DEPARTMENT OF MANAGEMENT

Chair of International Economics and Industrial Dynamics

THE ECONOMIC POLICIES OF U.S.A. AND CHINA.
TRUMP versus XI JINPING: "THE DUTIES WAR".

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INTRODUCTION

International trade also known as ‘foreign trade’ can be defined as “the exchange of products, services, and money across national borders; essentially trade between countries. When consumers in the U.S. purchase Swiss-made watches, Guatemalan-grown fruits, Chinese-made toys and electronics, Japanese-manufactured automobiles they experience the end result of international trade.” [1]

The need for international trade has arisen because the production of different types of goods and services require different kinds of resources (including economic resources) which are used in different proportions, but all these resources are unevenly distributed all over the world and the international mobility of these resources is limited. Land is a major economic resource, but it is geographically immobile.

At the vanguard of the globalization movement, it is committed to promotion of free trade by reducing obstacles such as tariffs, quotas and regulations that slow and reduce the movement of goods between different countries.

But, free trade, has its strengths and weaknesses, if it not properly regulated and if the countries don’t respect these rules.

The current U.S. President, Donald Trump, has for years accused the Chinese Government of unfair trade practices, which he says puts the U.S. companies at a disadvantage. Many other foreign leaders have agreed that China unfairly subsidies its businesses and has at times devalued its currency to boost exports.

Under the World Trade Organization (WTO) rules, a developing country is entitled, to a certain extent, to use non-market practices to spur economic development. Since it became an economic power house trailing only the U.S., developed countries want China to follow the same rules and responsibilities as a market economy. While China has significantly liberalized its economic and trade regimes over the past three decades, it continues to maintain or has recently imposed a number of states directed policies that appear to distort trade and investment flows.

But what is the current weight of China in the international trade?

China is the fastest emerging economy in the world and is also referred as a BRIC economy. (BRIC is a term coined by a US investment bank in the year 2001 to refer to the four countries in the world which are Brazil, Russia, China and India).

China fully opened to international trade when its President Deng Xiaoping announced the ‘open door’ policy in December 1978, before this China was mainly trading with USSR and its satellites (socialist countries). China had some trade links with the capitalist countries, but it was the first time that they had opened to the capitalist economy on such a large scale. So, the ‘open door’ policy refers to the set of policies adopted by China to develop and expand the economic relations with the capitalist world economy.

China announced the ‘open door’ policy because they had realized that if they want to grow and become a developed country, they need western investment and technology and they should also open the door to

[1] www.wisegeek.com

foreign businesses. The first step China took to attract the foreign investment was authorizing special economic zones in southern China with incentives such as tax concessions, reductions in land use fees and favorable labour prices. By making these reforms China's economy took off and since 1980s it is said to be the fastest growing economy in the world. Continuing with the reformation process, in 2001 China joined World Trade Organization (WTO) with the hope that its membership will help their economic system to flourish more.

Today, the U.S. and China are the two biggest economies in the world.

A trade war between U.S and China would have very serious repercussions all over the world. It could derail the current global economic expansion and cripple American businesses that depend on business with China. It could also further complicate geopolitical priorities given the Trump administration has enlisted the help of the Chinese in solving the crisis with North Korea.

The U.S.-China trade rose rapidly after the two nations re-established diplomatic relations in January 1979, signed a bilateral trade agreement in July 1979 and provided mutual most favored nation (MFN) treatment, beginning in 1980. In that year (which was shortly after China's economic reforms began), the total U.S.-China trade (exports plus imports) was approximately $4 billion. In 2017, the total US merchandise trade with China was $636 billion, making China the US' largest trading partner.[2]

On March 8, 2018, the U.S. President Donald Trump announced imposing additional tariffs on China's export of steel and aluminum to USA. On March 22, 2018, President Trump announced plans to enact sanctions against China over its Intellectual Property Rights (IPR) policies that negatively affect the U.S. stakeholders. These sanctions included raising tariffs by 25 percent on selected Chinese products valued at $50 billion to $60 billion. On April 1, China announced that it had retaliated against the U.S. action by raising tariffs on various American products, such as pork. On April 3, the U.S. administration unveiled a list of 1,333 products worth $50 billion in trade to which it intended to apply a 25 percent tariff. These Chinese goods are in strategic sectors such as information technology, robotics, advanced rail and shipping, new energy vehicles and high-technology medicine and health care. A few hours later, China released its proportional response: 25 percent tariffs on 106 products, also worth $50 billion in trade. Thus, there is a tit-for-tat action going on between China and the U.S. The Trump administration's plans to tax $50 billion worth of Chinese imports was met with threats by the Chinese to subject $50 billion worth of American products to the same. China threatened to retaliate with tariffs on American cars, chemicals and other products.[3]

So far, China's government has reacted to new tariff actions by the Trump administration with relatively restrained words and promises of proportional responses to the American government's actions.

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[2] Morrison W.M., *China-US Trade Issues*, April 16, 2018

[3] Myers S.L., *Why China is Confident it Can Beat Trump in a Trade War*, The New York Times, April 5, 2018

In my graduation thesis I will examine the aspects of international trade and in particular the commercial relations between the two strongest economic powers in the world of our times - U.S. and China - and their trade policies in order to solve their disputes.

I will examine all the possible consequences of a failed agreement between the two parties and I will observe the role of the WTO in resolving international trade disputes: certainly, this is the most intricate but also the most interesting of all time.

We are going to see how it will end!

CHAPTER I
THE INTERNATIONAL TRADE

Preface

Global rules of trade provide assurance and stability. Consumers and producers know they can enjoy secure supplies and greater choice of the finished products, components, raw materials and services they use. Producers and exporters know foreign markets will remain open to them. This leads to a more prosperous, peaceful and accountable economic world[4].

Trade has long been a core part of international relations. Bilateral, plurilateral and multilateral trade flows and agreements have arisen in many ways and in many areas over the centuries[5]. From regional arrangements, such as the North American Free Trade Agreement, to the all-encompassing General Agreement on Tariffs and Trades and then the World Trade Organization, the system of global trade has seen struggles and successes alike. The contemporary debate about the American tariffs on Chinese imports is comparable to the traditional debate over liberalization and protectionism: with ever-expanding globalization facing all states, the future of global trade seems to be no less controversial than it was centuries ago.

In the world of international trade, there are always winners and losers, but as economists have long argued, the benefits to the winners outweigh the costs borne by the losers, resulting in a net gain to society[6].

Moreover, economists argue that in the long-run, free trade stimulates economic growth and raises living standards across the board.

The economic arguments surrounding the benefits and costs of free trade in goods and services are not abstract academic ones. International trade theory has shaped the economic policy of many nations for the past 50 years.

It was the driver behind the formation of the World Trade Organization and regional trade blocs such as the European Union and the North American Free Trade Agreement (NAFTA). The 1990s, in particular, saw a global move toward greater free trade, in which a government does not attempt to influence through quotas or duties what its citizens can buy from another country, or what they can produce and sell to another country.

[4] Sauvant K.P., *Year Book on International investment law & policy*, Oxford University Press, N.Y. 2010.
[5] Bairoch P., *Economics and World History*, London: Harvester, 1993.
[6] Palmeter D., *A note on the ethics of free trade*, Cambridge University Press, 2005.

1.1 *Introduction to the International Trade*

Why do countries trade?

Countries trade because they are different. They have different technologies or have a different amount of capital and labour. Or they trade because they produce different varieties of the same good. In the first case trade generates gains because it allows countries to specialize in the production of the good it can produce relatively more efficiently or that it uses intensively the factor that they are more endowed with. In the second case trade generates gains because people love variety and trade provides access to different varieties of goods produced all over the world. By increasing the variety of goods consumers can access and buy, trade makes consumers better off.

The world trade has become harder to characterize in simple terms.

A century ago, each country's exports were obviously shaped in large part by its climate and natural resources. Disputes over trade were also easy to explain: the classic political battles over free trade versus protectionism[7].

When countries trade, they ship manufactured goods such as automobiles, computers, and clothing. They trade in mineral products (such as copper, coal, oil and so on) in agricultural products (such as wheat, soybeans and cotton). In the past, primary products - agricultural and mining goods - played a much more important role in world trade. Today, services of various kinds play an important role in the international trade. In recent years new types of service trade, made possible by modern telecommunications, have drawn a great deal of media attention. The most famous example is the rise of overseas call and help centers. And then there are the manufactured goods that dominate both sides of its trade.

Anyway, common sense suggests that some international trade is beneficial.

For example, nobody would suggest that Iceland should grow its own oranges. Iceland can benefit from trade by exchanging some of the products that it can produce at a low cost (fish) for some products that it cannot produce at all (oranges). Thus, by engaging in international trade, Icelanders are able to add oranges to their diet of fish.

The gains arise because international trade allows a country to specialize in the manufacture and export of products that can be produced most efficiently in that country, while importing products that can be produced more efficiently in other countries.

During the 1980s economists such as Nobel Prize winner Paul Krugman developed what has come to be known as the New Trade Theory.

New Trade theory (for which Krugman won the Nobel Prize in 2008) stresses that in some cases countries specialize in the production and export of particular products not because of underlying differences in factor endowments, but because in certain industries the world market can support only a limited number of firms[8].

[7] Bairoch P., *Economics and World History*, London: Harvester, 1993.
[8] Krugman P., Obstfeld M., Melitz M. J., *International economics, theory and policy*, Global ed., 2014.

In such industries, firms that enter the market first are able to build a competitive advantage that is subsequently difficult to challenge. Thus, the observed pattern of trade between nations may be due in part to the ability of firms within a given nation to capture first-mover advantages. For example, the United States is a major exporter of commercial jet aircraft because American firms, such as Boeing, were first movers in the world market. Boeing built a competitive advantage that has subsequently been difficult for firms from countries with equally favorable factor endowments to challenge (although Europe's Airbus Industry has succeeded in doing that)[9].

It becomes apparent that opening an economy to trade is likely to generate dynamic gains of two sorts:

- free trade might increase a country's stock of resources as increased supplies of labor and capital from abroad become available for use within the country;
- free trade might also increase the efficiency with which a country uses its resources[10].

Also, opening an economy to foreign competition might stimulate domestic producers to look for ways to increase their efficiency.

The invisible hand of the market mechanism, rather than government policy, should determine what a country imports and what it exports[11].

1.2 *Trade policy*

But, what should a nation’s trade policy be?

The policies that governments adopt toward international trade involve a number of different actions. These actions include taxes on some international transactions, subsidies for other transactions, legal limits on the value or volume of particular imports, and many other measures (for example, the use of a tariff or an import quota to protect own industries against competition from other countries).

What are the instruments of trade policy? Following I will give a short definition of the most important trade policies’ terms.

1.2.1 Tariffs

A tariff, the simplest of trade policies, is a tax levied when a good is imported. Specific tariffs are levied as a fixed charge for each unit of goods imported (for example, $3 per barrel of oil). Ad-valorem

[9] Porter M., *The Competitive Advantage of Nations*, The Free Press, A Division of McMillan, Inc., N.Y., 1990.
[10] Samuelson P., *The Gains from International Trade Once Again*, Economic Journal 72, 1962.
[11] Evensky J., *Adam Smith's Wealth of Nations*, New York, Cambridge University Press, 2015.

tariffs are taxes that are levied as a fraction of the value of the imported goods (for example, a 25 percent U.S. tariff on imported trucks)[12].

In either case, the effect of the tariff is to raise the cost of shipping goods to a country.

Tariffs are the oldest form of trade policy and have traditionally been used as a source of government income. Until the introduction of the income tax, for instance, the U.S. government raised most of its revenue from tariffs[13]. Their true purpose, however, has usually been twofold: both to provide revenue and to protect particular domestic sectors. In the early 19th century, for example, the United Kingdom used tariffs (the famous Corn Laws) to protect its agriculture from import competition. In the late 19th century, both Germany and the United States protected their new industrial sectors by imposing tariffs on imports of manufactured goods. The importance of tariffs has declined in modern times because modern governments usually prefer to protect domestic industries through a variety of nontariff barriers, such as import quotas (limitations on the quantity of imports) and export restraints (limitations on the quantity of exports - usually imposed by the exporting country at the importing country's request). Nonetheless, an understanding of the effects of a tariff remains vital for understanding other trade policies.

1.2.2 Customs Duty

Customs Duty is a tax imposed on imports and exports of goods. The rates of customs duties are either specific or on ad valorem basis, that is, it is based on the value of goods.

Import duties are generally of the following types:

- Basic duty;
- Additional Customs duty;
- True Countervailing duty or additional duty of customs;
- Anti dumping duty/Safeguard duty.

Customs duties may also be levied to protect the domestic industry from foreign competition. In cases foreign producers attempt to subsidize the goods being exported by them so that it causes domestic production to suffer because of a shift in domestic demand towards cheaper imported goods, the government makes mandatory the payment of a "countervailing duty" on the import of such goods to the domestic economy.

This raises the price of these goods leading to domestic goods again being equally competitive and attractive. Thus, domestic businesses are cushioned. These duties can be imposed under the specifications

[12] Bhagwati J., *On the Equivalence of Tariffs and Quotas*, in Robert E. Baldwin et al., eds. Trade, Growth, and the Balance of Payments. Chicago: Rand McNally, 1965.

[13] Lewis W.A., *The Theory of Economic Development*. Homewood, IL: Irwin, 1955.

given by the WTO (World Trade Organization) after the investigation finds that exporters are engaged in dumping. These are also known as anti-dumping duties[14].
Finally, it is important to notice that there is a deep difference between Tariff and Duty:

- A **Tariff** directly relates to the harmonized tariff system codes (HTS) which imported/exported products are classified under. For example, HTS codes let U.S. Customs know what tariff rate should be charged to specific products, this mainly applies to imports over exports.

- A **Duty** is the actual amount of money paid on the imported/exported product. Although, the actual tax reference is the same thing, the import duty paid depends on the quantity imported.

1.2.3 Quotas

The best-known form of non-tariff barrier is a quota. This is the maximum quantity of some good that may be imported.

1.2.4 Export subsidies

Export subsidies also represent an instrument of trade policy, as governments by providing support to the export activity distort trade.

1.2.5 Any other policy-induced trade cost

There are many other ways in which governments influence trade. In general, any policy-induced trade cost represents a barrier to trade. For example, non-tariff barriers may be a particular type of standard that increases relative costs of production for foreigner producers. Or, particularly time-consuming customs clearance procedures that increase overall transport costs. High transport costs due to anti-competitive behaviors or the low quality of infrastructure may also be thought of as barriers to trade[15].
Below I list some of them briefly.

- **Export credit subsidies**. This is like an export subsidy except that it takes the form of a subsidized loan to the buyer. The United States, like most other countries, has a government institution, the Export-Import Bank, that is devoted to providing at least slightly subsidized loans to aid exports.

[14] Davis D.R., Weinstein D.E., *An Account of Global Factor Trade*, American Economic Review, December 2001.
[15] Corden W. M., *Trade Policy and Economic Welfare*. Oxford, Clarendon Press, 1974.

- **National procurement**. Purchases by the government or strongly regulated firms can be directed toward domestically produced goods even when these goods are more expensive than imports. The classic example is the European telecommunications industry. The nations of the European Union in principle have free trade with each other. The main purchasers of telecommunications equipment, however, are phone companies - and in Europe, these companies have until recently all been government owned. These government-owned telephone companies buy from domestic suppliers even when the suppliers charge higher prices than suppliers in other countries. The result is that there is very little trade in telecommunications equipment within Europe.

- **Red-tape barriers**. Sometimes a government wants to restrict imports without doing so formally. Fortunately, or unfortunately, it is easy to twist normal health, safety, and customs procedures in order to place substantial obstacles in the way of trade. The classic example is the French decree in 1982 that all Japanese videocassette recorders had to pass through the tiny customs house at Poitiers effectively limiting the actual imports to a handful.

In all these cases the analysis of the impact of trade barriers are quite similar. For simplicity, in the rest of the analysis I will look at the impact of import tariffs but, the same comments, are applicable to all other forms of barriers to trade.

1.3 *The effects of trade policy*

The effects of the major instruments of trade policy are usefully summarized by Table 1.1, which compares the effect of four major kinds of trade policy on the welfare of consumers. All four trade shown policies benefit producers and hurt consumers. The effects of the policies on economic welfare are at best ambiguous; two of the policies definitely hurt the nation as a whole, while tariffs and import quotas are potentially beneficial only for large countries that can drive down world prices. Why, then, do governments so often act to limit imports or promote exports?[16]

[16] Vernon R., *International Investments and International Trade in the Product Life Cycle*, Quarterly Journal of Economics, 1966.

Effects of Alternative Trade Policies

	Tariff	Export Subsidy	Import Quota	Voluntary Export Restraint
Producer surplus	Increases	Increases	Increases	Increases
Consumer surplus	Falls	Falls	Falls	Falls
Government revenue	Increases	Falls (government spending rises)	No change (rents to license holders)	No change (rents to foreigners)
Overall national welfare	Ambiguous (falls for small country)	Falls	Ambiguous (falls for small country)	Falls

Tab. 1.1 *Effects of alternative trade policies*[17]

1.4 *Why do governments impose import tariffs?*

In the next paragraph I will argue why the governments use import tariffs and what is their impact on international trade.

International trade theory clearly asserts the benefits of free trade and highlights the inefficiency losses of imposing a tariff. In reality, very few countries have adopted total free trade. An exception is probably the one of Hong Kong. In other cases, trade policies aimed at promoting economic development often lead to rates of effective protection much higher than the tariff rates themselves[18]. There are various reasons for this.

1.4.1 The political economy justification

Often it is a question of political economy. Saying that there is a political economy justification behind the imposition of a tariff means that protectionist policies are the consequence of the lobbying activity of industries in the import-competing sectors that wish to be protected against competition from the rest of the world[19].

There are also some theoretical arguments that can justify the use of protection from a national welfare point of view.

1.4.2 Economic arguments for protection

Most tariffs, import quotas, and other trade policy measures are undertaken primarily to protect the income of particular interest groups. Politicians often claim, however, that the policies are being undertaken

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[17] Hill C.E.L., *International business: competing in the global marketplace*, New York , 2013

[18] Bhagwati J., *Protectionism*, Cambridge, MA: MIT Press, 1988 and *Costs of Protection*, Journal of Commerce, September 25, 1991.

[19] Rousslang D., Suomela A., *Calculating the Consumer and Net Welfare Costs of Import Relief*, U.S. International Trade Commission Staff Research Study 15. Washington, 1985.

in the interest of the nation as a whole. Although economists often argue that deviations from free trade reduce national welfare, there are, in fact, some theoretical grounds for believing that activist trade policies can sometimes increase the welfare of the nation as a whole.[20]
In a synthetic way, below, I will try to explain some possible economics arguments:

- ***Terms-of-Trade argument***, according to which there is an optimal level of tariff at which national welfare is maximized.
- ***Infant industry argument***. According to this theory, there are circumstances where an industry may need temporary protection in order for the country to develop a comparative advantage in that sector.
- ***Strategic trade policy***. There might be circumstances where a subsidy to a domestic firm may deter foreign companies from entering into the market and competing with the domestic firm. In this case, the domestic firm will benefit from monopoly profits and the country overall may gain.
- ***Other arguments***. They rely on the fact that import tariffs are a tool to raise government fiscal revenue or they are a tool to redistribute income from the export sector to the protected sector.

1.5 *What is the impact of an import tariff?*

A tariff drives a wedge between foreign and domestic prices, raising the domestic price but by less than the tariff rate.
An important and relevant special case, however, is that of a “small” country that cannot have any substantial influence on foreign prices. In the small country case, a tariff is fully reflected in domestic prices.
The costs and benefits of a tariff or other trade policy may be measured using the concepts of consumer surplus and producer surplus. So, using these concepts, the domestic producers of a good gain because a tariff raises the price they receive; the domestic consumers lose, for the same reason. There is also a gain in government revenue[21].
If we add together the gains and losses from a tariff, we find that the net effect on national welfare can be separated into two parts: on one hand is an efficiency loss, which results from the distortion in the incentives facing domestic producers and consumers, on the other hand is a terms of trade gain, reflecting the tendency of a tariff to drive down foreign export prices.
In the case of a small country that cannot affect foreign prices, the second effect is zero, so that there is an unambiguous loss.

[20] Hill C.E. L., *International business: competing in the global marketplace*, New York, 2013.
[21] Bhagwati J., *On the Equivalence of Tariffs and Quotas*, Robert E. Baldwin et al., eds. Trade, Growth, and the Balance of Payments, Chicago: Rand McNally, 1965.

The analysis of a tariff can be readily adapted to analyze other trade policy measures, such as export subsidies, import quotas, and voluntary export restraints[22]. An export subsidy causes efficiency losses similar to those of a tariff but compounds these losses by causing a deterioration of the terms of trade. Import quotas and voluntary export restraints differ from tariffs in that the government gets no revenue. Instead, what would have been government revenue accrues as rents to the recipients of import licenses (in the case of a quota) and to foreigners (in the case of a voluntary export restraint).
In the following study - cases I will analyze the impact of an import tariff on a certain economy. I will consider at first the case of a small country (where by small country I mean the case of a country that cannot affect the world price of the imported good) and then the opposite case of a large country.

1.5.1 Case of a small country

Suppose initially that there are no tariffs. Then, consumers in this country pay the world price to consume. Suppose that the government decides to levy a tariff on the imports of rice, for example. The imposition of a tariff will, first of all, increase the domestic price of the imported good. People who want to consume rice will now have to pay the world price plus the tariff. Domestic consumers of rice will, therefore, be worse off, as they will have to pay more, if they want to consume the same quantity of rice as before.
On the other hand domestic producers of rice will gain, because they will be able to sell rice at a higher price. And the government will also gain, as it will be able to collect tariff revenue.
Overall, in the case of a small country, international trade theory shows that the country as a whole will lose and national welfare will be reduced by the imposition of a tariff.

1.5.2 Case of a large country

Different is the case of a large country. Notice that here, by large country we do not mean a country that is large in terms of its geographical size, but rather a country whose import demand for a certain good is so large that it can affect the world price of the imported good.
What happens if a large country imposes a tariff on the import of a good, let's say rice? Like in the case of a small country, first of all, the domestic price for rice will increase. This will reduce the demand for imports of rice. But, now, in the case of a large country, the lower demand for imports will lead to a reduction in the world price of rice.
In other words, by imposing a tariff on an imported good, a large country is able to affect the price of the good to its own advantage! Economists refer to this gain as "terms of trade gain" (TOT gain). This gain

[22] Corden W.M., *The Theory of Protection.* Oxford: Clarendon Press, 1971.

stems precisely from the ability of the country to affect the world price of the imported good. It is because of the possibility of terms-of-trade gain that in the case of a large country the impact of the imposition of a tariff on national welfare of a country is ambiguous, i.e., it can be either positive or negative. What is important to highlight at this stage is that terms-of-trade effects only occur in the case of a large country. In the case of a small country, the imposition of a tariff is unambiguously welfare decreasing!

