawing from the agreement, but Trump insisted on renegotiating it and proceeded to make the renegotiation process needlessly contentious. The administration made odd demands of Canada and Mexico, including that the deal should result in balanced trade and include a sunset clause that could terminate the agreement after five years, thus eliminating the benefits of reduced uncertainty.

The three countries finally reached a new agreement last September. Unimaginatively called the United States–Mexico–Canada Agreement (USMCA), it is hardly a major rewrite of NAFTA. It preserves

NAFTA's requirement of duty-free access, would slightly open up Canadian dairy markets to U.S. farmers, and incorporates a host of new provisions from the TPP.

The renegotiation was in some ways an unnecessary exercise. NAFTA was a sound agreement—no one in the administration could identify what made it such a terrible deal—and many of its shortcomings had been fixed in the TPP, from which Trump withdrew the United States in 2017. But the contrast between the hostile rhetoric Trump heaped on NAFTA and the soft reality of the USMCA illuminates the president's approach to trade. Trump just doesn't like certain outcomes, including trade deficits and the loss of certain industries. But instead of addressing their underlying causes, which have little to do with specific trade agreements, he opts for managed trade, substituting government intervention for market forces, or new rules—a requirement that a greater proportion of a vehicle be made in the United States for it to enter Mexico duty free, for example—that try to force his preferred outcome. The goal is not to free up trade further but to constrain trade according to Trump's whims.

The USMCA is currently stalled in Congress, partly because the administration did not cultivate congressional support for the renegotiation in the first place. But if the USMCA ultimately dies, neither Canada nor Mexico will miss it. Both felt the need to sign the deal simply to get past the uncertainty created by Trump's threats to withdraw from NAFTA, as well as to forestall the chance that he would impose auto tariffs.

Both Japan and the EU also begrudgingly signed up for trade talks with the administration, in large part to delay Trump's auto tariffs for as long as possible. Of the two, Japan is more likely to agree to a deal—after all, it negotiated a trade agreement with the Obama administration as part of the TPP. The Europeans are less likely to do so, not only due to conflicts over agriculture but also because of Trump's unpopularity across Europe. But the Europeans hope that by agreeing to talk, they can put off Trump's auto tariffs and perhaps run out the clock on the administration.

YOU'RE GONNA MISS ME WHEN I'M GONE

Acts of protectionism are acts of self-harm. But the Trump administration is also doing broader, and more permanent damage to the rules-based trading system. That system emerged from the ashes of the trade wars of the 1930s, when protectionism and economic depression fueled the rise of fascism and foreign governments made deals that cut U.S. commercial interests out of the world's leading markets. In 1947, the United States responded by leading the negotiations to create the WTO's predecessor, the General Agreement on Tariffs and Trade, which limited arbitrary government interference in trade and provided rules to manage trade conflicts. Under this system, trade barriers have gradually fallen, and growing trade has contributed to global economic prosperity.

The United States once led by example. No longer. Trump has threatened to leave the WTO, something his previous actions suggest is more than idle talk. He says the agreement is rigged against the United States. The administration denounces the WTO when the organization finds U.S. practices in violation of trade rules but largely ignores the equally many cases that it wins. Although the WTO's dispute-settlement system needs reform, it has worked well to defuse trade conflict since it was established over two decades ago.

Trump's attacks on the WTO go beyond rhetoric. The administration has blocked appointments to the WTO's Appellate Body, which issues judgments on trade disputes; by December, if nothing changes, there will be too few judges to adjudicate any new cases. When that happens, a dispute-settlement system that countries big and small, rich and poor have relied on to prevent trade skirmishes from turning into trade wars will disappear. This is more than a withdrawal of U.S. leadership. It is the destruction of a system that has worked to keep the trade peace.

That is particularly unwelcome because so much of global trade has nothing to do with the United States. The system resolves conflicts between Colombia and Panama, Taiwan and Indonesia, Australia and the EU. Most disputes are settled without retaliation or escalation. The WTO has created a body of law that ensures more predictability in international commerce. The system it manages works to the benefit of the United States while freeing the country from having to police global commerce single-handedly.

The dispute-settlement system is not perfect. But rather than make constructive proposals for how to improve it, something Canada and others are now doing, the United States has disengaged. The Trump administration may end up destroying the old system without having drafted a blueprint for its successor.

