FOREIGN AFFAIRS
Published by the Council on Foreign Relations

Tuesday, November 6, 2018 - 12:00am

Trade Under Trump

What He's Done So Far—and What He'll Do Next

Douglas A. Irwin

DOUGLAS A. IRWIN is Professor of Economics at Dartmouth College and the author of *Clashing Over Commerce: A History of U.S. Trade Policy*.

During the 2016 presidential campaign, Donald Trump repeatedly claimed that the United States was being taken advantage of by its trading partners [1]. Bad trade deals, he said, were to blame for lost jobs and deepening trade deficits. Yet he never laid out in detail what he intended to do about it—and his trade policy as president has been nothing if not haphazard. The midterm elections provide a good moment to take stock of Trump's trade agenda: what has he done so far and what might he do next?

COSMETIC CHANGES

In one of his first official acts, Trump withdrew [2] the United States from the Trans-Pacific Partnership (TPP). He took this precipitous step without even considering renegotiating or rebranding the pact. Other countries have continued to implement the agreement, leaving the United States outside the major trade deal in the Pacific at a time when other governments are questioning Washington's commitment to East Asia and tensions with China are rising. That decision may well go down as the Trump administration's original sin, one for which a future administration will have to atone.

Trump also threatened to withdraw the United States from NAFTA. Yet in this case, he wisely opted to continue negotiations. Despite the administration's hostile stance during the talks, the renegotiation of what Trump called the "worst trade agreement ever" succeeded with few significant changes to the original deal. The new United States Mexico Canada Agreement (USMCA) increases the proportion of an automobile's parts that must be sourced inside North America for the vehicle to count as made inside the bloc, slightly opens Canada's dairy market to American and Mexican exporters, strips out some protections for foreign investors in Mexico, and updates the old pre-internet NAFTA with provisions on e-commerce and digital data from the TPP. Although some parts of the renegotiated agreement will promote more trade within North America, others seem to restrict it; on balance, the deal is not a major change from the status quo.

This tinkering at the margins managed to keep most parties fairly happy. Those who liked NAFTA were relieved that the agreement wasn't scrapped; those who disliked it regretted that it was still in place but supported the moves to tilt it in a less liberal direction. The administration took a similar approach to the U.S.–Korea Free Trade Agreement, which was modified to limit potential Korean auto exports and, ostensibly at least, open up the Korean auto market a little more. The renegotiated agreement moves slightly in the direction of more managed trade but hardly constitutes a revolutionary change to what Trump had labeled a very unfair agreement.

“I WANT TARIFFS”

In 2017, although Trump talked a lot about the benefits of protectionist measures, he implemented few of them. (He did impose duties on washing machines and solar panels, but those cases had been initiated during the Obama administration.) The delay did not reflect a lack of interest, only a lack of authority. U.S. presidents cannot change tariffs on a whim, and Congress, not the president, is constitutionally responsible for regulating trade. Trump was dismayed by his inability to act. In August 2017, he told senior staff in the Oval Office, “I want tariffs, bring me some tariffs.”

This year, his staff did just that. In mid 2018 , the administration dusted off an old statute allowing the president to impose tariffs if he determined that they were needed for national security. After the necessary investigations were completed, Trump imposed a 25 percent tariff on imported steel and a 10 percent tariff on imported aluminum. This drew cheers from the steel industry but groans from the many more industries that use steel to manufacture other goods.

Despite presidential adviser Peter Navarro’s confident assertions that other countries would not retaliate, many of them did. Canada, China, Mexico, the European Union, and others all cracked down on U.S. exports. They targeted soybeans, Harley-Davidson motorcycles, bourbon, and other key products as a way of putting political pressure on the administration and sending a signal about the costs of further escalation. As President of the European Commission Jean Claude Juncker said, “we can do stupid too.”

FIGHTING CHINA

The Trump administration has taken its hardest line against China. The administration has a long list of economic complaints: the large bilateral trade deficit, supposed Chinese currency manipulation, Chinese theft of intellectual property, Beijing’s policy of forcing U.S. companies to hand over their technology in return for access to the Chinese market, the easy credit available to Chinese state-owned enterprises, a domestic market often closed to foreign companies, and a Chinese industrial policy—backed by the Made in China 2025 initiative—designed to achieve commercial dominance in important sectors. The Trump administration’s anti-China agenda is driven not just by its economic concerns, but also by its belief that China poses a threat to U.S. global interests.

In August 2017, the administration turned to Section 301 of the Trade Act of 1974, the same provision the Reagan administration used against Japan in the 1980s. That law allows the president to retaliate against foreign unfair trade practices, as judged by U.S. officials rather than the WTO. And so in April this year, Trump imposed tariffs on $50 billion worth of U.S. imports from China. China then retaliated against U.S. agricultural exports. Trump countered with new tariffs on $200 billion of Chinese imports and threated to place tariffs on another $267 billion of Chinese goods.

Pundits asked what the economic end game might be. But it is becoming evident that the administration had none in mind. Negotiations with China were half-hearted at best. Although there was some discussion of managed trade—potential Chinese limits on exports and support for imports from the United States—Washington was really gunning for something larger: a revolution in China's economic system. Reducing the U.S. trade deficit with China would have been difficult enough; uprooting China's system of state capitalism would be next to impossible. The administration may implicitly recognize this fact and may be aiming simply to disengage the U.S. economy from China's by cutting off Chinese exports to the United States, thereby ripping up supply chains, limiting Chinese access to U.S. technology, and reducing Chinese investment in American high-tech firms. The U.S.-Chinese economic relationship has thus taken a back seat to the geopolitical rivalry between the two countries.

