Trade Wars of the United States

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Providing a structural context to the trade imbalances of the United States, which has stirred President Donald Trump into authorising a series of potentially catastrophic retaliatory actions, this article describes the bare bones of US’s actions and the likely impact on the global economy and institutions like the World Trade Organization.

In the past few months, President Donald Trump has authorised a series of protectionist measures, the likes of which have not been seen in the post-war decades. The first salvo was fired in early March 2018, with the imposition of tariffs on imports of steel and aluminium from all countries except its immediate neighbours, Canada and Mexico. The President of the United States (US) then turned his attention to China, announcing that relatively high tariffs would be imposed to counter, what he perceived was “unfair” trade practised by the second largest economy. Both acts of protectionism were promptly responded to by the targeted countries, resulting in a virtual trade war between several major economies. In particular, China adopted a tit-for-tat strategy, escalating the conflict. Over the past two months, the two countries have raised tariffs on $100 billion worth of bilateral trade, and both have threatened to expand the net much wider.

The trade conflagration seems to be particularly ill-timed. Over the past several months, major economies, including that of the US, have seen sustained growth, which has not happened since the economic recession of 2008. In this distinctly upbeat mood, not many would have anticipated these conflicts, less so the intensity of trade retaliation that is on view. But, now that the initial rounds of trade retaliation have played themselves out, there is a need to consider carefully, the implications of the actions that have already been taken and also those that are likely in the months ahead. While a trade war between the US and China would have an adverse impact on global economy, the unilateral actions taken by the two countries bypassing the rules-based multilateral system under the World Trade Organization (WTO), could have a far serious impact on global economic governance.

This article will put in perspective President Trump’s protectionist policies. We will argue that the US President is diverting the attention from the structural problems in the world’s largest economy which have caused its trade imbalances by blocking imports from the major economies. We will first examine whether the US trade administration has adequate justification to target its partner countries. This question has added relevance since President Trump had drawn a link between imports by the US and the decline in its manufacturing sector, which has, in turn, resulted in job losses.

Is US Trade Protectionism Justified?

In order to assess whether US trade protectionism is justified, we will have to take a somewhat long-term view regarding the external payments situation of the US. Figure 1 provides a summary of the external sector of the country from just before the breakdown of the Bretton Woods System in 1971.

The figure shows that except a few exceptions, the current account was negative, largely on account of the deficit in goods trade. From the late 1980s, the services sector of the country entered into positive territory and the surplus kept increasing, but this increase was unable to make any dent in the rapidly deteriorating goods trade imbalance.

The key aspect of the goods trade deficit was that a noticeable increase first

Figure 1: Trends in US’s External Sector Payments ($ billion)

Source: International Monetary Fund.
appeared in the 1980s, which kept growing through the decade. After a small improvement in the initial years of the 1990s, deficit deteriorated after the mid-1990s, and at a rapid rate since the early years of the new millennium, which also coincides with China’s joining the WTO. This is where the US administration finds a justification for blaming China, namely that China took advantage of the “permanent normal trade relations” (PNTR) to increase its penetration into the US market.

Figure 2 provides the trends in the trade account of the US and China using the data provided by the United States Census Bureau (USCB) of the US Department of Commerce.

The figure shows that trade deficit with China has been a constant for the US for more than three decades. In 1985, the first year for which data on the US–China are available from the USCB, there was a marginal deficit faced by the former, which grew to more than $10 billion by 1990. By the beginning of the next decade, the deficit had grown to over $100 billion, and within the next couple of years, it had crossed the $200 billion mark. In 2012, the US’s trade deficit vis-à-vis China was $315 billion and in 2017, it was nearly $376 billion. One significant fact that needs to be mentioned is that between 2001 and 2017, the period of China’s WTO membership, its exports to the US grew from $125 billion to $505 billion, while imports from its largest trade partner increased from $19 billion to nearly $130 billion.

