

TRADE WARS: WHAT DO THEY MEAN? WHY ARE THEY HAPPENING NOW? WHAT ARE THE COSTS?

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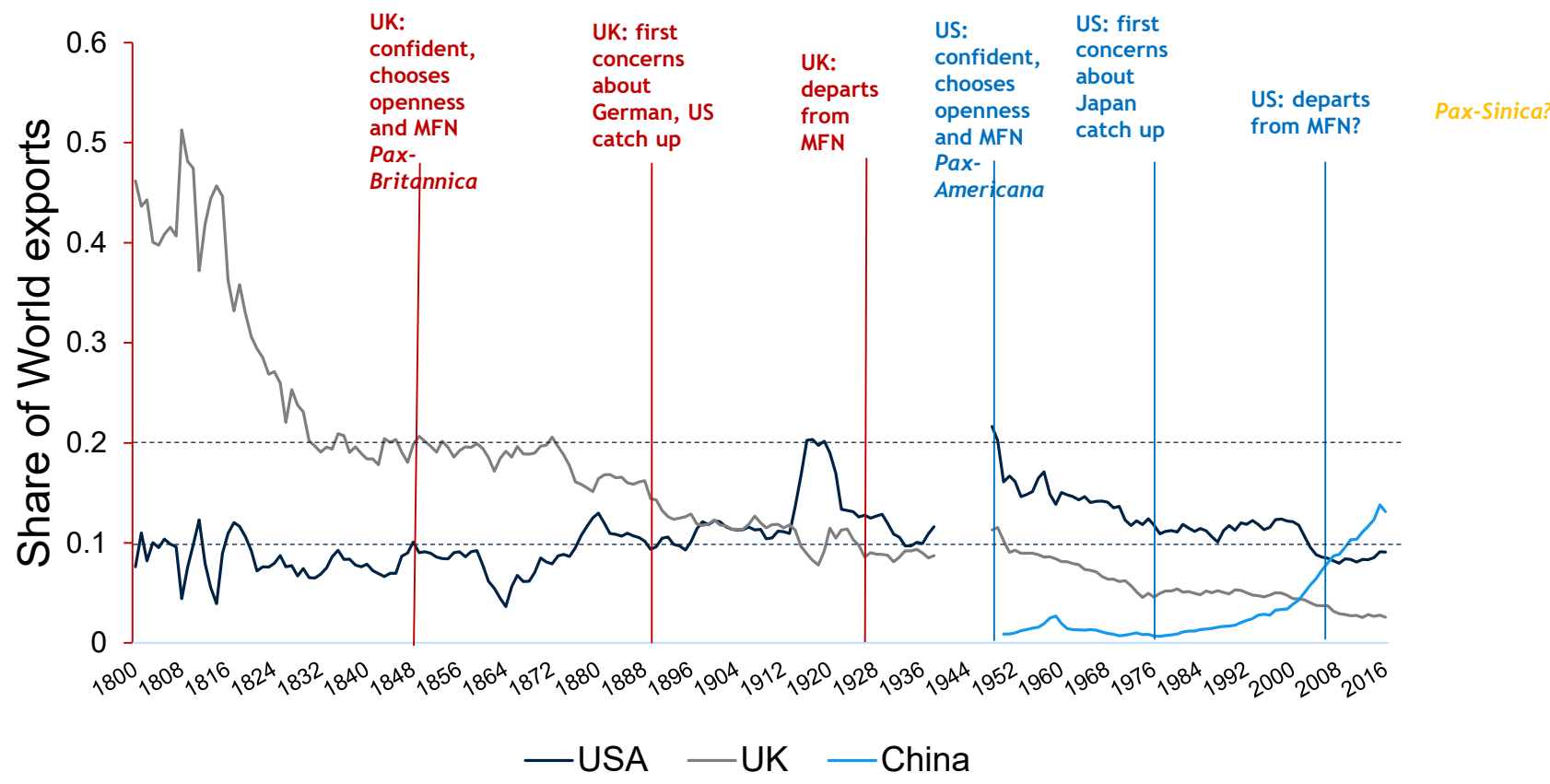
(based on Mattoo and Staiger, 2019)

World Bank, ABCDE, June 2019

The threat to globalization may be a historical inevitability

Shifts in trade shares and changes in policy stance

The UK and US Share of World Trade, 1800-2016



US TRADE WARS



Donald J. Trump 

@realDonaldTrump



When a country Taxes our products coming in at, say, 50%, and we Tax the same product coming into our country at ZERO, not fair or smart. We will soon be starting RECIPROCAL TAXES so that we will charge the same thing as they charge us. \$800 Billion Trade Deficit-have no choice!

