THE RESURGENCE OF PROTECTIONISM:
THE CASE OF THE U.S.

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Introduction

The decade following the financial crisis of 2008 has witnessed a rise in protectionism around the world’s top economies. Many countries have adopted trade and fiscal policies in order to maintain strategic international advantages, to bolster key industries and to protect local jobs. These include advanced economies such as those in the European Union and the U.S., as well as other economies like India, Russia and Argentina. Protectionism can be viewed either positively or negatively depending on the country and markets. Trade tariffs can bring potential revenue streams in the future and help local businesses, but repercussions from other countries can worsen the economy. The U.S. has been one of the most protectionist countries in the past few years and, with the election of Donald Trump as President, the protectionist stance of this country has intensified. The choice for this topic stems from the interest in a controversial subject such as Trump. It also serves to observe the impact that protectionism on the part of a big country such as the United States is having both locally and on the rest of the world.

The thesis is organized as follows: before addressing the issues in the United States, the first chapter illustrates how global trade has grown in the past century as a result of trade liberalization regulated through multilateralism. Multilateral trade agreements allow for the movement of goods and services with low or no trade restrictions. The General Agreement on Tariffs and Trade (GATT) was a multilateral agreement first signed in 1947 and continued through the 1990’s, facilitating global trade. Yet in the more recent past, bilateral and regional agreements have increased in number. The reasons for this move and the pros and cons of multilateral versus bilateral agreements are examined.

In the second chapter, the focus shifts towards the role of trade policy in an open economy, followed by a closer look at trade policies in the U.S. The chapter begins with a description of economic theories on trade policies starting from Mercantilism and the theory of comparative advantage in the 17\textsuperscript{th} and 18\textsuperscript{th} centuries to more modern theories formulated in the 1900’s. These theories support the advantages of free trade. According to traditional trade theory, removal of import tariffs and liberalization of trade are positive from a welfare point of view. The chapter continues with a general overview of U.S. trade policies in recent times, tracing the move from free trade to a preference for bilateral and big regional agreements. A review follows of the Trump Administration’s highly restrictive trade measures, such as the imposition of tariffs on goods from many countries around the world, meant to protect local
jobs and businesses.

The third and final chapter demonstrates the effects of protectionism on the U.S. economy and worldwide. In the first part of the chapter, the U.S. economy is observed in particular through several economic indicators: GDP, unemployment rate and trade deficit. As the economy is impacted not only by trade policies, but also by fiscal measures, the new fiscal policy in the U.S., the Tax Cut and Jobs Act, is also illustrated, with major emphasis given on the more protectionist aspects of the new tax policy. The changes in business taxes are meant to stimulate domestic companies to increase their investments in the United States thanks to tax savings and increased profits, while possibly also motivating further foreign investment in the country. The final section of this paper presents studies and data published by various global institutions regarding the effects of Trump’s increased U.S. protectionism on other nations and on the world economy. Conclusions follow.
Chapter 1. Trade policies: Multilateralism versus Bilateralism

1.1 Multilateralism regulation in the 20th century

Most economists agree that free trade of goods and services among countries results in positive effects on economic growth, as liberalization of trade can increase exports and provide advantages from economies of scale. Consumers can also benefit from lower prices and a greater choice of goods. Trade relations between countries are governed by trade policies that define rules, regulations, standards and goals, with the aim of boosting a nation’s international trade. All countries formulate national trade policies to protect their trade and citizens, while remaining aligned with their national foreign policies. Trade policies are managed via different activities such as tariffs, trade barriers and inspection regulations. Tariffs are taxes that are imposed on imports with the purpose of protecting local markets through the inflation of prices of imported goods. Trade barriers are restrictions of particular products with specific nations, which, besides tariffs, can also include duties, subsidies on local goods, embargoes and quotas. Inspection regulations ensure that only goods with set quality and safety standards are imported in a country.

Trade Agreements are negotiation instruments that have as their objective the liberalization of trade through the reduction or even elimination of tariffs, quotas and other trade restrictions on items traded between the participants, where each signatory could be a country, a trade bloc or a custom territory. Trade agreements can give individual countries expanded access to other markets, increasing each country’s economic growth; nonetheless, provisions included in the agreements are heavily shaped by domestic and international political realities. Trade liberalization can be negotiated via multilateral, bilateral or regional mechanisms, examined herewith.

Multilateralism refers to global trade agreements between many countries or blocs of countries. They are usually intended to lower trade barriers between participating countries and, as a consequence, increase the degree of economic integration between the participants. In fact, these agreements reduce tariffs and make it easier for businesses to import goods from other countries and to export their local products, leading to economic growth. Multilateral trade agreements are considered the most effective way of liberalizing trade in an interdependent global economy and countries entering in the agreement are treated in the same way, without discrimination. In fact, the main benefit that countries can take advantage of is equal treatment. In a multilateral trade agreement, member countries share common
standards and procedures, which allow the movement of goods and services without trade restrictions. When entering into the agreement, member countries have the possibility of sharing the good values, beliefs and assumptions to achieve development goals and objectives. As a consequence, less powerful countries can achieve objectives that they could not achieve before entering into a multilateral agreement, thanks to the allocation of knowledge with more powerful ones. The biggest disadvantage of multilateral agreements is that they are very complex and this makes them difficult and time consuming to negotiate. In fact, the decision making process could take a long time since all countries have to enter into an agreement and, because of the length of time, there is a chance that the agreement will not take place at all. Another main disadvantage is that less powerful countries can actually suffer from the equal treatment between countries and there is the risk that the agreement exploits small open economies. Small businesses cannot compete with bigger ones and a multilateral agreement does not consider the well-being of small economies, which could lead to an abrupt stop of the success of a small nation to prosper further.

General Agreement on Tariffs and Trade (GATT) was a multilateral agreement first signed in 1947 by 23 nations. The purpose was to regulate international trade and eliminate harmful trade protectionism through "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis." A significant pillar of GATT is Article 1 relating to the “Most Favored Nation” (MFN) clause that requires members to provide all other members with the same most favorable treatment, thus forbidding member countries from pursuing discriminatory trade policies against one another. In general, MFN means that all members have to be treated equally so, every time a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services from all other countries. Two important exceptions to this rule as allowed by GATT are the treatment of developing countries (which can be given tariff preferences) and the formation of free trade areas, or customs unions. For many years GATT reduced tariffs on non-agricultural goods, boosting world trade. This was seen as a success and many more countries wanted to join. By 1995, GATT had 128 members, generating 80% of world trade. However, as discussed earlier, multilateral trade agreements can disrupt small domestic industries and destabilize small, traditional economies. In fact in the 1980s, as GATT was no longer relevant to the realities of world trade, there were many more rounds of international talks in subsequent years.
Tab 1. Chronology of GATT trade talks

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<th>Period</th>
<th>Conclusion</th>
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<tr>
<td>GATT</td>
<td>1947</td>
<td>GATT creation + 45,000 tariff cuts</td>
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<tr>
<td>Second Round</td>
<td>1949</td>
<td>5,000 tariff concessions</td>
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<tr>
<td>Third Round</td>
<td>1950-1951</td>
<td>8,700 tariff concessions</td>
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<tr>
<td>Fourth Round</td>
<td>1956</td>
<td>$2.5 billion worth of tariff reductions</td>
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<td>The Dillon Round</td>
<td>1960-1962</td>
<td>4,400 tariff concessions covering $4.9 billion in trade</td>
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<td>The Kenney Round</td>
<td>1964-1967</td>
<td>Tariff reductions covering trade of $40 billion among 50 countries + anti-dumping measures.</td>
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<tr>
<td>The Uruguay Round</td>
<td>1986-1994</td>
<td>Tariff reductions + non-tariff measures, rules, services, intellectual property, environment, creation of WTO. Largest negotiation (123 nations)</td>
</tr>
<tr>
<td>The Doha Round</td>
<td>2001</td>
<td>Failed</td>
</tr>
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</table>

Sources: World Trade Organization, Wilson Center

One of the largest and most important rounds of discussions was the Uruguay Round, which covered almost all trade sectors as well as including protection of the environment for the first time. It also focused on the needs of developing countries regarding labor-intensive textile clothing manufacturing and agriculture. The round also led to the creation of the World Trade Organization (WTO) in 1995. The WTO is currently the most important negotiating forum for international multilateral trade relations, in areas that extend not only to trade in goods but also to services and intellectual property. Today, the World Trade Organization is composed of 157 members who account for more than 97% of world trade. This organization regulates, supervises and encourages international trade and the breaking down of trade barriers between countries. It provides a code of conduct in trade policy and serves as a trade forum helping member governments to resolve trade disputes or create negotiations. It also provides a common framework for trade negotiations in order to allow members to conduct their commercial relations with the aim of increasing the standard of living of their citizens, ensuring full employment and expanding the trade in goods and services while safeguarding the optimal use of global resources compatible with environmental protection. So the main tasks of the WTO are to facilitate the implementation of multilateral trade agreements and, in addition to issues related to trade, the World Trade Organization considers also environmental issues, workers’ rights and cultural rights.
The final round, the Doha Round was launched at the WTO meeting in Doha, Qatar in November 2001. The Doha round of trade talks were centered around agriculture and services and was to include all members of the World Trade Organization (WTO). Its goal was to finish up by January 2005, but talks never culminated in any tangible agreements because of the sensitivity of the issues and the large number of participants. The agreement's purpose was to boost the economic growth of developing countries. It centered on reducing subsidies for developed countries’ agricultural industries, which would allow developing countries to export food, something they were already good at producing. In return, the developing countries would open up their market to services, particularly banking. That would provide new markets to the developed countries’ service industries. It would also modernize these markets for the developing countries. But agricultural negotiations were very difficult because of protectionism in developed countries, where governments provide agricultural subsidies to their farmers in order to protect their own agricultural production, thus reducing imports from developing countries whose main productions are usually agricultural. The failure of Doha set a precedent for future multilateral trade agreements, which would be doomed to fail for the same reasons unless developing countries changed their internal policies. Instead, as a consequence to the Doha failure, bilateral and regional trade agreements, which are much easier to negotiate, have increased in number.