To what extent was the China factor responsible for the US’s mounting trade deficit? Figure 3 tells us that trade with China, though important, explains less than half of its trade deficit. In 2017, US’s trade deficit with China was $375 billion, but its overall trade deficit stood at $775 billion. In other words, even if it succeeds in blocking of all imports from China, the US will still be left with a gaping hole in its trade balance. Thus, if the Trump administration has to succeed in its protectionist intents, the only option it has is to follow the path of autarchy. This means that the initial steps of the trade war launched by the President of the US, which targeted imports of steel and aluminium from several other key trade partners, including the European Union (EU), Korea and India, make more logical sense than his subsequent China-alone retaliation. The important question that arises here is the following: Can the most vocal promoter of the ideals of globalisation from the early decades of the 20th century afford to turn its back on the project, using which it has dominated the global economy and polity for seven decades?

The point we are making is that the Trump administration needs to understand that the real reason for the unsustainable trade deficit which the US faces is, in fact, self-inflicted. This is the reason why the trade deficit or a surplus of imports over exports, in terms of the national income identity, is equal to the savings–investment gap. The higher the trade deficit, the larger is the savings–investment gap, which is symptomatic of the domestic savings rates. Generations of economists and policymakers in the US and elsewhere have only mildly commented about the problems that the US has created for itself, being a consumption-led economy in which the savings rates have been abysmally low. Its domestic savings rate has never touched 24% in the period since 1950; but in the more recent years, it has gone below 17%.

The US could persist with its spendthrift ways by borrowing from the global capital markets. As long as the country could successfully borrow, it felt no pressures to change its ways. Only when capital markets are stressed would there be any cause of concern; the US faced this reality during the 2008–09 financial crisis. Capital markets were unable to support the largest economy, leading to an economic collapse, which, in turn, resulted in the domino effect around the world. For once, the US administration tacitly admitted that its economic problems were home-grown; that it was neglecting its domestic economy. The onus was on the Barack Obama administration to bail out the economy and it pump-primed the economy out of the morass. It seemed that for once, the US had identified the real problems facing the economy, including the unsustainable trade imbalances, and were willing to invest in a turnaround. This was the first time that the US administration had tacitly admitted that there were serious structural weaknesses in the country’s economy that needed to be addressed. Explicitly, however, the administration has blamed the trade partners for disallowing the produce of its farmers, ranchers and workers, by resorting to unfair trade practices.

If President Obama had tried to find a long-term solution to the country’s woes, his successor has decided to move in the opposite direction by feeding in to the consumption fetish through tax cuts, which has fuelled import growth yet again. The average annual trade deficit...
during the Obama presidency was close to $710 billion (excluding 2009, which saw severe import squeeze), but in its first year and a half, the Trump presidency has pushed the deficit to beyond $800 billion. This is where the latter has found the rationale for its trade war. It also gives a powerful message to President Trump’s “base,” that American jobs that were taken away by imports would come back, if imports are squeezed.

President Trump’s tariff war, the first step towards which was taken on 1 March 2018,7 has had, until now, two dimensions. The first was to raise tariffs on steel and aluminium sectors, which was seen as “an important first step in ensuring the economic viability of [us’s] domestic steel industry.” This decision targeted countries supplying these products to the us, except its two immediate neighbours, namely Canada and Mexico. Affected as a result were a number of countries, including Brazil, Korea, Argentina, India and the eu.

The second dimension, unveiled on 22 March 2018, was President Trump’s directive to the United States Trade Representative (ustr) to take all possible actions against China, including using penal tariffs on its exports, for “harming American intellectual property rights, innovation, or technology development.”

Trump Administration’s Tariff War

While initiating unilateral trade protectionism, the us President announced his decision to impose import tariffs of 25% and 10% on steel and aluminium.9 Tariffs were increased by invoking the provisions of Section 232 of the Trade Expansion Act of 1962 that allows protection for domestic industries on the grounds of “national defense” and “national security.” An investigation conducted by the Bureau of Industry and Security of the US Department of Commerce made a strong case for import tariffs on steel and aluminium for national security.9 This was based on the understanding that national security can be interpreted more broadly to include the general security and welfare of certain industries, beyond those necessary to satisfy national defense requirements that are critical to the minimum operations of the economy and government.10