8:57 AM - Mar 2, 2018

 27.5K  14.3K people are talking ... 

What do trade wars mean? A popular view

- A popular view among economists is that recent U.S. trade actions defy economic logic
 - seem to link gains from trade to bilateral trade imbalances and depict trade as a zero-sum game
- And according to this view, these actions are undesirable because they will lead to higher tariffs
 - either by design or, if a ploy to induce liberalization abroad,
 - because the ploy will fail and the higher “bargaining tariffs” will remain
- There is also a logical consequence of this view
 - in the event that these trade wars *do* lead to more open markets,
 - the tactics must be regarded as a success

AN ALTERNATIVE INTERPRETATION

- According to this interpretation it is possible to see a logic to these actions
 - the United States is initiating a change from “rules-based” to “power-based” tariff bargaining
 - and is selecting countries with which it runs bilateral trade deficits as suitable targets of its bargaining tariffs
- The costs of these trade tactics cannot be avoided even if they happen to deliver lower tariffs
 - the main costs will arise from the use of the tactics themselves
 - and from the damage to the rules-based multilateral trading system

STRUCTURE OF PRESENTATION

- The rules-based trading system
- Why? US actions as bargaining tariffs
- Why now? Hegemonic transition
- The costs of myopia

THE RULES-BASED MULTILATERAL TRADING SYSTEM

- **MFN**
- **Reciprocity**
- **Together constrain the exercise of power in bargaining**
- **Recent US actions as an attempt to escape these constraints**