1.2 Bilateral and Regional Trade Agreements

Bilateral agreements are trade agreements between two nations. These agreements eliminate tariffs and give companies within both countries a price advantage as well as fewer barriers to trade. Compared to multilateral trade agreements, bilateral agreements are easier to negotiate and can go into effect faster, reaping trade benefits more quickly. In case multilateral trade agreement negotiations fail, most nations generally negotiate a series of bilateral agreements instead. However, bilateral trade agreements can cause less successful companies to go out of business since they cannot compete with more powerful companies of another country. In fact, on an even larger scale, bilateral agreements tend to favor the country with the best economy, putting the weaker nation at a disadvantage.

Regional Trade Agreements (RTAs) are arrangements midway between multilateral and bilateral contracts that involve a group of countries negotiating within a geographic region as explained below:
### Tab 2. Areas in which Regional Trade Agreements operate

<table>
<thead>
<tr>
<th>RTA area</th>
<th>Definition</th>
<th>Costs and benefits</th>
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</table>
| Free-trade area (i.e. NAFTA, CETA, TTIP) | No tariffs, taxes, or quotas on trade of goods and services between countries | **Costs:**  
- Not concerned with “non-tariff” barriers that can impact services.  
- Generally no free movement of labor and capital.  
**Benefits:**  
- Members can focus on their comparative advantages and obtain higher efficiency and profitability  
- Members can negotiate own trade deals outside of the free trade area. |
| Customs Union (i.e. EU, EACU, Mercosur) | In addition to removal of tariffs and quotas, members agree to impose a common tariff on imports coming from the outside world. | **Costs:**  
- Not concerned with “non-tariff” barriers that can impact services  
- Members cannot negotiate own trade deals.  
- Limited free movement of labor and capital, though there are generally no border checks.  
**Benefits:**  
- Trade deals for whole customs union prevents members from agreeing better deals with non-members and undercut the rest of the group.  
- Once goods have cleared customs in one country, they can be shipped to others without further tariffs. |
| Single market (i.e. EU plus Norway, Liechtenstein and Iceland) | In addition to removal of tariffs and quotas and a common tariff on imports from the outside world, other barriers to trade are also removed such as different rules on packaging, safety and standards. Free movement of goods, services, capital and labor. | **Costs:**  
- Members give up the freedom to pursue their own independent deals.  
- Monopolies or cartels could be formed and create private barriers to trade.  
- Loss of control over free movement and immigration.  
**Benefits:**  
- Harmonization of policies, regulations and standards. Members can target favorable policies to own firms to make production cheaper.  
- Businesses have a larger consumer base and can exploit economies of scale.  
- Members can influence procedures by which the common market laws are made. |

Sources: King’s College London - Dr. John Paul Salter  
BBC Business News – Jonty Bloom

RTAs cover more than half of all international trade and operate alongside global multilateral agreements under the World Trade Organization (WTO) and can either be truly regional, or signed by countries in other parts of the globe. Although one of the core principles of the WTO is non-discrimination among trading partners, RTAs, which are reciprocal preferential trade agreements between two or more partners (thus by definition discriminatory
against the rest of the world), are actually authorized under the WTO, as exemptions. They are, however, subject to a set of rules which basically give guidelines to help trade flow more freely among the countries in the RTA without setting barriers to trade against the outside world.

Do Bilateral and Regional Trade Arrangements help move the world towards freer global trade, or, as free-purists think, do they weaken true liberalization and fragment the global trading system? WTO’s point of view is that RTAs have been increasing since the 1990s, thus causing a drop in multilateralism, possibly also reducing free trade. There have in fact been three major waves of regionalism. In the 1950s, six western European countries united and began a process of economic integration that led to the establishment of a customs union, which led to other RTAs. A second wave of regionalism was initiated by the United States’ departure from GATT’s non-discrimination principle in the 1980s, followed by the implementation of the 1993 North American Free Trade Agreement (NAFTA). Except for the important developments in Europe’s economic integration and NAFTA, it turned out that discriminatory trade policies posed less of a threat to the global trading system than was thought. The third and last wave of regionalism took place in the early 2000s. East Asia held the perception that global economic institutions were the reason that led the decline in region during the Asian Crisis. Therefore, many Asian countries entered into bilateral negotiations, also joined by the USA. A problem with using simple counts of Regional Trade Agreements is that, while some agreements are important, others are negligible. Though RTAs have been large in numbers, they are of minor importance to the global economy, as many are bilateral involving historic events around ex Yugoslavia, USSR and Czechoslovakia as well as the dissolution of CMEA (i.e. COMECON countries) in Europe. Also, new states joining the WTO have simply gone through the process of notifying the organization of their current relations, bringing up the count of RTAs. An alternative measure of the degree of regionalism is the share of global trade under Regional Trade Agreements. RTAs are said to represent between 55 - 90% of total trade. But some of the bigger trade agreements, like CUSTA for Canada and USA really have minor impacts on trade flows, as tariffs under WTO without a regional agreement were already lower than 5% and trade would have occurred anyway.

RTAs are often signed for non-trade reasons to facilitate trade flows between countries/regions. For example, Canada used CUSTA as insurance against protectionism measures by the USA and both parties signed to ensure that anti-dumping measures were followed. Dumping is a process where a company exports a product at a price lower than the price it normally charges on its own home market. To contrast dumping and to protect local
businesses and markets, many countries impose stiff duties on products they believe are being dumped in their national market. Modern RTAs include “deep integration” provisions that go beyond WTO trade rules. Deep integration is the process in which domestic regulatory policies and measures are modified in order to remove barriers to trade, as opposed to “shallow integration” where border measures such as tariffs and quotas are eliminated. These measures can include customs procedures, competition policy, product standards, rules around access to government procurement, intellectual property rights, and so forth. Deep integration also has the potential to help improve welfare by cutting trade costs and reducing non-tariff barriers to trade, which hamper regional integration. Deep integration RTAs can also help to raise concerns about a partner’s domestic policies or service sector structure, bringing out problems regarding poorly developed infrastructure and financial institutions. These can lead to improved financial systems and improved customs clearance efficiencies, which are beneficial to all. RTAs can serve as testing grounds for international policies in new areas and can improve relations when used as instruments of foreign policy, thus improving the national security of the countries involved and reducing the likelihood of war.

A key question raised around the formation of an RTA is whether or not these improve member countries’ welfare. The preferential removal of tariffs may in reality lead to imports shifting away from the most efficient supplier to the country receiving preferential treatment, creating trade diversion. This generates inefficiency and hurts members of the agreement if the change in consumer prices, and therefore in consumer surplus, is too small to cover the costs from the inefficiency. In contrast, if the RTA leads to greater imports, consumer gains outweigh the costs from production inefficiency, improving members’ welfare. In principle, RTAs can generate either trade creation or trade diversion but it is important to consider that participation in any RTA is a political decision and agreements will be formed based on local governments’ objectives. If governments were only interested in welfare in their countries, only trade-creating RTAs would become operative. However, governments, often influenced by special interest groups, may pursue trade-diverting RTAs rather than seeking to improve their country’s welfare.

As multilateralism and regionalism are correlated, an important question is whether the spread of regionalism will help or harm the multilateral trading system. To answer this question, an analysis can be done considering the Hecksher-Ohlin model and the Stolper-Samuelson effect. The Hecksher-Ohlin trade theory argues that trade occurs between two countries due to differences in labor, labor skills, physical capital, capital, or other factors of production across countries. The theory of this model basically holds that a country will export
those commodities that are produced by the factor that it has in relative abundance and that it will import products whose production requires factors of production where it has relatively less abundance. Basically, a labor-abundant country will specialize in and export labor-intensive commodity, whereas a capital-abundant country will specialize in and export capital-intensive commodity. With these conditions, both nations would be better off if they freely traded, and under such a situation of free trade, this would maximize efficiency, resulting in a greater total production of commodities and cheaper prices for consumers than would be the case without trade. According to the Stolper-Samuelson theorem derived from the Heckscher-Ohlin model, under the assumptions of constant returns and perfect competition, if the relative price of a good increases, then the real wage or rental rate of the factor used intensively in the production of that good increases, while the real wage or rental rate of the other factor decreases. Subsequently, Samuelson argued that factor prices would be the same in all countries under free trade conditions, based on what is known in economics as the factor price equalization theorem. This might mean, for example, that international trade would cause wage rates for unskilled workers to fall in the high-wage country in relation to the rents available from capital and to the same level as wages in the low-wage country, and for wages to rise in relation to the rents available from capital in the low-wage country and equal to the level of the country where labor was less abundant. The Stolper-Samuelson theorem states that any change in the relative price of goods alters the distribution of income. Both the Heckscher-Ohlin model and the subsequent Stolper-Samuelson theorem state that trade between two countries affect prices of goods, in turn affecting income growth, inferring that bilateral agreements may provide huge gains, undermining support toward multilateral trade agreements. But it is also true that bilateral agreements could be harmful to the prospects of global free trade in that they limit economic globalization by localizing areas of trade, making it more difficult for those outside of the region to trade with those within the agreement, which ultimately could also limit the growth prospects of both parties.

Free trade is also weakened by Rules of Origin (ROO), criteria to determine the national source of a product, which are added to RTAs and bilateral agreements to avoid the possibility that a product destined to a high-tariff member country will be first imported into the lowest-tariff member country and then re-exported to the former. However, ROOs create distortions and create more trade diversion. Why do countries use complex ROOs if their consequences are difficult to determine and they are likely to reduce welfare? The reason is that, without ROOs, imports would enter the Free Trade Agreement (FTA) through the lowest-tariff country, which would then collect most tariff revenue from regional imports,
distorting trade and reducing the positive effects of FTAs. The Spaghetti Bowl Effect is an interesting phenomenon in trade economics where the increasing number of FTAs between countries slows down trade relations between them. In Free Trade Agreements, members agree on a lower internal tariff to be applied between them, while at the same time each member can have its own external tariff levied on imports from non-member countries. This introduces the concept of country of origin used to distinguish products of one country from the other since products often pass through many countries. Each FTA has its own ROO and the problem arises when, as FTAs grow in number, so do the rules of origin. Thus, it is not easy for producers to comply with all the rules of origin simultaneously. The effect leads to discriminatory trade policy because the same commodity is subjected to different tariffs for the purpose of domestic preferences. With the increase in FTAs throughout the international economy, the Spaghetti Bowl phenomenon has led to paradoxical, and often contradictory outcomes amongst bilateral and multilateral trade partners.

