

What Next for Global Trade?

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The year 2018 marked the return of the import tariff. As of October, the US had imposed levies on roughly 12,000 products, accounting for 12.6% of its total imports; its main trading partners had retaliated with tariffs on 2,087 products, accounting for 6.2% of US exports. With trade tensions mounting, many observers have warned of a full-scale trade war, or even the collapse of the global trading system.

Of course, this is not the first time in recent history that the US has tried using trade policy to advance its interests. In 1971, the Nixon administration famously imposed a 10% tariff on all imports in an attempt to halt the growth of the US current-account deficit. More recently, the Reagan administration erected non-tariff barriers against a number of import goods, particularly from Japan.

Nonetheless, there are some key differences between these episodes and the latest wave of tariff increases. For starters, the timing is surprising. Until 2018, globalization seemed like an unstoppable and irreversible force. International trade was considered to be completely liberalized, and any talk of trade policy was met with yawns in academic and policy circles alike. Stranger still, the rise of protectionism has come at a time when US unemployment is at a 50-year low, the stock market is up, and GDP growth is projected to be around 3% for the year.

The opening salvo of tariff increases- on washing machines and solar panels- seemed to be geared toward protecting specific domestic industries that had been hurt by import competition. These were soon accompanied by sweeping tariffs of 25% on steel and 10% on aluminium, as well as the renegotiation of the North American Free Trade Agreement (NAFTA). The latest wave has singled out China, presumably to address long-standing concerns about that country's treatment of intellectual property, restriction of market access, and subsidies for state-owned enterprises. As for America's trading partners, each has responded in a way designed to inflict political damage on congressional Republicans.

The recent US trade policy thus seems to be motivated by two key priorities: To protect US jobs in import-competing sectors, and to address frustrations with the current trading system that the World Trade Organization (WTO) has failed to resolve. It is this second motivation that makes the current bout of protectionism different-and potentially more dangerous-than other recent episodes.

After all, using trade policy to protect domestic jobs is not new, though it has fallen out of favour over time. Most policymakers now accept that a social safety net and domestic policies such as retraining or relocation subsidies are more effective responses to the displacement of workers in open, constantly evolving economies. The fact that NAFTA survived the renegotiation process with only minor modifications is a case in point.

The real issue, then, is the current trading system and its various shortcomings. In fact, the claim that trade has been completely liberalized in advanced economies is tenable only if one focuses solely on tariffs and ignores "behind the border" measures, which are substantially harder to measure, let alone address. These include regulatory restrictions that hinder cross-border investment; subsidies to domestic industries; licensing requirements that inhibit trade in services; privacy requirements that

restrict e-commerce; restrictions on foreign ownership that interfere with inward direct investment; and stringent joint-venture requirements that often entail handing over intellectual property.

If there is one area of wide agreement across countries and political parties, it is that cross-border transactions and regulation leave a lot to be desired.

In principle, these issues should have been addressed through multilateral negotiations at the WTO. In practice, they have been dealt with in an ad hoc fashion, through a slow, overly bureaucratic process that has failed to get to the root of the problem.

The medium- and long-term effects of today's trade disputes remain to be seen. Simulations based on computational general equilibrium models predict that the current tariff increases will have a small impact on the US and a slightly larger impact on China. In the case of a "full-scale" trade war-meaning 25% tariffs on all Chinese imports to the US, and vice versa-the effects would be slightly larger, but by no means catastrophic.

The greater danger is that today's policy shifts will continue to create uncertainty, thus reducing investment. Scholars have repeatedly shown that overall investment is highly sensitive to changes in perception regarding the economic environment.

For example, studies have found that investment in a given locality can even be affected by the victory or loss of a local sports team. Now consider the current situation, in which there is growing uncertainty about the future of the rules-based trading system and global value chains. Needless to say, the effect on investment could be chilling indeed.

Moreover, while large economies like the US and China will survive the current contretemps-albeit with bruises- smaller emerging economies have much more to lose. For many of these smaller economies, trade has been the ticket out of poverty. By adhering to the common rules of the WTO, they managed to keep domestic lobbies and special interests at bay and develop economically. Were the multilateral trading system to collapse, protectionist interests around the world would suddenly have little standing in their way.

An optimistic view of the current situation is that it will bring countries to the negotiating table, eventually leading to a more effective multilateral system. Such a system might include a reformed WTO; trade liberalization in services and e-commerce; agreements limiting subsidies and protecting intellectual property; and deeper cross-border regulatory coordination.

An optimist cannot help but draw parallels to the 1980s, when the global trading system was challenged by rising tensions between the US and Japan. Rather than collapsing, the trading system emerged from those disputes stronger than before, setting the stage for the hyper-globalization of the last three decades. Perhaps a similar future for international trade lies ahead.

Or perhaps not. For those concerned about the future of trade, the only certainty about the year ahead is that it will be a nail-biter.

*Pinelopi Koujianou Goldberg is **World Bank** Group Chief Economist, Professor of Economics at Yale University, and a former editor-in-chief of the American Economic Review.*