1.6 *International negotiations and trade policy*

From the mid-1930s until about 1980, the United States and other advanced countries gradually removed tariffs and some other barriers to trade, and by so doing aided a rapid increase in international integration. Figure 1.1 shows the average U.S. tariff rate on dutiable imports from 1891 to 2008; after rising sharply in the early 1930s, the rate has steadily declined[23].

Most economists believe this progressive trade liberalization was highly beneficial. However, how was this removal of tariffs politically possible? At least part of the answer is that the great postwar liberalization of trade was achieved through international negotiation. That is, governments agreed to engage in mutual tariff reduction. These agreements linked reduced protection for each country's import-competing industries to reduced protection by other countries against that country's export industries. Such a linkage helps to offset some of the political difficulties that would otherwise prevent countries from adopting good trade policies.

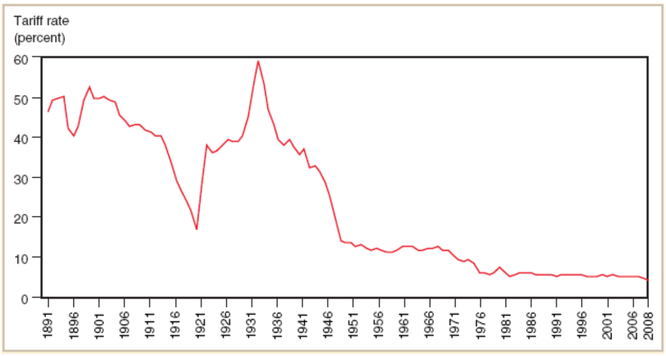

Fig. 1.1 The U.S. Tariff Rate[24]

1.6.1 The Advantages of Negotiation

Why countries trade, what determines the patterns of trade, and what are the gains and the costs associated with trade liberalization? These are certainly interesting questions, but what is more interesting to understand is what a trade policy of a country should be, in order to foster development.

[23] Destler M., *American Trade Politics*, 4th edition, Washington, D.C.: Peterson Institute for International Economics, 2005.
[24] U.S. International Trade Commission. *The Economic Effects of Significant U.S. Import Restraints.* Washington, D.C., 2009

Development is a complex concept: it is a process in which people through their work, investing and trading with other countries, are able to secure their basic needs (education, health, comfortable living standards and freedom). In order to obtain all this, people need adequate economic forces. Therefore, an adequate level of income is a basis for all this. The trade liberalization can help countries to better utilize their resources through specialization and through the exploitation of Economies of Scale[25] that are more productive than less specialized employees and equipment. Trade also fosters the incentive for innovation and the diffusion of technologies. It is a more efficient use of resources that provides the potential for a higher level of income and therefore a higher level of development.

There is a generally positive relationship between openness and income and the general picture is that open and export-oriented countries have succeeded in their development efforts, while heavily protected and inward-looking countries have not.

However, often a number of protectionist policies have been used as well to favor development. It is interesting to analyze how protectionist policies work. What are the instruments for protection? What are their effects and what is the rationale behind protectionist policies? And what policies can a government implement to face the adjustment problems connected with trade liberalization?

1.7 *The WTO (World Trade Organization)*

How can we ensure that trade is as fair as possible, and as open as is practical? By negotiating rules and abiding by them.

The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between Nations. The WTO's creation on 1 January 1995 marked the biggest Reform of international trade since after the Second World War[26].

At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading Nations and ratified in their Parliaments.

"Each member receives guarantees that its exports will be treated fairly and consistently in other members' markets. Each promise to do the same for imports into its own market"[27].

But the WTO is not just about liberalizing trade, and in some circumstances its rules support maintaining trade barriers (for example, to protect consumers, prevent the spread of disease or protect the environment).

Essentially, the WTO is a place where member governments go, to try to sort out the trade problems they face with each other.

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[25] Economies of Scale are unit cost reductions associated with a large scale of output. They have a number of sources, including the ability to spread fixed costs over a large volume, and the ability of large-volume producers to utilize specialized employees and equipment.

[26] World Trade Organization, World Trade Report 2006.

[27] www.wto.org

Today, the World Trade Organization (WTO) is the only international Organization dealing with the global rules of trade. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible[28].

Decisions in the WTO are typically taken by consensus among all members and they are ratified by members' Parliaments.

Trade frictions are channeled into the WTO's dispute settlement process, where the focus is on interpreting agreements and commitments and how to ensure that members' trade policies conform with them. That way, the risk of disputes spilling over into political or military conflict is reduced. By lowering trade barriers through negotiations among member governments, the WTO's system also breaks down other barriers between peoples and trading economies[29].

At the heart of the system - known as the multilateral trading system - are the WTO's agreements, negotiated and signed by a large majority of the world's trading economies, and ratified in their parliaments.

These agreements are the legal foundations for global trade. Essentially, they are contracts, guaranteeing WTO members important trade rights. They also bind governments to keep their trade policies transparent and predictable which is to everybody's benefit.

The agreements provide a stable and transparent framework to help producers of goods and services, exporters and importers conduct their business.

The goal is to improve the welfare of the peoples of the WTO's members.

The **WTO**	
LOCATION:	*Geneva, Switzerland*
ESTABLISHED:	*1 January 1995*
CREATED BY:	*Uruguay Round negotiations (1986-94)*
MEMBERSHIP:	*164 members representing 98% of world trade*
BUDGET:	*197 million Swiss francs for 2018*
SECRETARIAT STAFF:	*630*

[28] Kalpana S., *Economic for Law Students*, New Delhi: Universal Law Publishing Co. Pvt. Ltd. 2009
[29] Bansal N.S., *The world Trade Organisation,* Mittal Publications, New Delhi, India 2007.

HEAD:	*Roberto Azevêdo (Director-General)*

Tab. 1.2 *Update informations about WTO as of 30 September 2018*[30]

The principal functions of WTO are:

- *Administering WTO trade agreements;*
- *Forum for trade negotiations;*
- *Handling trade disputes;*
- *Monitoring trade policies;*
- *Technical assistance and training for developing economies;*
- *Cooperation with other international organizations.*

1.7.1 How WTO is organized

Actually, the WTO has 164 members, accounting for 98% of world trade. A total of 22 countries are negotiating membership[31].

Decisions are made by the entire membership. This is typically by consensus. A majority vote is also possible, but it has never been used in the WTO, and was extremely rare under the WTO's predecessor, the GATT. The WTO's agreements have been ratified in all members' parliaments.

The WTO's top-level decision - making body is the Ministerial Conference, which meets usually every two years. Numerous specialized committees, working groups and working parties deal with the individual agreements and other areas, such as the environment, development, membership applications and regional trade agreements.

[30] www.wto.org

[31] World Trade Organization, 2018.

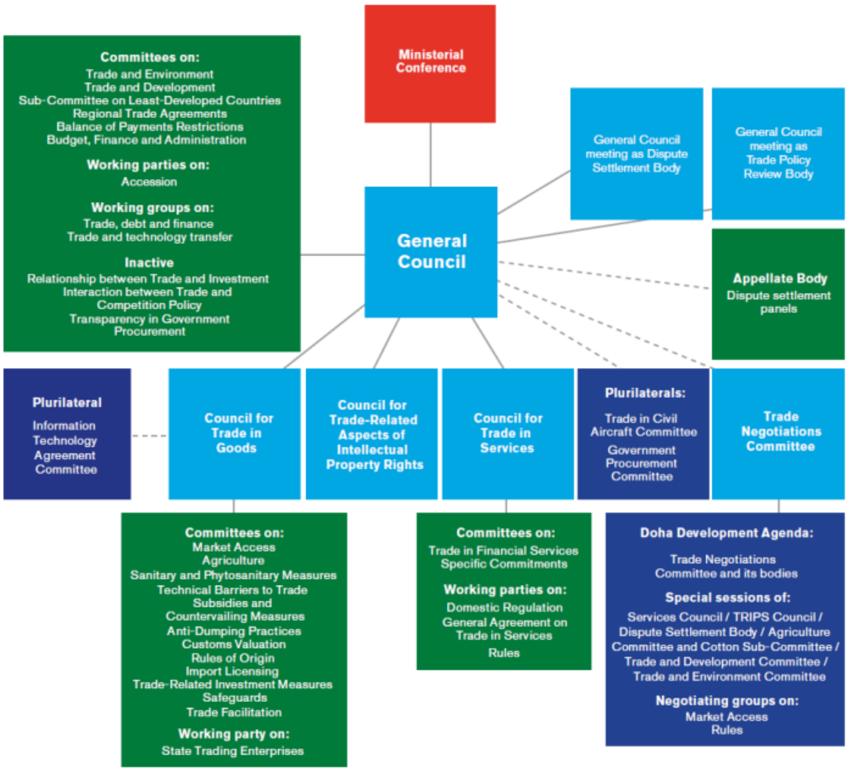

Fig. 1.2 *WTO organization*

1.7.2 WTO Secretariat

The WTO Secretariat, based in Geneva, has around 630 staff and is headed by a Director - General. It does not have branch offices outside Geneva. Since decisions are taken by the WTO's members, the Secretariat does not itself have a decision-making role.

The Secretariat's main duties are to supply technical support for the various councils/committees and the ministerial conferences, to provide technical assistance for developing economies, to analyze world trade and to explain WTO activities to the public and media.

The Secretariat also provides some forms of legal assistance in the dispute settlement process and advises governments wishing to become members of the WTO. The annual budget contributed by members is roughly 197 million Swiss francs.

1.7.3 History of WTO: the GATT [32]

After the Second World War In 1948 in Havana (Cuba) an attempt was made to create an international trade organization, but it failed. Subsequently there were other attempts (Annecy - France, Torquay - UK, Tokyo - Japan, Punta del Este - Uruguay, Montreal - Canada, Brussels - Belgium and finally to Marrakesh -

[32] www.wto.org

Morocco in 1994). During that period, the trading system came under GATT that helped establish a strong and prosperous multilateral trading system that became more and more liberal through rounds of trade negotiations. But by the 1980s the system needed a thorough overhaul. This led to the Uruguay Round and ultimately to the WTO.

From 1948 to 1994, the General Agreement on Tariffs and Trade (GATT) provided the rules for much of world trade and presided over periods that saw some of the highest growth rates in international commerce. It seemed well-established, but throughout those 47 years, it was a provisional agreement and organization.

The original intention was to create a third institution to handle the trade side of international economic cooperation, joining the two "Bretton Woods" institutions, the World Bank and the International Monetary Fund. Over 50 countries participated in negotiations to create an International Trade Organization (ITO) as a specialized agency of the United Nations. The draft ITO Charter was ambitious. It extended beyond world trade disciplines, to include rules on employment, commodity agreements, restrictive business practices, international investment, and services. The aim was to create the ITO at a UN Conference on Trade and Employment in Havana, Cuba in 1947.

Meanwhile, 15 countries had begun talks in December 1945 to reduce and bind customs tariffs. With the Second World War only recently ended, they wanted to give an early boost to trade liberalization, and to begin to correct the legacy of protectionist measures which remained in place from the early 1930s.

This first round of negotiations resulted in a package of trade rules and 45,000 tariff concessions affecting $10 billion of trade, about one fifth of the world's total. The group had expanded to 23 by the time the deal was signed on 30 October 1947. The tariff concessions came into effect by 30 June 1948 through a "Protocol of Provisional Application". And so the new General Agreement on Tariffs and Trade was born, with 23 founding members (officially "contracting parties").

The 23 members were also part of the larger group negotiating the ITO Charter. One of the provisions of GATT says that they should accept some of the trade rules of the draft. This, they believed, should be done swiftly and "provisionally" in order to protect the value of the tariff concessions they had negotiated. They spelt out how they envisaged the relationship between GATT and the ITO Charter, but they also allowed for the possibility that the ITO might not be created. They were right.

The Havana conference began on 21 November 1947, less than a month after GATT was signed. The ITO Charter was finally agreed in Havana in March 1948, but ratification in some national legislatures proved impossible. The most serious opposition was in the US Congress, even though the US government had been one of the driving forces. In 1950, the United States government announced that it would not seek Congressional ratification of the Havana Charter, and the ITO was effectively dead. So, the GATT became the only multilateral instrument governing international trade from 1948 until the WTO was established in 1995.

For almost half a century, the GATT's basic legal principles remained much as they were in 1948. There were additions in the form of a section on development added in the 1960s and "plurilateral" agreements

(with voluntary membership) in the 1970s, and efforts to reduce tariffs further continued. Much of this was achieved through a series of multilateral negotiations known as “trade rounds” - the biggest leaps forward in international trade liberalization have come through these rounds which were held under GATT’s auspices.
In the early years, the GATT trade rounds concentrated on further reducing tariffs. Then, the Kennedy Round in the mid-sixties brought about a GATT Anti-Dumping Agreement and a section on development. The Tokyo Round during the seventies was the first major attempt to tackle trade barriers that do not take the form of tariffs, and to improve the system. The eighth, the Uruguay Round of 1986-94, was the last and most extensive of all. It led to the WTO and a new set of agreements.

1.7.4 The Tokyo Round: a first try to reform the system

The Tokyo Round lasted from 1973 to 1979, with 102 countries participating. It continued GATT’s efforts to progressively reduce tariffs. The results included an average one-third cut in customs duties in the world’s nine major industrial markets, bringing the average tariff on industrial products down to 4.7%. The tariff reductions, phased in over a period of eight years, involved an element of “harmonization” - the higher the tariff, the larger the cut, proportionally.
In other issues, the Tokyo Round had mixed results. It failed to come to grips with the fundamental problems affecting farm trade and also stopped short of providing a modified agreement on “safeguards” (emergency import measures). Nevertheless, a series of agreements on non-tariff barriers did emerge from the negotiations, in some cases interpreting existing GATT rules, in others breaking entirely new ground. In most cases, only a relatively small number of GATT members (mainly industrialized) subscribed to these agreements and arrangements. Because they were not accepted by the full GATT membership, they were often informally called “codes”.
They were not multilateral, but they were a beginning. Several codes were eventually amended in the Uruguay Round and turned into multilateral commitments accepted by all WTO members. Only four remained “plurilateral” - those on government procurement, bovine meat, civil aircraft and dairy products. In 1997 WTO members agreed to terminate the bovine meat and dairy agreements, leaving only two.

1.7.5 Did GATT succeed?

GATT was provisional with a limited field of action, but its success over 47 years in promoting and securing the liberalization of much of world trade is incontestable. Continual reductions in tariffs alone helped spur very high rates of world trade growth during the 1950s and 1960s — around 8% a year on average. And the momentum of trade liberalization helped ensure that trade growth consistently out-paced production growth throughout the GATT era, a measure of countries’ increasing ability to trade with each other and to reap the benefits of trade. The rush of new members during the Uruguay Round demonstrated that the multilateral trading system was recognized as an anchor for development and an instrument of economic and trade reform.

But all was not well. As time passed new problems arose. The Tokyo Round in the 1970s was an attempt to tackle some of these but its achievements were limited. This was a sign of difficult times to come.

GATT's success in reducing tariffs to such a low level, combined with a series of economic recessions in the 1970s and early 1980s, drove governments to devise other forms of protection for sectors facing increased foreign competition. High rates of unemployment and constant factory closures led governments in Western Europe and North America to seek bilateral market-sharing arrangements with competitors and to embark on a subsidies race to maintain their holds on agricultural trade. Both these changes undermined GATT's credibility and effectiveness.

The problem was not just a deteriorating trade policy environment. By the early 1980s the General Agreement was clearly no longer as relevant to the realities of world trade as it had been in the 1940s. For a start, world trade had become far more complex and important than 40 years before: the globalization of the world economy was underway, trade in services - not covered by GATT rules - was of major interest to more and more countries, and international investment had expanded. The expansion of services trade was also closely tied to further increases in world merchandise trade. In other respects, GATT had been found wanting. For instance, in agriculture, loopholes in the multilateral system were heavily exploited, and efforts at liberalizing agricultural trade met with little success. In the textiles and clothing sector, an exception to GATT's normal disciplines was negotiated in the 1960s and early 1970s, leading to the Multifibre Arrangement. Even GATT's institutional structure and its dispute settlement system were causing concern.

These and other factors convinced GATT members that a new effort to reinforce and extend the multilateral system should be attempted. That effort resulted in the Uruguay Round, the Marrakesh Declaration, and the creation of the WTO.

1.7.6 GATT trade Rounds

Below I will outline the main steps in history of WTO.

Year	**Place/Name**	**Subjects covered**	**Countries**
1947	Geneva	Tariffs	23
1949	Annecy	Tariffs	13
1951	Torquay	Tariffs	38
1956	Geneva	Tariffs	26
1960-1961	Geneva-Dillon Round	Tariffs	26
1964-1967	Geneva-Kennedy Round	Tariffs and anti-dumping measures	62
1973-1979	Geneva-Tokyo Round	Tariffs, non-tariffs measures, "frameworks agreements	102

1986-1994	Geneva-Uruguay Round	Tariffs, non-tariffs measures, rules, services, intellectual property, dispute settlement, textile, agriculture, creation of WTO, etc.	123

Tab. 1.3 *Gate trade rounds*

1.7.7 The Uruguay Round

It took seven and a half years, almost twice the original schedule. By the end, 123 countries were taking part. It covered almost all trade, from toothbrushes to pleasure boats, from banking to telecommunications, from the genes of wild rice to AIDS treatments[33]. It was quite simply the largest trade negotiation ever, and most probably the largest negotiation of any kind in history. Trade rounds: progress by package. They are often lengthy - the Uruguay Round took seven and a half years - but trade rounds can have an advantage. They offer a package approach to trade negotiations that can sometimes be more fruitful than negotiations on a single issue.

At times it seemed doomed to fail. But in the end, the Uruguay Round brought about the biggest reform of the world's trading system since GATT was created at the end of the Second World War. And yet, despite its troubled progress, the Uruguay Round did see some early results. Within only two years, participants had agreed on a package of cuts in import duties on tropical products, which are mainly exported by developing countries. They had also revised the rules for settling disputes, with some measures implemented on the spot. And they called for regular reports on GATT members' trade policies, a move considered important for making trade regimes transparent around the world.

1.7.8 What happened to GATT?

The WTO replaced GATT as an international organization, but the General Agreement still exists as the WTO's umbrella treaty for trade in goods, updated as a result of the Uruguay Round negotiations. Trade lawyers distinguish between GATT 1994, the updated parts of GATT, and GATT 1947, the original agreement which is still the heart of GATT 1994[34].

1.7.9 The post-Uruguay Round built-in agenda

Many of the Uruguay Round agreements set timetables for future work. Part of this "built-in agenda" started almost immediately. In some areas, it included new or further negotiations. In other areas, it included

[33] Schott J., *The Uruguay Round: An Assessment*. Washington, D.C.: Institute for International Economics, 1994.
[34] Stewart T., *The GATT Uruguay Round: a negotiating history: 1986-1992*, Deventer etc., Kluver law and taxation publishers, 1993.

assessments or reviews of the situation at specified times. Some negotiations were quickly completed, notably in basic telecommunications, financial services. (Member governments also swiftly agreed a deal for freer trade in information technology products, an issue outside the "built-in agenda".)
The agenda originally built into the Uruguay Round agreements has seen additions and modifications. A number of items are now part of the Doha Agenda, some of them updated.
The 15 original Uruguay Round subjects were[35]:

- Tariffs;
- Non-tariff barriers;
- Natural resource products;
- Textiles and clothing;
- Agriculture;
- Tropical products;
- GATT articles;
- Tokyo Round codes;
- Anti-dumping;
- Subsidies;
- Intellectual property;
- Investment measures;
- Dispute settlement;
- The GATT system;
- Services.

1.8 *WTO POLICIES*

The WTO does not tell Governments what to do or how to conduct their trade policies. Rather, it's a "member-driven" organization. That means:

- the rules of the WTO system are agreements resulting from negotiations among member governments,
- the rules are ratified by member's Parliament, and
- decision taken in the WTO are virtually all made by consensus among all members[36].

In other words, decisions taken in the WTO are negotiated, accountable and democratic.

[35] www.wto.org
[36] World Trade Organization, Annual Report 2002.

The only occasion when a WTO body can have a direct impact on government's policies is when a dispute is brought to the WTO and if that leads to a ruling by the Dispute Settlement Body (which consists of all members). Normally the Dispute Settlement Body makes a ruling by adopting the findings of a panel of experts or an appeal report.

Even then, the scope of the ruling is narrow: it is simply a judgment or interpretation of whether a government has broken one of the WTO's agreements (agreements that the infringing government had itself accepted). If a government has broken a commitment it has to conform[37].

In all other respects, the WTO does not dictate to governments to adopt or drop certain policies.

As for the WTO Secretariat, it simply provides administrative and technical support for the WTO and its members.

In fact, the governments themselves dictate to the WTO.

1.8.1 The WTO is not for Free Trade and any Cost

One of the principles of the WTO system is for country to lower their trade barriers and to allow trade to flow more freely. After all, countries benefit from the increased trade that results from lower trade barriers. It's just a question of what countries are willing to bargain with each other, or give and take, request and other[38].

But just how low those barriers should go is something member countries bargain with each other. Their negotiating positions depend on how ready they are to lower the barriers, and on what they want to obtain from other members in return.

One country's commitments become another country's rights, and vice versa.

The WTO role is to provide the forum for negotiating liberalization. It also provides the rules for how liberalization can take place.

The rules written into the agreements allow barriers to be lowered gradually so that domestic producers can adjust. They have special provisions that take into account the situations the developing countries face. They also spell out when and how governments can protect their domestic producers, for example from imports that are considered to have unfairly low prices because of subsidies or "dumping"[39].

The objective is fair trade, just as important as freer trade - perhaps more important - are other principles of the WTO system: non-discrimination, and making sure the conditions for trade are stable, predictable and transparent[40].

The WTO is not only concerned about commercial interests, this does not take priority over development.

[37] Stoll P., Schorkopf F., *WTO: world economic order, world trade war*, Leiden, 2006.
[38] Hoda A., *Tariff negotiations and renegotiations under the GATT and the WTO: procedures and practices*, Cambridge University press., 2001.
[39] World Trade Organization, *Understanding the WTO*. Geneva: World Trade Organization, 2007.
[40] Van den Bossche P., *The Law and Policy of the World Trade Organization*. Cambridge University Press, 2008.

CHAPTER II
TRADE POLICY IN DEVELOPING COUNTRIES: THE RISE OF CHINA

2.1 *The WTO and the developing countries*

“A WTO Committee on Trade and Development looks at developing economies’ special needs”.