What will come next? In the worst-case scenario, the new world trading system will be dominated by discriminatory trade blocs that raise the costs of commerce, make trade negotiations harder, and encourage retaliation. Size and economic power, not principles or rules, will determine the outcome of trade disputes. Such a system will hurt smaller, weaker countries and could push them to align with more powerful ones for self-preservation. It was precisely that trend in the 1930s that forced the United States to create the postwar trading system. And the lack of adherence to trade rules beginning in the 1970s made the United States press for the creation of a stronger, more effective dispute-settlement system in the 1990s, resulting in the WTO. For Washington to tear down the trading system it created would be a tragedy.

CONSCIOUS DECOUPLING

Nowhere has the Trump administration left a greater mark on U.S. trade policy than with China. In early 2018, it released a lengthy report documenting a litany of concerns with Chinese trade practices. China had been forcing U.S. companies to form joint ventures with local firms to access its 1.4 billion consumers. These arranged marriages then allowed China to acquire U.S. technology. Sometimes companies would hand it over to grease the palms of regulators, sometimes they would license it at below commercially viable rates, and sometimes Chinese firms or spies would steal it. Combined with some of the economic concerns underlying the U.S. steel and aluminum tariffs—China's industrial subsidies, state-owned enterprises, overcapacity, and failure to more fully transform into a market economy—the list of U.S. grievances created a recipe for confrontation. The result was tariffs, and countertariffs, on $360 billion worth of trade between the two countries, an unprecedented figure.

Many observers assumed that the Trump administration simply wanted to get a better deal from China. But what constituted a better deal was always vague. If the primary concern was the bilateral trade deficit, China could be pressured to go on a massive spending spree, buying up U.S. soybeans and energy products. If it was intellectual property theft, China might be persuaded to change a few laws and commit to international norms.

It has become clear, however, that the administration does not want a permanent deal, or at least any deal with an explicit path forward that the Chinese government might accept. Even if Trump and Chinese President Xi Jinping come to some superficial agreement, it is unlikely to be more than a temporary truce in what is now a permanent trade war. The administration's goal seems to be nothing less than the immediate and complete transformation of the Chinese economy or bust—with bust the most likely outcome. To satisfy the United States, China would have to end forced technology transfers, stop stealing intellectual property, curtail subsidies to state-owned enterprises, abandon industrial policies designed to gain technological dominance, stop harassing foreign firms operating in China, and begin to open markets that the government deliberately closed to give control to domestic firms. In other words, the United States wants China to turn its state-dominated economic system into a market-based one overnight.

The Trump administration's goal seems to be nothing less than the immediate and complete transformation of the Chinese economy.

Such a change would perhaps be in China's best interest, but economic regime change is quite an ask for one country to make of another. The Communist Party leadership keeps its lock on power by maintaining control over all facets of the Chinese economy. Losing that control would jeopardize its grip on political power. No one seriously expects China's leaders to cede control of the economy simply because of U.S. threats.

The Trump administration may not even expect them to; it may have been asking all along for something that it knew China could not deliver. If so, the objective was never a comprehensive deal; it was the tariffs themselves. For one thing, if the administration had been serious about getting a deal from China, it would have maximized its leverage by bringing along Japan and the EU, both of which have similar economic concerns. Indeed, Japan and the EU have made considerable efforts to work with the administration when it comes to China. They have mostly been rebuffed.

There were hints from the beginning that the administration was never searching for a deal that would truly end the trade war. In 2017, Navarro outlined the administration's view that trade with China threatened U.S. national security. He also let slip that he wanted to rip up the supply chains that bound the United States and China together. At the time, some dismissed him as a rogue eccentric. Now, the United States is on the cusp of slapping tariffs on all imports from China—the first step toward Navarro's goal. Geopolitics has trumped economics.

This is not protectionism in the sense of trying to help a domestic industry in its struggle against imports. The goal is much broader and more significant: the economic decoupling of the United States and China. That would mark a historic fragmentation of the world economy. It would represent, in the words of former Treasury Secretary Henry Paulson, the falling of an "economic iron curtain" between the world's two largest economies. Such a separation would have foreign policy and national security implications well beyond the economic consequences.

In some respects, the rupture is already happening. Students and scientists from China are no longer as welcome in the United States as they once were. China's already meager investments in the U.S. economy are now under heightened scrutiny from national security agencies. The administration is tightening up export controls, curtailing how and with whom Americans can share their inventions, especially in cutting-edge areas such as artificial intelligence, advanced computing, and additive manufacturing. That will not stop China from gaining better technology, however; German, Japanese, and South Korean firms will simply fill the void. Going it alone will put the U.S. economy at even more of a disadvantage.