In the past 15 years regionalism has become, by far, the most popular form of trade. This trend has been met with skepticism by trade economists, many of whom are concerned with the distortions from the discriminatory policies inherent to these arrangements that could threaten global trade. This chapter has discussed concerns raised around bilateral and regional trade agreements, possibly endangering multilateralism and although theoretically there are different viewpoints, it is not clear yet if the threat is a real one. Empirical evidence seems to indicate that trade creation, not trade diversion, is the norm due to the fact that governments are very careful when forming regional trade agreements, also adjusting other trade policies to moderate distortions from discrimination. RTAs are normally entered into for reasons not necessarily linked strictly to the elimination of tariffs, and in fact, in a WTO world with already low tariffs, RTAs are unlikely to make much difference in trade flows. In addition, when examining the relationship between regionalism and multilateralism, it turns out that many RTAs are actually formed during multilateral negotiations. Yet it is always important to take it into consideration the threat of bilateral and regional trade agreements to global trade in order for trade economists to continue to look for ways to better integrate regionalism with continued increase in global trade. In today’s era, globalization depends on sound trade policies that reflect market changes, establish free and fair trade practices and expand the possibilities for prosperous international trade. In the next chapter, we will examine the impact of trade policies on economic growth, with additional focus on the United States of America.
Chapter 2. The role of trade policy in an open economy: the case of the US

2.1 The role of trade policy in an open economy

An open economy is a market that engages in international exchanges of goods, services and investments between domestic businesses and communities outside of the country. Advantages to citizens in countries with open economies are that they have large variety of goods and services at their disposal to choose from, as well as the possibility to invest outside of their country. On the other hand, the dependence of open economies to other economies can expose them to risk. In an open economy, a country’s spending in a year may not equal its output of goods and services. If a country spends more than it produces, it needs to borrow from abroad, while if it spends less than what it produces, it has funds available for lending to foreigners. Governments can control movements of capital and labor, resulting in different degrees of openness. Open economies prevail in most developed countries that support free trade policies. On the other hand, developing nations prefer to protect their local industries and are generally more closed.

There are different economic theories around the role of trade policy and the relation of a country’s economic growth to its openness to international trade. Economists generally support the theory that liberalizing trade has positive effects on economic growth, while some theorists have even concluded in some scenarios that liberalization may actually slow growth. In the seventeenth and eighteenth centuries, the predominant thinking was that a nation should export more than it imports. This idea, called Mercantilism, expressed an outlook that in our days would be considered economic nationalism, which gives the power to governments to support domestic industry and domestic trade. Mercantilists alleged that governments should promote exports and, to ensure an export surplus, place restrictions on imports. In fact, mercantilists believed in a common theory of international trade, the balance of trade theory. This theory states that a nation could only gain through foreign trade if it had a favorable balance, in other words, an excess in value of exports over imports. Subsequently, Adam Smith challenged the Mercantilist way of thinking in his “Wealth of Nations”, published in 1776. He claimed that when one nation is more efficient compared to another in producing a commodity, while the other nation is more efficient in producing a different commodity, then both nations could benefit by trading with each other. Based on the “Wealth of Nations”, David Ricardo introduced an important modification to Adam Smith’s theory. He argued that it was important to consider the comparative advantage of each nation in production. Ricardo’s theory states that a country has a comparative advantage in producing a good if the
opportunity cost of producing that good in terms of other goods is lower in that country than it is in other countries. If each country exports the goods in which it has a comparative advantage, both of the countries will benefit from trade. It is important to note that these theories only considered labor as a factor of production. In the early 1900s, two Swedish economists, Eli Heckscher and Bertil Ohlin developed Ricardo’s theory, considering several factors of production. The Heckscher-Ohlin theory holds that a country will export commodities that are produced by the factor that it has a relative abundance in, and it will import products whose production requires factors of production where it has relatively less abundance. According to traditional trade theory, free trade or the liberalization of trade via a removal of import tariffs or export impediments, are the best strategies from a welfare point of view. In static terms, the law of comparative advantage holds that all nations can benefit from free trade because of more output available as a consequence of more efficient production. Conversely, many economists believe that the dynamic benefits of free trade may be greater than the static benefits. Dynamic trade theory is based on neoclassical assumptions. Neoclassical growth theory is an economic theory that outlines how a steady growth rate can be achieved with the proper amounts of labor, capital and technology. This theory is based on the belief that the accumulation of capital within an economy and its relationship with labor is important for economic growth and for determining output. Neoclassical growth theory goes back to Solow, the simplest model of economic growth, and originally it assumed a closed economy. As in the 1900s economic policy started to have a more importance, the neoclassical model was also applied to open economies. Since the start of this theory, trade liberalization had a positive impact on the level of income. This was subsequently confirmed by the neoclassical growth theory, when applied to open economies. As a result of trade liberalization, a rise in the savings rate will lead to an increase in investment, which will have a positive impact on income and on the growth rate. However, the rise in investment will only happen temporarily, up until the point at which savings are sufficient to cover depreciation and growth. This means that, without the presence of any technological change, per capital income would also stop increasing. In fact, technology can lead to very high economic growth. Anyhow, in the short and medium-run, growth in income could occur even without the presence of technological change but, in the long run, income is entirely dependent on technological change.

The new trade theory was developed by Paul Krugman in the late 1970s to predict international trade patterns. While the traditional theory of international trade made it possible to exchange goods based on comparative advantage between countries, the new theory
includes the determinants of comparative advantage, such as geography and factor proportions, into the model. New Trade Theory of International Trade takes a different approach from the Ricardian and the Heckscher-Ohlin models on why countries engage in international trade. Both models assumed constant returns to scale, meaning that if all factors of production are doubled then output will also double. However, a firm may have increasing returns to scale so that when all factors of production are doubled, output more than doubles which will force firms to engage more in international trade, because of the need for a larger market. Therefore, the increase in output compared to the situation with constant returns to scale must be associated to an increase in market size. New Trade Theory of International Trade is opposed to the assumption made in the Ricardian and Heckscher-Ohlin models that there is perfect competition in the market in that there is no existence of monopoly profits. The presence of economies of scale leads to a breakdown of a perfect competition and creates more efficient firms, which continue to expand in the market because of increased outputs. In his 1979 paper, Krugman analyses a simple model with two countries. Consumers in both countries have a preference towards variety but there is a trade off between variety and costs. Because of economies of scale, unit costs fall as the firm produces more, therefore as variety increases the firm entails higher costs. Let’s consider a situation without trade, in which both countries produce the same number of varieties. The countries are similar and there are not specific reasons for trade. Nevertheless, trade could be welfare enhancing since, with trade, economies of scale can increase, reducing costs and prices. The situation after trade between the two countries is interesting. Even if the number of total varieties decreases, the number of varieties available to each consumer increases, increasing their welfare. As already stated, this theory relaxes the assumptions of perfect competition and it concludes that, under conditions of imperfect competition, restrictions to trade can be welfare improving. New trade theory argues that if the output required represents a substantial proportion of total world demand for the product, the world market can sustain only a limited number of firms. Thus, the firms that first enter the world markets gain an advantage that may be difficult for the other firms to match. In other words, firms that gain that advantage possess market power. Market power can be used to eliminate foreign competitors by selling products at a price below marginal cost until competitors are unable to maintain their position in the market. This argument is the notion of “first-mover advantage” and is called predatory pricing. Having market power means that a producer is able to increase output and the market share. In such a situation, small competitors do not have a high chance of surviving in the market.
Tab 3. Economic theories

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<td>Labor</td>
<td>Perfect competition</td>
<td>Constant returns to scale. Opposition of tariffs. Countries export based on comparative advantage.</td>
</tr>
<tr>
<td>Hecksher-Ohlin</td>
<td>Labor and capital</td>
<td>Perfect competition</td>
<td>Constant returns to scale. Similar beliefs to the Ricardian model.</td>
</tr>
<tr>
<td>New trade theory</td>
<td>Labor and capital</td>
<td>Imperfect competition</td>
<td>Increasing returns to scale. When all factors of production are doubled, output more than doubles. enable firms to engage more in international trade, because of the need for a larger market.</td>
</tr>
</tbody>
</table>

Source: Wilson Center

The objective of reducing barriers to trade is to improve the economic well being, by increasing the level of trade. Economists measure economic well being in terms of gross domestic product, since it is considered the best measurement available, but it could have difficulties. The equation for determining GDP is the sum of consumption, investment, government spending and balance of trade (difference between exports and imports). The impact of trade on GDP is the net amount between exports and imports. The economic impact of increased imports is a reduction of gross domestic product; a consequence could be a decrease in production and employment, which will lead to a reduction in output. This would suggest that the belief of the mercantilists was correct and a nation should consider restricting imports. Nonetheless, almost all economists would reject that conclusion since, based on the theories of comparative advantage, they believe that reducing trade barriers benefits a country whether of not the country’s trade partners also reduce their barriers.

2.2 U.S. Trade policies in the U.S. in the past 20 years

In the 19th century, the Industrial Revolution was the force that led the transition of the American economy from an agricultural to an industrial one, making the United States an industrial power with significant global impact. The U.S. became the world’s most important industrial power after the Second Industrial Revolution, between 1870 and 1914. During this period, large urban centers like New York and Boston evolved, bringing influxes of migrant
workers. Industrialists became very wealthy thanks to the capitalist principle of wage labor, as theorized by Adam Smith and Karl Marx. America’s large population and extensive natural resources helped shape America as a global economic power in the international market.

Since World War II, the United States has played a leading role in the liberalization of trade in goods and services. The support for liberalized trade has helped the United States to maintain international relations at bilateral and multinational levels safeguarding the nation from damage arising from protectionism. The U.S. was very active in the negotiation of GATT, even leading the eight rounds of multilateral negotiations that resulted in the creation of the World Trade Organization (WTO) during the Uruguay Round, which was launched by President Ronald Reagan in 1986 and concluded under President Bill Clinton in 1994. Tariffs fell, non-tariff barriers were removed and world trade surged. Most economists agree that this growth in trade contributed to a strong U.S. economic growth in the years following WWII. In 1947, imports and exports accounted for 10.9% of the U.S. Gross National Product, which rose to just over 30% in recent years. The U.S. also negotiated the North American Free Trade Agreement (NAFTA) with Canada and Mexico, which went into effect January 1, 1994 and eliminated all trade barriers between the three countries, creating a duty-free market of around 450 million people accounting for 24% of total world GDP. Investments were opened up and the agreements also included side pacts on environment and labor and the elimination of agricultural barriers.