Developing country is a term used by international organizations that has now become standard, even though some “developing” countries have gone through extended periods of declining living standards. A more descriptive but less polite term is less-developed countries (LDCs).

The WTO agreements are full of provisions taking the interests of development into account, in fact freer trade boosts economic growth and supports development: commerce and development are good for each other. At the same time, whether or not developing countries gain enough from the system is a subject of continuing debate in the WTO. The agreements include many important provisions that specifically take developing countries’ interests into account.

Developing countries are allowed more time to apply numerous provisions of the WTO agreements. Least - developed countries receive special treatment, including exemption from many provisions. The needs of development can also be used to justify actions that might not normally be allowed under the agreements, for example governments giving certain subsidies.

And the negotiations and other work launched at the Doha Ministerial Conference in November 2001 include numerous issues that developing countries want to pursue.

Over three-quarters of WTO members are developing or least-developed economies. All WTO agreements contain special provisions for them, including longer time periods to implement commitments, measures to increase their trading opportunities and support to help them build the infrastructure needed to participate in world trade.

The Aid for Trade initiative, launched by WTO members in 2005, is designed to help developing economies build trade capacity, enhance their infrastructure and improve their ability to benefit from trade - opening opportunities. So far, over US$ 340 billion has been disbursed to support Aid for Trade projects. A Global Review of the initiative is held every two years at the WTO’s headquarters. The Enhanced Integrated Framework (EIF) is the only multilateral partnership dedicated exclusively to assisting least developed countries (LDCs) in their use of trade as an engine for growth, sustainable development and poverty reduction. The EIF partnership of 51 countries, 24 donors and eight partner agencies, including the WTO, works closely with governments, development organizations, civil society and academia. The EIF has invested in over 170 projects, with US$ 220 million committed to supporting the poorest countries in the world. Another partnership supported by the WTO is the Standards and Trade Development Facility (STDF), set up to help developing economies meet international standards for food safety, plant and animal health and access global markets. The WTO houses the Secretariat and manages the STDF trust fund, which has provided financing of over US$ 40 million to support projects in low-income economies[41].

The WTO organizes hundreds of technical cooperation missions to developing economies annually. It also holds many trade policy courses each year in Geneva for government officials. Regional seminars are held regularly in all regions of the world, with a special emphasis on African countries. E-learning courses are also available. In 2017, some 18.500 participants benefited from WTO training aimed at improving understanding of WTO agreements and global trade rules.

2.1.1 *Customs duties and WTO rules*

In April 1994 the agreement establishing the WTO was signed, the World Trade Organization with the general function of regulating and liberalizing international trade, the regime of international trade and tariffs. One of the cardinal principles of the Organization is to guarantee the gradual liberalization of trade through negotiation; this principle finds expression with the reduction of trade barriers, meaning both customs duties and equivalent measures[42].

We know that customs duties on merchandise imports are called tariffs. Tariffs give a price advantage to locally-produced goods over similar goods which are imported, and they raise revenues for governments. One result of the Uruguay Round was countries' commitments to cut tariffs and to "bind" their customs duty rates to levels which are difficult to raise. The current negotiations under the Doha Agenda continue efforts in that direction in agriculture and non-agricultural market access.

The WTO agreements, which were the outcome of the 1986-1994 Uruguay Round of trade negotiations, provide numerous opportunities for developing countries to make gains. Further liberalization through the Doha Agenda negotiations aims to improve the opportunities.

Among the gains are export opportunities. They include:

- fundamental reforms in agricultural trade;
- phasing out quotas on developing countries' exports of textiles and clothing;
- reductions in customs duties on industrial products;
- expanding the number of products whose customs duty rates are "bound" under the WTO, making the rates difficult to raise;
- phasing out bilateral agreements to restrict traded quantities of certain goods - these "grey area" measures (the so-called voluntary export restraints) are not really recognized under GATT-WTO.

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[41] www.wto.org

[42] Visone F., *I principi fondamentali della WTO*. Ius in Itinere, 16 giugno 2017.

In addition, liberalization under the WTO boosts global GDP and stimulates world demand for developing countries' exports.

Developing countries have placed on the Doha Agenda a number of problems they face in implementing the present agreements.

And they complain that they still face exceptionally high tariffs on selected products (tariff peaks) in important markets that continue to obstruct their important exports. Examples include tariff peaks on textiles, clothing, and fish and fish products.

In the Uruguay Round, on average, industrial countries made slightly smaller reductions in their tariffs on products which are mainly exported by developing countries (37%), than on imports from all countries (40%). At the same time, the potential for developing countries to trade with each other is also hampered by the fact that the highest tariffs are sometimes in developing countries themselves. But the increased proportion of trade covered by "bindings" (committed ceilings that are difficult to remove) has added security to developing country exports.

A related issue is "tariff escalation", where an importing country protects its processing or manufacturing industry by setting lower duties on imports of raw materials and components, and higher duties on finished products. The situation is improving. Tariff escalation remains after the Uruguay Round, but it is less severe, with a number of developed countries eliminating escalation on selected products. Now, the Doha agenda includes special attention to be paid to tariff peaks and escalation so that they can be substantially reduced.

Below there is a brief explanation of the terms "Tariff peaks" and "Tariff escalation".

Tariff peaks	**Tariff escalation**
Most import tariffs are now quite low, particularly in developed countries. But for a few products that governments consider to be sensitive - they want to protect their domestic producers - tariffs remain high. These are "tariff peaks". Some affect exports from developing countries.	If a country wants to protect its processing or manufacturing industry, it can set low tariffs on imported materials used by the industry (cutting the industry's costs) and set higher tariffs on finished products to protect the goods produced by the industry. This is "tariff escalation". When importing countries escalate their tariffs in this way, they make it more difficult for countries producing raw materials to process and manufacture value - added products for export. Tariff escalation exists in both developed and developing countries.

Tab. 2.1 *Definition of Tariff peaks and Tariff escalation.*

2.2 *International Trade as an economic growth factor for a developing country*

The impacts of foreign trade on economic growth have been studied by many economists from various points of views. In economics literature, for example, the effects of foreign trade have been seen as a major factor for economic growth by Grossmann and Krueger[43].

In particular, the effects of exports on economic growth have been taken much more attention maybe due to the increasing role of export-led growth strategies in many developing countries.

Furthermore, the importance of foreign trade in economic growth is discussed in terms of its impacts on composition of investments and total accumulation of capital through allowing access to imported production factors that incorporating new and improved technologies. Therefore, the accumulation of imported capital would likely affect domestic product as an additional factor of production and as a productivity fomenter due to its technologically advanced feature.[44]

International trade could widen the availability of intermediate goods and capital equipment which would likely make contributions to the productivity of the country's other resources.

In the form of embodied capital goods, trade permits developing countries access to the improved technology of developed countries. Moreover, while trade leads to intensification of capacity utilization which cause more production and consumption, foreign trade would provide a larger market for domestic producers, and would allow them to operate at minimum required scale and to reap benefits of increasing returns to scale[45.]

In general, technology is regarded as a factor that affects the productivity which, in turn, attributes to the economic growth of a country. In that sense, technology transfer through foreign trade would become an important part of the process in economic growth. This is evaluated with the argument that supposes foreign trade to provide opportunity for a developing country to facilitate adaptation process of production technology of advanced countries which leads to a TFP (total factor productivity) growth[46].

2.3 *Trade effects in developing countries*

Trade and financial liberalization are prominent features of globalization. International trade has increased dramatically in recent decades, and flows of goods and services are crucial for achieving sustained growth in developing countries. Alongside trade, growing flows of capital across national borders could

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[43] Grossman G. M., Krueger A. B., *Economic Growth and the Environment*, Quarterly Journal of Economics, 1995.
[44] Afonso O., *The Impact of International Trade on Economic Growth*, FEP Working Papers, 2001.
[45] Shigeyuki H., Razafimahefa I.F., *Trade and Growth Relationship: Some Evidence from Comoros, Madagascar, Mauritius and Seychelles*, Asian and African Area Studies, 2003.
[46] Lucas R., *On the mechanics of economic development*, Marshall Lectures, 1985.

significantly contribute to economic growth and poverty reduction. The international mobility and division of labour is also expected to generate important distributional changes in domestic economies[47].

But trade is only an aspect of the wider development process. It is crucial to combine trade reforms with well-designed public policies, notably social protection.[48]

How do trade flows and trade openness affect poverty and inequality?

Who are the winners and losers at the international and domestic levels? The issue involves establishing the links between trade, growth, poverty and inequality.

The insufficient development of exports and trade capacity in LDCs also reflects in the fact that poor households only receive a small portion of global trade revenues, and in most cases their share has been flat or declining since the global liberalization waves starting in the 1990s [49]. Empirical results show that poor countries face higher barriers on their exports than advanced countries[50]. Thus, the consistency and sustainability of trade policy reforms should be carefully considered, especially when linking the outcomes of trade liberalization to poverty and income distribution.

In addition to the impact on traditional measures of poverty and inequality, trade liberalization is expected to increase the relative wage of low-skilled workers. But liberalization might also worsen income distribution, for example by encouraging the adoption of skill-biased technical change in response to increased foreign competition, or to the increased globalization of production[51].

2.3.1 *International trade and income distribution*

In order to better understand the effects of trade on income distribution, I will compare two of the most important theories as following.

In the Ricardian Model, labour is the only factor of production: it is assumed that labour within each country can move freely without costs from one sector to another one. To the single individual, it does not make a difference whether he is employed in one sector or another one. This implies that a similar model not only predicts that all countries gain from trade, but also within each country every individual is better off as a result of international trade.

According to the Factoring Proportion Theory[52], industries differ in the mix of the production factors they require.

In the simplest case, there are two production factors: capital and labour and two sectors - one “capital intensive” and the other one “labour intensive”. The specialization in one of these two sectors, say the

[47] Goldberg P.K., Pavcnik N., *Distributional Effects of Globalization in Developing Countries*, Journal of Economic Literature, 2007.
[48] Ravallion M., *Growth, Inequality and Poverty: Looking Beyond Averages*. *World Development*, 2001.
[49] International Trade Centre, *Market Access, Transparency, and Fairness in Global Trade: Export Impact for Good*. Geneva, Switzerland, 2010.
[50] Looi Kee H., Nicita A. and Olarreaga M., *Estimating Trade Restrictiveness Indices*, Economic Journal, 2009.
[51] Feenstra R.C., Hanson G.H., *Globalization, Outsourcing, and Wage Inequality*, American Economic Review, 1996
[52] Ethier, W., Svensson L., *Theorems of International Trade with Factor Mobility*, JIE, 1988.

specialization in the production of the capital intensive good, increases the demand for one factor (capital) while lowering demand for the other factor of production (labour).
So, it is not necessarily true that each individual in each country will gain from trade liberalization. Trade generates income re-distribution effects, so that there will be groups who will gain and groups who will lose.
In both models countries trade because they are different: they are either different in terms of their technological level or in terms of factor endowments. Countries specialize in the production of the good for which they have a comparative advantage and export that product.
Who will gain and who will lose?
The Stolper-Samuelson Theorem helps us to identify winners and losers[53]. According to their theory, the free trade raises the earnings of the country's relatively abundant factor and lowers the earnings of the relatively scarce factor.
Let's consider the example of a capital abundant country: what will happen in this country after liberalization? In the capital abundant country, trade induces a reallocation of resources towards the capital intensive goods (therefore more capital will be demanded and this will increase the domestic price of capital). Owners of the capital will therefore gain more because returns to capital increase. What will happen to the demand of labour in this country? This is the relatively scarce factor, where the country hasn't got a comparative advantage. The demand for labour will go down and wages will go down.
To sum up, in the capital abundant country, owners of capital will gain and owners of labour will lose.
In practice, there are costs to move from one sector to another one. Therefore, it is likely that resources employed in the import-competing sector suffer the consequences of a restriction shrinking of that sector. This explains why in industrialized countries at the moment where a labour intensive sector (like the textiles sector) is liberalized both capital owners and workers in that sector oppose free trade. The important result of the theory is that despite income distribution effects, the country overall gains - that is gains outweigh losses.

- *Similar countries trade similar goods: Intra-industry trade*

In both models countries trade because they are different (they are either different in terms of their technological level or in terms of factor endowments). Countries specialize in the production of the good for which they have a comparative advantage and export that product.
However, in reality most of the trade occurs between similar countries. And, between one quarter and one half of world trade is intra-industry trade. That is trade between goods that fall in the same industrial classification. This is particularly true, if one considers trade among developed countries and in particular trade in manufacturing. In that case, intra-industry trade is most of the trade occurring.

[53] Goldsmith J., *The Winners and the Losers, in The Case against the Global Economy*, eds. J. Mander and E. Goldsmith, San Francisco: Sierra Club, 1996.

In order to explain intra-industry trade, I will introduce economies of scale (that I have already mentioned in the previous Chapter I).

In many industries, the larger the scale of production, the more efficient the production. These industries are characterized by increasing returns to scale, or economies of scale. This implies that by doubling the input, like, for example, doubling the number of workers in the production of a certain good, the output is more than doubled.

Consider, for example, a company that produces bicycles. And, suppose that the production of bicycles is characterized by economies of scale. This implies that if 10 workers, say, produce in a day five bicycles, then twenty workers will produce fifteen bicycles in the same time period. This is more than twice as much as 10 workers can produce.

2.3.2 *Gains from economies of scale*

Now I suppose that there are:

- two countries: Country A and Country B, and
- two goods: video cameras and bicycles, for example.

I suppose that both the production of video cameras and the production of bicycles are subject to economies of scale so that, doubling the number of workers employed in each sector, more than doubles the output of the sector. I also suppose that the two countries are identical: that is they have the same technologies and same endowment of resources and, finally, that the labour is the only endowment for each country.

Initially Country A employs 10 workers in the smartphones sector, and produces 10 smartphones, and employs 10 workers in the production of motorbikes and produces 5 motorbikes. Assume that the situation is identical in Country B. So that overall the world will produce 20 smartphones and 10 motorbikes. Suppose now that all production of smartphones gets concentrated in Country A, while that of motorbikes concentrates in Country B. Then, Country A will employ 20 workers in the production of smartphones and Country B will employ 20 workers in the production of motorbikes. Because of economies of scales, the use of twice as many workers as before in the production of smartphones will more than double the output of smartphones produced in Country A. Suppose, for example, that the production of smartphones in Country A increases to 25. Similarly, suppose that in Country B, the production of motorbikes will rise to 15, say. Of course, given that all workers have been moved to the other sector, no motorbikes will be produced in Country A, and no smartphones will be produced in Country B.

What happens to world production?

Overall the world will gain:there will be 25 smartphones available and 15 motorbikes available. Therefore, the potential exists for both countries to be better off with trade than without trade.

The figure below shows the case situation.

	Without Trade			With Trade		
	A	B	World	A	B	World
Smartphones	10	10	20	25	0	25
Motorbikes	5	5	10	0	15	15

Tab. 2.2 *Case study's report*

2.3.3 *Gains from access to greater variety of goods and services*

It is possible to generalize the above case-study and assume that each industry is characterized by a variety of goods.

For instance, motorbikes can be differentiated according to their style, colour, comfortableness of their seats, and so on. Similarly, one can differentiate smartphones in terms of their qualities, their memory power and so on.

So, trade liberalization may reduce the number of varieties produced by each country, but consumers gain access to a greater variety of goods overall.

In these circumstances trade allows each country to specialize in the production of a smaller range of goods than it would produce in the absence of trade. However, overall the consumers in each country will have available a wider choice of goods. This is because trade makes available to the consumer in each country, not only the varieties of the goods produced domestically, but also the varieties of goods produced in the other countries. Gains from trade in this case will arise from the access to a greater variety of goods and services produced worldwide. Countries will trade different varieties of the same good, thus leading to intra-industry trade.

- ✓ No income distribution effects

An important result of the intra-industry trade theory is that intra-industry trade gives raise to very small income distribution effects. To the extent that trade is of an intra-industry type, trade will not create social problems of income distribution.

Since intra-industry trade occurs mainly between similar countries, it follows that from a social point of view, **it is easier to liberalize trade among similar countries than among different countries**. This is because trade between different countries is mainly driven by comparative advantage and generates income distribution effects, thus hurting some groups. These groups may lobby against trade liberalization.

2.3.4 *Gains from faster innovation and technology transfer*

The previous analysis referred to a static gain from trade. But there are also, however, dynamic gains from trade.
Trade enhances the incentive to innovate through:

- ✓ Competitive effect.

First of all, trade enhances the incentive to innovate. Innovation is the basis of economic growth . Therefore, through fostering innovation, trade may have positive effects on growth. Where does the incentive to innovate come from? The incentive to innovate is determined by what in economics is called "competitive threat".
That is, the difference between the profits that a firm would make if it innovates and the profits that it would make if another firm innovates first. Trade increases competition between countries, therefore it increases the losses a firm would face, if it fails to innovate, while a competitive firm does it. This, in turn, increases the competitive threat and the incentive to innovate.

- ✓ Scale effect.

The second source of incentive to innovate is the scale effect. Trade, by enlarging the size of the market, increases the profits of a firm, if it innovates, thus increasing the incentive to innovate and invest in research and development.

2.3.5 *Trade supports technology transfer through various channels*

A higher level of technology and productivity can also be due to the transfer of technology coming from abroad. Trade is one of the channels through which technology can be transferred across countries.

- Reverse engineering.

A simple example is reverse engineering. Trade makes available goods to a country. The mere fact of looking at a good, at its design, at its technology, allows competitors to capture in part the knowledge embodied in the good. To the extent that this knowledge is transferred to the importing country, the technology is transferred.

- Personal contacts.

Technology is also transferred through personal contacts between importers and exporters.

- Enhanced foreign direct investment (FDI).

Technology can potentially be transferred through FDI. Trade also favors the inflow of foreign investments into the domestic country. The presence of a foreign company, technologically more advanced, may not only provide an incentive to existing domestic companies to update their technologies to remain competitive, but may also directly contribute to the transfer of technology through the training provided to local employees, or the quality standards required from local firms that supply inputs to the production process of the foreign firm or distribute its output. All this may trigger growth.

2.4 *Trade and Growth: Takeoff in Asia*

By the 1970s there was widespread disillusionment with import-substituting industrialization as a development strategy[54]. But what could take its place?

A possible answer began to emerge as economists and policy makers took note of some surprising success stories in the developing world - cases of economies that experienced a dramatic acceleration in their growth and began to converge on the incomes of advanced nations.

At first, these success stories involved a group of relatively small East Asian economies: South Korea, Taiwan, Hong Kong, and Singapore. Over time, however, these successes began to spread; today, the list of countries that have experienced startling economic takeoffs includes the world's two most populous nations, China and India[55].

Figure 2.1 illustrates the Asian takeoff by showing the experiences of three countries: South Korea, the biggest of the original group of Asian "tigers", China and India.

In each case, the figure shows per-capita GDP as a percentage of the U.S. level, an indicator that highlights the extent of these nations' economic "catchup." As you can see, South Korea began its economic ascent in the 1960s, China at the end of the 1970s, and India circa 1990.

What caused these economic takeoffs?

[54] Lewis W.A., *The Theory of Economic Development*. Homewood, IL: Irwin, 1955.

[55] Little I.M.D., Scitovsky T., Scott M., *Industry and Trade in Some Developing Countries*. New York: Oxford University Press, 1970.

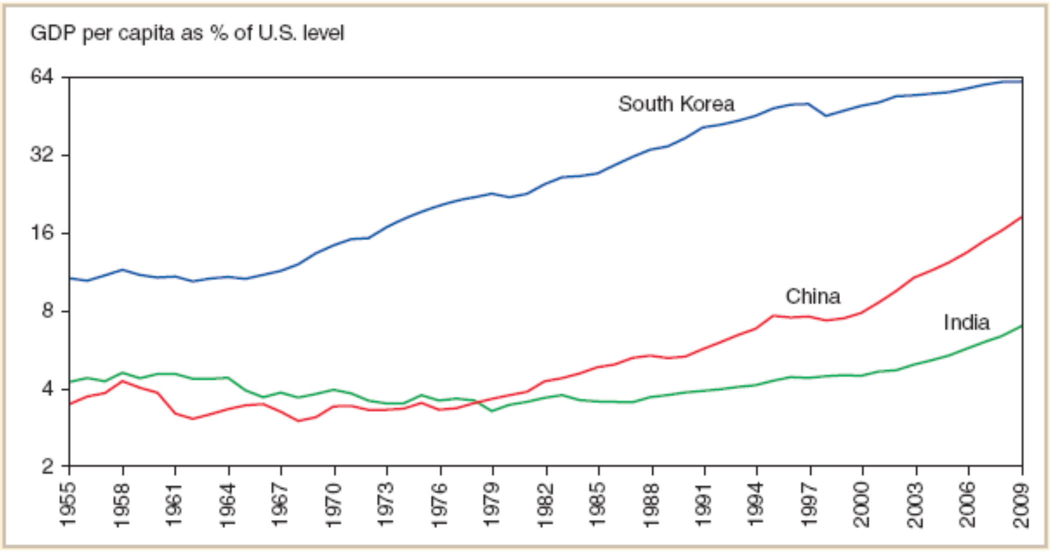

Fig. 2.1 *GDP per capita as a percentage of South Korea, China and India*[56].

Each of the countries experienced a major change in its economic policy around the time of its takeoff. This new policy involved reduced government regulation in a variety of areas, including a move toward freer trade. The most spectacular change was in China, where Deng Xiaoping, who had taken power in 1978, converted a centrally planned economy into a market economy in which the profit motive had relatively free rein[57]. That policy reforms were followed by a large increase in the economy's openness, as measured by the share of exports in GDP (see figure 2.2). So, it seems fair to say that these Asian success stories demonstrated that the proponents of import-substituting industrialization were wrong: it is possible to achieve development through export-oriented growth.

What is less clear is the extent to which trade liberalization explains these success stories. As we have just pointed out, reductions in tariffs and the lifting of other import restrictions were only part of the economic reforms these nations undertook, which makes it difficult to assess the importance of trade liberalization per se. In addition, Latin American nations like Mexico and Brazil, which also sharply liberalized trade and shifted toward exports, did not see comparable economic takeoffs, suggesting at the very least that other factors played a crucial role in the Asian miracle. So the implications of Asia's economic takeoff remain somewhat controversial. One thing is clear, however: The once widely held view that the world economy is rigged against new entrants and that poor countries cannot become rich have been proved spectacularly wrong. Never before in human history have so many people experienced such a rapid rise in their living standards.

[56] https://www.conference-board.org/data/economydatabase/
[57] Naughton B., *The Chinese Economy: Transitions and Growth*. Cambridge: MIT Press, 2007.