This interpretation lends itself easily to bringing substantially more products under the dragnet of high import tariffs. Equally egregious is President Trump’s insistence that the tariffs on steel and aluminium have been imposed for an “unlimited period.”11

This decision has two disquieting dimensions, stemming from President Trump’s comment that the tariff hikes are “reciprocal tax” against countries, including developing countries like India, since they use tariffs on products imported from the us.12 The first is that it blatantly violates the multilateral trade rules of the General Agreement on Tariffs and Trade (gatt) and its successor organisation, the wto. The tariff cuts under the aegis of the gatt were based on the principle that developed countries would not “expect reciprocity” from the developing countries “in trade negotiations to reduce or remove tariffs and other barriers to the trade.”13 This meant that the developing countries could reduce their tariffs by a smaller proportion as compared to the developed countries. This principle of “non-reciprocity” was also accepted as the basis for tariff cuts in the Doha Round negotiations.14

Second, President Trump’s authorisation of unilateral increases in tariffs mirrors the Smoot–Hawley Tariffs Act of 1930,15 whose objectives were almost identical to those of the present administration, namely protecting American jobs.16 Many commentators have argued that Smoot–Hawley tariffs had contributed to the deepening of the Great Depression by triggering trade wars in the early 1930s.17

If imposition of tariffs on steel and aluminium was a damaging step, President Trump made it worse by announcing that he would exempt a subset of the targeted countries from the proposed tariffs until 1 May 2018.18 The reason given was that these countries, namely Argentina, Australia, Brazil, Canada, Mexico, the Republic of Korea and the eu, had “important security relationship with the United States,” and that the administration would treat them differently as compared to other exporters like India. It implied that an act of unilateralism was now laced with discriminatory treatment against several countries, which is another violation of the basic tenets of the wto.

Accordingly, the Trump administration negotiated with Argentina, Australia, Brazil, and the Republic of Korea negotiated import quotas, setting limits on their exports of steel and aluminium to the us.19 This was nothing but voluntary export restraints (vers) that are prohibited by the wto Agreement on Safeguards.

But, while the us was able to find a “negotiated settlement” with some countries, the disputes with its three largest trade partners, the eu, Canada and Mexico, remained unresolved. These countries, therefore, announced a series of retaliatory measures, the details of which would be discussed in the next section.

The second dimension of the us’ trade war was formally launched against China on 22 March 2018, though the process of targeting its largest partner was initiated several months earlier. In 2017, the ustr initiated an investigation to determine whether China’s acts, policies, and practices related to technology transfer, intellectual property, and innovation are unreasonable, unjustifiable, or discriminatory and burden or restrict us commerce.

The investigation was carried out under Section 301 of the us Trade Act of 1974, under which the ustr can be authorised to initiate trade retaliation against any country that conducts any of the following acts: (i) denies the us its rights under any trade agreement; (ii) enacts a legislation, implements a policy, or follows a practice that denies benefits to the us under any trade agreement; and (iii) burdens or restricts the us commerce.20 Upon investigation, the ustr determined that China’s interventions resulted in an annual loss of “at least $50 billion to the us economy.”21 The ustr, therefore, decided to impose additional tariffs of 25% on 1333 products, including aerospace, information and communication technology, and machinery products.22 The identified products were those that benefited from Chinese industrial policies, including “Made in China 2025.”23 After subsequent investigations, the targeted products were reduced to 1,102, valued at $50 billion at 2018 prices. On 818 of these products, valued at $34
billion, additional duties were imposed from 6 July 2018. The remaining products, valued at $16 billion, were covered by additional import tariffs of 25% on 23 August 2018. A larger conflagration between the two largest trading nations looms large with President Trump authorising the US to impose 10% tariffs on China’s imports valued at $200 billion.26

Not to be restrained by Trump administration’s trade protectionism, most countries adversely affected by its unilateral actions of trade protectionism have responded by taking “rebalancing measures.” However, this term seems no better than a euphemism for trade retaliation, taken either directly or by making a notification to the WTO. This has raised the grim prospects of a trade war, reminiscent of the early 1930s.28 Nearly nine decades ago, the trade war had escalated in absence of global trade rules, but today, major economies seem to be walking the same path, this time by disregarding the multilateral trade rules, but today, major economies seem to be walking the same path, this time by disregarding the multilateral trade rules that have evolved over the decades. Pushing the framework of trade rules governed by the WTO to the brink can seriously disrupt global trade, the implications of which can be far-reaching.