By 1995, U.S. efforts to liberalize trade had achieved incredible success. However, concerns around “globalization” following WTO and NAFTA led the environmental community to view the U.S. trade agreements as an enemy to the environment and to developing countries now opening up to competition from developed nations. In addition, labor unions in the U.S. viewed trade liberalization as a mechanism to transfer good jobs from the U.S. to the rest of the world. These alarms led to mass protests against globalization in late 1999, which made the WTO’s launch of a new round of multilateral negotiation in Seattle fail. As we described earlier in this paper, another unsuccessful round of negotiations, Doha, was launched in 2001 to promote economic development in the poorest countries, but talks were suspended in 2006.

In the early 2000s, with multilateral negotiations at a standstill, the United States sought to negotiate regional and bilateral agreements in order to continue with market liberalization. In 2001, the U.S. negotiated a bilateral FTA with Jordan purely for political reasons, to promote peace between Israel and its neighbors. Shortly after the terrorist attacks on September 11, 2001, the U.S. launched an initiative to further promote peace in the Middle East by
negotiating a Middle East Free Trade Agreement extending from the Persian Gulf to the Atlantic Ocean. Many agreements came out as a result of this and the hope was that by including both Arab nations and Israel in FTAs, the resulting economic growth in this area of the world would promote peace and discourage terrorism in the Middle East.

More recently, under President Obama, the U.S. completed negotiations for a regional trade agreement called the Trans-Pacific Partnership (TPP) between Australia, Brunei, Canada, Chile, Japan, Malaysia, New Zealand, Peru', Singapore and Vietnam. President Obama was in support of U.S. participation in the agreement, considering it a strategic path to Asia, and all members signed the agreement on February 4, 2016. The transaction would have been the world’s biggest free trade deal, covering 40% of the global economy. However, on January 23, 2017, President Donald Trump withdrew the U.S. from the agreement, so the agreement could not enter into force. Another trade agreement that the Obama administration also negotiated, but did not finish, was the Transatlantic Trade and Investment Partnership (TTIP), a bilateral free trade agreement between the U.S. and Europe, two of the world’s largest economies, generating a third of the world’s GDP of $127 trillion. If completed, TTIP would become the world’s largest trade agreement, even bigger than NAFTA. Negotiations have stalled and President Trump has neither withdrawn nor progressed in talks with European leaders.

Tab 4. U.S. Trade Policies in recent times

<table>
<thead>
<tr>
<th>Time Frame</th>
<th>Trade policy</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>19th century</td>
<td>From agricultural to industrial</td>
<td>U.S. most important industrial power; evolution of large urban centers.</td>
</tr>
<tr>
<td>20th century</td>
<td>Free Trade expansion</td>
<td>GATT, WTO creation, NAFTA; Tariffs fell from an average 40% in 1950 to 9% in 2013, world trade reached $19 trillion in 2013.</td>
</tr>
<tr>
<td>Early 2000’s</td>
<td>Preference for FTAs and bilateral agreements following free trade skepticism and concerns around globalization.</td>
<td>Jordan, Caribbean Basin, Chile, Peru, Singapore, Australia, Bahrain, Morocco, Oman, Colombia, Panama, South Korea, CAFTA-DR etc.</td>
</tr>
<tr>
<td>President Barack Obama (2009 – 2017)</td>
<td>Open up to largest and fastest-growing markets to U.S. exports, mainly Asia-Pacific and Europe; enforce U.S. trade rights and global standards to ensure level playing field.</td>
<td>Negotiations in Trans - Pacific Partnership (TPP), Transatlantic Trade and Investment Partnership (TTIP), Trade in Services Agreement (TiSA), enforcement cases to WTO (including 15 against China);</td>
</tr>
</tbody>
</table>

Source: Washington International Trade Association
The U.S. and the EU are also among the 23 members of the WTO that are currently negotiating the Trade in Services Agreement (TiSA), aimed at opening up markets and improving rules in areas such as licensing, financial services, telecoms, e-commerce, maritime transport, and professionals moving abroad temporarily to provide services. The participating countries account for 70% of world trade in services.

Support for trade agreements such as WTO and NAFTA, and free trade in general, is at low levels among the American public. A 2015 CNBC survey found that half of the respondents believed that U.S. trade agreements had more drawbacks than benefits. A March 2016 poll by Bloomberg politics resulted in 65% of respondents believing that the U.S. should have more restrictions on imports, with only 22% believing there should be fewer restrictions. Opinion polling in February 2017 recorded a 72% consensus of Americans viewing trade as an economic opportunity. But in April 2017, 52% of Americans surveyed said that free-trade agreements with other countries were a good thing for the U.S., down from 59% in 2014. And 40% said that trade deals had been a bad thing, up 10% over the same period. These growing results reflecting public dissent against free trade are due to a number of things, including the belief that jobs are being lost, mainly in manufacturing, because of increased international competition coming from trade. Another reason for public backlash against trade is the use or perceived use on the part of other countries of unfair trade practices such as dumping, subsidies, the use of state-owned enterprises and currency manipulation, all practices that undermine U.S. public trust that the playing field is level. This explains why contenders to the 2016 U.S. presidential elections (Donald Trump, Bernie Sanders and Hillary Clinton) appealed to those hurt by trade. However, a study published in 2017 concluded that 13% of job losses in manufacturing between 2000 and 2010 resulted from trade, while over 85% were actually caused by automation and other technologies.

2.3. The “Trump” Administration trade policy

Throughout the years, Americans thought that freedom, free markets, progress and human rights were values of utmost importance. Some of these beliefs have been challenged with the election of the current president of the United States, Donald Trump. Before entering politics, Donald Trump was a businessman who collected vast hotels and other properties in New York City and around the world. Trump has only recently become very active in politics; in June 2015 he announced that he would be a candidate in the U.S. presidential election of 2016. In his final days of campaign, Trump promised his supporters that “every dream you ever dreamed for your country” would come true if he were to be elected as president. Pledging to
“Make America Great Again” (MAGA), he promised to create new jobs, to inflict a penalty on American companies if they exported jobs outside of the United States, to repeal the Affordable Care Act (ACA), better known as Obamacare, to improve infrastructure and to reform the tax system. He also introduced his views on trade: playing to the American public’s general dissatisfaction with globalization, especially those who felt left behind by trade, Donald Trump promised to reduce the trade deficit and bring back jobs to the U.S. by raising tariffs on imports, doing away with bad deals and getting tough with countries not abiding by the rules. What is ironic is that his proposal to raise tariffs could hurt the very people who voted for him, as those with modest incomes spend larger proportions of their pay on imported goods, so tariffs on these goods would actually increase their prices to U.S. consumers. Trump also seems to place heavy emphasis on the U.S. merchandise trade deficit while largely ignoring the surplus in the services sector. In his inaugural address on January 20, 2017, Trump announced that he intended to break the US’s common long-lasting pattern on trade by taking decisions that would run opposite to traditional policy approaches to trade. Contrary to the United States’ stance on liberalized trade, President Trump’s trade proposals reject the theory of comparative advantage and the liberal belief of stability that arises from commitment to economic interdependence. Indeed, he has promised to Make America Great Again by adopting protectionist policies that will supposedly lead to great prosperity and strength. Trump attracted anti-Establishment voters who were not dissuaded by his harsh solutions and were no longer convinced of the current administration’s capability in remedying the ongoing economic problems. Being a businessman and not the standard example of a politician, his populist agenda appealed to “blue-collar” workers, thus he gained votes in the more industrial areas of the country, sufficient to win an electoral majority for the presidency. The revision of U.S. trade policy is clear from the proposals President Trump has made. The Trump administration has indicated the decision of participating only in bilateral agreements, consistent with the president’s rejection of the theory of competitive advantage; a trade agreement between two nations will tend to favor the country with the best economy, in this case the U.S., putting the weaker nation at a disadvantage. Trump and his advisers also see bilateral deals as easier and quicker to negotiate than the larger and more complex regional or multilateral arrangements, also because in bigger deals, the U.S. gets “picked apart by all countries”, as stated by Wilbur Ross, the U.S. Secretary of Commerce.

One of Trump’s first acts as President was to withdraw from the signed Trans-Pacific Partnership (TPP) accord, an agreement among twelve countries that contained measures to lower both non tariff and tariff barriers to trade, that would have deepened economic ties
between these countries and would have advanced U.S. strategic interests in the Asia-Pacific region. President Trump saw the deal as likely to accelerate U.S. decline in manufacturing, lower wages, and increase inequality. So as to not lose any opportunities in that region, Trump and his advisors are pursuing a bilateral trade agreement with Japan, with which the U.S. has a large trade deficit, hoping to get better market access for U.S. automobiles and agricultural products such as beef.

President Trump is also threatening to withdraw the United States from the North American Free Trade Agreement (NAFTA) signed by Canada, Mexico and the United States. Since the cooperation started, U.S. trade with the members of NAFTA has grown more rapidly compared to American trade with the rest of the world, with Mexico and Canada being the second and third largest exporters to the United States, after China. Under the agreement, the three members do not pay any tariffs on goods that cross the borders, which has led to important trade equilibriums in the automotive, apparel, agricultural and medical devices fields. Nonetheless, Trump has criticized NAFTA for creating unfair cooperation, allowing Mexico to steal jobs from the United States and opening the border to tariff-free goods. However, pulling out of the pact could have negative economic consequences: if Trump decides to withdraw from the agreement, WTO regulations would apply between the three countries, as all three are members of the World Trade Organization. More specifically, under WTO, tariffs on U.S. exports to Mexico would be particularly costly (i.e. 15% on wheat, 25% on beef, 75% on chicken and potatoes, 15-20% on soap, clothing, etc.) while Mexican goods going to the U.S. would be subject to tariffs averaging 3.5%. Canada also would be subject to tariffs from both countries, along with its own exported goods becoming more expensive by an average of 4.2% in tariffs. Prices of goods would become higher in all three countries, impacting companies and consumers, while also putting complex supply chains created at risk and possibly leading to a loss of the North American competitive edge over other major global manufacturing hubs in Europe and Asia. Rather than being dismantled, the NAFTA agreement is currently in a renegotiation process and in order to avoid going against WTO rules that do not allow sector by sector negotiations, the participating countries can work out certain sections of the agreement under the image of modernization to include digital economy concepts such as e-commerce and data flows, as well as energy market investment provisions for Mexico, originally exempted by Mexico’s constitution.

