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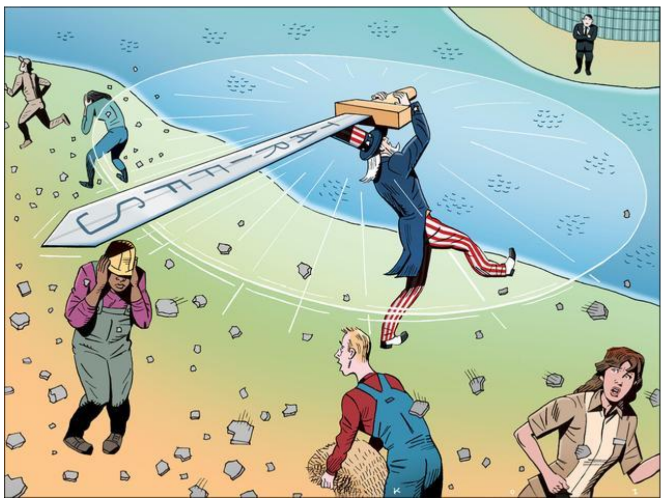
Trade Truths Will Outlast Trump

The president's failed experiments with tariffs and bilateral deals helped validate old best practices.

By Douglas A. Irwin



Trade was central to Donald Trump's 2016 campaign. He saw trade as a win-lose, zero-sum proposition, blaming trade deficits for deindustrializing the American heartland, calling the North American Free Trade Agreement "a disaster," and condemning China for unfair trade practices. He thought getting tough on trade would give him the leverage to get better deals.

President Trump called himself a "tariff man" and imposed 25% levies on imported steel and aluminum while launching a trade war against China. He pulled out of the Trans-Pacific Partnership, renegotiated Nafta, and threatened to leave the World Trade Organization.

Mr. Trump's defeat provides an opportune moment to reassess his trade policy. After four years, what have we learned? Many things, but especially that <u>old economic truths still have value:</u>

• *<u>Tariffs don't reduce the trade deficit.</u>* ……………………………………………..

If a country imports more than it exports, it would seem that tariffs would slash imports and help close the gap. But it doesn't work that way. Economists have long pointed out that the <u>trade deficit is driven by macroeconomic factors</u>, particularly international capital flows. The strong pre-Covid economy, along with the administration's expansionary fiscal policy, ensured that spending remained high and imports continued to pour in. The result: The merchandise trade deficit was $864 billion in 2019, more than $100 billion higher than in 2016.

Why didn't tariffs help close the gap? Not unexpectedly, other countries retaliated by imposing stiff tariffs on our exports. And when the administration placed tariffs on China, <u>imports were simply diverted to Vietnam</u> and other foreign suppliers without reshoring production.

• *<u>Tariffs are paid by consumers, destroy jobs and hurt the economy.</u>* …………………

Mr. Trump insisted that China would pay for the 15% to 25% duties that he imposed on $300 billion of its exports. In fact, the tariffs were passed on to American consumers, who paid more either directly for imported consumer goods or indirectly for imported intermediate inputs that increase production costs and ended up raising consumer prices.
Take steel. Higher prices might have saved some jobs in the steel industry, but not many: The industry is capital-intensive and doesn't employ the tens of thousands of workers of yesteryear. In the 1980s, it took 10 hours of work to produce a ton of steel; now it takes one hour.

In fact, steel protection is a job-destroying policy. Economists at the Federal Reserve found that the steel and aluminum tariffs reduced overall employment in manufacturing by 75,000 workers.

How could that be? Many more workers are employed in steel-using industries than in the steel industry itself. Higher steel prices penalized domestic producers of steel-intensive products, such as farm equipment and machinery, harming their competitive position in domestic and foreign markets (by reducing their exports and increasing other imports). Ford said higher steel prices cost it about $1 billion during a period from 2018-19.

More broadly, tariffs are a drag on the economy. In January, the Congressional Budget Office projected that higher tariffs would reduce real gross domestic product by roughly 0.5% and raise consumer prices by 0.5% this year, reducing average real household income by $1,277.

• Trade agreements are a key part of today's globalized world. **………………………..**

On the 2016 campaign trail, Mr. Trump excoriated Nafta as the worst trade agreement ever and threatened to pull out of it. Republicans from farm states—whose exports to Mexico have surged in the wake of the agreement—persuaded him to renegotiate it instead.

Mr. Trump boasted that he could get a better deal. But he never identified any provisions in the agreement that were unfair to the U.S., because there were none. He hated some of the outcomes that arose with Nafta—more imports from Mexico—while ignoring benefits to consumers as well as increased American exports to Mexico.

The result? Nafta was rebranded as the U.S.-Mexico-Canada Agreement, which preserves zero tariffs on trade among all three countries while somewhat tightening rules in the auto sector. In the end, Nafta was simply too important to ditch.

***• A China reset was overdue but requires a careful strategy*……………………..**

The Trump administration singled out China for its unfair trade practices and imposed tariffs on most Chinese imports. Here the administration was right: Beijing doesn't follow the rules, or the rules don't cover its model of state capitalism. But the administration's heavy-handed approach was arguably counterproductive.

Despite the president's insistence that "trade wars are good, and easy to win," they are costly and difficult to win. The tariffs came with a stiff price: Trump tariffs were met by immediate retaliation against farm exports, which has caused the administration to spend tens of billions of dollars to bail out ailing farmers.

As for its vaunted Phase 1 trade agreement, China's purchases are way behind its commitments, and U.S. exports remain depressed. An agreement on structural barriers in China remains to be negotiated, if it ever will be. The administration's tough approach has caused Beijing to double down on its state-led model and put reformers on the defensive.

Washington needs an effective strategy to deal with China, and one that includes American allies is most likely to succeed. When Mr. Trump pulled out of the TPP without thought or study, we lost an opportunity to establish rules and cement relationships in the Asia-Pacific region.

All this points to a disappointing—but entirely predictable—set of outcomes that, unfortunately, have damaged the U.S. economy and alienated allies. The president sought to reduce the trade deficit, increase manufacturing employment, change China's policies, and reach better deals, but fell short on all counts.

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