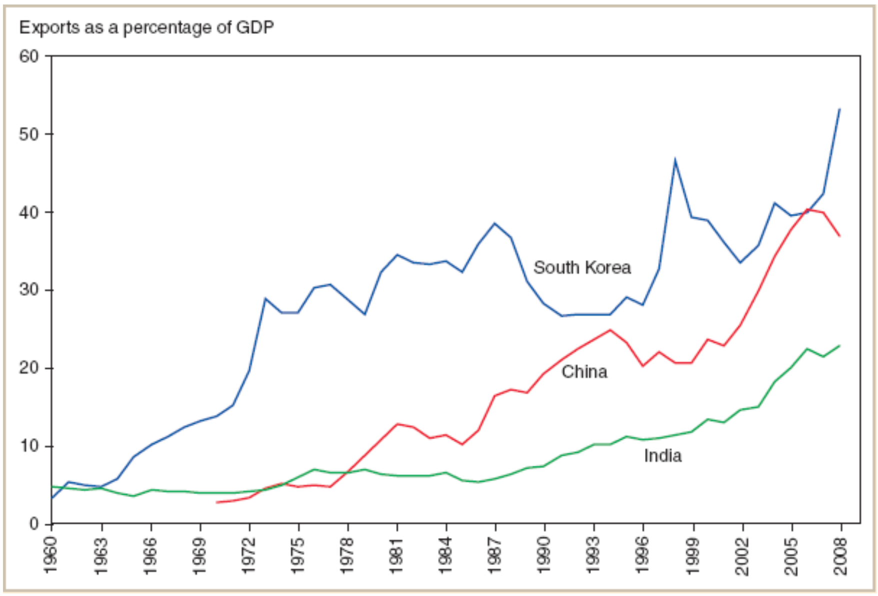

Fig. 2.2 *Asia's surging trade*[58]

The view that economic development must take place via import substitution, and the pessimism about economic development that spread as import-substituting industrialization seemed to fail, have been confounded by the rapid economic growth of a number of Asian economies.

These Asian economies have grown not via import substitution but via exports. They are characterized both by very high ratios of trade to national income and by extremely high growth rates[59].

The reasons for the success of these economies are highly disputed, with much controversy over the role played by trade liberalization.

Now, I will discuss the recent economic history of the Asian countries, such as China, and I will detail the relationship between their rapid economic growth and their participation in International Trade.

2.5 *China Economic Overview*

The Chinese economy experienced astonishing growth in the last few decades that catapulted the country to become the world's second largest economy. In 1978, when China started the program of economic reforms, the country ranked ninth in nominal GDP (Gross Domestic Product) with USD 214 billion; 35 years later it jumped up to second place with a nominal GDP of USD 9.2 trillion. Since the introduction of the economic reforms in 1978, China has become the world's manufacturing hub, where the secondary sector (comprising industry and construction) represented the largest share of GDP.

[58] https://www.conference-board.org/data/economydatabase/

[59] Krugman P., Obstfeld M., Melitz M. J., *International economics, theory and policy*, Global ed., 2014.

2.5.1 *Economic History*

After Mao Zedong's death in 1976, Deng Xiaoping, who was the core of the second generation of Chinese leadership, became China's paramount leader and pushed ahead bold reforms that reshaped the country's economy. At the Third Plenum of the 11th Central Committee of the Communist Party of China, held in December 1978, Deng announced the official launch of the Four Modernizations - agriculture, defense, industry and science and technology - which marked the beginning of the reform and opening-up policies. Economic reforms under Deng's era increased the role of market mechanisms and reduced government control over the economy. The measures included, among others, breaking down the collective farms, opening up China to foreign investment, encouraging business entrepreneurship, establishing Special Economic Zones and introducing market incentives in the state-owned companies. Moreover, China started to participate in the global economy and the country joined the International Monetary Fund (IMF) and the World Bank in 1980.

In early 1990s, Jiang Zemin - the third generation of Chinese leadership - became the new paramount leader of the country and his administration implemented substantial economic reforms. Under his mandate, most of the state-owned companies, except large monopolies, were privatized or liquidated, thus expanding the role of the private sector in the economy at the cost of leaving millions unemployed. During the same period, President Jiang and Premier Zhu Rongji reduced trade barriers; ended state planning; introduced competition, deregulation and new taxes; reformed and bailed out the banking system; and drove the military stratum out of the economy. In addition, Jiang guided China to join the WTO (World Trade Organization) in December 2001, which buttressed the country's trade.

In 2002, Jiang Zemin stepped down as General Secretary of the Communist Party, thereby initialing the transition to the fourth generation of leadership, led by President Hu Jintao and Premier Wen Jiabao. The Hu-Wen administration tried to reduce the income gap between the coastal cities and the countryside, as China's skyrocketing growth mostly benefited just one part of the population. They increased subsidies, scrapped agricultural taxes, slowed privatization of state assets and promoted social welfare. Despite the government's efforts to prevent the country from overheating, by the mid -2000s the economy experienced an unprecedented economic growth mainly due to booming exports, resilient private consumption, soaring manufacturing and massive investment. However, the 2008 global financial crisis forced the Chinese authorities to launch an aggressive stimulus package and adopt a loose monetary policy.

The fifth generation came to power in 2012, when President Xi Jinping and Premier Li Keqiang took the reins of the country. The new Xi-Li administration unveiled an ambitious reform agenda in an attempt to change the country's economic fundamentals and ensure a sustainable growth model. In this regard, authorities expressed their willingness to tolerate lower growth rates as a necessary condition to push forward economic reforms. Xi coined the term "**Chinese Dream**" as his contribution to the guiding ideology of the Communist Party of China. Although vague, the “Chinese dream" emphasizes people’s happiness and the idea of a strong China[60].

2.5.2 *China’s Balance of payments*

China’s external position is extremely solid. The current account has recorded a surplus in every year since 1994. The capital account followed suit and only recorded two deficits in the last 20 years. This situation of surpluses in the both the current and the capital put pressure on the national currency and prompted the Central Bank to sterilize most of the foreign currency that entered the country. As a result, China’s foreign exchange reserves skyrocketed to almost USD 4.0 trillion in 2014. The current account surplus reached its peak in 2007, when it represented 10.1% of GDP. Since then, however, the surplus has since narrowed as the currency strengthened and domestic demand increased.

China’s capital account has bold controls, which implies that the country lacks the freedom to convert local financial assets into foreign financial assets at a market-determined exchange rate and vice versa. The new Xi-Li administration and the People’s Bank of China vowed to accelerate interest rate liberalization and capital account convertibility. In this regard, Chinese authorities have started to implement some measures, such as removing a cap on foreign-currency deposit rates in Shanghai and releasing some controls on the currency.

The capital account benefited from strong inflows of Foreign Direct Investment (FDI). FDI has performed strongly in the last decade, with record inflows of USD 118 billion in 2013, thereby becoming the second largest recipient of foreign investment. Among the countries that invest more in China are Hong Kong, Singapore, Japan, Taiwan, and the United States. In addition, China’s outward investment soared in recent years and, according to some analysts, the country could become a net exporter of capital in the coming years.

2.5.3 *China’s trade structure*

China has experienced uninterrupted trade surpluses since 1993. Total trade multiplied by nearly 100 to USD 4.2 trillion in only three decades and, in 2013, China surpassed the United States as the world’s biggest trading nation. The opening of the country and the government’s massive investment programs have prompted the country to become a major manufacturing hub. This situation fostered trade growth, particularly after China joined the World Trade Organization in 2001. As an economy highly integrated into the global trade system, the country benefited from a steady improvement in its terms of trade since 2000. However, the global economic downturn in 2008-2009 led the country to reduce manufacturing output, thus

[60] https://www.focus-economics.com/countries/china

dragging on China's trading sector. Moreover, the country has engaged in several bilateral and multilateral trade agreements that have opened new markets for its products. In 2003, China signed the Closer Economic Partnership Arrangement with Hong Kong and Macau. A Free Trade Agreement (FTA) between China and the ASEAN nations came into effect on January 2010, which created the world's third largest free trade area in terms of nominal GDP. China also established, among others, FTA with countries such as, Australia, Chile, Costa Rica, Korea, Pakistan, Peru, New Zealand, and Singapore. Moreover, there are other FTAs under negotiation with the Gulf Cooperation Council, Japan, Norway and Sri Lanka.

2.5.4 *Exports from China*

Electronics and machinery make up around 55% of total exports, garments account for 13% and construction material and equipment represent 7%. Sales to Asia represent over 40% of total shipments, while North America and Europe have an export share of 24% and 23%, respectively. Although exports to Africa and South America expanded rapidly, they only account for 8% of total shipments. Due to favorable global trade conditions and China's accession to the World Trade Organization in December 2001, the country has experienced an astonishing growth of 26.9% annually in real goods and services exports during the 2002-2008 period.

2.5.5 *Imports to China*

In order to supply factories and support China's rapid development, the country's imports are mostly dominated by intermediate goods and a wide range of commodities, including oil, iron ore, copper and cereals. China's soaring demand for raw materials pushed global commodity prices up leading up to 2015, thereby boosting the coffers of many developing nations and commodity-exporting economies. However, since the end of the commodities super cycle at the end of 2014, global commodities prices have fallen partially due to a decrease in demand from China. The acceleration that many of those same developing and commodity-exporting economies experienced has dramatically decreased since the end of 2015. Supply of imports into China is mostly dominated by Asian countries, with a combined share of around 30% of total imports. Purchases from Europe and the U.S. account for 12% and 8%, respectively. As a major global buyer of commodities, imports from Africa, Australia, the Middle East and South America have increased strongly in the last decade to represent a combined share of around 50%. In parallel with skyrocketing exports, growth in imports of real goods and services soared in the 2002-2008 period, recording an annual average expansion of 24.4%. Imports experienced a contraction in 2009 due to the global crisis, but recovered quickly in 2010 and 2011. In the 2012-2013 period, imports recorded a modest increase of 7.2%. As the construction boom fades in China, fewer natural resources are demanded. This has pulled down global prices for base metals, energy products, as well as other resources. Imports contracted a sharp 14.3% in 2015 as the Chinese economy adjusted to its new growth dynamics.

2.5.6 *China's economic policy*

Economic growth soared in the last few decades mainly due to the country's increasing integration into the global economy and the government's bold support for economic activity. However, the successful economic model that lifted hundreds of millions out of poverty and fueled the country's astonishing economic and social development has also brought many challenges. Severe economic imbalances, mounting environmental issues, rising economic inequality and an aging population are the key questions that the new administration lead by President Xi Jinping will have to tackle in the near future in order to ensure the country's sustainability.

2.6 *China's role in International trade and relationships with U.S.*

International trade is a key component of economics and is the one that has played an important role in the growth of China. Over the last three decades, the value of Chinese trade has approximately doubled every four years. This rapid growth has transformed the country from a negligible player in world trade to the world's second largest exporter, as well as a substantial importer of raw materials, intermediate inputs, and other goods. This tremendous growth is seen by some observers as posing a threat to China's trading partners.[61] For industrial countries, China presents the opportunity of a low-cost labor force.
Whether the goods are simple toys sold by Mattel, or personal computers sold by Lenovo (the Chinese owner of what used to be IBM's PC division), or sophisticated components for the European Airbus, a large part of Chinese exports involves contracting manufacturing in China for goods that are designed elsewhere. This phenomenon is known as "processing trade," and involves importing inputs into China, which are assembled there and then exported again. This role that China plays in contract manufacturing means that its own success is intricately tied to the fortunes of its trading partners[62]. On the export side, China is a formidable competitor in many markets, overlapping in its export composition with other countries such as India, Malaysia, Mexico and Pakistan (that often attribute declines in their own export demand to competition from China) and on the import side, too, China's impact is felt worldwide. Its demand for raw materials, especially to fuel the investment boom of recent years, creates market pressure and higher prices for building materials.

[61] Samuelson P., *Where Ricardo and Mill rebut and confirm arguments of mainstream economists supporting globalization*, Journal of Economic Perspectives 2002.
[62] Feenstra R.C., Shang J.W., *China's growing role in world trade*, National Bureau of Economic Research, 2010.

The challenges created by China's rapid growth and expanding trade are both domestic and international in scope. There is no doubt that the boom in China's exports during the past decades is large enough to have significant impacts on its domestic employment and production, as well as on the price levels of its trading partners and pressure for exchange rate adjustment.

But when and how did China fully open to international trade, and what are the benefits they have and problems they are coming across after opening to international trade?

China fully opened to international trade when its President Deng Xiaoping announced the 'open door' policy in December 1978, before this China was mainly trading with USSR and its satellites (socialist countries). China had some trade links with the capitalist countries, but it was the first time that they had opened to the capitalist economy on such a large scale. So, the 'open door' policy refers to the set of policies adopted by China to develop and expand the economic relations with the capitalist world economy. 'Open door' policy also consisted of "a set of sub-policies in the spheres of foreign trade, foreign direct investment and foreign borrowing."[63] The term foreign direct investment refers to "investment, which is made to serve the business interests of the investor in a company, which is in a different nation distinct from the investor's country of origin."[64] China announced the 'open door' policy because they had realized that if they want to grow and become a developed country they need western investment and technology and they should also open the door to foreign businesses. The first step China took to attract the foreign investment was authorizing special economic zones in southern China with incentives such as tax concessions, reductions in land use fees and favorable labour prices. By making these reforms China's economy took off and since 1980s it is said to be the fastest growing economy in the world. Continuing with the reformation process, in 2001 China joined World Trade Organization (WTO) with the hope that its membership will help their economic system to flourish more[65]. China had made all these efforts and is still making efforts to enjoy the benefits of international trade.

There are many benefits which are associated to international trade like, by doing business with other regions and countries a business or a country learns a great deal about the product development strategies and technologies, and also there is always an opportunity for them to make more profit, sell more, increase productivity and remove seasonal fluctuations of supply and demand. International trade also leads to more and better choices of goods and services for consumers; increase in competition leads to competitive prices in domestic and international markets which again are good for consumers. Competition will also lead to, better quality products, reduction in unemployment and poverty level and a rise in the GDP (Gross Domestic Product) level. Consequently, this leads to maturity and growth of a country's economy including its businesses.[66]

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[63]Howell J., *China Opens Its Doors*. Hertfordshire. Harvester Wheatsheaf, 1993.
[64] www.economywatch.com
[65] Ibidem.
[66] Essays, U.K., *How International Trade Has Helped The Chinese Economy*, 2018.

China has grown at a rapid pace after opening to international trade making it a manufacturing hub of the world. According to some reports between 1990-2004 China's economy grew at an average rate of 10 percent per annum which was the highest growth rate in the world and substantial part of this growth was international trade as 45 percent of growth came from exports. China also has surpassed Germany recently to become the world's second largest trading nation.[67] Total foreign trade in China in the year 2007 was estimated to be $2.17 trillion which was an enormous increase from 1978 when total international trade estimated was $21 billion.[68] According to one report from World Bank in 2001 China contributed 21 percent to global trade growth. This growth in international trade and business activity has resulted in a drastic reduction of poverty level. China has been credited by World Bank for lowering the percentage level of East Asian population living in poverty from 80 percent to 18 percent within a time span of 20 years.[69] As more foreign investment has come into the country and as the country has rapidly grown in world trade more employment opportunities have been created reducing the unemployment rate in the country.

Moving on with the benefits of trade, by opening to foreign trade China's technological expertise and firms have been open to increased technological and business exposure and this has enabled China to acquire some highly sophisticated technology helping them to built a number of advanced manufacturing plants producing a large range of sophisticated equipment such as satellites and nuclear weapons making China and its domestic firms more competitive at international level.

Another advantage of trade is that it has increased the variety of goods and services available to the Chinese consumers, and at the same time it has also increased the competition level in the local markets. As multinational firms have entered into the Chinese markets, prices have become more competitive again benefiting the consumers as they are able to buy products at lower prices. This increase in competition due to trade has also helped the local Chinese firms to mature, especially the suppliers, as they are now able to support local firms as well as multinational firms operating in their country or other countries for example Toyota and General Motors who are operating in China as well as Japan, but their supplies are mainly coming from the Chinese firms.

The Chinese government have also been earning huge revenues from trade helping them "to increase investment in public welfare and social infrastructure," and as a result increasing the well being of China and its people. Another advantage China has from trade is that it is not dependent on any single country for its imports and exports which enables it to manage the seasonal fluctuations of demand and supply of the products by switching sources of imports and diverting exports as and when required. In 2006, Chinese imports were around $751.9 billion from Japan 14.6 percent, South Korea 11.3 percent, Taiwan 10.9 percent, the United States 7.5 percent, and Germany 4.8 percent. While Chinese exports were around $969.7

[67] Ibidem.
[68] http://tutor2u.net/economics/revision-notes/a2-macro-trade-brics.html
[69]http://prabhakarit.wordpress.com/2008/12/24/understanding-advantages-and-disadvantages-of-international-trade-china/

billion to countries as United States 21 percent, Hong Kong 16 percent, Japan 9.5 percent, South Korea 4.6 percent, and Germany 4.2 percent.[70]

However, despite many benefits trade also leads to problems which are not that clear at the outset of trade. Trade is said to increase employment in a country but at the same time it is blamed for job cuts in other countries. As businesses move their manufacturing units from a developed country to underdeveloped or developing countries, they take advantage of weak labour policies, cheap labour, support of the government, and weak environmental policies in those countries. Businesses are in a position to recruit more and as a result they produce more for less in the host countries, but their movement leads to job losses in the countries they had left or they originate from, usually these are developed countries. International trade leads to job losses in underdeveloped or developing countries as well because multinational firms expose underdeveloped and developing countries to automation (technology) and modernization and to compete with these multinational firms' local businesses start using technology in their operations, requiring a smaller number of people and creating job cuts. Many local and weak firms are also not able to compete with multinational firms in terms of productivity and prices and may lead to closure creating unemployment in the country. However, this also has to be realized that multinational firms will also increase employment opportunities which might be greater than the potential job losses. As the multinational firms take advantage of weaker labour and environmental policies there will be more environmental pollution resulting in environmental and health complications in the host country and in addition to this there will be labour discrimination resulting in weaker social well-being of workers. Firms also have to realize that the intellectual property rights might not be understood, recognized or may be weak in some countries which will lead to problems such as copyright violations, piracy, product copies, and patent violations eroding the brand image (reputation) and competitive advantage of the firms.

One of the major problems existing in China due to trade is labour discrimination. According to a survey 86 percent has said that labour discrimination exists in China's labour market; 51 percent of the respondents have said that it is serious. China's labour market is woefully ineffective and foreign companies are in a good position to take unfair advantage of this. Many multinational firms, for example Reebok, a famous brand known worldwide, have been found guilty, of taking unfair advantage of weak labour policies, and of labour discrimination. Now even local businesses are taking such advantages.[71]

Environmental problems have also grown in China along with the trade. According to SEPA (State Environmental Protection Administration) about 130 foreign companies were found guilty of not complying with the current environmental laws in China. Many multinational companies have been and are blamed for maintaining different environmental standards in their own countries and in China. Forbes has reported that according to Environmental Protection Authorities, since 2004, 90 multinational companies have been found violating the water pollution regulations (General Motors, Unilever, Samsung, Pepsi, Pizza Hut and

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[70] www.factsanddetails.com

[71] www.wisegeek.com/what-is-international-trade.htm

Kentucky Fried Chicken). The Chinese government has also been blamed for polluting the environment. As China has opened to foreign trade more companies and money have moved into China making it a manufacturing hub but with this increase in companies demand for electricity has increased and to fulfil this demand the Chinese government has been using coal to produce electricity. It is said that coal accounts for 70 percent of the electricity produce in China. This large consumption of coal has made China the largest sulphur dioxide polluter almost emitting 26 million tons of the gas in 2005 which was a 27 percent increase from 2000. The release of this gas results in acid rain which damages crops, soil, buildings and create health problems for humans.[72]

Another problem which has arisen in China is the difficulty in protecting the Intellectual Property Rights leading to further problems such as piracy and copyrights violations. One of the reasons behind these problems is that there is not much awareness about, the laws of piracy and copyrights violations, and that in China infringement is a crime. Another reason for these problems is that the number of firms involved in the activities of piracy and copyrights violations have grown so fast, in large numbers, and have become so huge that it has become difficult for the Chinese government to regulate them.

Unemployment is also a major problem of international trade that is being faced by China. By opening to trade business systems and production techniques have started changing and with time the use of technology has increased creating unemployment in manufacturing industries of China. The Conference Board in New York working with China's National Bureau of Statistics reported that in China from 1995 to 2002 manufacturing unemployment fell from 98 million to 83 million.

Hence it can be concluded that there are benefits of international trade to China which have helped China to become a major economic power in the world, and has also helped China in tackling many serious problems like poverty and unemployment, but, there are several issues which put forward that international trade has also contributed to serious problems in China[73].

Certainly, during its climb in the world economy, there were disputes on the respect of the rules imposed by the WTO and international agreements (as is currently happening between China and U.S) in which China were involved both as a complainant (plaintiff) and as a respondent (defendant). These disputes increase the risk of overwhelming and even paralyzing the WTO dispute settlement mechanism (as distinct from the antidumping regulations).

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[72] http://tutor2u.net/economics/revision-notes/a2-macro-economic-growth-costs-benefits.html

[73] http://news.bbc.co.uk/1/shared/spl/hi/asia_pac/02/china_party_congress/china_ruling_party/key_people_events/html/open_door_policy.stm

2.6.1 *Historical background: the difficult relations between U.S. and China*[74]

In this paragraph I will run through the China's history from 1949 to 2017 specially to know the evolution of relationships between China and U.S. and to better understand the recent debate on their business relations.

In 1949 Chinese Communist Party leader Mao Zedong establishes the People's Republic of China in Beijing on October 1 after peasant-backed Communists defeat the Nationalist government of Chiang Kai-shek. Chiang and thousands of his troops flee to Taiwan. The United States - which backed the Nationalists against invading Japanese forces during World War II - supports Chiang's exiled Republic of China government in Taipei, setting the stage for several decades of limited U.S. relations with mainland China.

In 1954 President Dwight Eisenhower lifts the U.S. navy blockade of Taiwan in 1953, leading Chiang Kai-shek to deploy thousands of troops to the Quemoy and Matsu islands in the Taiwan Strait in August 1954. Mainland China's People's Liberation Army responds by shelling the islands. Washington signs a mutual defense treaty with Chiang's Nationalists. In the spring of 1955, the United States threatens a nuclear attack on China. That April, China agrees to negotiate, claiming a limited victory after the Nationalists' withdrawal from Dachen Island. Crises erupt again in 1956 and 1996.