WHY? US ACTIONS AS BARGAINING TARIFFS

Trade negotiations: from win-win to zero sum; or later comers problem

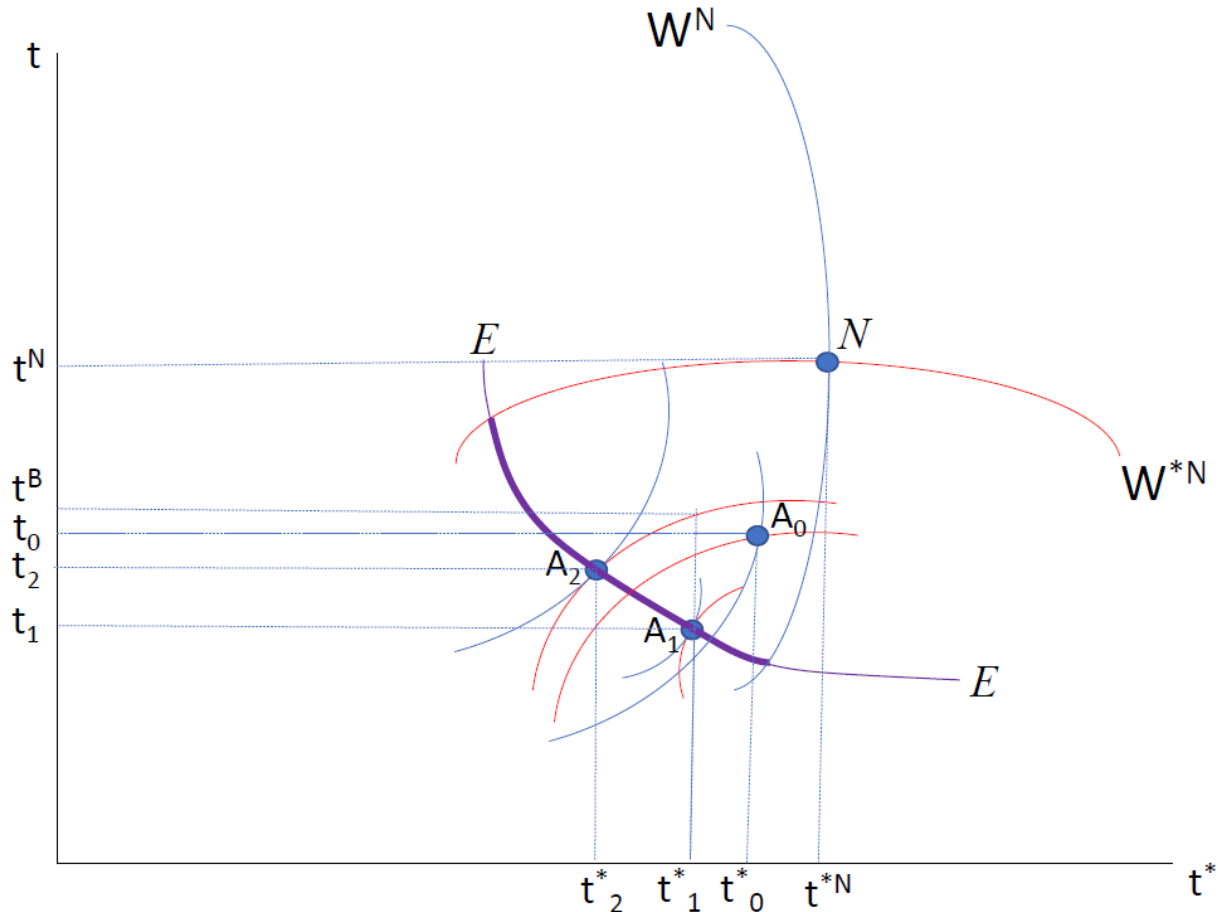


Figure 1

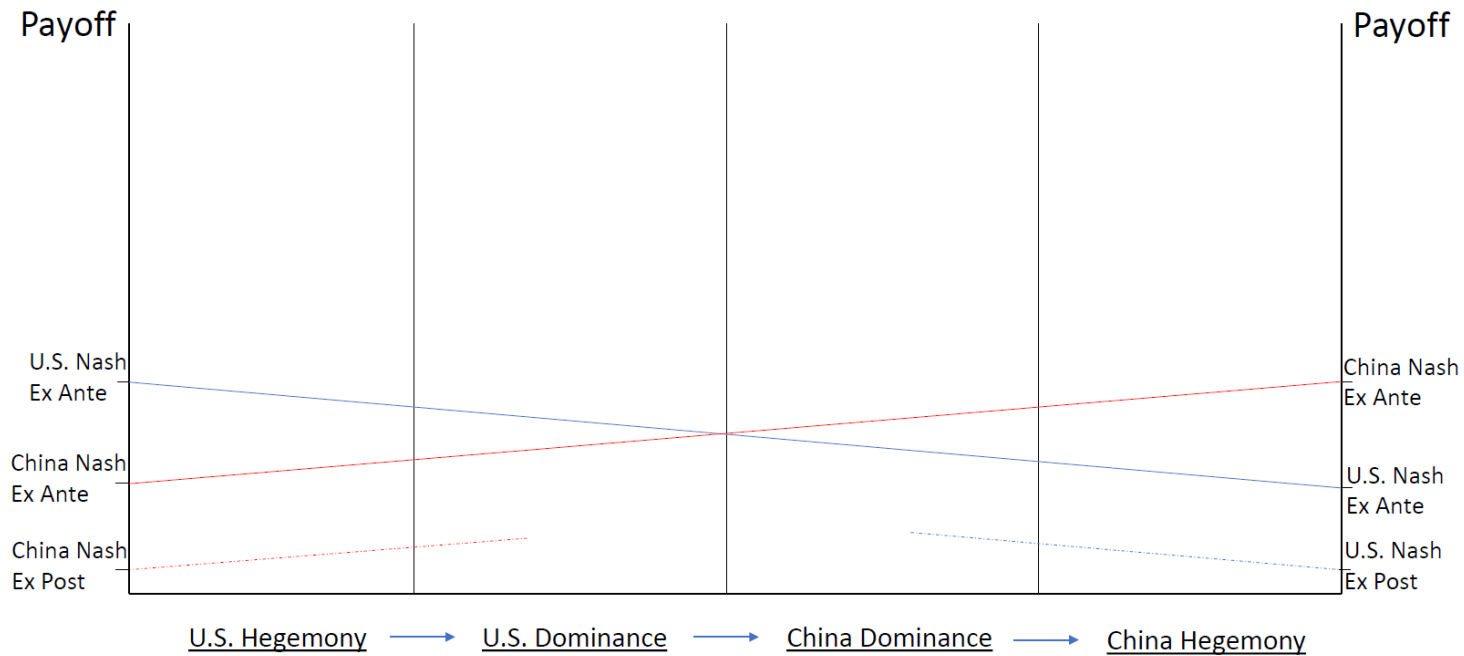
And bilateral trade deficits signify trading partners with whom US bargaining tariffs create strongest threat point