Trade Retaliation by US Trade Partners

The Trump administration’s announcement of tariff hikes on steel and aluminium brought strong responses from its major trade partners, in particular, the EU, Canada and Mexico, who threatened to retaliate. The EU announced its “rebalancing measures” targeting 340 American export items valued at $7.2 billion, roughly corresponding to the amount of its steel and aluminium exports affected by the US tariffs. In the first phase that became effective on 23 June, 182 export items, including agricultural products (Bourbon whiskey, orange juice and corn), industrial (steel and aluminium products) and manufactured goods (clothes, motorcycles and boats) worth $3.2 billion (in 2017 prices) were subjected to additional tariffs of 25%. A second stage was proposed three years later, when additional tariffs on 10%–50% were proposed to be levied on 158 American products. Importantly, the EU had earlier notified the committee on safeguards of the WTO about its intentions to retaliate against US’s actions targeting its steel and aluminium exports.

As regards the two other major partners, Canada and Mexico, the former announced tariffs of up to 25% on the US imports of steel and aluminium as well as orange juice, whiskey and other food products, worth up to 16.6 billion Canadian dollars, which was the value of Canadian steel exports to the US that was being targeted. Mexico announced similar measures on a number of products, mostly dairy, horticulture and meat products, “up to an amount comparable to damage caused by the United States’ action.”

The US–China trade dispute has been more intense, simply because the stakes are high. The US and China are already locked in a $100 billion dispute, which is threatening to escalate.

In early April, the Customs Tariff Commission of China’s State Council decided to retaliate against US’s action by imposing tariffs on 128 products. These products accounted for $3 billion of the US exports to China in 2017 and were aimed at offsetting the losses suffered in the aftermath of the US invoking Section 232 of its Trade Act of 1974. On the first set of products, covering fresh fruits, dried fruits and nuts, wines, modified ethanol, American ginseng, and seamless steel pipes, the Chinese authorities proposed to impose import tariffs of 15%. The US’s exports of these products to China were $977 million in 2017. Tariffs of 25% were proposed on a second set of products, including pork and its products, and recycled aluminium. The value of these products imported by China was nearly $2 billion in 2017.

China continued its tit-for-tat policy, synchronising its response to the US’s imposition of additional tariffs. In June, the Ministry of Commerce, People’s Republic of China (MOFCOM) decided to impose additional tariffs of 25% on chemical products, medical equipment and energy imported from the US, having current market value of $16 billion. Again, in early August, MOFCOM announced “China’s new countermeasures” to impose additional tariffs on about $60 billion worth of imports from the US. The Customs Tariff Commission of the State Council unveiled lists of 5,207 US products that would face additional tariffs of 5%–25%. The knock on effect of this much larger targeting of China could be significant as some evidence is already suggesting.

Undermining the WTO

We have already alluded to the various ways in which Trump administration’s protectionism violate US’s commitments to the WTO, after committing the “original sin,” namely increasing tariffs unilaterally. Disputes can only be adjudicated by WTO’s Dispute Settlement Body (DSB). Here we will discuss another important violation of WTO rule book by the US, the unilateral determination that China was infringing intellectual property rights (IPRs) owned by the US companies and imposing additional tariffs on imports, which it did by invoking Sections 301 and 304 of its Trade Act of 1974. As mentioned earlier, the US increased tariffs on its imports from China after the US authorised an investigation under Section 301 of the Trade Act of 1974 that China had violated its IPRs and was forcing American companies to transfer technologies to Chinese firms. Further, Section 304 was used for the determination of China’s violations.