Most traditional supporters of free trade are not so naive as to believe that the United States should tolerate China's bad behavior as long as cheap goods continue to flow into the United States. China, they agree, breaks the rules. But the Trump administration's clumsy unilateral approach is not the right answer. A better response would be to identify specific instances in which China has violated international agreements and then join with trading partners and allies to file cases with the WTO. (This is not as hopeless a tactic as it might sound: China has complied with findings from the WTO surprisingly often.) Where China has not explicitly violated agreements, Washington could still sanction unfair practices, preferably together with other countries so as to exert the maximum pressure possible, but unilaterally if that is the only feasible option.

The final plank of a sensible trade policy would be to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, the revised trade deal struck by the remaining members of the TPP after the U.S. withdrawal. Joining the CPTPP would establish a large zone of trade rules favorable to the United States and unfavorable to China. That would help push China to resume its progress toward economic reform. Historians will look back on Trump's precipitous decision to quit the TPP as a major blunder.

If the Trump administration really does want to separate the U.S. and Chinese economies, the United States will have to pay an economic price. Trump denies that his strategy has costs. China, he says, is paying the tariffs. "I am very happy with over $100 Billion a year in Tariffs filling U.S. coffers," he tweeted in May. This is nonsense: research shows that firms pass on the cost of the tariffs to American consumers. And U.S. exporters—mainly farmers facing the loss of markets due to China's retaliation—are paying the price, as well. So, too, are American taxpayers, now on the hook for tens of billions of dollars needed to bail out the reeling agricultural sector.

Whether Trump appreciates these costs isn't clear, but it's evident that economic considerations aren't driving policy. The president's willingness to look past stock market slumps and continue to push China shows that he is willing to pay an economic price—whatever he says in public. For someone whose reelection depends on maintaining a strong economy, that is a bold gamble.

THE DAMAGE DONE

If Trump becomes a one-term president, the next administration will have an opportunity to reverse many of its predecessor's trade policies—eliminating the steel and aluminum tariffs, repairing relationships with the United States' NAFTA partners, joining the CPTPP, and improving the WTO. That would not only help restore U.S. credibility on the world stage but also enable other countries to lift their retaliatory duties on U.S. exports, helping suffering farmers. If Trump wins reelection and continues down the path of economic nationalism, however, the prospect of continued, and perhaps intensified, trade conflict is likely to destroy the world trading system. That would do incalculable damage to the world economy.

Although many of Trump's policies can be reversed, the tariffs on China are a game changer. Any future administration would have a difficult time removing them without sizable concessions from the Chinese leadership and some way of alleviating the heightened national security fears that now dominate the bilateral relationship. A future Democratic administration may be even more disinclined to change course. Many Democrats opposed the TPP and broadly support the president's anti-China stance. In May, Senate Minority Leader Chuck Schumer, Democrat of New York, tweeted his support for Trump on China, urging him to "Hang tough" and not to cave in to a bad deal. More than a decade ago, Schumer and his Senate colleagues supported slapping even higher tariffs on Chinese goods than the ones Trump has imposed, on the grounds that China was keeping its currency artificially low to boost exports. Concerns over human rights will also push Democrats to confront China. Although China's herding of over a million Muslim Uighurs in western China into concentration camps did not factor into the Trump administration's trade negotiations, it could loom large in those of a future administration.

The system of world trade that the United States helped establish after World War II is often described as multilateral. But it was not a global system; it originally consisted of a small number of Western, market-oriented economies and Japan and excluded the Soviet Union, its eastern European satellites, and other communist countries. That division was about more than politics. Market and nonmarket economies are in many ways incompatible. In a market economy, a firm losing money has to adjust or go bankrupt. Under state capitalism, state-owned firms get subsides to maintain production and save jobs, forcing non-state-owned firms—at home or abroad—to make the painful adjustment instead. The Trump administration, together with China, as it retreats from pro-market reforms, may be moving the world back to the historic norm of political and economic blocs.

The fall of the Berlin Wall and the collapse of communism opened up eastern Europe and the former Soviet Union to global markets. The reforms of Deng Xiaoping did the same for China. But only in the unipolar moment, which began in 2001, when China joined the WTO, were open markets truly global. Now, the period of global capitalism may be coming to an end. What many thought was the new normal may turn out to have been a brief aberration.