With regards to the Transatlantic Trade and Investment Partnership (TTIP) negotiations with Europe, Trump has not overtly withdrawn from the talks, but these have stalled following his election. Yet there have been concerns on the part of Europeans around the fact...
that European standards would be at stake if U.S. exporters are granted increased access to the EU market for products such as cars, industrial machinery, agricultural goods and pharmaceuticals, as currently demanded by the U.S. government. Instead of pressing on negotiations with Europe, following on the Trump Administration’s preferred choice of bilateral agreements, there is an interest on the part of U.S. administration to negotiate trade matters with the UK, yet a deal is unlikely until the post-Brexit arrangements between the UK and the EU are finalized.

An important decision Trump has made in his protectionist trade policy is the increase of tariffs on imports. A tariff is a tax or duty that the government fixes on imported goods to protect domestic industries. From the start of his campaign, the President promised to impose new tariffs on countries that harm U.S. interests through unfair trade practices. He believes that tariffs should be applied to all imports entering the United States and on imports made by American companies with outsourced production facilities in foreign countries. Trump has stated that previous trade agreements have incentivized U.S. corporations to outsource manufacturing to foreign nations and, as a consequence, manufacturing jobs have declined immensely. Therefore imposing tariffs would encourage foreign manufacturers to build plants in the United States, improving workforce in the country. Another reason to impose tariffs is to protect the United States from nations that partake in unfair trade practices, such as copying U.S. products, stealing workers, subsidizing local products, manipulating their currency to their advantage and so forth. Donald Trump’s protectionism is an important topic to consider since it could lead to precarious international relations with other countries. Could it be that Trump’s actions will mirror an old and dangerous mistake? In 1929, after a sharp decline in stocks, the Fed, which was introduced for the purpose of preventing the failure of banks, did not intervene to support them. So, from that moment on many banks failed in the U.S., with a consequent contraction of the quantity of money in circulation. Deflation could have been restricted only to the U.S., but Congress turned a serious internal crisis into a catastrophe that was not just American, by approving the Smoot-Hawley tariff act in 1930. This act introduced tariffs on 20,000 imported products, contributing to the contraction of international trade around the world and consequently facilitating the start of the Great Depression. The financial situation of the U.S. is different from that which led to the Great Depression, so Trump’s introduction of customs tariffs on many products imported from Europe and China may not have the same impact as in 1930, but only time will tell. What is probable in the short-term is retaliation from many countries that could lead to trade wars and consequences that would be detrimental to all parties and to international trade and development.
The first tariffs imposed by Trump’s administration in January 2018 were on imported washing machines and solar panels, both predominantly impacting China. In the early 2000s, demand for solar power grew as subsidies on installations were being granted around the world. As a consequence, China began focusing on exports and soon China became the global leader in solar production. In a 2012 study, the Department of Commerce established that Chinese manufacturers were being given uneven subsidies from the Chinese government, harming U.S. manufacturers in competition with lower-priced Chinese products being imported in the U.S. market. Trump believes that the tariff on solar panels will prevent cheap foreign goods to undercut domestic products, creating more manufacturing jobs in the U.S. However, this move could in part backfire and burden a $28 billion industry that relies on parts made abroad for 80% of its supply, and the Solar Energy Industries Association has projected tens of thousands of job losses in a sector that currently employs 260,000 people. Trump’s next big move in March and May 2018 was to impose a 25% tariff on steel imports and a 10% tariff on aluminum imports to the U.S., the stated goal being to protect and expand American steel and aluminum manufacturers, which would strengthen industries that have been struggling for years. The countries most impacted are U.S. allies such as Canada, Mexico, Germany and the EU in general, while other countries like South Korea, Australia, Brazil and Argentina were exempted. Both China and the EU initiated complaints with the WTO, citing violations of WTO rules that prohibit member countries from discriminating against one another, under the most-favored-nation (MFN) clause. There have been considerable tit-for-tat situations with the EU and China as can be seen in the table below, which could lead to escalating trade wars. Though all economies would suffer from further escalation, the U.S. would find itself especially vulnerable, being the focus of global retaliation as well as having a relatively higher share of its exports taxed in global markets. A study made prior to the election found that a trade war could lead to a recession in the U.S. in 2019 with over 4.8 million jobs lost. Export-dependent industries that manufacture equipment used to create capital goods in IT, aerospace and engineering would be the most severely affected. But even a “milder” form of protectionism would have negative consequences for the U.S. economy. Imposing tariffs on imports from specific countries would result in rising prices for consumers as well as to firms that depend on importing intermediary goods. As a consequence of higher priced intermediary goods, U.S. exports would also become more expensive and less competitive in the global marketplace. This could lead to trade diversion to other markets, as imports could be sourced from countries not impacted by tariffs.
Tab. 5. Trump’s protectionist trade policy actions

<table>
<thead>
<tr>
<th>Protectionist policy</th>
<th>Actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preference for bilateral agreements</td>
<td>Withdrawal from TPP</td>
</tr>
<tr>
<td></td>
<td>Threat to withdraw from NAFTA</td>
</tr>
<tr>
<td></td>
<td>Stalled TTIP negotiations with Europe</td>
</tr>
<tr>
<td></td>
<td>Attempt at negotiations with Japan, UK, Russia, Vietnam</td>
</tr>
<tr>
<td>Tariffs to protect domestic economy</td>
<td>Washing machines (20-50%, then 16-40% in 3 years)</td>
</tr>
<tr>
<td></td>
<td>Solar panels (30% falling to 15% in 4 years)</td>
</tr>
<tr>
<td></td>
<td>Steel (25%) and aluminum (10%)</td>
</tr>
<tr>
<td></td>
<td>- Canada’s response: tariffs matching the value of the U.S. tariffs dollar-for-dollar on almost 300 U.S. goods including steel, aluminum, inflatable boats, yogurt, whiskies, etc.</td>
</tr>
<tr>
<td></td>
<td>- EU’s response: tariffs on 180 types of products on $3 billion of U.S. goods ranging from Bourbon whiskey to motorcycles and playing cards</td>
</tr>
<tr>
<td></td>
<td>Threat of 20% import duty on cars from EU</td>
</tr>
<tr>
<td></td>
<td>- European Commission followed with a letter threatening to hit $300 billion of U.S. goods with tariffs</td>
</tr>
<tr>
<td></td>
<td>Tariffs on $50 billion of Chinese goods as a response to China’s unfair trade practices over the years, including theft of U.S. I.P.</td>
</tr>
<tr>
<td></td>
<td>- China’s response: tariffs on 128 American products</td>
</tr>
<tr>
<td></td>
<td>Tariffs of 25% on $34 billion of Chinese goods in response to a months-long investigation that documented trade practices that ranged from forcing U.S. companies to share trade secrets to subsiding domestic industries, widely condemned as unfair</td>
</tr>
<tr>
<td></td>
<td>- China’s response: targeting a range of goods from soy beans to electric vehicles</td>
</tr>
<tr>
<td></td>
<td>Threat to hit $200 billion of China’s imports with a 10% tariff, possibly even 25%</td>
</tr>
<tr>
<td></td>
<td>Threat to hit all of China’s $505 billion exports to the U.S. with punitive tariffs</td>
</tr>
</tbody>
</table>

Source: New York Times

A more detailed discussion about China is essential at this point; a country targeted by Trump because of the unfair trade practices being applied, which he and a majority of Americans perceive as impacting U.S. jobs. In a very short time, China has transitioned from a self-sufficient economy to one of the world’s largest trading nations. Changes in China’s exchange rate regime have been influential in the country’s participation in global trade and,
starting in 2002, competitiveness of Chinese goods in international markets increased significantly, leading China’s trade to a large surplus position. The Chinese currency, called the renminbi, is a “policy currency”, meaning that, unlike most currencies that rise and fall in value in free market trading, the currency’s value against the dollar is set by the People’s Bank of China, an arm of the Chinese government. The PBOC has gradually tried to make the value of the renminbi more reflective of market forces, setting trading bands in which the renminbi is allowed to fluctuate every day; however it is still manipulated by the government. Yet currency manipulation is normally considered an unfair trade practice, in that it provides an unfair trade advantage through government or central bank intervention via the purchase of foreign currency in exchange for a country’s own domestic currency. In 2016, the U.S. Treasury Department placed China and other countries on a “Monitoring List” of major trading partners that merit close attention to their currency practices, with the intention of determining if they were engaging in currency manipulation, yet they did not formally accuse anyone of such practices. During his campaign, Trump promised to denounce China as a currency manipulator, but he has not done so yet. Things may change in the near future, as China has begun devaluing their currency as a stratagem to hit back against the U.S. in a non-tariff way. While the U.S. bought $505 billion of goods from China last year, the Chinese only imported $129 billion worth of U.S. goods, meaning that China will run out of imports to tax long before the U.S. does. China seems to have willfully allowed their currency to decline 7.6% in the four months leading to July 2018, making their goods cheaper, such that the 10% tariffs promised by Trump on some Chinese products do not make much of a difference, being offset for the most part by the devaluated renminbi.

Donald Trump was elected president partly because he was able to tap into the emotions of voters who felt they had been left behind by trade. Although some of this public skepticism around global trade comes from misperceptions, Trump has pointed out valid concerns about international trade, including unfair practices by some countries. Following up on these concerns provides an opportunity to move the debate on trade forward, while addressing some genuine shortcomings within the current trade system. The administration’s protectionist policy is seeking to reduce the trade deficit and enforce trade laws to help domestic businesses through actions such as renegotiation of NAFTA, moving from multilateral and regional to bilateral deals, making more aggressive use of trade remedies, tackling unfair practices and discouraging offshoring of jobs. The U.S. had already started to abandon its leadership role in international trade even before Trump’s election in 2016, so the prospects of the WTO being able to move the multilateral agenda forward are remote. External partners who benefit from
trade links involving the U.S. will need to find the right allies within the Trump administration to emphasize economic and strategic opportunities of trade with their countries.
Chapter 3. Trump’s economic policy

3.1 Economic situation in the USA and the new fiscal policy

The United States is the world’s third largest economy. The economy of the United States is a highly developed mixed economy, meaning that it operates as a free market economy in goods and services. To analyze the economy, two main economic indicators are being considered: Gross Domestic Product and unemployment rate. GDP measures the total value of all goods and services over a given year. There are three measurements of GDP: Nominal GDP, Real GDP and GDP growth. Nominal GDP is the economic output produced in a given year. Real GDP is equal to the economic output adjusted for the effects of inflation. The GDP growth rate measures how fast the economy is growing, by comparing one quarter of the country’s GDP to the previous quarter. The United States is the world’s largest economy in terms of Nominal GDP, which amounted roughly to $19 trillion in 2017. Over the last 10 years, it has grown on average 1.2% annually, about $200 billion per year. Changes in the amount of GDP are generally the result of government policies such as reduction in taxes, which generally leads to more incentive for businesses to create and innovate, or trade policies intended to expand local economies. The unemployment rate measures the percentage of unemployed workers, calculated by dividing the number of unemployed people by the number of individuals who are in the labor market, considered to be those who have jobs or who are actively looking for one. However, this number is not very precise since it does not include people who have given up looking for a job, resulting in an unemployment rate that is higher than what it really is. The graph below shows how these two economic indicators have changed from 2000 onwards.