In 1999, the EU challenged the WTO-consistency of these provisions, namely Section 301 and all the related provisions, before the DSB of the organisation. This case was significant as 16 other members had joined as third parties to the dispute. The findings of the Dispute Settlement Panel of the above-mentioned case are relevant for the present discussion, which we shall briefly discuss.6

The panel was called upon to rule whether Section 304 of the Trade Act of 1974, giving powers to the US to make determinations of whether another country was infringing it under any trade agreement, was inconsistent with the provisions of the Dispute Settlement Understanding (DSU) of the WTO. Article 23(a) of the DSU made it obligatory for every WTO member not to make a judgment as to whether another member had harmed its interests without first taking recourse to the DSB. The panel’s contention
was that the WTO’s dispute settlement process is the sole authority to adjudicate in a dispute between members and to also determine the manner of resolving the dispute. In other words, unilateral measures against another WTO member were violation of the rules of the organisation.

The panel observed that the language of Section 304 was “prima facie inconsistent with Article 23.2(a) of the DSU of the WTO.” However, the Panel gave due consideration to whether the USTR had used Section 304 against any WTO member, which it had not until then. Since the US had settled all its disputes through the WTO’s DS, the panel ruled that Section 304 did not violate US’s WTO obligations.

This yardstick used by the panel to judge on the legality or otherwise of the Section 304 of US’s Trade Act of 1974, has been breached through its unilateral action against China. Not surprisingly, China has promptly approached the DS against the unilateral actions of the US with a complaint similar to that of the EU’s. The ruling in this case will be crucial for its ruling on the US unilateralism hinges the integrity of the multilateral trade rules.

NOTES

1. PNTT was the equivalent to the “most favoured nation” (MFN) principle, the bedrock of the WTO rules. Politically, the US could not be seen as treating China as its “most favoured nation.”

2. For a recent article, see McBride (2017).

3. Summers and Carroll (1987; Table 1).

4. The American Recovery and Reinvestment Act (ARRA) of 2009 was enacted to stimulate the economy. Federal funds spent on this programme between 2009 and 2019 was expected to be $840 billion, according to a Congressional Budget Office estimate in 2015.

5. An extensive programme, a de facto industrial policy, was put in place to get the economy on track. For details, see Dhar (2014).

6. The USTR undertakes an annual exercise, National Trade Estimates, in which it documents the trade practices of partner countries that are preventing entry of products made in the US. But despite producing all this humungous evidence, the USTR has not approached the WTO’s Dispute Settlement Body as often as is merited by the evidence that it has produced.


8. The relevant Presidential Proclamation was issued on 8 March 2018. See for details, Proclamation 9705 of 8 March 2018.


10. This interpretation of “national security” was given by a US Department of Commerce Report in 2001.


13. Article XXXVI of the GATT. For details see GATT (1986).

14. The Doha Ministerial Declaration stated the following: “The negotiations (on tariff reduction for industrial products) shall take fully into account the special needs and interests of developing and least-developed country participants, including through less than full reciprocity in reduction commitments.” See WTO (2001).

15. Introduced through Trade Act of 1970, better known as the Smoot–Hawley Tariff Act, after its sponsors, Senator Reed Smoot and Representative Walter Hawley.


17. There is an unsettled debate on the impact of the Smoot–Hawley Tariffs on the Great Depression. While Melzer argued that the American protectionism had its cascading effect on the global economy, Eichengreen argued that the legislation could have stimulated the US’s economy, something that President Trump is intending to realise through his actions. For details, see Melzer (1976) and Eichengreen (1986). For an excellent synthesis, see Irwin (1998).


19. See Proclamation 9740 of 30 April 2018.


22. USTR, 16 June 2018.

23. Federal Register, 6 April 2018.


25. Federal Register, 16 August 2018.


29. WTO, 18 May 2018.


34. One indication of this was the provisional safeguard duties that the European Commission had imposed in July 2018, to “address the diversion of steel from other countries to the EU market as a result of the recently imposed US tariffs.” The EU had thus, adopted protectionism in order to prevent “serious harm to EU steelmakers and workers.” For details, see European Commission, 18 July 2018.


38. WTO, 5 April 2018.

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