A MATTER OF DISPUTES

Trump has sometimes complained that the World Trade Organization is even worse than NAFTA. He believes—or at least, says—that it is designed to take advantage of the United States. On several occasions he has expressed his desire to leave it.

The administration's main gripe with the WTO is that it does not result in reciprocal tariffs, just non-discriminatory ones. That is, some countries can have higher tariff levels than others; the only requirement is that they cannot favor one country over another, absent a free trade agreement. The administration also complains that the WTO's dispute settlement system has overreached its authority and does not respect U.S. sovereignty. Yet that is an odd complaint for Washington to make, since at the WTO's creation, in 1995, the United States was the prime mover behind the dispute settlement system and insisted on stronger rules and tougher enforcement mechanisms than in the previous General Agreement on Tariffs and Trade.

The WTO is the pinnacle of the multilateral trading system that the United States helped design after World War II. Walking away from it would be an astounding act; the administration doesn't seem ready to go quite that far, although the president has threatened to do just that. The administration's policy toward the WTO has been bifurcated: it has brought new cases against other countries for violating the rules, but has also pushed back against countries that have brought their own cases against the United States (over the steel tariffs, for example). On top of that, it has blocked the appointment of new judges to the WTO's Appellate Body, which hears trade disputes, in an effort either to shut down the system or force changes.

WHAT THE FUTURE HOLDS

Running through every administration policy is Trump's obsession with the trade deficit [3]. In his mind, the deficit measures the extent to which other countries have been taking advantage of the United States. As he told an audience of steelworkers in Granite City, Illinois, in July, "If we didn't trade, we'd save a hell of a lot of money."

Trump may kick at the deficit, but success in reducing it has eluded him. As economists wearily point out, the trade balance is driven by macroeconomic factors, not by how high tariffs are or how open a country's market is. In particular, if a country saves a lot more than it invests, it will have a trade surplus because it will end up sending some of its excess savings abroad, buying foreign assets instead of foreign goods. That is why China, Germany, and Japan—all of which have high savings rates—run trade surpluses. The United States runs deficits because it saves less than others, consumes more, and draws in investment from the rest of the world.

Trump's economic policies are likely to increase the trade deficit because they will reduce national savings. The large corporate and individual tax cuts Trump signed last year and the subsequent rise in government spending will temporarily boost consumption and economic growth, but also drive up the trade deficit by juicing domestic demand. In addition, higher government borrowing will tend to lead to a higher trade deficit. How Trump will react to this unpleasant arithmetic, especially if growth slows, remains to be seen.

Previous U.S. presidents usually took protectionist steps only when they caved to domestic political pressure. Trump, by contrast, is acting out of conviction rather than political calculation. He truly believes that higher tariffs are good things, either producing "better" trade deals or just protecting domestic industries. The timing of Trump's actions also breaks with history; in the past, presidents have responded to demands for help from domestic producers during tough economic times. Trump has gone protectionist when the economy is in rude health and even when the relevant domestic industries haven't asked him to act.

Whatever happens in tomorrow's election, the administration is likely to continue to pursue an active and disruptive trade agenda. Republicans—even those from the Midwest, where foreign retaliation against agricultural exports has taken a toll—have been loath to check the president. Democrats, meanwhile, are likely to support many of his moves to protect domestic manufacturing. In any event, Trump has invoked specific laws that allow him to impose tariffs without Congress' say-so, although he will need legislative approval for new trade agreements, such as the revamped NAFTA.

What's next? Now that the NAFTA renegotiation is done, the trade war with China looms larger. A ramp up in tariffs on Chinese goods would have global economic ramifications. The administration might also put the WTO in its crosshairs. Trump has promised more trade deals, particularly with Japan and the European Union. But since the administration has a less than full-throated commitment to free trade—it seems to prefer more managed trade to protect favored groups—the negotiations are likely to prove difficult and require plenty of patience, something Trump has in short supply.

Trump may yet find new protectionist levers he can pull. In mid-2018, the Commerce Department started an investigation into whether imported automobiles posed a threat to national security. The administration would not have begun this process if it was not seriously considering imposing tariffs on foreign cars. Whether it has the guts to do so will be interesting to see. U.S. automobile producers are not asking for more protection, so tariffs would be imposed against their will. Unlike the steel tariffs, which hit steel-consuming firms, higher auto tariffs would hit American households directly and might lead to a backlash from consumers and Congress. European trade partners would also be sure to retaliate against U.S. exporters, just as they did after the steel tariffs.

The Trump administration took its first year to prepare the way for all the actions it has taken in its second. The president's abiding interest in trade makes it likely that the next two years will not be quiet. The global trading system is not safe yet.

Links
[1] https://www.foreignaffairs.com/articles/united-states/2017-04-17/false-promise-protectionism
[2] https://www.foreignaffairs.com/articles/asia/2017-02-06/china-will-miss-tpp
[3] https://www.foreignaffairs.com/articles/2016-06-13/truth-about-trade