An analysis of the peaks and troughs highlights known issues in the last two decades. The sudden decline in GDP and increase in the unemployment rate in 2001 occurred after the 9/11 terrorist attacks and the 2001 recession, an eight-month economic downturn that began in March and lasted until November. This recession resulted from the fear that the existing software in the 1900s would have not worked from the year 2000 onward. Therefore, in 1999, there was an economic boom in computer and software sales since many companies bought new computer systems to be certain that their software was Y2K compliant (year 2000 versus existing software system set at 19xx).
The economic boom coming from the purchase of software to be compliant with Y2K, led to a bust in 2001. The Bush administration intervened to end this recession with an expansionary fiscal policy. In June 2001, he signed The Economic Growth and Tax Relief Reconciliation Act, designed to cut taxes in order to stimulate the economy right after the recession. The Federal Reserve also intervened with an expansionary monetary policy, by lowering interest rates, which made the cost of homes and education less expensive. The global financial crisis, which started in August 2007, was the worst in the economic history since the Great Depression in the 1930’s. The crisis hurt the economy of both developed and developing countries and it had an impact on financial economic variables. In fact, GDP growth rates drastically dropped, global financial markets collapsed and the unemployment rate increased immensely. Since Donald Trump became president in 2017, GDP and unemployment figures indicate improvements. The latest Q2 2018 GDP results reveal a growth rate of 4.1%, which is one of the strongest rates in the last ten years. The unemployment rate has also dipped to 4%, the lowest it has been in decades, indicating that there are many jobs available. The Trump Administration has associated these economic successes with his Administration’s new protectionist fiscal and trade policies, but only time will tell if the more long-term impact of his protectionist policies will continue to boost these achievements.
As can be seen in Graph 2, in the latter part of 2017 and beginning of 2018, the total U.S. trade deficit was very high, indicating higher imports compared to exports. From the start, President Trump has declared his desire to reduce the high deficit with protectionist measures. In March 2018, he announced he would impose a 25% tariff on steel imports and a 10% tariff on aluminum. As the graph illustrates, the U.S. trade deficit drastically decreased in April and May. The threat of tariffs and an impending trade war caused a surge in U.S. exports in the second quarter, leading to the decline in the trade deficit. What essentially happened is that exporters scrambled to get their products out before tariffs were put in place and China and other countries rushed to buy these products before the additional tariffs were to be added to their cost. Morgan Stanley sent a note to their clients after the strong Q2 2018 GDP results were issued indicating that “hefty contributions to GDP from trade and inventories is likely a reflection of stockpiling ahead of the implementation of trade tariffs, and so they are likely to subtract from growth in the following quarters”. Even major banks and forecasters expect the economy’s growth rate to return to 2.5% to 3% in the second half of the year. Next year’s economic growth could be even slower as the impact of tax cuts and increase in government spending begin to diminish and the Federal Reserve continues to raise interest rates. The Federal Reserve has slowly been increasing the United States’ federal funds interest rate in its
consideration of the fact that the U.S. economy is currently in a very strong position compared to previous years. In fact, the economy no longer requires the low interest rates that were established after the financial crisis of 2008 to stimulate growth. In general, higher interest rates in a country increase the value of the country’s currency since they tend to attract foreign investments. Oppositely, lower interest rates tend to be less appealing to foreign investment and, therefore, this leads to a weakening of the country’s currency. The increase in the Fed rate and the recent surge in U.S. exports following Trump’s announcement of tariffs have strengthened the dollar against the Euro, the Pound and other currencies, as the need to pay for goods and services in dollars has also increased the demand for dollars. There are pros and cons around a strong currency; for the U.S. this helps to attract foreign capital to help finance the huge deficit and makes imports cheaper, while at the same time it makes U.S. exports expensive which can lead to loss of jobs in the long-term.

Since Donald Trump became president, the U.S. economy has grown stronger, unemployment has fallen to the lowest level in the last 18 years and 3.2 million jobs were created. For the first time in many years, the number of jobs available is larger than the number of people seeking a job. Many economists agree that it is Trump who deserves the credit for the booming economy. According to the International Monetary Fund’s April 2018 World Economic Outlook report, growth in the U.S. is expected to climb from 2.3% in 2017 to 2.9% in 2018 before declining slightly to 2.7% in 2019. This forecasted growth increase is the result of the expected impact of the tax reform, in particular the lower corporate tax rate and the temporary allowances for full expensing of investments, which should stimulate short term activity. The increased fiscal deficit and the temporary nature of some of the provisions will bring lower growths than expected for a few years from 2022 onward.

President Trump signed the Tax Cuts and Jobs Act (TCJA) into law on December 22, 2017 following its passage by the House of Representatives and the Senate. Although Trump has stated that this will be the biggest tax cut in the history of the country, tax analysts have indisputably said that Trump’s claim is not true. Although the law cuts corporate tax rates permanently, the individual tax cuts are temporary, potentially setting the stage for another president to eventually extend and get the credit for Trump’s tax legislation in 2025, when the cuts become void due to sunset provisions built in the new bill.

TCJA makes significant revisions to Individual income taxes, with most provisions expiring at or before the end of 2025. The table below includes the main changes in Individual income tax provisions between the prior law and the new TCJA provisions.
<table>
<thead>
<tr>
<th>Issue</th>
<th>Prior Law</th>
<th>TCJA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Tax Rate</td>
<td>Seven brackets (10, 15, 25, 28, 33, 35, 39.6).</td>
<td>Seven brackets (10, 12, 22, 24, 32, 35, 37) with higher thresholds for most brackets (See example in Graph 2 below).</td>
</tr>
<tr>
<td>Standard Deduction</td>
<td>$6,500 (single), $13,000 (joint), $9,550 (head of household).</td>
<td>$12,000 (single); $24,000 (joint), $18,000 (head of household).</td>
</tr>
<tr>
<td>Personal and Dependent Exemptions</td>
<td>$4,150</td>
<td>Repealed (but see Child Tax Credit below which has been increased).</td>
</tr>
<tr>
<td>Child Tax Credit</td>
<td>Credit equal to $1,000 per qualifying child under 17; Phases out above $75,000 (single); $110,000 (joint); Refundable portion equals 15% of earnings in excess of $3,000.</td>
<td>Credit equal to $2,000 per qualifying child under 17, $500 for other dependents; Phases out beginning at $400,000 for joint filers; Refundable portion equals 15% of earnings in excess of $2,500 up to $1,400 per qualifying child.</td>
</tr>
<tr>
<td>Estate Tax</td>
<td>Top rate of 40% on estates above $5.6 million; $11.2 million (couples).</td>
<td>Top rate of 40% on estates above $11.2 million; $22.4 million (couples).</td>
</tr>
<tr>
<td>ACA Individual Mandate Penalty</td>
<td>Individuals without adequate health insurance coverage must pay a tax penalty or claim a coverage exemption.</td>
<td>Penalty set to zero. Permanent change.</td>
</tr>
<tr>
<td>Inflation Index</td>
<td>Consumer Price Index (CPI).</td>
<td>Chain-weighted consumer price index (C-CPI), a more accurate measure as it accounts for the fact that people substitute for goods where prices increase faster than others. This generally increases at a slower rate than the traditional CPI. Permanent change.</td>
</tr>
</tbody>
</table>

Source: Tax Policy Center / Urban Institute & Brookings Institution

The Tax Cuts and Jobs Act’s most fundamental changes relate to Business tax provisions, which, unlike individual tax provisions, do not expire. The fiscal changes reflect Trump’s protectionist policy and desire to increase domestic growth by providing advantages to U.S. firms and businesses. The prior law included a gradual corporate rate schedule with a top rate of 35%, the highest rate of any large, developed country. This has been eliminated and substituted by a permanent flat rate of 21%. According to the Tax Foundation, the statutory rate combined with state and local taxes under the new law will be 26.5%, which places the U.S. just below the weighted average for EU countries of 26.9% and lower than the average statutory tax rate of 29% in OECD countries. The corporate tax cut puts U.S. federal taxation in line with, or even below, other large advanced countries such as Canada, France, Germany, Japan and the United Kingdom.
The main changes in business tax provisions are summarized in the table below.