Nine years after the People's Republic of China asserts control over Tibet, a widespread uprising occurs in Lhasa. Thousands die in the ensuing crackdown by PRC forces, and the Dalai Lama flees to India. The United States joins the United Nations in condemning Beijing for human rights abuses in Tibet, while the Central Intelligence Agency helps arm the Tibetan resistance beginning in the late 1950s.

China joins the nuclear club in October 1964 when it conducts its first test of an atomic bomb. The test comes amid U.S. - Sino tensions over the escalating conflict in Vietnam. By the time of the test, China has amassed troops along its border with Vietnam.

Differences over security, ideology, and development models strain Sino-Soviet relations. China's radical industrialization policies, known as the Great Leap Forward, lead the Soviet Union to withdraw advisors in 1960. Disagreements culminate in border skirmishes in March 1969. Moscow replaces Washington as China's biggest threat, and the Sino-Soviet split contributes to Beijing's eventual rapprochement with the United States.

In the first public sign of warming relations between Washington and Beijing, China's ping-pong team invites members of the U.S. team to China on April 6, 1971. Journalists accompanying the U.S. players are among the first Americans allowed to enter China since 1949. In July of 1971, Secretary of State Henry Kissinger makes a secret trip to China. Shortly thereafter, the United Nations recognizes the People's Republic of China, endowing it with the permanent Security Council seat that had been held by Chiang Kai-shek's Republic of China on Taiwan since 1945.

[74] https://www.cfr.org/timeline/us-relations-china

President Richard Nixon spends eight days in China in February 1972, during which he meets Chairman Mao Zedong and signs the Shanghai Communiqué with Premier Zhou Enlai. The communiqué sets the stage for improved U.S.-Sino relations by allowing China and the United States to discuss difficult issues, particularly Taiwan. However, normalization of relations between the two countries makes slow progress for much of the decade.

U.S. President Jimmy Carter grants China full diplomatic recognition, while acknowledging mainland China's One China principle and severing normal ties with Taiwan. Chinese Vice Premier Deng Xiaoping, who leads China through major economic reforms, visits the United States shortly thereafter. However, in April, Congress approves the Taiwan Relations Act, allowing continued commercial and cultural relations between the United States and Taiwan. The act requires Washington to provide Taipei with defensive arms but does not officially violate the U.S.'s One China policy.

The Reagan administration issues the "Six Assurances" to Taiwan, including pledges that it will honor the Taiwan Relations Act, it would not mediate between Taiwan and China, and it had no set date to terminate arms sales to Taiwan. The Reagan administration then signs in August 1982 a "third joint communiqué" with the People's Republic of China to normalize relations. It reaffirms the U.S. commitment to its One China policy. Though Ronald Reagan voices support for stronger ties with Taiwan during his presidential campaign, his administration works to improve Beijing-Washington relations at the height of U.S. concerns over Soviet expansionism. President Reagan visits China in April 1984 and in June, the U.S. government permits Beijing to make purchases of U.S. military equipment.

In the spring of 1989, thousands of students hold demonstrations in Beijing's Tiananmen Square, demanding democratic reforms and an end to corruption. On June 3, the government sends in military troops to clear the square, leaving hundreds of protesters dead. In response, the U.S. government suspends military sales to Beijing and freezes relations.

In September 1993, China releases Wei Jingsheng, a political prisoner since 1979. That year, President Bill Clinton launches a policy of "constructive engagement" with China. However, after Beijing loses its bid to host the 2000 Olympic Games, the Chinese government imprisons Wei again. Four years later, Clinton secures the release of Wei and Tiananmen Square protester Wang Dan. Beijing deports both dissidents to the United States.

The Nationalist Party's Lee Teng-hui wins Taiwan's first free presidential elections by a large margin in March 1996, despite Chinese missile tests meant to sway Taiwanese voters against voting for the pro-independence candidate. The elections come a year after China recalls its ambassador after President Bill Clinton authorizes a visit by Lee, reversing a fifteen-year-old U.S. policy against granting visas to Taiwan's leaders. In 1996, Washington and Beijing agree to exchange officials again.

NATO accidentally bombs the Chinese embassy in Belgrade during its campaign against Serbian forces occupying Kosovo in May 1999, shaking U.S.-Sino relations. The United States and NATO offer apologies for the series of U.S. intelligence mistakes that led to the deadly bombing, but thousands of Chinese demonstrators protest throughout the country, attacking official U.S. property.

In October 2000, U.S. President Bill Clinton signs the "**U.S.-China Relations Act of 2000**" in October, granting Beijing permanent normal trade relations with the United States and paving the way for China to join the World Trade Organization in 2001. Between 1980 and 2004, U.S.- China trade rises from $5 billion to $231 billion.

In 2006, China surpasses Mexico as the United States' second-biggest trade partner, after Canada.

In April 2001, a U.S. reconnaissance plane collides with a Chinese fighter and makes an emergency landing on Chinese territory. Authorities on China's Hainan Island detain the twenty-four-member U.S. crew. After twelve days and a tense standoff, authorities release the crew, and President George W. Bush expresses regret over the death of a Chinese pilot and the landing of the U.S. plane.

In a September 2005 speech, Deputy Secretary of State Robert B. Zoellick initiates a strategic dialogue with China. Recognizing Beijing as an emerging power, he calls on China to serve as a "responsible stakeholder" and use its influence to draw nations such as Sudan, North Korea, and Iran into the international system. That same year, North Korea walks away from Six-Party Talks aimed at curbing Pyongyang's nuclear ambitions. After North Korea conducts its first nuclear test in October 2006, China serves as a mediator to bring Pyongyang back to the negotiating table.

In March 2007, China announces an 18 percent budget increase in defense spending for 2007, totaling more than $45 billion. Increases in military expenditures average 15 percent a year from 1990 to 2005. During a 2007 tour of Asia, U.S. Vice President Dick Cheney says China's military buildup is "not consistent" with the country's stated goal of a "peaceful rise." China says it is increasing spending to provide better training and higher salaries for its soldiers, to "protect national security and territorial integrity."

In September 2008, China surpasses Japan to become the largest holder of U.S. debt - or treasuries - at around $600 billion. The growing interdependence between the U.S. and Chinese economies becomes evident as a financial crisis threatens the global economy, fueling concerns over U.S.-China economic imbalances.

China surpasses Japan as the world's second-largest economy after it is valued at $1.33 trillion for the second quarter of 2010, slightly above Japan's $1.28 trillion for that year.

China is on track to overtake the United States as the world's number one economy by 2027, according to Goldman Sachs chief economist Jim O'Neill.

At the start of 2011, China reports a total GDP of $5.88 trillion for 2010, compared to Japan's $5.47 trillion.

In an essay for Foreign Policy, U.S. Secretary of State Hillary Clinton outlines a U.S. "pivot" to Asia. Clinton's call for "increased investment - diplomatic, economic, strategic, and otherwise - in the Asia-Pacific region" is seen as a move to counter China's growing clout. That month, at the Asia-Pacific Economic Cooperation summit, U.S. President Barack Obama announces the United States and eight other nations have reached an agreement on the Trans-Pacific Partnership - a multinational free trade agreement. Obama later announces plans to deploy 2,500 marines in Australia, prompting criticism from Beijing.

The U.S. trade deficit with China rises from $273.1 billion in 2010 to an all-time high of $295.5 billion in 2011. The increase accounts for three-quarters of the growth in the U.S. trade deficit for 2011. In March, the United States, the EU, and Japan file a "request for consultations" with China at the World Trade Organization over its restrictions on exporting rare earth metals. The United States and its allies contend China's quota violates international trade norms, forcing multinational firms that use the metals to relocate to China. China calls the move "rash and unfair," while vowing to defend its rights in trade disputes.

The 18th National Party Congress concludes with the most significant leadership turnover in decades as about 70 percent of the members of the country's major leadership bodies - the Politburo Standing Committee, the Central Military Commission, and the State Council - are replaced. Li Keqiang assumes the role of premier, while Xi Jinping replaces Hu Jintao as president, Communist Party general secretary, and chairman of the Central Military Commission. Xi delivers a series of speeches on the "rejuvenation" of China.

In June 2013 U.S. President Barack Obama hosts Chinese President Xi Jinping for a "shirt-sleeves summit" at the Sunnylands Estate in California in a bid to build a personal rapport with his counterpart and ease tense U.S. - China relations. The presidents pledge to cooperate more effectively on pressing bilateral, regional, and global issues, including climate change and North Korea. Obama and Xi also vow to establish a "new model" of relations, a nod to Xi's concept of establishing a "new type of great power relations" for the United States and China.

A U.S. court indicts five Chinese hackers, allegedly with ties to China's People's Liberation Army, on charges of stealing trade technology from U.S. companies. In response, Beijing suspends its cooperation in the U.S. - China cybersecurity working group. In June 2015, U.S. authorities signal that there is evidence that Chinese hackers are behind the major online breach of the Office of Personnel Management and the theft of data from twenty-two million current and formal federal employees.

On the sidelines of the 2014 Asia-Pacific Economic Cooperation summit, U.S. President Barack Obama and Chinese President Xi Jinping issue a joint statement on climate change, pledging to reduce carbon emissions. Obama sets a more ambitious target for U.S. emissions cutbacks, and Xi makes China's first promise to curb carbon emissions' growth by 2030. These commitments by the world's top polluters stirred hopes among some experts that they would boost momentum for global negotiations ahead of the 2015 UN-led Climate Change Conference in Paris.

In February 2017 U.S. President Donald J. Trump says he will honor the One China policy in a call with Chinese President Xi Jinping. After winning the presidential election, Trump breaks with established practice by speaking on the telephone with Taiwanese President Tsai Ing-wen and questioning the U.S. commitment to its One China policy. Washington's policy for four decades has recognized that there is but one China. Under this policy, the United States has maintained formal ties with the People's Republic of

China but also maintains unofficial ties with Taiwan, including the provision of defense aid. Secretary of State Rex Tillerson, visiting Beijing in March, describes the U.S.- China relationship as one “built on non-confrontation, no conflict, mutual respect, and always searching for win-win solutions.”

In April of the same year, President Donald J. Trump welcomes China’s Xi Jinping for a two-day summit at the Mar-a-Lago estate in Florida, where bilateral trade and North Korea top the agenda. Afterward, Trump touts “tremendous progress” in the U.S.-China relationship and Xi cites a deepened understanding and greater trust building.

In mid-May, U.S. Commerce Secretary Wilbur Ross unveils a ten-part agreement between Beijing and Washington to expand trade of products and services like beef, poultry, and electronic payments. Ross describes the bilateral relationship as “hitting a new high,” though the countries do not address more contentious trade issues including aluminum, car parts, and steel.

In March 2018 the Trump administration announces sweeping tariffs on Chinese imports, worth at least $50 billion, in response to what the White House alleges is Chinese theft of U.S. technology and intellectual property. Coming on the heels of tariffs on steel and aluminum imports the measures target goods including clothing, shoes, and electronics and restrict some Chinese investment in the United States. China imposes retaliatory measures in early April on a range of U.S. products, stoking concerns of a trade war between the world’s largest economies. The move marks a hardening of President Trump’s approach to China after high-profile summits with President Xi in April and November 2017.

The Trump administration imposes fresh tariffs totaling $34 billion worth of Chinese goods. More than eight hundred Chinese products in the industrial and transport sectors, as well as goods such as televisions and medical devices, will face a 25 percent import tax. China retaliates with its own tariffs on more than five hundred U.S. products. The reprisal, also valued around $34 billion, targets commodities such as beef, dairy, seafood, and soybeans. President Trump and members of his administration believe that China is “ripping off” the United States, taking advantage of free trade rules to the detriment of U.S. firms operating in China. Beijing criticizes the Trump administration’s moves as “trade bullying” and cautions that tariffs could trigger global market unrest.

CHAPTER III
THE U.S. – CHINA TRADE WAR AND GLOBAL ECONOMIC DOMINANCE

3.1. Governments influence international trade flows

In a world without trade barriers[75], trade patterns are determined by the relative productivity of different factors of production in different countries. Countries will specialize in products that they can make most efficiently, while importing products that they can produce less efficiently.

Although many nations are nominally committed to free trade, they tend to intervene in international trade to protect the interests of politically important groups or promote the interests of key domestic producers.

Which are the political and economic reasons that governments have for intervening in international trade? When governments intervene, they often do so by restricting imports of goods and services into their nation, while adopting policies that promote domestic production and exports[76]. Normally, their motives are to protect domestic producers. In recent years, social issues have intruded into the decision-making calculus. In the United States, for example, a movement is growing to ban imports of goods from countries that do not abide by the same labor, health, and environmental regulations as the United States.

And which are trade policy's instruments that governments use to intervene in international trade?

There are: tariffs, subsidies, import quotas, voluntary export restraints, local content requirements, administrative policies, and antidumping duties.

Tariffs are the oldest and simplest instrument of trade policy.

A fall in tariff barriers in recent decades has been accompanied by a rise in nontariff barriers, such as subsidies, quotas, voluntary export restraints, and antidumping duties.

In addition to the formal instruments of trade policy, governments of all types sometimes use informal or administrative policies to restrict imports and boost exports.

Administrative trade policies are bureaucratic rules designed to make it difficult for imports to enter a country.

As with all instruments of trade policy, administrative instruments benefit producers and hurt consumers, who are denied access to possibly superior foreign products.

In the context of international trade, dumping is variously defined as selling goods in a foreign market at below their costs of production or as selling goods in a foreign market at below their "fair" market value. There is a difference between these two definitions; the fair market value of a good is normally judged to be greater than the costs of producing that good because the former includes a "fair" profit margin.

[75] **free trade** refers to a situation in which a government does not attempt to restrict what its citizens can buy from or sell to another country. According to the theories of Smith, Ricardo, and Heckscher-Ohlin, the consequences of free trade include both static economic gains (because free trade supports a higher level of domestic consumption and more efficient utilization of resources) and dynamic economic gains (because free trade stimulates economic growth and the creation of wealth).

[76] Hill, C.W. *Global Business Today, 8th Edition*. McGraw-Hill Learning Solutions, 09/2013.

Antidumping policies are designed to punish foreign firms that engage in dumping. The ultimate objective is to protect domestic producers from unfair foreign competition. Although antidumping policies vary somewhat from country to country, the majority are similar to those used in the United States. If a domestic producer believes that a foreign firm is dumping production in the U.S. market, it can file a petition with two government agencies, the Commerce Department and the International Trade Commission.
The government agencies then investigate the complaint. If a complaint has merit, the Commerce Department may impose an antidumping duty on the offending foreign imports (antidumping duties are often called countervailing duties). These duties, which represent a special tariff, can be fairly substantial and stay in place for up to five years.

3.1.1. Why governments sometimes intervene in international trade?

Arguments for government intervention take two paths: political and economic[77].
Political arguments for intervention are concerned with protecting the interests of certain groups within a nation (normally producers), often at the expense of other groups (normally consumers), or with achieving some political objective that lies outside the sphere of economic relationships, such as protecting the environment or human rights. Economic arguments for intervention are typically concerned with boosting the overall wealth of a nation (to the benefit of all, both producers and consumers).

- ***Political arguments for intervention***

Political arguments for government intervention cover a range of issues, including preserving jobs, protecting industries deemed important for national security, retaliating against unfair foreign competition, protecting consumers from "dangerous" products, furthering the goals of foreign policy, and advancing the human rights of individuals in exporting countries.

- ***Protecting Jobs and Industries***

Perhaps the most common political argument for government intervention is that it is necessary for protecting jobs and industries from unfair foreign competition. The tariffs placed on imports of foreign steel by President George W. Bush in 2002 were designed to do this (many steel producers were located in states that Bush needed to win reelection in 2004). But he imposition of steel tariffs in 2002 raised steel prices for American consumers, such as automobile companies, making them less competitive in the global marketplace.

[77] Wilkinson R., *The WTO: Crisis and the Governance of Global Trade*, Routledge 2006.

- ***National Security***

Countries sometimes argue that it is necessary to protect certain industries because they are important for national security. Defense-related industries often get this kind of attention (e.g., aerospace, advanced electronics, semiconductors, etc.).

- ***Retaliation***

Some argue that governments should use the threat to intervene in trade policy as a bargaining tool to help open foreign markets and force trading partners to "play by the rules of the game." The U.S. government has used the threat of punitive trade sanctions to try to get the Chinese government to enforce its intellectual property laws. Lax enforcement of these laws had given rise to massive copyright infringements in China that had been costing U.S. companies such as Microsoft hundreds of millions of dollars per year in lost sales revenues. After the United States threatened to impose 100 percent tariffs on a range of Chinese imports, and after harsh words between officials from the two countries, the Chinese agreed to tighter enforcement of intellectual property regulations. If it works, such a politically motivated rationale for government intervention may liberalize trade and bring with it resulting economic gains. It is a risky strategy, however. A country that is being pressured may not back down and instead may respond to the imposition of punitive tariffs by raising trade barriers of its own. This is exactly what the Chinese government threatened to do when pressured by the United States, although it ultimately did back down. If a government does not back down, however, the results could be higher trade barriers all around and an economic loss to all involved.[78]

- ***Protecting Consumers***

Many governments have long had regulations to protect consumers from unsafe products. The indirect effect of such regulations often is to limit or ban the importation of such products.
Furthering Foreign Policy Objectives
Governments sometimes use trade policy to support their foreign policy objectives.12 A government may grant preferential trade terms to a country with which it wants to build strong relations. Trade policy has also been used several times to pressure or punish "rogue states" that do not abide by international law or norms.

- ***Protecting Human Rights***

Protecting and promoting human rights in other countries is an important element of foreign policy for many democracies. Governments sometimes use trade policy to try to improve the human rights policies of trading partners.

[78] Helpman, Elhanan, Krugman P., *Market Structure and Foreign Trade.* Cambridge, MA:MIT Press. 1987.

3.1.2. Strategic Trade Policy

With the development of the new trade theory and strategic trade policy, the economic arguments for government intervention have undergone a renaissance in recent years.[79] Until the early 1980s, most economists saw little benefit in government intervention and strongly advocated a free trade policy. This position has changed at the margins with the development of strategic trade policy, although there are still strong economic arguments for sticking to a free trade stance.

The new trade theory argues that in industries in which the existence of substantial economies of scale implies that the world market will profitably support only a few firms, countries may predominate in the export of certain products simply because they have firms that were able to capture first-mover advantages.[80]

The strategic trade policy argument has two components. First, it is argued that by appropriate actions, a government can help raise national income if it can somehow ensure that the firm or firms that gain first-mover advantages in an industry are domestic rather than foreign enterprises. Thus, according to the strategic trade policy argument, a government should use subsidies to support promising firms that are active in newly emerging industries.

The second component of the strategic trade policy argument is that it might pay a government to intervene in an industry by helping domestic firms overcome the barriers to entry created by foreign firms that have already reaped first-mover advantages

If these arguments are correct, they support a rationale for government intervention in international trade. Governments should target technologies that may be important in the future and use subsidies to support development work aimed at commercializing those technologies. Furthermore, government should provide export subsidies until the domestic firms have established first-mover advantages in the world market. Government support may also be justified if it can help domestic firms overcome the first-mover advantages enjoyed by foreign competitors and emerge as viable competitors in the world market. In this case, a combination of home-market protection and export-promoting subsidies may be needed.

3.1.3. Retaliation and trade war

P. Krugman argues that a strategic trade policy aimed at establishing domestic firms in a dominant position in a global industry is a beggar-thy-neighbor policy that boosts national income at the expense of other countries. A country that attempts to use such policies will probably provoke retaliation. In many cases, the resulting trade war between two or more interventionist governments will leave all countries involved worse off than if a hands-off approach had been adopted in the first place[81].

[79] Rafael A., Fischer A., *The Effect of Trade with Low-Income Countries on US Industry*,2008.Unpublished.
[80] Deardorff A.V., Staiger R.W., *An Interpretation of the Factor Content of Trade*, Journal of International Economics,1988.
[81] Krugman P., Obstfeld M., Melitz M. J., *International economics, theory and policy*, Global ed., 2014.

The problem, however, is how to respond when one's competitors are already being supported by government subsidies.
According to Krugman, the answer is probably not to engage in retaliatory action but to help establish rules of the game that minimize the use of trade-distorting subsidies. This is what the World Trade Organization seeks to do.[82]

3.1.4. Protecting Intellectual Property

Another issue that has become increasingly important to the WTO has been protecting intellectual property. The 1995 Uruguay agreement that established the WTO also contained an agreement to protect intellectual property (the Trade-Related Aspects of Intellectual Property Rights, or TRIPS, agreement).[83] The TRIPS regulations oblige WTO members to grant and enforce patents lasting at least 20 years and copyrights lasting 50 years. Rich countries had to comply with the rules within a year. Poor countries, in which such protection was generally much weaker, had 5 years' grace, and the very poorest had 10 years. The basis for this agreement was a strong belief among signatory nations that the protection of intellectual property through patents, trademarks, and copyrights must be an essential element of the international trading system. Inadequate protections for intellectual property reduce the incentive for innovation. Because innovation is a central engine of economic growth and rising living standards, the argument has been that a multilateral agreement is needed to protect intellectual property.
Without such an agreement it is feared that producers in a country - China - might market imitations of patented innovations pioneered in a different country - the United States. This can affect international trade in two ways. First, it reduces the export opportunities in China for the original innovator in the United States. Second, to the extent that the Chinese producer is able to export its pirated imitation to additional countries, it also reduces the export opportunities in those countries for the U.S. inventor. Also, one can argue that because the size of the total world market for the innovator is reduced, its incentive to pursue risky and expensive innovations is also reduced. The net effect would be less innovation in the world economy and less economic growth.
Intellectual property rights violation is also an endemic problem in several other industries, most notably computer software and music. The WTO believes that reducing piracy rates in areas such as drugs, software, and music recordings would have a significant impact on the volume of world trade and increase the incentive for producers to invest in the creation of intellectual property. A world without piracy would have more new drugs, computer software, and music recordings produced every year. In turn, this would boost economic and social welfare, and global economic growth rates. It is thus in the interests of WTO members

[82] Helpman, Elhanan, Krugman P., *Market Structure and Foreign Trade.* Cambridge, MA:MIT Press. 1987.
[83] Feenstra R., Hanson H. G., *Ownership and Control in Outsourcing to China: Estimating the Property-Rights Theory of the Firm*. Quarterly Journal of Economics, 2005.

to make sure that intellectual property rights are respected and enforced. While the 1995 Uruguay agreement that created the WTO did make headway with the TRIPS agreement, some believe these requirements do not go far enough and further commitments are necessary.

