“U.S. Trade Policy: Where are we Heading?”

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Featured Presentation

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### US trade policy: rules-based

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<th>OECD</th>
<th>US</th>
<th>LOW TARIFFS</th>
<th>HIGHTARIFFS</th>
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<td>LOW TARIFFS</td>
<td>GATT/WTO:</td>
<td>High trade volume</td>
<td>Beggar-thy-neighbor</td>
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- **US**: Trade policy rules-based
- **OECD**: Trade policy rules-based

**Notes:**
- **GATT/WTO**: Global Agreement on Tariffs and Tariff-Quotas
- **Beggar-thy-neighbor**: Economic strategy where countries restrict imports to stimulate domestic production
- **Inter-war period**: Period between World Wars I and II
- **Low trade volume**: Low international trade activity
Tariffs: US vs. China

Source: Bown (April, 2019)
## US trade policy: rules-based to power-based

<table>
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<td>LOWER AVERAGE TARIFFS</td>
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- **GATT/WTO**
  - Average MFN=3.4%
  - Power-based Bargaining
- **Accession to WTO**
  - Average MFN=9.6%
  - Trade war
Level of tariffs against China

Trump’s Latest Trade War Escalation Will Push Average Tariffs on China Above 20 Percent

38.6%
If China were not a member of the WTO

Announced on August 1, 2019
21.5%
+3.2pp
Section 301

Threatened scenario
27.8%
+6.3pp
Section 301

2017
MFN tariff
3.1%

2018
Section 301: 10% tariff on $200 billion; 25% tariff on $50 billion
12.4%
+8.5pp
Section 301

May 10, 2019
Section 301: 10% tariff on $200 billion raised to 25%
18.3%
+5.9pp
Section 301

September 1, 2019
Section 301: new 10% tariff on $300 billion
21.5%

Pending
Section 301: 10% tariff on $300 billion raised to 25%; almost all US imports from China face 25% tariff
27.8%
+6.3pp
Section 301

Source: Bown and Zhang (August, 2019)
Coverage of tariffs against China

Tariffs on almost all remaining US imports from China would raise special trade protection coverage to unprecedented level

Source: Bown and Zhang (May, 2019)
Impact of “China shock” on US political economy

- Post-2000–increase in US imports from China not offset by increase in US exports (Autor et al., 2016)
- Effect of China import shock well-documented, Autor et al. (2013), and Pierce and Schott (2016)
- Trade exposure contributed to growth of populism (Grossman and Helpman, 2018) and polarization in US politics (Autor et al., 2017)
- Populism reflected in anti-elitism (Eichengreen, 2018) and shift to economic nationalism (Colantone and Stanig, 2018) – i.e., opposition to free trade
- China targeted over its trade policies, e.g., level of tariffs, exchange rate policy, and trade surplus
US imports from China

Source: Bown (April, 2019)
China’s imports from US

Source: Bown (April, 2019)
Chinese market distortion and WTO

- US concerns about China’s trade practices well-documented (USTR, 2018; Morrison, 2018):
  - Forced technology transfer
  - Discriminatory licensing restrictions
  - Theft of intellectual property
  - Investment restrictions
  - Subsidies to state-owned enterprises (SOEs)

- WTO case could be built against China that one or more Chinese government measures “nullify or impair” benefits of US and other WTO members (GATT Article XXIII:1(a))
“China, Inc.”

- China’s economy structured in ways not anticipated by WTO negotiators (Wu, 2016):
  
  - Party controls “commanding heights” of economy
  - Party controls and directs largest banks
  - Party coordinates government agencies and firms
  - Party-set performance metrics of SOEs, banks etc.
  - Informal linkages between Party and private firms

- Party controls economy while still taking advantage of benefits of market mechanism, i.e., control is not via state
“China, Inc.”

- WTO case could also be made against China under “non-violation nullification or impairment” (NVNI) clause of GATT (Article XXIII:1(b)) (Hillman, 2018)

- Argued only way to approach this is through “grand coalition” of countries (Hillman, 2018; Lawrence, 2018)

- Problem with US unilateral approach:
  - “Shallow” deal (Hillman, 2018)
  - “Free-riding” (Bown, 2018)
  - Potential to undermine WTO (Mattoo and Staiger, 2019)
Provoking a trade war

- Conventional wisdom - US has deliberately poked holes in weakest spots of WTO (Bown, 2019):
  - Imposed tariffs on steel and aluminum in 2018 on grounds of national security – US argued these would be “non-justiciable”, i.e., cannot be questioned as with anti-dumping duties
  - US unilaterally implemented tariffs on $250 billion of Chinese imports after internal investigation by USTR (2018) – based on Section 301 of US Trade Act
  - US chose to block judicial appointments to WTO Appellate Body (AB)
Trade war and WTO dispute settlement

- US imposed national security tariffs in part because of Chinese economic model (Bown, 2019):
  - Chinese trade practices had to be countered
  - Anti-dumping duties had not worked
  - Safeguard tariffs would have been stopped by WTO
  - US would not win case at WTO due to “China, Inc.”

- Counter-argument – US gave up on formal dispute settlement too soon, i.e., specifically, it should have appealed to NVNI clause

- Requires AB to deal with complex interactions in non-market economy
US anti-dumping duties and China

Source: Bown (April, 2019)
Failure of WTO dispute settlement

- Concerns over “judicial over-reach” in AB, and emergence of principle of *stare decisis* in WTO case law (Payosova *et al.*, 2018)
- Dispute settlement will break down by end of 2019, i.e., any member will be able to block panel rulings
- Members should agree on procedures for AB to submit uncertain legal issues arising on appeal to respective WTO committees – *legislative remand*
- Emphasizes need for permanent negotiations in WTO
- Also requires US to stop “…kicking at the working leg of a limping institution…” (The Economist, December 7, 2017)
Costs of trade war

- Initial economic effects (Fajgelbaum et al., 2019):
  - Loss from higher prices - -$68.8 billion
  - Terms of trade gains - +$23.0 billion
  - Tariff revenue - +$39.4 billion
  - Aggregate loss to US - - $6.4 billion

- Potential to undermine WTO – reputation, and norms of cooperation matter in a rules-based system (Mattoo and Staiger, 2019)

- Even if multilateral trading system is maintained, return to GATT-type system would allow countries with bargaining power to veto disputes (Bown, 2019)
Tariffs are a small source of revenue

Source: Bown and Irwin (July 16, 2019)
Conclusions

- Trade war already imposing costs on US, which will increase as height/breadth of tariffs increases

- Potential to increase downside risk to global economy (IMF, July 23, 2019)

- US-China trade deal likely to be “shallow”, targeted at trade deficit with little focus “behind the border”

- A coalition of WTO members would likely be more appropriate way to deal with “China Inc.”

- Failure of US to follow rules-based trading system runs risk China will not follow system if (when) it becomes dominant economic power
Citations


11. The Economist (December 7, 2017). “As WTO members meet in Argentina, the organization is in trouble”.