<table>
<thead>
<tr>
<th>Issue</th>
<th>Prior Law</th>
<th>TCJA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top Corporate Income Tax Rate</td>
<td>Four brackets (10%, 25%, 34%, 35%). 34% rate starts at income of $75,000</td>
<td>21% flat rate</td>
</tr>
<tr>
<td>Corporate Alternative Minimum Tax</td>
<td>Yes</td>
<td>Repealed</td>
</tr>
<tr>
<td>Income from Pass-Through Business (for sole proprietorships, partnerships and S-corporations)</td>
<td>Taxed at ordinary income rates (maximum rate of 39.6%)</td>
<td>Provides 20% deduction (maximum rate of 29.6%); Deduction limited above $157,500 (single), $315,000 (joint) for personal service income and based on compensation paid or investment property; Sunsets after 2025</td>
</tr>
<tr>
<td>New Investment Purchases</td>
<td>2018: 40% bonus depreciation for qualified property; 2019: 30% bonus depreciation for qualified property; 2020: 20% bonus depreciation for qualified property; Small business (Section 179) expensing up to $500,000</td>
<td>100% bonus depreciation for qualified property; Phases down from 100% by 20% increments per year starting in 2023; Small business (Section 179) expensing up to $1,000,000</td>
</tr>
<tr>
<td>Business Interest Deduction</td>
<td>Fully deductible (generally)</td>
<td>Disallowed for net interest in excess of 30% of business income (excluding depreciation after 2022); Exemption for businesses with gross receipts of $25 million or less</td>
</tr>
<tr>
<td>Taxation of U.S. Multinational Companies</td>
<td>Worldwide system with deferral and foreign tax credit</td>
<td>Modified territorial system with base erosion provisions; Anti-abuse tax on certain payments to foreign corporations; One-time tax on un-repatriated foreign earnings at 8% (15.5% on liquid assets)</td>
</tr>
</tbody>
</table>

Source: Tax Policy Center / Urban Institute & Brookings Institution

Supporters of cutting the corporate tax rate argue that it will reduce the incentives for companies to shift their tax base to low or no tax jurisdictions outside of the United States, and will make the U.S. a more attractive place to do business for U.S. as well as foreign firms. Big domestic companies like Walmart, American Airlines and Wells Fargo have already demonstrated their enthusiasm in the new tax law by increasing their employee’s salaries and, in some cases, also giving bonuses during the course of 2018. In order to pay for the massive corporate tax cut, estimated to cost over $1.4 trillion over the next decade, the TCJA raises tax revenues in other areas, mainly on foreign operations of multinational companies (MNCs). Lowering corporate taxes on domestic production while increasing taxes on MNC production...
abroad falls in line with Trump’s “Made in America” campaign, but whether or not this favoritism toward domestic firms is beneficial for America is to be seen. Although MNCs represent only 1% of all companies in the U.S., they absorb 19% of U.S. employment and generate 74% of all R&D expenditures. It is a general belief that offshoring drains capital and shifts jobs out of the U.S. economy. Yet there is evidence that shows that job gains that result from offshoring are greater than the losses and that the expansion of U.S. firms abroad raises productivity, lowers costs and increases their global market share, allowing these firms to hire more workers not just in other countries but also at home.

The new tax law allows full expensing of qualified property investments for the next five years, rather than requiring them to be depreciated over time, which could increase productive activities in the U.S. This could lead to the return to the U.S. of foreign investments on the part of domestic firms as well as a decision on the part of foreign firms to localize their headquarters in the U.S. On the other hand, the deduction of interest will be limited to 30% of earnings before interest, taxes, depreciation and amortization (Ebitda), compared to no cap in the prior law, which could actually offset the purchase of loan-backed capital investments.

The Tax Cuts and Jobs Act has moved corporations from a worldwide tax system to a residency-based (territorial) tax system, the most common world norm for taxation, where only domestic earnings are subject to tax; in other words only income earned in the U.S. is subject to U.S. corporate tax. Prior to January 1, 2018, under the worldwide system of taxation, foreign income was subject to normal U.S. corporate taxes upon repatriation, yet multinational companies were allowed to keep their accumulated earnings abroad indefinitely, never subject to U.S. tax. Under TCJA, future foreign earnings will not be subject to U.S. tax, whether retained abroad or returned to the U.S. One of the goals of the change to a territorial system of taxation is to encourage multinational companies to bring their earnings back and to invest in productive activities in the U.S. However, the TCJA does impose a 15.5% repatriation tax on cash and liquid assets accumulated abroad between December 1986 and December 2017 and an 8% tax on income reinvested abroad over the same period. Goldman Sachs estimates that U.S. companies hold $3.1 trillion of profits overseas and that the one-time repatriation taxes included in the TCJA are expected to cost U.S. multinational companies $339 billion over the next decade. Already big banks and investment banks with worldwide interests are including major profit reductions in their 2018 budgets to take into account repatriation taxes, but Wells Fargo analysts have projected that these one time costs will be more than offset by future tax savings estimated at $30 billion per year going forward, not to mention their increased competitiveness in the domestic market.
The Tax Cuts and Jobs Act includes new and complex provisions impacting multinational companies negatively, meant to fight base erosion and profit-shifting, tax planning strategies that involve moving taxable profits made in one country to another with low or no taxes. A tax called GILTI, “global intangible low-taxed income”, is intended to discourage MNCs from locating valuable intangible assets in low-tax jurisdictions like Ireland, a practice that has been target of negative publicity recently. A second provision is a new deduction for “foreign-derived intangible income” (FDII), which are earnings attributable to licensing U.S. income. This provision aims to encourage firms to keep their intangible property in the U.S. and license its use to related and unrelated enterprises abroad. This provision benefits U.S. companies that conduct their activities at home, but it will not benefit MNCs that create and retain intangible assets abroad. European finance ministers argue that this preferential tax policy could be in violation of WTO rules in that it effectively subsidizes exports. Lastly, companies with over $500 million in annual gross receipts are also subject to the “base erosion anti-abuse tax” (BEAT). U.S. firms are required to calculate what their U.S. taxable income would be if they disregard deductions for cross-border payments to foreign affiliates, considered base-eroding payments, and pay the difference between a 10% tax on this “normalized” taxable income versus the 21% corporate tax on their regular tax base.

The Trump Administration expects the above protectionist tax changes to drive domestic companies to increase their investments in the United States thanks to tax savings and increased profits. Multinational companies are also incentivized to have fewer interests abroad, and it is expected that even foreign companies find the new U.S. tax environment interesting for their headquarters. This is all expected to trigger growth in the economy.

According to the Joint Committee on Taxation (JCT), the U.S. GDP is projected to increase by 0.7% above current forecasts over the next 10 years. The Tax Foundation, the nation’s leading independent tax policy research organization, is even more optimistic, foreseeing increases in GDP of 2.9% above current forecasts over a decade. However, according to estimates made by the Congressional Budget Office and the JCT, the new tax law will reduce tax revenues by $1.455 billion, impacting the deficit over the next 10 years. According to the European Central Bank’s Economic Bulletin 1/2018, available estimates suggest that, although the U.S. GDP will be positively impacted in the short-term, the long-term effects are dependent on how the tax reform will be financed. A higher public debt, already forecasted at $10 trillion for the next decade, could lead to higher long-term interest rates, which raising the cost of capital will counterbalance the positive effects. This could also create serious social justice problems as important government-funded public services in areas
such as education and healthcare could encounter significant reductions and cutbacks, which would mainly impact the less-wealthy U.S. citizens. The benefits to the economy could be protected if the additional deficit arising from the tax reform is financed by reduced spending or even by raising other taxes.

3.2 Effects of Trump’s protectionism around the world

As we have observed in this chapter, the effects of Trump’s protectionist trade and fiscal policies have begun to materialize in the United States during the first half of 2018. Economic indicators suggest strengthening growth in the United States. Nevertheless, the impact of the U.S.’s protectionism on the rest of the world has been the target of many studies that largely reveal detrimental repercussions.

In listing the effects of Trump’s new fiscal policy resulting in the Tax Cut and Jobs Act, the European Central Bank’s 1/2018 bulletin states that the euro area, similarly with the rest of the international tax landscape, will be negatively affected by the tax reform. First of all, lower U.S. corporate taxes increase the tax attractiveness of the United States compared to other countries, which will influence corporations’ incentives to invest in the U.S. and inbound foreign investment from the EU will outweigh outbound investment into the EU. Furthermore, because of the move to a territorial system and the differences in tax rates between the U.S. and some high-tax countries, the reform will also affect tax-planning strategies of multinational enterprises, which will find new incentives for profit shifting as well as incentives to relocate intellectual property to the United States. As the bulletin states, “More generally, the reform risks intensifying tax competition worldwide, entailing a possible erosion of tax bases in EU countries”, suggesting that lower tax revenues can lead to less government spending on public services. Lastly, the ECB points out that some of the international provisions in the TCJA may not be in accordance with WTO rules and double taxation treaties.

With regards to Trump’s protectionist trade policy, the European Central Bank has made a simulation of the effects on the U.S. and the global economy assuming that the U.S. imposes tariffs of 10% on all imports of goods and that its trade partners do the same for their imports from the U.S. An assumption of the study is that it is hard to substitute domestic goods for imports, so consumer prices increase. Therefore, tariffs have a negative impact on GDP growth because of lower consumption, investment and employment. U.S. exports would also suffer from retaliatory practices on the part of its trade partners. The study is based on extreme assumptions and results in a reduction in U.S. GDP of 2.5% below the base level just
after one year. Globally, exports would fall by 3% over a year and global GDP by 1%. Likewise, the International Monetary Fund (IMF) has warned that these rising tensions between the U.S. and the rest of the world could lower global growth by as much as 0.5% by 2020 and cost the global economy $430 billion in lost GDP.

China is the world’s largest exporter, with 19% of its total exports going to the United States and a similar percentage to Europe, amounting to around half a billion dollars in each market. With China accounting for roughly half of the U.S.’ total trade deficit, it is the primary target of U.S. trade actions. Already the U.S. has imposed tariffs on specific products to protect its domestic production, but in the case of China, it has gone so far as to declare the country a *strategic competitor*, a player in the market undermining the prosperity and security of the United States through unfair practices. China could come under pressure as a result of U.S. tariffs, as the U.S. plans to cut the trade deficit with China by $100 billion, institute investment restrictions and set visa limitations for Chinese citizens. China’s growth target for 2018 is 6.5%, but as domestic demand is expected to decline due to internal issues, it would need to compensate this with a growth in its exports. If a trade conflict with the U.S. escalates and exports shrink further, the Chinese administration could initiate trade and economic countermeasures that could impact the U.S. and even the rest of the world. Oxford Economics simulated the impact of tariffs between the U.S. and China assuming a real trade war in which the U.S. imposes 10% tariffs on an additional $400 billion of imports from China, on top of the 25% on 50 billion of imports, and China responds with 25% tariffs on all U.S. imports. The results of the simulation indicate that in 2019, GDP growth would fall by 0.7% in the U.S., 0.8% in China and 0.5% globally, with cumulative GDP losses causing global GDP to fall by 0.7% by 2020. The match between the U.S. and China has also extended toward dominance in the high-tech business as China, in its “Made in China 2025” plan, has declared it will join the world’s leading manufacturing powers by 2025 and is already aggressively targeting American and other overseas firms. As the U.S. and China are the world’s largest and second-largest powers in terms of both GDP and military power, a trade war between these two countries would surely also impact the rest of the world. Whereas planned and threatened U.S. tariffs would have only a mildly inflationary impact on the U.S. economy, at a global level it would be deflationary, as weaker U.S. and Chinese GDP growth would cause a reduction in growth in the rest of the world.