- **closing case: U.S. Tariffs on Tire Imports from China[84]**

In September 2009, President Obama placed a tariff on imports of tires from China. The tariff was a response to a rising tide of imports from China and intense lobbying from the United Steelworkers union, which represents 15,000 workers at 13 tire plants in the United State[85]s. Tires imported from China are usually low-end models that sell for half the price of American-made, name-brand tires. In 2008, the United States imported 46 million tires from China, three times as many as it did in 2004. China's share of the American market leaped from 5 percent to almost 17 percent over the same period, while U.S. employment in the industry fell by more than 5,000 and domestic production slumped from 218 million tires to 160 million tires[86].

The United Steelworkers petitioned the International Trade Commission, which is a unit of the U.S. Department of Commerce, for protection. After reviewing the case, the commission concluded that the surge in Chinese tire imports was causing significant “market disruption” and recommended imposing a three-year tariff on Chinese imports of tires. The Obama administration agreed and placed a 35 percent tariff for one year on tire imports from China, followed by a 30 percent tariff in the second year and a 25 percent tariff in the final year. These tariffs were placed on top of an existing 4 percent import tariff.

The Chinese quickly objected, calling the tariffs “a serious case of protectionism” and arguing that the United States was violating World Trade Organization (WTO) rules, of which both countries were members. For its part, the United States argued that the tariffs were allowed under the terms of a special safeguard provision that was part of the U.S. agreement to support China's entry into the WTO in 2001. Under that provision, U.S. companies or workers harmed by imports from China can ask the government for protection simply by demonstrating that American producers have suffered a “market disruption” or have experienced a surge in imports from China[87].

The WTO's dispute resolution panel quickly took on the case. In December 2010, the panel issued its ruling, finding that the United States “did not fail to comply with its obligations” under world trade agreements and allowing the tariffs to remain. China immediately appealed the ruling. Chinese officials stated the tariff has hurt the interests of both China and the United States.[88] They argued that the tariffs cost jobs in the U.S. sales sector, causing some small and medium-size wholesalers and dealers to go out of business. Moreover,

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[84] Chan S., *World Trade Organization Upholds American Tariffs on Imports of Tires from China*, The New York Times, December 14, 2010.
[85] Miller S., *EU Trade Sanctions Have Dual Edge*, The Wall Street Journal, February 26, 2004.
[86] Bussey J., *Get Tough Policy on Chinese Tires Falls Flat*,The Wall Street Journal, January 20, 2012.
[87] *WTO Rules US Tariff on Chinese Tire Imports*, China Daily, December 14, 2010.
[88] Ibidem.

they argued that the tariff has burdened low-income consumers in the United States, with the average price of tires increasing 10 to 20 percent since the tariffs were imposed.

For its part, the United Steelworkers argued that the tariff had been a big success. For the first six months after the tariffs were imposed, U.S. production increased more than 15 percent, and the union claimed that U.S. producers were making plans to add additional capacity. During the same period, tire imports from China fell by 34 percent. However, the union may have been too quick to claim victory. Over the next 18 months, tire imports surged from Thailand, Indonesia, and Mexico, suggesting that low-cost producers in other countries were taking advantage of the tariffs on Chinese tires to increase their exports to the United States. Furthermore, U.S. producers did not add capacity. Indeed, several U.S. tire makers have factories in China and elsewhere and had, for some time, been exporting from them. To complicate matters, China responded to the tariffs on tires by placing tariffs on the export of some U.S. products, such as broiler chickens, to China[89].

3.2. U.S. trade policy in the Trump administration

The 2016 presidential election, in which Republican candidate Donald J. Trump was elected president on an explicitly protectionist platform, marks a potential turning point where the Unites States could reserve course on 80 years of movement toward freer trade and enhanced multilateral cooperation[90].

Asia figures prominently in these developments.

Over the past two generations, the U.S. economy has experienced a tremendous increase in globalization. That expansion of trade has largely been driven by falling transportation and communications costs and rising incomes, but supportive trade policies has also played a role. Asia has been an important part of this process, accounting for more than one-third of U.S. trade for the last 30 years.

Expansion of international trade - in particular the so-called “China shock” of the 1990s and the granting of permanent normal trade relations following China’s accession to the World Trade Organization (WTO) in 2001, together with a period of Chinese currency undervaluation - contributed to a surge in manufactured imports with adverse consequences for US manufacturing employment.[91] But that period of rapid increase in import penetration has passed and the productivity change accounted for 88 percent of the job losses.

Instead, the Trump administration is responding with protectionist trade policy. Since the 1930s, when a global drive to raise trade barriers deepened the Great Depression, U.S. specialists and the public at large have shared the belief that a liberal U.S.- led rules (based international trade regime is in the United States’ national interest). Trade policy has thus seldom, if ever, risen to a top-tier issue in electoral politics.

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[89] Freedman J. M., *WTO Rules US Tariffs on Chinese Tire Imports Legal*, Bloomberg Businessweek, December 27, 2010.

[90] www.whitehouse.gov/inaugural-address.

[91] Autor D.H., Dorn D., Hanson G.H., *The China Syndrome: Local Labor Market Effects of Import Competition in the United States*, American Economic Review, 2013.

During the campaign, President Donald Trump has emphasized three recurring themes regarding trade policy:

- the importance of trade balances, including bilateral trade balances (in this view, a major challenge facing the U.S. in its $500 billion merchandise trade deficit, around half of which is whit China, with Japan and Korea also contributing);
- currency manipulation to gain unfair advantage in trade, and
- “disastrous” trade agreements.

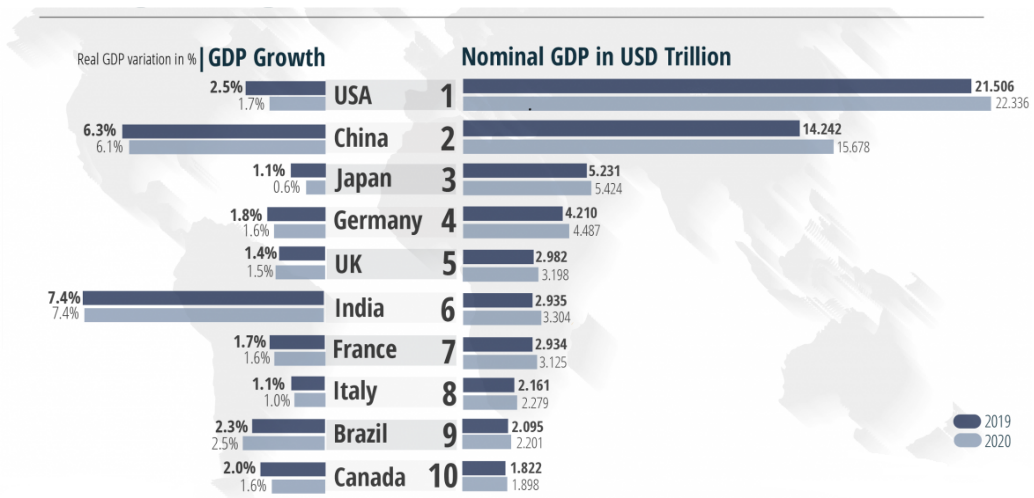
Trump withdrew the United States from the Trans-Pacific Partnership, is increasing contingent or process protection, demanding the renegotiation under duress of the North American Free Trade Agreement (NAFTA) and the Korea-United States Free Trade Agreement (KORUS FTA)[92].

3.2.1. The United States’ role in the world economy[93]

To the top national economies globally the key players are usually the same , although the order may shift around slightly from one year to the next. At the top of the list is the United States of America has been at the head of the table going all the way back to 1871. However, as has been the case for a good few years now, China is gaining on the U.S., with some even claiming that China has already overtaken the U.S. as the world’s Number 1 economy. [94]

Nonetheless, going by nominal GDP measured in U.S. dollars alone, the U.S. maintains its spot followed by China and Japan.

But change is afoot.



[92] Noland M., *US international economic policy in the Trump Administration*, East-Western center working paper, 2018.
[93] Dees S., Saint Guilhem A., *The role of the United States in the global economy and its evolution over time*, 2009.
[94] https://www.focus-economics.com/blog/the-largest-economies-in-the-world.

Fig. 3.1 *The world's biggest economies for 2019-2020*

3.2.2. Historical and contemporary overview on U.S.' economy[95]

The end of World War II marked the beginning of a golden era for the U.S economy. This period was marked by a surge in economic activity and productivity, a growing and more prosperous middle class, and the rise of the baby boomer generation. From the late 1940s to the early 1970s, U.S. GDP grew at an average annual rate of nearly 4%. By the 1970s, the structural change in the economy away from industry and manufacturing to services was in full force. However, after several decades of unprecedented growth, the economy began to show signs of slowing and a series of events, including the collapse of the Bretton Woods system, the 1973 oil crisis and increased global competition, precipitated important economic changes. The 1970s were marked by a period of stagnating growth and inflation referred to as "stagflation". The 1980s gave rise to Reaganomics, a series of economic policies promoted by President Ronald Reagan. The main objectives were reduced government spending and regulation, as well as lower taxes and a tighter money supply. Regan was highly successful in overhauling the tax code and pushing ahead with deregulation in several major sectors of the economy; and while growth and productivity increased, the government's debt multiplied significantly. In a broader sense, Reaganomics marked a turn toward free-market supply-side economics and away from the Keynsian-inspired economics that had been favored since the Great Depression. Increasing global integration and the rise of new technology, including the adoption of productivity-enhancing IT in the workplace and the surge of high-tech companies, helped fuel an economic boom in the 1990s. The period between 1993 and 2001 marked the longest sustained expansion in U.S economic history, and powered a steep rise in employment, income and consumer demand. Moreover, the strong growth and low unemployment during this time were particularly remarkable because the government budget was reigned in simultaneously and actually achieved a surplus for four years between 1998 and 2001. The fiscal improvement was made possible in part by tax increases introduced by President Bill Clinton, but also thanks to the booming economy and surging stock market. The stock market was driven up by the rise of internet-based companies in what is known as the "dot-com bubble", which generated vast sums of unanticipated revenue for the government on capital gains taxes and rising salaries. However, the overvaluation of dot-com stocks eventually became apparent and the bubble burst in 2000.

The first years of the 2000s saw a sharp drop in economy activity following the dot-com burst. The terrorist attacks on September 11, 2001, and several corporate scandals put a further damper on economic activity and business confidence. The Federal Reserve (the Fed), under Alan Greenspan, stepped in to counteract the struggling economy by introducing low interest rates. This move would later be considered a major factor in

[95] Lapsansky-Werner, Emma J., Levy P.B.; Randy R.; Taylor A., *United States History Reconstruction to the present* Indiana Prentice Hall-Pearson, 2008.

causing the massive housing market bubble that burst and precipitated the Great Recession that began in 2008.

For more than a century, the United States has been the world's biggest economy, accounting for over 24% of the world's gross domestic product (GDP) in 2016[96].

Despite facing challenges at the domestic level along with a rapidly transforming global landscape, the U.S. economy is still the largest in the world with a nominal GDP forecast to exceed USD 21 trillion in 2019. The U.S. economy represents about 20% of total global output and is still larger than that of China. The U.S. economy features a highly-developed and technologically-advanced services sector, which accounts for about 80% of its output. The U.S. economy is dominated by services-oriented companies in areas such as technology, financial services, healthcare and retail. Large U.S. corporations also play a major role on the global stage, with more than a fifth of companies on the Fortune Global 500 coming from the United States.

The U.S. economy is projected to grow 2.5% in 2019 and 1.7% in 2020.

Even though the services sector is the main engine of the economy, the U.S. also has an important manufacturing base, which represents roughly 15% of output. The U.S. is the second largest manufacturer in the world and a leader in higher-value industries such as automobiles, aerospace, machinery, telecommunications and chemicals. Meanwhile, agriculture represents less than 2% of output. However, large amounts of arable land, advanced farming technology and generous government subsidies make the U.S. a net exporter of food and the largest agricultural exporting country in the world. The U.S. economy maintains its powerhouse status through a combination of characteristics. The country has access to abundant natural resources and a sophisticated physical infrastructure. It also has a large, well-educated and productive workforce. Moreover, the physical and human capital is fully leveraged in a free-market and business-oriented environment. The government and the people of the United States both contribute to this unique economic environment. The government provides political stability, a functional legal system, and a regulatory structure that allow the economy to flourish. The general population, including a diversity of immigrants, brings a solid work ethic, as well as a sense of entrepreneurship and risk taking to the mix. Economic growth in the United States is constantly being driven forward by ongoing innovation, research and development as well as capital investment.

The U.S. economy is currently emerging from a period of considerable turmoil.[97] A mix of factors, including low interest rates, widespread mortgage lending, excessive risk taking in the financial sector, high consumer indebtedness and lax government regulation, led to a major recession that began in 2008. The housing market and several major banks collapsed, and the U.S. economy proceeded to contract until the third quarter of 2009 in what was the deepest and longest downturn since the Great Depression. The U.S. government intervened by using USD 700 billion to purchase troubled mortgage-related assets and propping

[96] https://data.worldbank.org/indicator/NY.GDP.MKTP.CD

[97] Harrigan J., *International Trade and American Wages in General Equilibrium, 1967–1995.* In *The Impact of International Trade*, edited by Robert C. Feenstra, Chicago: University of Chicago Press. 2000.

up large floundering corporations in order to stabilize the financial system. It also introduced a stimulus package worth USD 831 billion to be spent across the following 10 years to boost the economy.
The economy has been recovering slowly yet unevenly since the depths of the recession in 2009. The economy has received further support through expansionary monetary policies. This includes not only holding interest rates at the lower bound, but also the unconventional practice of the government buying large amounts of financial assets to increase the money supply and hold down long-term interest rates - a practice known as “quantitative easing”. While the labor market has recovered significantly and employment has returned to pre-crisis levels, there is still widespread debate regarding the health of the U.S. economy. In addition, even though the worst effects of the recession are now fading, the economy still faces a variety of significant challenges going forward. Deteriorating infrastructure, wage stagnation, rising income inequality, elevated pension and medical costs, as well as large current account and government budget deficits, are all issues facing the US economy.[98]
About the United States’ Balance of payments, over the past several decades, the U.S. current account balance has been heavily influenced by international trade flows, with the ongoing trade deficit resulting in a consistent current account deficit.[99] Earnings on U.S. assets and investments owned abroad have a very small part in the current account, and a surplus in this category is not nearly enough to offset the large trade deficit. Overall, the current account deficit implies that **the value of the goods and services being purchased from abroad by the United States exceeds the value of the goods and services being sold to foreigners**.[100] The U.S. current account deficit widened progressively since the 1990s and reached an all-time record and global high of 5.8% of GDP in 2006. The deficit has since narrowed due in part to increased domestic oil production.
The current account deficit is mirrored by a capital account surplus. The net amount of capital inflows received in the United States from abroad makes it possible to finance the current account deficit. Foreigners continue to invest in U.S. assets and companies, and so the net international investment position of the United States has grown over time. The United States is by far the top recipient of foreign direct investment (FDI). About 80% of FDI in the United States comes from a set of just nine industrialized countries. The UK, Japan and the Netherlands are the top sources of FDI in the U.S. The U.S. manufacturing sector draws about 40% of FDI.
But what is the United States’ Trade Structure?
The U.S. is the 2nd leading exporter of goods and services in the world and the number one leading importer. The U.S. has consistently run a trade deficit, mainly due to the dependence on foreign oil to meet its energy needs and high domestic demand for consumer goods produced abroad, however thanks to advances in domestic oil production, the energy gap is closing. The main trading partners of the U.S. are

[98]https://www.nationsencyclopedia.com/economies/Americas/United-States-of-America-OVERVIEW-OF-ECONOMY.html
[99] https://tradingeconomics.com/united-states/balance-of-trade
[100] Kose M.A., Otrok C., Whitemann C.H., *International business cycles: world, region and country specific factors*, American economic Review, 2003.

Canada, China, Mexico and Japan. Canada is the main destination for U.S. exports, whereas China is the main source of imports. The U.S. plays a major role in the international trade system and is generally seen as a proponent of reduced trade barriers and free trade agreements. The United States currently has more than a dozen free trade agreements in place. Among them are the North American Free Trade Agreement (NAFTA), which was created in conjunction with Canada and Mexico in 1994. The United States is also an active member of the World Trade Organization (WTO).
Regarding exports, although the United States has lost some of its competitive edge in recent decades, material goods still represent two thirds of its total exports. The United States mainly exports high-value capital goods and manufactured products, including industrial machinery, airplanes, motor vehicles and chemicals. In 2015, the U.S. exported USD 1.510 trillion in goods. The United States is the world's leading exporter of services. This includes financial and professional business services as well as other knowledge-intensive services. Travel, transportation and tourism services are also a major export. Services represent about one third of total exports.
While for imports, more 80% of total imports brought to the United States from abroad are goods. Roughly 15% of these imports are in the form crude oil, fuel oil and petroleum products. Industrial machinery, supplies and equipment represent another 15% of imported goods. Almost 25% of imported goods are capital goods, such as computers, computer accessories, electronics, medical equipment, and telecommunications equipment. Consumer goods represent another 25% of imported goods. Cell-phones, pharmaceuticals, toys, household equipment, textiles, apparel, televisions, and footwear are the main types of consumer goods imported to the United States. An additional 15% of imported goods are automotive vehicles, parts, and engines. Food and beverages represent only about 5% of imported goods. Services represent only 20% of total imports, and are primarily financial services, as well as travel and transportation.[101]

3.2.3. Mr. Donald Trump's trade policies

Republican Donald John Trump is the 45th president of the United States. His first term is from 2017 to 2021. Trump's economic plan focuses on "making America great again."
He negotiated "the biggest deal of my life" with those voters who felt they had lost the American Dream. Trump's policies follow economic nationalism.
Protecting American industry, especially steel, was a centerpiece of Trump's 2016 campaign. "It will be American steel that will fortify America's crumbling bridges," he said on the stump. Steel employment has fallen from nearly 650,000 workers in the 1950s to some 140,000 today, with many of the closed mills in swing states such as Pennsylvania.

[101] Wooldridge J. M., *Econometric Analysis of Cross Section and Panel Data.* Cambridge, MA: MIT Press. 2002.

Many steel and aluminum producers around the world have long blamed the Chinese government for subsidizing production of the metals in violation of global trade rules, which many analysts say has flooded the global market with low-cost product and sent prices plunging. U.S. producers have clamored for protection from such “dumping” via tariffs or quotas, which previous administrations have provided in limited cases.
The Reciprocal Trade Agreement Act of 1934 was the first law giving the president power to create tariffs on imported goods. Section 232 of a later law, the Trade Expansion Act of 1962, gave the president the ability to impose a tariff on items imported into the U.S. that are a threat to national security.
Trump’s planned tariffs, however, are potentially much broader. The president has the authority to apply them under a national security, rather than purely economic, rationale (based on a little-used 1962 trade law). In April 2017, the Commerce Department began an investigation into whether steel and aluminum imports “impaired national security”. It concluded in early 2018.
This allowed president Trump to apply tariffs. Trump’s announcement came little more than a month after he applied broad tariffs on solar panel and washing machine imports to protect domestic producers.
The 2018 steel and aluminum tariffs - sometimes known as the "Trump Tariffs" - aren't the first time in recent history a U.S. president has imposed tariffs on imports of the metals. In 2002, then-President George W. Bush put a tax on steel imports. The tariffs took effect in March of that year and were scheduled to last until 2005. Bush ended up lifting the tariffs in December 2003. Then, as now, there was a negative response to the steel tariffs. Some countries threatened retaliation. The World Trade Organization believed the Bush tariffs violated its global rules.

3.2.4. How do Trump’s proposals differ from past tariffs?

Tariffs, in theory, make U.S. - made products cheaper than imported ones, and encourage consumers to buy American.
A number of previous presidents-imposed tariffs or other trade barriers to protect U.S. industry from cheap foreign imports. Presidents Lyndon B. Johnson, Richard M. Nixon, Jimmy Carter, and Ronald Reagan applied either quotas - import limits - or price floors on steel. Economic studies have concluded that these measures did little to stop the decline of the industry. More recently, the administrations of George W. Bush and Barack Obama both applied steel tariffs. Bush imposed broad tariffs of up to 30 percent on steel imports in 2002. These were meant to last three years but were withdrawn early, after the World Trade Organization (WTO) ruled against them. Some research has shown that these tariffs cost the U.S. economy as many as two hundred thousand jobs. Meanwhile, Obama applied tariffs of up to 522 percent on some Chinese steel in 2016.[102] The Commerce Department also regularly applies targeted antidumping duties on specific steel products that it finds benefit from unfair subsidies; there are over a hundred such trade remedy actions

[102] Capretta J.A., *The Fed and fiscal policy during the Obama years,* 2016

currently in place. But economists say that Trump's proposal is different. Trade expert Chad P. Bown calls the policy "unprecedented" in both its scope and legal justification. Previous tariffs targeted specific countries, such as China, or included exemptions for close allies, as Bush's did. Trump says his tariffs will apply to all countries. Further, Trump's use of a national security law to implement the tariffs is extremely unusual, though Bown notes that Reagan used the same law for more limited purposes. The law also gives the president total discretion over how and for how long to apply the tariffs, unlike other trade actions, which are based on economic conditions and subject to periodic review.[103]

3.3. The escalating trade-battle between U.S. and China on tariffs

U.S. President Donald Trump has complained about China's trading practices since before he took office in 2016.

"On day one of the Trump administration the U.S. Treasury Department will designate China as a currency manipulator and to begin a process that impose appropriate countervailing duties on artificially cheap Chinese products"[104].

The United States has a multifaceted economic relationship with China, and the issues of currency manipulation, NME status, and market access are all potential flashpoints. Mismanagement of these issues could harm the US economy and create collateral damage elsewhere in Asia.[105]

The pursuit of bilateral deals is likely to be difficult (because of the perception of their zero-sum nature) and have relatively limited impact. Rather than retreating or pursuing bilateralism, a re-examination, revision, and expansion of a regional agreement is more likely to generate substantial and sustained benefits to the US economy. Unfortunately, the Trump administration is in effect doing the opposite: increasing contingent or process protection, which could significantly hurt some Asian partners, and demanding renegotiation of existing deals such as NAFTA, threatening to terminate them if renegotiations are unsuccessful[106]. There is scope for improvement of both agreements. But badly renegotiated deals could harm the US economy and disadvantage trade reliant partners in Asia. In the worst case, these actions could spark trade wars to the detriment of all.

3.3.1. Trade war scenarios

Existing laws give the president considerable authority to undertake unilateral action without congressional approval. If the president were to decide that the current situation warranted imposing punitive

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[103] *Annual Statistical Report on the Social Security Disability Insurance Program*. US Social Security Administration. Various years.

[104] Hoffman M., *Donald Trump says he favors big tariffs on Chinese exports*, New York Times, January 7, 2016.

[105] Branstetter, Lee, and Lardy N., China's Embrace of Globalization.National Bureau of Economic Research Working Paper 2006.