WHY NOW? HEGEMONIC TRANSITION

- In 1947, the United States was the unquestioned hegemon of the world economy and played a central role in the creation of the GATT
- And it can be in a hegemon's enlightened self-interest to support a rules-based system that limits its ability to exercise power
- But if the hegemon's dominance wanes, its support for the WTO rules-based multilateral system could rationally erode
 - ⇒ it may be in the country's interest to depart from these rules (this is accelerating with Trump, but didn't start with him)
- More broadly, historian/commentator Robert Kagan
 - sees the rules-based international order as “a historical anomaly” made possible by U.S. leadership and now collapsing,
 - “returning the world to its natural state - a dark jungle of competing interests, clashing nationalism, tribalism and self-interest.”

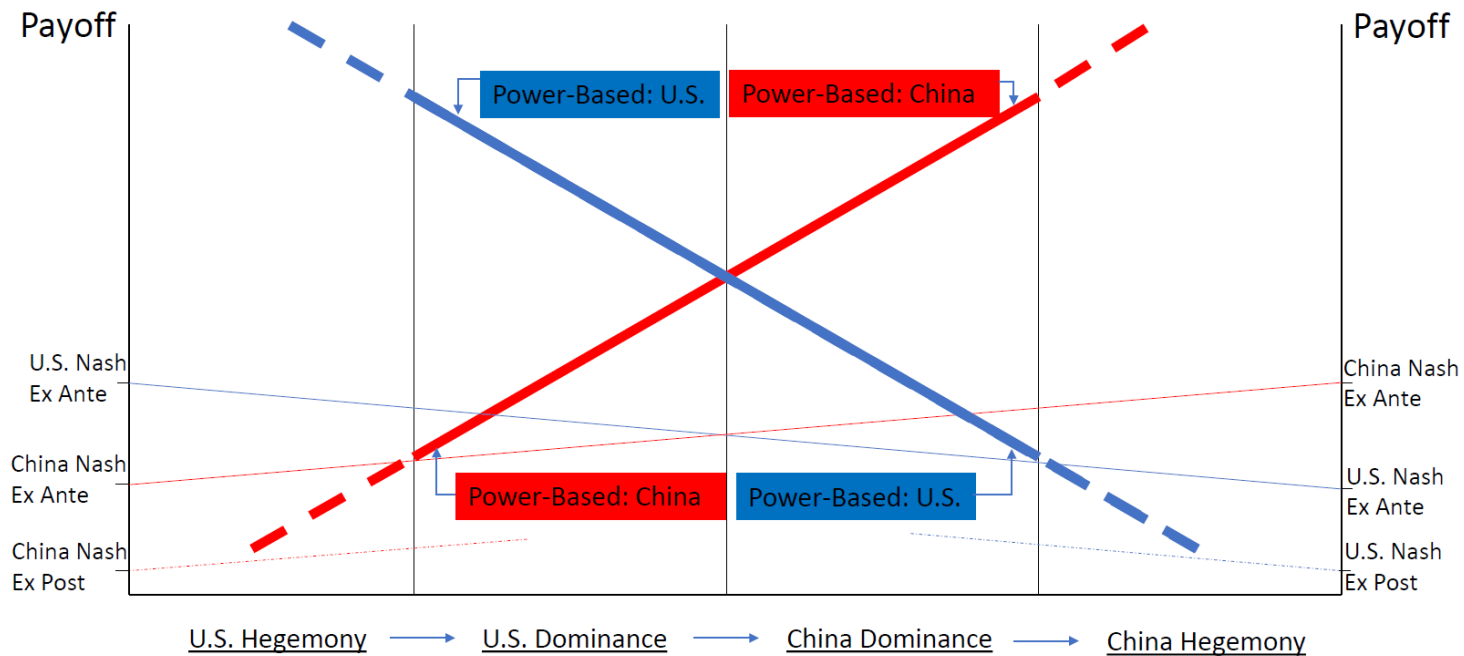
WHY NOW? HEGEMONIC TRANSITION

Figure 2. Hegemonic Transition: Equilibrium Payoffs



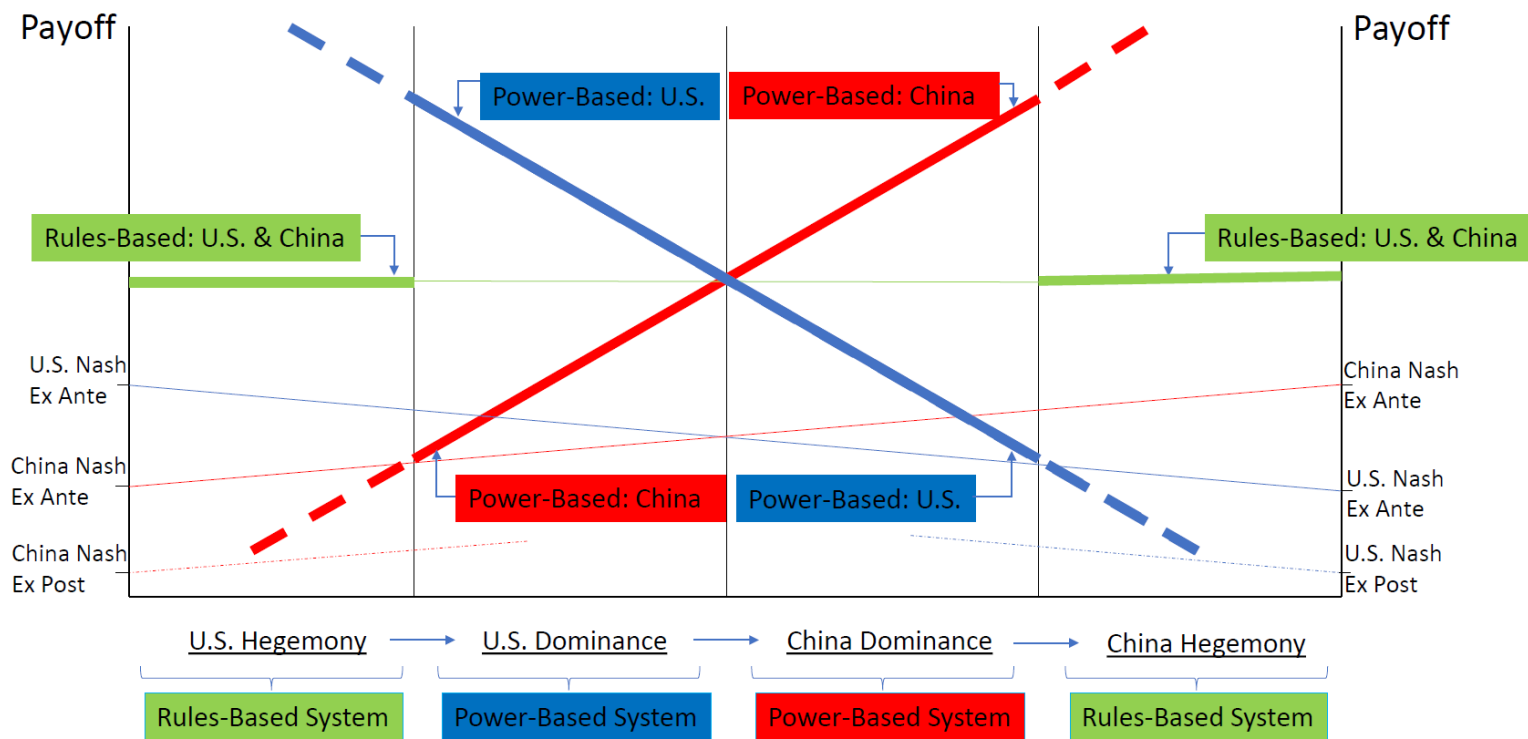
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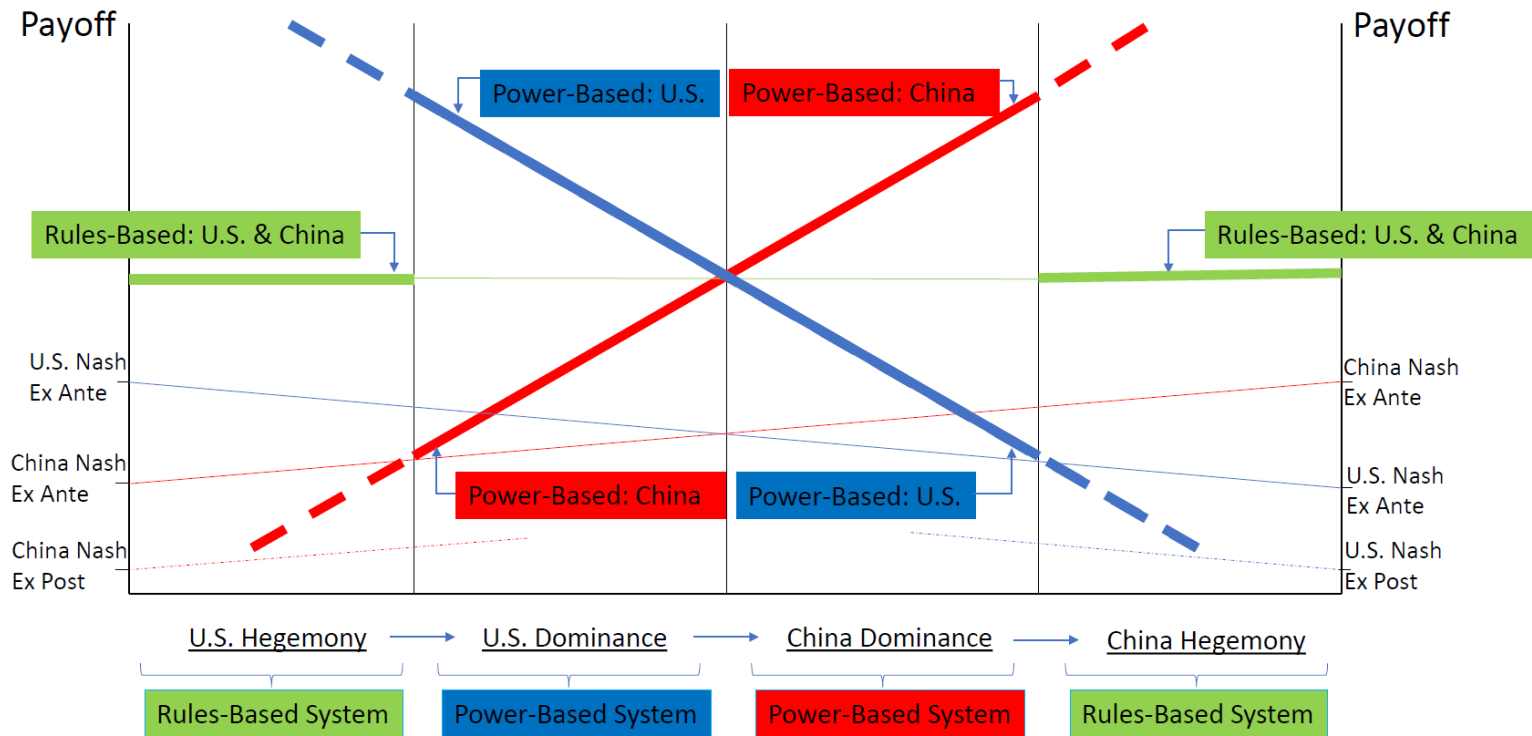
Duration of phases is not exogenously determined and depends on policy choices