The launch of Trump’s tariffs has given China and the European Union unprecedented incentive to work together, and have deepened their partnership this year. As reported by Eurasia Group, the leading global political risk research and consulting firm, the EU is

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China’s biggest trading partner and its second-largest export market. In the first half of 2018, Chinese investment in the U.S. fell 92% over the same period, to just $2 billion, while investment into Europe hit $12 billion. The United States is still the European Union’s biggest export market, and the EU had an annual trade surplus in 2017 of $150 billion. Exports to the U.S. amounted to 2.5% of EU’s GDP. According to Oxford Economics, a trade war between the U.S. and Europe remains a significant risk and a full-blown trade war could reduce EU GDP by 1% by 2021. On the other hand, it can be argued that an imminent increase in interest rates in the U.S. could instead be beneficial to Europe, in that the influx of capital to the U.S. would strengthen the dollar, therefore favoring European exports to the U.S. Of all the European countries, Germany is the EU’s biggest economy, also thanks to the country’s strong exports; Germany has the biggest trade surplus with the U.S., in particular in the automobile market. In 2017, German manufacturers sold 1.35 million new vehicles in the U.S. Even with a stronger dollar, Trump’s threat of a 35% tariff on cars from Europe could cause a decrease in exports in the U.S. of half a million automobiles and economic damage in Europe between 5 and 17 million Euros. But although U.S. protectionism is starting to weigh on Germany’s economy, EU Commissioner Cecilia Malmstrom believes that U.S. policies could be beneficial for the European Union. The EU is already in negotiations with almost all of the nations that are part of the Trans-Pacific Partnership deal from which Trump withdrew in January 2018, as well as in talks with Mexico, South American trade bloc Mercosur and Japan. The EU has almost completed a deal with Vietnam and is also preparing for possible trade talks with Australia and New Zealand. On another positive note, in July 2018, President Donald Trump and European Commission President Jean-Claude Juncker reached an agreement to lower some industrial tariffs and increase Europe’s purchase of U.S. soybeans and liquefied natural gas, while re-examining the existing U.S. tariffs on steel and aluminum along with the retaliatory ones from Europe, pushing farther away a possible trade war between the U.S. and the EU. In July 2018, Japan and the European Union signed a free trade deal, sending a clear message against U.S. protectionist measures. The deal removes EU tariffs on Japanese cars and car parts and would eliminate Japanese duties on EU cheese and wines, with both sectors expected to increase in the respective markets. According to EU officials, the deal is expected to boost EU’s economy by 0.8% and Japan’s by 0.3% in the long term.

The global multilateral trading system could be at risk. The world trading system is based on the idea that conflicts over national measures are carried out by way of a dispute settlement system overseen by the World Trade Organization. However, the DOHA round failure
blocked WTO members from addressing new sources of policy tension and impeded their collaboration to update the WTO rules to reflect the changes that have occurred in the global economy in the 25 years since the WTO treaty was negotiated. Following Trump’s imposition of tariffs on steel and aluminum, there have been a number of countries that have launched legal proceedings against the U.S. at the WTO, including Europe, China, India, Canada, Mexico and Norway. These disputes against the U.S. could lead to the largest national economy terminating its membership in the WTO, which in turn would endanger the existence of the organization itself, making the future of international trade unpredictable. If instead the U.S. were to win in an action brought before the WTO, the organization would create a particularly risky precedent that could legitimize the U.S.’ protectionist application to other states as well. If other countries answer the U.S.’s levying of tariffs with counter tariffs, a global trade war could arise.

Trade wars are quite damaging to most economies, but there can be some winners. The wins take place when demand moves from goods most affected by tariffs to the less affected ones. Modeling done by Oxford Economics shows that trade diversion effects are large in a US-China tariff scenario. As trade drops between the two, U.S. exports to China and Chinese exports to the U.S. fall by 26-27%. However, the drop in exports to the U.S. is offset by exports to other markets. The study shows that Canada and Mexico’s total exports increase, as do those of other Asian exporters. The auto sector is examined more closely, modeling 25% car tariffs between the U.S., EU and China. EU car exports to the U.S. would drop by 60%, with Germany car output falling by 4%. The winners from trade diversion would instead be Japan, South Korea, Mexico and Canada.

The countries closest to the United States, Canada and Mexico, are living turbulence of their own. The steel and aluminum tariffs imposed by the U.S. could weigh heavily on the economies of these two countries, especially Canada, exporting over $12 billion in steel and aluminum to the U.S. Both Canada have Mexico have responded with their own tariffs, which could lead further negative repercussions in the North American economies. The renegotiation of the North American Free Trade Agreement is also undergoing difficulties, as from the beginning of his tenure, Trump stalled talks and threatened to withdraw from this agreement. The possible U.S. withdrawal from NAFTA, along with other tariff-related scenarios have been modeled by Global Economics Dynamics (GED), the result being that the economy of all three countries would be damaged, while many other countries could gain from the decline cross-border trade between the NAFTA members. The realization of the negative consequences of a withdrawal may be the reason for Trump making an initial
“handshake deal” with Mexico in August 2018, which potentially clears the way for Canada to rejoin negotiations as well.

The International Monetary Fund’s April 2018 World Economic Outlook report sums up the negative effects of an increase in tariffs and other trade barriers. These could disrupt global supply chains and slow the advancement of new technologies, which would reduce global productivity and investment. Greater protectionism would make consumer goods more costly thereby lowering consumer welfare. An IMF scenario analysis indicates that an eventual 10% increase in import prices everywhere would lower global output and consumption by 1.75% after 5 years and almost 2% in the long term, with global investment and trade falling even more. Moving away from a global trading system to one in which tariff actions increase consumer prices can put people back into poverty, who in the past few decades benefited from multilateral cooperation.
Conclusions

This paper addresses the reasons and effects of the resurgence in Protectionism in the United States, as reflected in the country’s trade and fiscal policies. To begin, general aspects of trade agreements and trade policies in open economies are explored, followed by a review of policies pursued by the United States in recent and current times. Finally, the effects of the new protectionist policies on the U.S. and on the rest of the world are examined, based on studies made by important institutions.

In the middle of 20th century, the liberalization of trade resulting from the introduction of multilateral trade agreements, reduced trade barriers, expanded the variety of goods and services available globally, allowed developing countries to export their goods and greatly contributed to global trade growth. However, support for globalization shrank as concerns flared in advanced economies around issues such as job losses and the environment. As a result, since the 1990’s there has been an increase in bilateral and regional trade agreements and a move away from multilateralism. In analyzing the impact of these different kinds of agreements on global trade, the conclusion was that there was not much difference in trade flows compared to global trade regulated by multilateral agreements in a WTO world with already low tariffs. An important advantage of RTAs is their inclusion of deep integration provisions including product standards, customs procedures and access to government procurement, which can improve welfare by reducing non-tariff barriers to trade. These selective arrangements do in fact complement WTO-regulated multilateral agreements, however, they cannot substitute multilateral cooperation that is necessary in order to include developing countries and to enhance welfare at the global level. A multilateral framework that can facilitate cooperation and resolve disputes is needed to sustain global improvements in living standards and economic security. A careful balance between regionalism and multilateralism is required, as selective trade openness can hurt certain groups, so measures need to be adopted to help those adversely affected by greater economic integration.

Much like the rest of the world, the United States benefitted from multilateralism in the 20th century. However, following public skepticism around globalization and the standstill in multilateral cooperation, in the last 20 years the U.S. entered in numerous bilateral and regional agreements, such as NAFTA. Support for big trade agreements was at an all-time low around the time of the 2016 U.S. presidential elections, as the public believed that jobs were being lost because of increased international competition coming from trade. There was also a sense that the playing field was not level, coming from the perception that other
countries were involved in unfair trade practices such as dumping, subsidies and currency manipulation. All of the presidential contenders played on these public fears during their campaigns, including the winner of the elections, Donald Trump, who did in fact address these issues early in his Presidency.

Following on his promise to “Make America Great Again”, President Trump has been using very strong protectionist measures in order to help domestic firms, protect U.S. jobs and strengthen the U.S. economy. Since the beginning of 2018, he has started imposing tariffs on many goods imported to the U.S., in particular those goods affecting manufacturing firms in the U.S., such as washing machines, solar panels, steel, aluminum, etc. He has also been quite active in bilateral negotiations and has withdrawn or threatened to withdraw from bigger regional deals like TPP and NAFTA. The Tax Cut and Jobs Act approved by Congress at the end of 2017 also includes provisions that help domestic corporations, while hitting multinational companies that have interests abroad. The Trump Administration expects that tax savings and increased profits that domestic companies will derive from the new tax reform will trigger an increase in investments in the U.S., even on the part of foreign companies.

During Trump’s Presidency, the effect on the U.S. economy has been positive, with economic indicators showing a healthy increase in GDP growth and a reduction in the unemployment rate at levels not seen since the economic boom in 2000. Obviously Trump has associated these economic successes with his Administration’s trade and fiscal policies, and there are many economists who agree as well. Only time will tell if the more long-term impact of these policies will maintain a positive momentum for the economy.

Studies and data published by eminent institutions suggest more worrying statistics. First of all, these studies assume that other countries will respond, as has been already occurring, with tariffs of their own, which in turn could develop into trade wars. Trade wars are quite damaging to most economies, although some countries could actually be winners and benefit from trade tension among other countries. The wins take place when demand moves from goods most affected by tariffs to the less affected ones, creating trade diversion to areas where tariffs are not applied. However, simulations carried out by the European Central Bank show that tariffs on imports cause increases in consumer prices, which reduce consumption, investment and employment. In the ECB’s simulations, U.S. exports would also suffer from retaliatory practices on the part of its trade partners. Exports would fall globally, as would global GDP. Even the International Monetary Fund confirms the negative effects of increases in tariffs, being the disruption of global supply chains and reduction in global productivity and investment. More importantly, consumer goods could become more costly
and put large groups of people back into poverty, causing a decline in welfare. The positive results of multilateralism activity in the 20th century could be lost because of escalating trade wars among big players. Preserving an adequate multilateral trading system is vital to enhancing welfare globally even among less developed countries and emerging economies. Anti-globalists continue the fight against free trade, using this as the reason for income inequality around the world, but evidence shows that advancing technology is a large cause of this inequality rather than globalization. The reversal of trade liberalization would increase trade costs and raise consumer prices, resulting in negative impacts for many economies. In the long run, an intensification of protectionism as is being triggered by the Trump Administration could result harmful to the world as well as to the United States itself.
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