[106] Romalis J., *NAFTA's and CUSFTA's Impact on International Trade*. Review of Economics and Statistics, 2007.

across-the-board tariffs, and the Chinese were to respond in kind, the resulting trade war would damage the U.S. economy, costing jobs, depressing output, and creating financial market turmoil[107]. Such a tariff war would damage China as well. The "Noland, Robinson, Moran model" indicates that from the standpoint of the United States, the capital goods sectors such as high-speed drives and gear manufacturing (a multibillion-dollar industry producing inputs used mainly in power transmission equipment) would be the worst hit. But the damage would not be limited to capital goods sectors. Iron and other metallic ore mining and aluminum production are also among the most intensely affected sectors, and the negative shock would forcefully propagate to so-called "non-tradable" sectors, such as retail distribution and housing, not normally associated with international trade.

Such catastrophic trade wars have been avoided thus far. It is possible that rather than developing through the imposition of the across-the board tariffs, China responded to U.S. actions by retaliating against specific sector such as aircraft, soybeans or business services, the magnitude and the incidence of damage would obviously differ accordingly. Chinese termination of aircrafts purchases could destroy 179.000 U.S. jobs.[108]

China could retaliate in a way that is less subject to a WTO challenge and more respectable in diplomatic circles by directing its state-owned enterprises (SOEs) to stop buying American. A variety of metrics - share of assets in the industrial sector, share of employment in business services - suggest that Chinese SOEs may account for approximately 40 percent of Chinese demand for US business service imports. (Apart from SOEs, the Chinese government might also influence managements of other businesses connected to the Chinese Communist Party.) Such an action would cost 85.000 U.S. jobs. Finally, China could retaliate against American agricultural products such as soybeans or corn.[109] While one would expect that it would be easier to substitute transactions in such commodities across alternative buyers and sellers, US-China bilateral trade in soybeans accounts for roughly one-quarter of the global market, making a smooth reorientation of trade flows, unlikely. A soybean embargo will produce two effects:

- First, the worst affected areas would be a band of rural counties running from Mississippi, through Arkansas, Tennessee, and into Missouri, with 21 counties experiencing a 10 percent or greater decline in employment. And unlike job loss in large, dense, urban labor markets, it would be exceedingly difficult for displaced workers to find alternative employment in these lightly populated contiguous rural counties.

- Second, the geographical incidence of these losses fall disproportionately on areas of the South and Midwest that voted for President Trump and are often represented by pro-trade Republicans whose

[107] Hufbauer G. C., Morant T., Noland M., Robinson S., *Assessing Trade agendas in the US Presidential Compaign*, Peterson Institute for international economics, 2016.
[108] Ebenstein, Avraham, Harrison, McMillan M., Phillips S., *Estimating the Impact of Trade and offshoring on American Workers Using the Current Population Surveys,* Unpublished, 2010.
[109] Yuyu C., Ginger Z.-J., Yue Y., *Peer Migration in China*, National Bureau of Economic Research Working Paper, 2010.

support has historically been needed to pass trade legislation through the Congress, especially the Senate.

3.3.2. Potential flashpoints with China

The Trump administration has been explicit that it regards China as the primary source of concern in regard to external economic relations[110]. Chinese exports are more frequently subject to trade impediments and encounter higher barriers entering the U.S. market than goods from other countries. Nevertheless, China has also been the focus of additional trade policy concerns as well.

The U.S. launched an investigation into Chinese trade policies in 2017 regarding intellectual property.

It imposed tariffs on billions of dollars worth of Chinese products last year (2018), and Beijing retaliated in kind. China has targeted products including chemicals, coal and medical equipment with levies that range from 5% to 25%. It has strategically targeted products made in Republican districts, and goods that can be purchased elsewhere, like soybeans.[111]

After months of hostilities, a breakthrough of sorts came in December 2018.

Both countries agreed to halt new trade tariffs for 90 days to allow for talks. China and the US have agreed to immediately begin negotiations on structural changes with respect to forced technology transfer, intellectual property protection, non-tariff barriers, cyber intrusions and cyber theft, services and agriculture. They imposed a deadline of early March 2019 to resolve their differences, or the battle may heat up again.

3.3.3. What tariffs are in place?

So far, the U.S. has imposed three rounds of tariffs on Chinese goods, totalling more than $250bn. The duties range from 10% to 25% and cover a wide range of industrial and consumer items - from handbags to railway equipment.

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[110] Lightizer R., *United States representative*, September 18, 2017.

[111] Amiti M., Freund C., *The Anatomy of China's Export Growth. In China's Growing Role in World Trade*, University of Chicago Press. 2010.

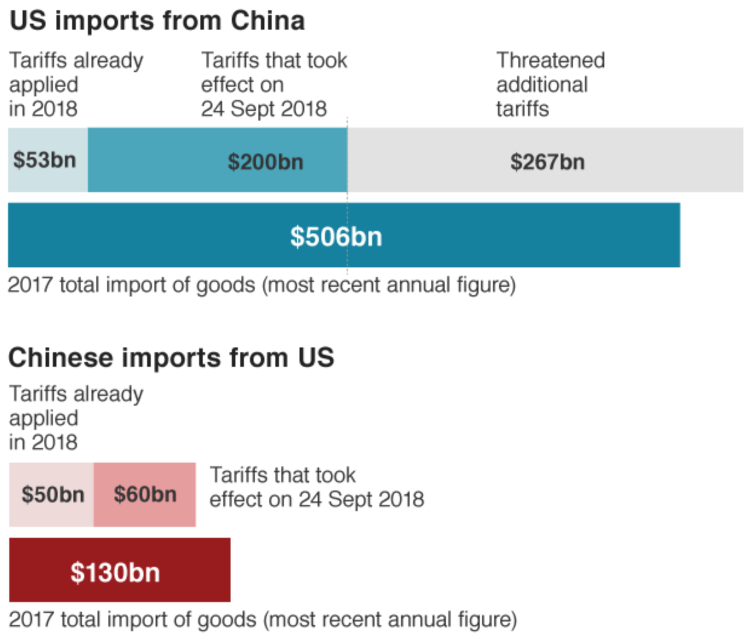

Fig. 3.2 *US and China tariffs against each other*[112]

President Trump has threatened tariffs on another $267bn worth of goods - meaning all Chinese imports could be subject to tariffs.
The U.S. has also put tariffs on worldwide imports of goods like steel and washing machines, which further affects products from China.
Beijing hit back with tariffs on $110bn of US goods, accusing the US of starting "the largest trade war in economic history".

3.3.4. The steel and aluminum tariffs

Thanks to the recently introduced U.S. steel and aluminum tariff, tariffs are back in the limelight and are a source of debate and concern across multiple sectors.
In the U.S., the history of tariffs is almost as long as the history of the country. One of the first laws ever passed by the first U.S. Congress was the Tariff Act of 1789, which imposed a 5 percent tax on any goods imported into the fledgling country. Until recently, though, tariffs weren't something that made a lot of news, at least in modern times. At the start of the 20th century, tariffs made up about 30 percent of the total value of goods imported into the country. By 2016, that number had fallen to just 1.5 percent of the total amount of goods imported into the U.S. The decline in tariffs was, in many ways, connected to the rise of free trade and to agreements that incentivized globalization. Additionally, the introduction of a federal income tax in the early 20th century proved to be a better source of revenue for the government than taxing imported goods.[113]

[112] US Census Bureau, BBC research, data as of 24 September 2018.
[113] Korte G., *Ordering national security investigation, Trump could block aluminum imports,* USA Today 2017.

In the summer of 2017, President Donald J. Trump announced he and his administration were considering restricting imports of aluminum and steel into the country. Around eight months, In March 2018, after the idea of restricting imports of steel and aluminum into the U.S. was introduced, the president announced a tariff would go into effect. Steel products imported into the country would be subject to a 25 percent tariff, while aluminum would be subject to a 10 percent tariff.

Trump argues that the measures are necessary to protect U.S. national security, which he claims has been degraded by the decline of the domestic steel and aluminum industries.

The potential restrictions seemed to divide the country. Some were against the idea of imposing a tariff on imported steel and metal. Companies in the auto manufacturing industry, for example, were generally against the tariffs. Meanwhile, companies that produced steel domestically were mostly in favor of the potential tariffs, believing steel import taxes would improve business for domestic producers. Many economists, however, say that previous experience shows that such tariffs will likely fail to revitalize domestic producers while imposing costs on the rest of the economy. Meanwhile, trade experts worry that the tariffs could set off a trade war that could ensnare some close U.S. allies, such as Canada, and undermine the global trading system.[114]

Initial reaction to the tariffs wasn't particularly positive, at least in some quarters. The Dow Jones, S&P 500 and Nasdaq all saw drops or declines on the day the tariffs were announced. Stock values didn't fall across the board, though. While auto companies such as Ford and General Motors and other companies that use a lot of steel saw a drop that day, companies such as U.S. Steel saw considerable gains.

Despite the negative response from certain parties and industries, the tariffs went into effect on March 23, 2018.

Many large steel and aluminum producers cheered the tariffs. The American Iron and Steel Institute thanked Trump for "addressing the steel crisis," and the second-largest American aluminum producer, Century Aluminum, said the measures will spur them to increase domestic investment.

However, most economists say that the tariffs are unlikely to help U.S. producers. They point to previous attempts to protect the steel industry that have failed to arrest the sector's decline, and they say that innovation in the industry, not imports, are primarily to blame for lost jobs. Declining demand for steel is another major factor, with U.S. consumption falling almost in half since the 1970s.

[114] Lawder D., *U.S. launches national security probe into aluminum* imports, April 2017.

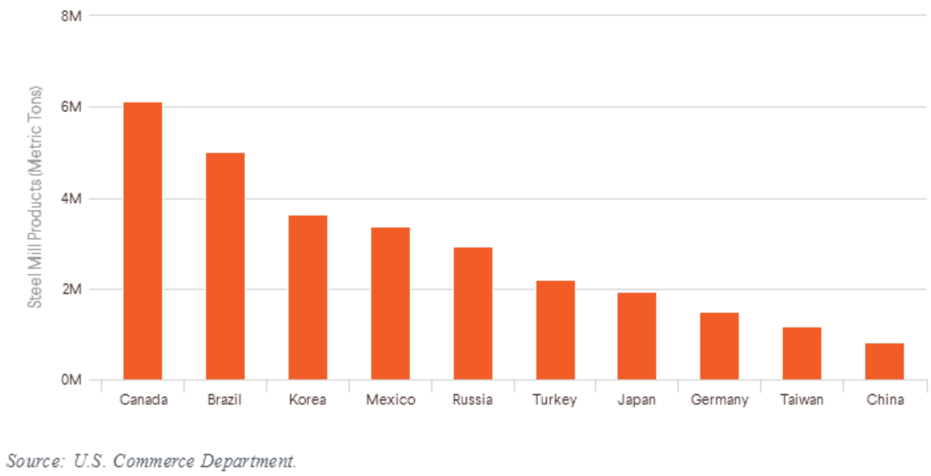

Fig. 3.3 *U.S steel import in 2017*

Economists also warn that tariffs, which will raise the cost of steel and aluminum, will hurt the many industries that use those metals, costing jobs and increasing prices for consumers. This could include automakers, aircraft manufacturers, beer and soda companies, the energy industry, and the construction sector. Together, these industries employ far more people than do steel and aluminum producers. Manufacturing groups have said Trump's measures will cost thousands of jobs.

It's worth pointing out not every country that imports steel and aluminum into the U.S. was affected by the tariffs, at least not initially. Mexico and Canada were both exempt from the duty, pending renegotiation of the North American Free Trade Agreement. Currently, Canada is one of the top suppliers of aluminum and steel to the U.S. About 16 percent of steel imports and 41 percent of aluminum imports come from Canada.

3.3.5. What are the tariff's effects?

Steel is one industry that seems perfectly poised to benefit from the tariffs on steel and aluminum. When the tariffs were initially announced, U.S. steel companies were among the only ones to see considerable gains, while the value of other companies' stock dropped. However, analysts expect the tariffs won't be that much of a help to companies that currently produce steel in the U.S. Past attempts at taxing steel imports might have led to job creation in that industry, but those jobs came at a significant cost.[115]

Compared to steel companies, domestic aluminum producers are a bit more pragmatic. They've argued the U.S. needs imports of the metal, as demand outweighs supply. There isn't enough aluminum mined in the U.S. to satisfy the need for it.

[115] Cassidy J., *What is Donald Trump's Trade Policy? Nobody Knows*, The New Yorker, May 1, 2018.

It's also worth taking a look at how the tariffs will affect companies that don't produce steel or aluminum, but that use it when manufacturing products. For those companies, it's very likely the increased tariffs would come at a high cost.

Industries that depend on imports of both steel and aluminum, such as car manufacturers, construction companies and other manufacturers, could see an increase in the price of imported aluminum and steel. That increase in price could then lead to a decrease in the number of jobs available or a decline in the number of goods made and sold.

One of the stated goals of the tariffs on steel is to revive the U.S. steel industry. However, it's very likely the attempt to revive the steel industry would adversely affect another major industry in the country: car manufacturing.

Industry experts estimate with the tariffs in place, the cost of a new passenger car of average weight and size could increase between 0.5 and 0.8 percent. That might not seem like much, but it could then lead to a drop in global sales from anywhere from 1.6 to 3.6 percent. Again, that might seem negligible, but the decline in sales of just 3 percent or so could mean 40,000 workers in the auto industry lose their jobs. The expectation is that the losses suffered by the auto industry will not be made up for by any benefits or gains in the domestic steel industry.

One of the potential adverse effects of the steel and aluminum tariffs on the market in the U.S. is that the tariffs will lead to an overall decline in the production of goods primarily made from steel or aluminum. While cars come to mind first but the list also includes items such as soda and beer cans, kitchenware, appliances and computers.

It's also worth noting that the tariffs won't necessarily "bring back" the steel industry, in part because imported steel isn't the only thing that has a led to a decline in the U.S. steel industry. There's also less demand for steel overall. Since the 1970s, consumption of steel in the U.S. has been nearly halved.

3.4. The escalating trade-battle between U.S. and China on digital protectionism.

Digital protectionism in Asia (especially China) and Europe increasingly threatens the only area of cross-border economic activity still growing nearly a decade after the global financial crisis. Web censorship, forced transfer of intellectual property, data localization, and onerous privacy rules have combined to hamstring the development of the data-based digital economy - the commerce in virtual, not physical, goods.[116] On July 20, 2017, CFR gathered more than two dozen current and former government officials, technology executives, economists, and trade lawyers at the half-day workshop “The Rise of Digital Protectionism: Implications for U.S. Interests and Possible Solutions,” in San Francisco, to examine these issues and explore options available to U.S. policymakers to counter the protectionist measures.

[116] Martin M.F., *What’s the Difference? Comparing US and Chinese Trade Data*, Congressional Research Service, April 23, 2018.

3.4.1. Reforming the U.S. approach to data protection and privacy

Rather than a comprehensive legal protection for personal data, the United States has only a patchwork of sector-specific laws that fail to adequately protect data. Congress should create a single legislative data-protection mandate to protect individuals' privacy.[117]

Half of all Americans believe their personal information is less secure now than it was five years ago, and a sobering study from the Pew Research Center reveals how little faith the public has in organizations, whether governmental or private-sector, to protect their data - and with good reason. In 2017, there was a disastrous breach at Equifax, Yahoo's admission that billions of its email accounts were compromised, Deep Root Analytics' accidental leak of personal details of nearly two hundred million U.S. voters, and Uber's attempt to conceal a breach that affected fifty-seven million accounts. Individuals are left stymied about what action they can take, if any, to protect their digital assets and identity.[118]

Yet record-shattering data breaches and inadequate data-protection practices have produced only piecemeal legislative responses at the federal level, competing state laws, and a myriad of enforcement regimes. Most Western countries have already adopted comprehensive legal protections for personal data, but the United States - home to some of the most advanced, and largest, technology and data companies in the world - continues to lumber forward with a patchwork of sector-specific laws and regulations that fail to adequately protect data. U.S. citizens and companies suffer from this uneven approach - citizens because their data is not adequately protected, and companies because they are saddled with contradictory and sometimes competing requirements. It is past time for Congress to create a single legislative data-protection mandate to protect individuals' privacy and reconcile the differences between state and federal requirements.[119]

Even organizations with multiple layers of digital and physical security are vulnerable to the persistent threats of commercial and governmental intrusion, as well as inept or intentionally malicious insiders. Perfect security is impossible, and the informational injuries that can result from the collection and (mis)use of data are constantly evolving.

Companies need clearer rules, and individuals need to be able to incentivize companies to secure data.

The twenty-first-century economy will be fueled by personal data. But it is not yet clear what rules will govern this information, with whom information will be shared, and what protections will be put in place.[120]

The U.S. Congress should join other advanced economies in their approach to data protection by creating a single comprehensive data-protection framework. Meaningful federal laws and regulations should seek to resolve the differences among the existing federal and state legal rights and responsibilities. This would not only simplify compliance for U.S. companies, but would also strengthen and bring the United States in line

[117]Maheshwari S., *That Game on Your Phone May Be Tracking What You Watch on TV*, NYT, Dec. 28, 2017.

[118] *National Telecommunications and Information Administration, Request for Comments on Developing the Administration's Approach to Consumer Privacy*, Sept. 25, 2018.

[119] Sydell L., *FTC Confirms It's Investigating Facebook for Possible Privacy Violations*, NPR, 2018.

[120] Turow J., *Let's Retire the Phrase 'Privacy Policy'*, N.Y. Times, 2018.

with emerging data-protection norms. Congress could implement an effective baseline privacy regime with at least the following four qualities.

a) the law should cover all institutions, not just tech companies, credit-rating agencies, and other narrow sectors of the economy. Data protection is not only part of corporate social responsibility in a digital age, it is also both an institutional risk and an essential compliance function for any organization that collects, uses, or shares personal information or other potentially sensitive consumer data.
b) Second, the law should harmonize the inconsistencies and fill the gaps created by the existing sectoral approach. Health information is sensitive regardless of whether it is input into a consumer application, generated by a wearable device, or conveyed to a medical professional. A baseline privacy law could polish away the inconsistent consent requirements, access rights, and security protections around health information that exist.
c) Incentives for companies to protect data should skew toward prevention, rather than self-flagellating disclosures. Disclosure after the fact only helps the legal and compliance industries that have cropped up in the wake of recent breaches. By the time a breach is disclosed, harm could already have befallen hundreds of thousands, if not millions, of individuals. Companies should offer easy-to-use individual access, correction, and deletion mechanisms for users' data, and documented risk assessments and other compliance requirements, which leave a paper trail. When these mechanisms are backed by the force of law, companies are put on notice that they need to prioritize data security, which in turn gives privacy and security professionals and consumer advocates more leverage to push for better industry practice. If the United States adopted the significant fines for noncompliance seen in the European Union's GDPR, corporate practice could be reshaped—for not just major technology firms but also small and medium-sized enterprises and nonprofit entities.
d) The U.S. legal framework should recognize and provide mechanisms to address the harms that result from privacy violations. Lawmakers and courts recognize the harm of breaches, but the definition of a "privacy harm" should be expanded. Identity theft is one such harm, but so too are the inconveniences suffered by affected individuals and their gnawing sense that they lack control over their "digital selves." These less quantifiable harms that result from the exposure of bits and bytes of individuals' personal lives should be recognized by law: as the depths of these harms are plumbed and addressed over time, individuals should be afforded a private right of action to hold companies accountable, and regulators should have the ability to penalize entities that flout their duty to be responsible stewards of personal information. Jack Balkin, the director of Yale Law School's Information Society Project, has suggested that companies be thought of as "information fiduciaries" and proposed a grand bargain that would extend a duty of care for personal information in exchange for legal certainty and safe harbors for industry.

3.4.2. The problem with China's digital protectionism

The two threads of the growing U.S.- China struggle - trade and security - are coming together in dramatic fashion.

China's embrace of digital protectionism is just a page from its standard playbook meant to undercut foreign competitors and boost Chinese companies. President Xi Jinping makes state control of the digital economy a "huge priority" for the Communist Party of China as it seeks to meet ambitious growth targets.

The protectionism takes many forms: web censorship through the so-called great firewall, forced technology transfer through mandated joint ventures with foreign firms, and a new cyber security law that places onerous requirements on nearly every foreign company doing business in China. The requirements in the new law that data be physically housed in China, in particular, and limits to data flows out of China are akin.

China seeks global dominance in several high-tech sectors projected to be at the forefront of growth in coming decades - artificial intelligence (AI), robotics, biotechnology, and autonomous vehicles, among others - and uses digital protectionism to carve out a privileged space for Chinese firms. The Communist Party sees the free flow of data and digital communications as a threat to regime stability and seeks greater state control of data flows.[121]

Such protectionism is neither new nor unique to China. But participants stressed that the sheer size and global importance of the Chinese economy makes Beijing's "bare-knuckle" approach to digital protectionism problematic for U.S. policymakers. Meanwhile, Western countries and international firms have been loath to push back against Chinese restrictions for fear of losing access to the world's largest economy by purchasing power parity.

3.4.3. Trump's digital and cyberspace policy program

In recent years, the European Union (EU) has ramped up its digital protectionism, vowing to create a digital single market with Europe-wide rules on data flows, implementing rigorous privacy standards, cracking down on hate speech, policing social media, and challenging the market dominance of (predominantly American) technology firms. Europe's digital protectionism is in line with Brussels' legalistic, top-down, heavily regulated approach to economic policy and that, like other E.U. initiatives, it lacks a comprehensive appreciation of the interplay of privacy, security, and innovation in the digital economy. U.S. firms are asked to do more than European firms with respect to privacy protections, for example. These and other requirements, such as data localization in different member states, create a regulatory burden that is especially costly for small- and medium-sized tech firms. The European policymakers, hostage to overlapping jurisdictions, are not equipped to tackle interrelated problems such as

[121] Gellman R., *Fair Information Practices*. A History, 2012.

privacy, security, and economic innovation in a unified way and often introduce flawed policies based on a misunderstanding of what technology can actually do and what effects the policy actually has on businesses and consumers. Laws intended to rein in corporate titans often impose substantial compliance burdens that ironically hurt small tech firms while the Googles of the world easily meet those requirements. The E.U. could help the United States push back against Chinese digital protectionism.

Barriers to the free flow of data and digital information are consequential to the United States because the global digital economy has quickly become a large part of cross-border trade flows: the cross-border data and digital flows account for between $2.8 trillion and $4 trillion of the $7 trillion to $15 trillion in total cross-border flows of goods and services.

Moreover, although cross-border flows in traditional goods and services flatlined after the 2008 financial crisis, data and digital flows have continually grown, increasing eighty-fold since 2005. The digital economy is the sole part of globalization that is still proceeding apace and is more diffuse than traditional globalization, given the active role that smaller firms and smaller countries play.