THE COSTS OF MYOPIA

- The logic above is myopic: it does not take account of the longer-term consequences of the recent U.S. trade actions
 - other countries will turn to power-based responses as the rules-based system unravels
 - if the rules-based system suffers lasting damage, the United States will lose when the rules-based system is unavailable to the next hegemon

THE COSTS OF MYOPIA

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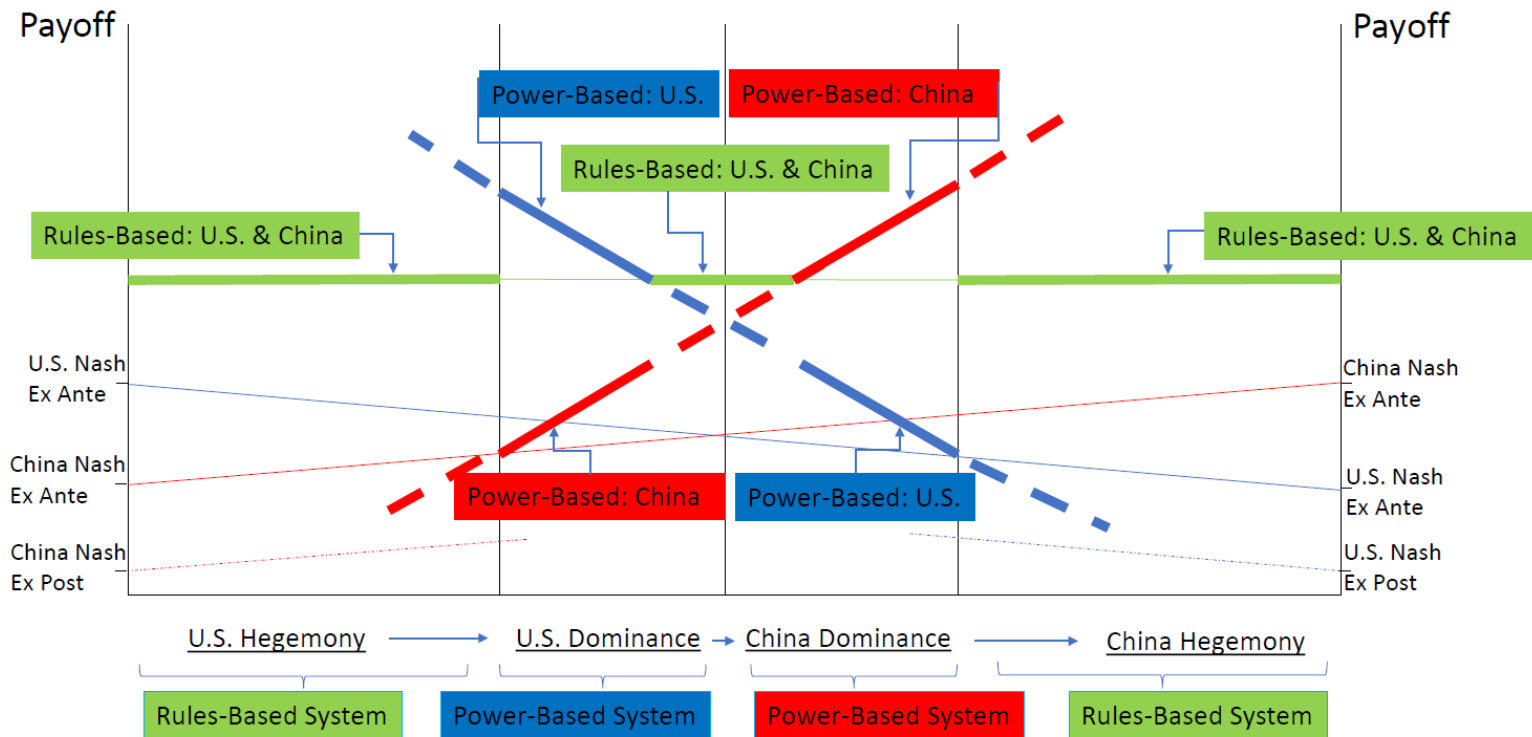


THE COSTS OF MYOPIA

- There is evidence that rules-based tariff bargaining is more efficient than power-based tariff bargaining
 - MFN and reciprocity can mitigate strategic behavior and the bargaining frictions that can accompany such behavior
 - ample historical evidence that bargaining tariffs lead to outcomes far away from those that might be considered desirable or efficient
 - \Rightarrow power-based regime less attractive to a declining hegemon
- \therefore A less myopic view would dictate greater U.S. restraint

THE COSTS OF MYOPIA

Figure 3. Hegemonic Transition: Equilibrium Payoffs



Evading the Thucydides trap by facilitating rather than resisting the new hegemony?

The domestic political economy of trade is also being turned on its head

- Classical view of national trade policy and trade negotiations: driven by concentrated producer interests
- But globalized production and ownership, weaken link between producer interests and national trade policy.
- The result: democratization of trade policy to favor diffuse and less-mobile labor and consumer interests.
- What does that mean for international trade cooperation?