New technologies are creating economic opportunities, but creeping protectionism, especially in China, could threaten U.S. competitiveness in critical sectors.[122] There is a massive Chinese investment in semiconductors, for example, as well as China's dominance of the supply chains for fifth-generation mobile phones, not to mention Chinese determination to stake out a leading position in sectors such as AI, robotics, electric and autonomous vehicles, and biotechnology. China's digital approach has already resulted in its dominance of crucial sectors, "and they will dominate going forward".[123]

Digital protectionism does not just pose a risk to U.S. competitiveness in sectors at the center of the future economy, it also threatens traditional sectors such as manufacturing, energy, and agriculture. The advanced manufacturing has a large and growing data component: 3-D printing and digital manufacturing, for example, rely on cross-border data flows as well as a data-intensive research and development program. Traditional sectors such as agriculture are seeing a growing role for data, for example, in biotechnology and the development of new strains of seeds. Likewise, extractive industries and the energy sector are being transformed to rely increasingly on data, from geological big data crunching that enabled the hydraulic fracturing revolution to global shipping that is becoming increasingly automated. In that sense China's digital protectionism, while boosting its dominance of high-tech sectors, could backfire in other areas.

The rise of big data across a growing number of sectors is helped by jurisdictions such as the United States that allow unfettered data flows. Europe's tough privacy laws also discourage innovation among technology firms; data localization requirements push tech startups to American shores, where compliance costs are lower.

Maintaining cross-border data flows with few government restrictions will be important as the digital transformation plays out in traditional sectors: an economy that tries to insulate itself from global data flows

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[122] *Understanding the US-China Trade Relationship, prepared for the US-China Business Council*, Oxford Economics, January 2017.

[123] Tonelson A., *All of the Reasons Why Trump Can Win a Trade War with China*, March 27, 2018.

by throwing up restrictions to cross-border data-sharing risks cutting itself off rather than protecting its national champions.
Conversely, for the United States, the data-rich patina overlaying sectors such as advanced manufacturing represents an opportunity for an open economy desperate to right its distorted trade balances.
To the extent that Chinese digital protectionism gives Beijing an advantage in the global economy, it could also give China an advantage on the battlefield. The United States' edge in military technology is threatened by concerted Chinese advances in areas that could enhance China's cyber capabilities.[124]
The digital restrictions, especially Europe's rigorous privacy protection, could make it harder for the United States to properly defend against national security threats, especially terrorism. While U.S. policymakers try to balance security, privacy, and economic concerns with digital regulation, Europe pursues each area of policymaking on its own separate track, which could have dire consequences for U.S. security.
Other less obvious security concerns arise from the trend toward digital protectionism. Data localization in Russia, for example, forces U.S. firms to store data from Russian users on servers in that country, opening the possibility of digital reprisals from Moscow in the event of U.S. sanctions against Russia, such as happened after the invasion and annexation of Crimea.
The first order of business is to address the Donald J. Trump administration's focus on traditional sectors of the economy and its corresponding lack of understanding of the scope of the threat from digital protectionism. The administration's public discussions of trade policy favor goods over services and tangible cross-border flows over data.
The first step should be to educate policymakers about the linkages between the traditional and the digital economies and about how digital protectionism could affect U.S. economic prospects.
U.S. government agencies also need to build a more coordinated approach to digital issues. The State Department and the National Security Council, for example, wall off digital innovation from cyber-security issues, complicating interagency and intra-governmental coordination on data and digital policies more broadly.
To craft an international charter, it need set the basic rules for regulators on how to approach data mobility and security, akin to the early trade guidelines that bounded the General Agreement on Tariffs and Trade and eventually morphed into an accepted, global trade architecture. Even if such a charter failed to secure a consensus among the United States, China, and Europe, it would at least put competing tradeoffs on the table - privacy versus security versus innovation - and avoid policymaking that treated each as an isolated issue.
It's fundamental prioritizing data and digital issues in upcoming trade talks, whether in the North American Free Trade Agreement (NAFTA) renegotiation or the continuing talks between the United States and Europe about a free-trade pact. Older trade agreements such as NAFTA could be revised now to address digital issues that were not apparent twenty-five years ago.

[124] Eichengreen B., *China and the Future of Democracy*, May 10, 2018.

Further, ambitious trade deals, such as the Trans-Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (TTIP), which seek to better deal with data and digital trade, face problematic futures. Asian and Latin American countries are trying to salvage a shrunken TPP after the U.S. withdrawal, while TTIP is burdened by EU divides, Brexit, and a skeptical public attitude in the United States and Europe toward free trade.

Some economists stressed that the U.S. government cannot tackle digital protectionism on its own. Many suggested that the Trump administration should work with the business community to strengthen its resistance to unreasonable digital oversight, since many firms - eager to dive into the Chinese market - acquiesce to restrictive digital regulations with little or no pushback.

To get businesses on board it need modify the Foreign Corrupt Practices Act (FCPA), which outlaws the transfer of money to foreign governments, and similar laws meant to prevent bribery and corruption by U.S. firms overseas. Expanding the concept of the FCPA to include in-kind handovers - such as data, access to networks, or veto over the ultimate use of corporate data - could force companies to stop accepting onerous digital rules.

At the same time, the United States have to enlist other countries, particularly those in Europe, to push back against Chinese digital protectionism. While many smaller economies are hesitant to do so for the fear of losing Chinese investment, the EU could play a role alongside the United States in pressuring China, especially on privacy.[125]

The timid U.S. government responses to Chinese protectionism in the past had ultimately encouraged such behavior, urged a tougher line. Using the World Trade Organization to tackle digital protectionism, starting with smaller countries to set precedents before taking aim at Chinese abuses, or retaliating using trade authority under U.S. domestic law.

An additional element of U.S. leverage is the access to the U.S. market.

Reforming the Committee on Foreign Investment in the United States, for example, to more closely scrutinize and, if needed, block potentially sensitive foreign investment in digital technology, could nudge China toward more reciprocal behavior. Yet others recommended a more aggressive use of export controls, which would hurt China's current acquisition spree and could ultimately drive concessions on digital protectionism.

3.4.4. The need to push back against China

A baseline privacy framework could ensure that all companies become responsible and ethical stewards of data, bring the United States in line with global standards, and better protect the data of U.S. citizens.

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[125] Elizabeth C. *Economy, Trump and Xi Agree: Short-Term Gain for Long-Term Pain*, April 4, 2018.

The big story between the United States and China right now was supposed to be the critical round of trade talks taking place in Washington, as negotiators race against a March 2 deadline for the Trump administration to further increase tariffs on Chinese imports.

Instead, on the eve of the negotiations the Justice Department on Jan. 28 revealed indictments against Chinese telecommunications giant Huawei Technologies, charging the company's leaders with deliberately evading U.S. sanctions on Iran and orchestrating a campaign to steal trade secrets from U.S. competitors.[126]

Huawei is one of the largest telecommunications equipment and services providers in the world, recently passing Apple to become the second biggest smartphone maker by volume after Samsung.

Huawei is what the Chinese call a national champion. A private firm, tasked with China's ambitions to go into the world and lead the way.

But the US and other Western nations have been concerned that the Chinese government could use Huawei's technology to expand its spying ability, although the firm insists there is no government control.

The arrest of Ms Meng, the daughter of Huawei's founder, infuriated China.

She was arrested on 1 December 2018 in Canada's western city of Vancouver at the request of the U.S.

She was later granted a C$10m bail by a local court. But she is under surveillance 24 hours a day and must wear an electronic ankle. [127]

Chinese telecoms giant Huawei has denied any wrongdoing after U.S. prosecutors filed a host of criminal charges against the firm. The charges filed against Huawei in the U.S. include bank fraud, obstruction of justice and theft of technology. The case could escalate tensions between China and the US. In a statement, Huawei said it was "disappointed to learn of the charges brought against the company today".[128]

In all, the US has laid 23 charges against the company. "These charges lay bare Huawei's alleged blatant disregard for the laws of our country and standard global business practices," said FBI Director Christopher Wray. Mr Wray said companies like Huawei "pose a dual threat to both our economic and national security". At a briefing in Beijing, government spokesperson Geng Shuang said there were "political motivations" behind U.S. attempts to "smear and suppress certain Chinese companies". "We urge them to treat Chinese enterprises in a fair and just way." The allegations by the U.S. Department of Justice are the most serious Huawei has ever seen, and go to the heart of the trade war between China and the U.S.

U.S. commerce secretary Wilbur Ross stated that the Huawei charges were "wholly separate" from ongoing trade negotiations with China.

The indictment alleges Huawei misled the U.S. and a global bank about its relationship with two subsidiaries, Huawei Device USA and Skycom Tech, to conduct business with Iran.

U.S. President Donald Trump's administration has reinstated all sanctions on Iran removed under a 2015 nuclear deal and recently imposed even stricter measures, hitting oil exports, shipping and banks.

[126] https://www.businesstimes.com.sg/technology/huawei-case-reveals-the-real-us-trade-war-with-china
[127] https://www.pressherald.com/2018/12/08/huawei-case-flash-point-in-u-s-china-trade-war/
[128] https://edition.cnn.com/2018/12/08/perspectives/huawei-cfo-arrest-us-china-trade/index.html

A second indictment alleges Huawei stole technology from phone company T-Mobile used to test smartphone durability, as well as obstructing justice and committing wire fraud.

Huawei said it settled the dispute with T-Mobile in a civil case filed in 2014.

The firm's technology, known as Tappy, mimicked human fingers to test phones.

The indictments are part of an escalating campaign by the administration to persuade allies to bar Huawei from any contracts in the development of the coming fifth-generation wireless networks, which will control everything from autonomous vehicles to power plants. The United States fears that Huawei's ties to the Chinese government mean that its equipment could be used for surveillance or even sabotage.

The Justice Department formally requested the extradition of the company's chief financial officer, Meng Wanzhou, who was arrested by Canadian police in Vancouver last month on a request from the United States. She is the daughter of Huawei founder Ren Zhengfei, Meng is named in this week's indictment which details her alleged role in helping the company skirt U.S. sanctions on Iran.

Decisions over Huawei pose a huge dilemma for many countries, however. Many are taking the security threat seriously. Japan, Australia and New Zealand have all moved to bar Huawei from their networks. But Huawei is a high-quality, low-cost producer of the network equipment needed as 5G networks expand. Many countries are already heavily invested; Canada's top telecoms providers, Telus and BCE, say it would cost them over $1 billion just to remove Huawei gear that has already been built in to their new networks. Many companies have warned that the rollout of 5G will be longer and costlier if Huawei is removed from the bidding.

The Trump administration has made that decision even harder by hinting that it might go easy on the company if China makes significant concessions in the current trade negotiations. Asked in December whether he might intervene in Meng's case, Trump said "If I think it's good for what will be certainly the largest trade deal ever made - which is a very important thing - what's good for national security - I would certainly intervene if I thought it was necessary."

There is a precedent for such action. Last spring Trump personally intervened to ease sanctions on ZTE, China's other large telecoms equipment maker. The Commerce Department had barred ZTE from importing any U.S.-made components as a penalty for what it said were repeated and willful violations of U.S. trade controls on Iran and North Korea. The sanctions would have crippled the company, which relies heavily on U.S.-made inputs. But Trump lifted the ban, in what seemed at the time part of an effort to ingratiate himself with Chinese President Xi Jinping and walk away with a better deal in the trade negotiations.

The administration's willingness to bargain away security measures for trade gains is troubling. It leads China and other countries to conclude that U.S. claims about the security threat posed by Huawei are merely a cynical pretext to gain an edge on trade. As China's state-run Global Times put it following Meng's arrest, "The U.S. and Canada are undoubtedly abusing their justice systems... Washington should not attempt to use its domestic laws as strategic support for its commercial and diplomatic competition."

This is a dangerous perception, one that will embolden China to strike back, as it has in arresting two Canadians on vague national security charges in retaliation for Meng's request. And it will lead to suspicions among allies that they are being asked to pay both a commercial and diplomatic cost in cutting off Huawei only to run the risk that the Trump administration will change its mind if it can leverage its way to a better trade deal.

Separating security and economics is going to become far harder in the future relationship with China. During the Cold War with the Soviet Union, the United States lined up allies in a global sanctions regime designed to prevent Russia from gaining any technologies that could be used to military advantage. While there were issues from time to time with European allies in particular, there was a broad consensus that the commercial gains from trade in high-technology products with Russia were not worth the security risk.

China is a much more complicated calculus. It is already a major technology exporter, and Chinese operations are integrated into the global supply chains of many leading western companies. While the United States has in the past restricted sales to China of sensitive technologies, and barred some Chinese acquisitions of U.S. companies, it has not pursued the sort of blanket restrictions that were imposed on the Soviet Union.

That could be changing. Some in the Trump administration are persuaded that China poses such a growing security threat that the U.S. needs to "decouple" its economy from China. The United States has tightened reviews of Chinese acquisitions to the point that few Chinese companies are even trying to acquire American companies any more. And the administration has stepped up its campaign against what it sees as widespread espionage by both the Chinese government and Chinese companies.

As the decisions so far by Japan and others to restrict Huawei suggest, Washington will get a serious hearing, and where the security threats seem real U.S. allies will be prepared to act. But the Trump administration needs to make it clear that its concerns over Huawei and other Chinese companies are matters of utmost security importance, not casual bargaining chips to be discarded for American commercial gain.

3.5. What is the role of the WTO in a war trade?

Most state-state disputes are handled by the WTO system, the primary body governing international trade. Each of its 164 members has agreed to the rules about trade policy, such as limiting tariffs and restricting subsidies. A member can appeal to the WTO if it believes another member is violating those rules.

Hardly a day goes by without major newspapers across the globe carrying stories about commercial disputes between World Trade Organization members.[129] A significant proportion of these concern agricultural products such as illegally subsidized cotton, sugar or wheat, or relate to import restrictions imposed for phytosanitary reasons on products such as apples, hormone treated meat or genetically modified organisms.

[129] Wilkinson R., Raith R., Howse R., Nicolaidis K., *Global trade governance: the WTO at a crossroads*, December 2006.

Allegedly illegal subsidies can, of course, also spark disputes over industrial goods such as ships or large commercial aircraft. Another important category of disputes concerns the application of commercial defense instruments - such as anti-dumping, countervailing duty and safeguard measures - to industrial imports (e.g. steel products, semiconductors). Others relate to alleged discriminatory treatment of imported goods as compared to domestic products (the national treatment principle) or discriminatory treatment of imports from one WTO member as compared to goods from another (most favoured nation treatment - MFN). Finally, there are the new issues - intellectual property protection and services - which were brought within the WTO's remit as a result of the Uruguay Round of trade negotiations.[130]

The 1947 General Agreement on Tariffs and Trade (GATT) introduced the first dispute settlement system, which was supplemented in 1989 with new measures to improve its rules and procedures.[131]

Between 1989 and 1994, almost 200 cases were dealt with under this process, resulting in 91 panel reports, 75 of which were adopted by the contracting parties.

The greatest shortcoming of this system was that it stipulated that contracting parties had to adopt panel reports unanimously before they could become legally binding. This allowed losing parties to unilaterally block their adoption and explains why 16 of the reports submitted during this period were rejected.

As a result of the Uruguay Round of trade negotiations between 1986 and 1994, this system - which was based more on trade diplomacy than on legal/judicial considerations - was replaced by the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).

These new rules, which came into force in 1995, represented a significant shift towards a judicial system for resolving disputes between WTO members.

Its basic features include:

- The creation of a permanent Appellate Body to hear appeals against panel reports on questions of law;
- The automatic adoption of panel and Appellate Body reports, even if the losing party disagrees.

Reports can only be blocked if there is a 'negative' consensus to do so and this would require the consent of the winning party. This constitutes a kind of 'security valve' and has so far never been used.

It is very important for members to cast the request for consultation as broadly as possible, because the panel will only rule on issues on which consultations have already taken place. The purpose of these consultations is two-fold.[132]

The first is to clarify the basis for the complaint. This may be particularly useful if the requesting member is not fully familiar with the other party's legal or administrative system but is less important in disputes between the E.C. and the U.S., given their extensive knowledge of each other's legal and administrative

[130] Jackson J.H., *The World Trading System: Law and Policy of International Economic Relations*, 2nd edition, London: MIT Press.1988.

[131] Decision on Improvements to the GATT Dispute Settlement Rules and Procedures (12.4.1989, BISD 36S/61).

[132] Hudec R. E., *The New WTO Dispute Settlement Procedure: an overview of the first three years*, Minnesota Journal of Global Trade, Vol.8: No.1, 1999.

systems.[133] The second aim is to give the parties an opportunity to settle their dispute before moving to the next stage of the process.
However, in practice, the consultation stage lasts longer and, in some cases, has continued for several years. This goal was achieved more frequently in the WTO's early days but has become rarer now. These formal consultations are generally, but not necessarily, held in Geneva and representatives of the parties (including officials from national capitals) attend. The WTO Secretariat is not present at such meetings, which usually take the form of a question-and-answer exercise based on questions (often submitted in writing in advance) raised by the requesting member. Replies are usually given orally, rather than in writing. If these consultations do not produce a settlement, the requesting member has the right to ask for a panel to be established within 60 days from the date when it lodged its original request.

3.5.1. WTO and China's trade policy

Another big issue is China's market economy status in the WTO. When China joined the WTO it was classified as a non-market economy (NME), which allows the Department of Commerce to use very elastic procedures in anti-dumping investigations. China understandably wants to constrain this discretion, and under its WTO accession agreement, NME status was to end in December 2016.[134]
If the Trump administration continues to treat China as an NME in anti-dumping investigations, China could probably take the United States to the WTO on the issue of market economy status and win, and indeed it has already initiated a complaint.
But going the WTO route would take a couple of years and might erode U.S. support for the whole WTO system, which has benefitted China greatly, especially in light of President Trump's periodic threats to ignore the WTO or withdraw the United States entirely.
Moreover, the rise of countervailing duty cases in recent years means that the real degree of de-protection if China were to be granted market economy status is probably less than either proponents or opponents expect - regardless of China's status, U.S. trade law retains significant tools to penalize unfair trade practices (Bown 2016). It might be preferable to enter into negotiations to strike a balance between China's desires for improved market access and U.S. concerns about market access in China. Sectoral market economy status might be one component of an overall accommodation.

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[133] Wilkinson R., *The WTO: Crisis and the Governance of Global Trade*, London: Routledge, 2006.
[134] Hsieh C.T., Ossa R., *A Global View of Productivity Growth in China*.National Bureau of Economic Research Working Paper, 2011.

3.5.2. Potential sources of trade friction

Economists warn that Trump's appeal to national security could undermine the framework of trade rules painstakingly constructed after World War II. Other countries could challenge Trump's tariffs at the WTO, but that body's rules include exemptions for national security measures, a loophole that has rarely been exploited. Legal experts say it is unlikely that the Trump administration would lose such a case.

U.S. allies have argued instead for a united front against Chinese overproduction.

A WTO challenge could have several unintended consequences, analysts say. If Trump were to lose, he could ignore the ruling, undermining the WTO, or he could withdraw the United States from the institution altogether, which he has previously threatened to do. On the other hand, if he were to win, it could open the door to other countries using the national security exemption, potentially escalating protectionism.
This, in turn, could relieve pressure on China, whose own subsidies and other trade distortions have been a major target at the WTO dispute forum. If national security were to become an accepted rationale for protectionism, Beijing could increase its own discriminatory practices and further block U.S. imports and investment.

3.5.3. What are the risks to global trade?

Trump's actions, especially if they are applied broadly rather than targeted at offending countries, run the risk of sparking a cycle of retaliation - a trade war. Some of Washington's closest allies would be hardest hit.[135] The largest exporter of steel to the United States is Canada. Germany, Japan and South Korea are also among the top - ten exporters, and China is only the eleventh largest. Canada called the tariffs "absolutely unacceptable," while top European Union officials said they are developing plans to retaliate. Some European companies said they were putting U.S. investments on hold in response. Retaliatory tariffs could put other U.S. industries in jeopardy as well. China is already reviewing whether to restrict imports of American wheat and soybeans in response to previous tariffs, and experts say Beijing could expand that policy to other major U.S. imports, including technology, aircraft, and intellectual property.[136]

[135] Corden M., Garnaut R., *The economic consequences of Mr. Trump*, the Australian economic review, 2018.
[136] Sapelli G., *Un nuovo mondo: la politica di Trump e i suoi effetti globali*, Guerini e associati, 2017.

CONCLUSION

Trade liberalization ought to be about agreed-upon principles and rules to govern trans-border exchanges that are legitimate as norms, and thus defendable as something other than concessions made by some members in return for gains in other areas. Proponents of this vision often advocate the 'constitutionalization' of the WTO; that is, a global pact on global economic governance which would be stable over time and protected from political vagaries.

Many perceive China as failing to play by the international trading rules, even as it embraces the WTO.

The US, for instance, has repeatedly brought WTO cases against China over its support for various export industries, including one in early 2017 alleging that Beijing unfairly subsidies aluminum producers. Although the case has not been decided, yet the Trump administration has already retaliated by unilaterally imposing tariffs on some Chinese aluminum producers.[137] China has stolen the US intellectual property rights and violated other trade obligations to the US. The Trump administration's policy on this subject has to deal with the following aspects:

- Launch a WTO complaint about 'coerced transfers', or China's act of coercing intellectual property transfers by the US firms operating in that country. The Trump administration has shown little patience to go through a WTO process to address that.
- The Trump administration's response to China's alleged trade agreement violations with import tariffs.
- Restricting Chinese foreign investment in the US.

The U.S. has two options to retaliate against another country for violating trade treaty obligations:

- **The Legal Route**. It involves raising a complaint at the World Trade Organization, which would mean litigation to prove to a WTO panel that the other country violated a trade agreement, followed by a similar process at an appellate body. If the charge is proved, the other country would then be given a chance to comply with the rules. If it fails to comply, the appellate body would approve specific retaliation, all of which generally take about four years.
- **Not Following the WTO Process**. It risks pushing everyone into a trade war and a seriously dangerous downward spiral. Trump's memorandum on the tariffs gives the US trade representative that option of pursuing the four-year process, even if his rhetoric did not indicate that.

The trend towards using legal proceedings to resolve disputes (known as 'judicialization') in global trade governance may be the most significant revolution in today's trade world. Indeed, it could be argued that

[137] McBride J., *How Are Trade Disputes Resolved?*, March 13, 2018.

political negotiations, on the one hand, and judicial settlement, on the other, have long constituted two alternative avenues for decision-making in trade governance; and that, faced with political stalemate, judicialization is increasingly superseding political bargaining as the major way of reaching decisions in this area.

However, today the real tension is between two very different visions of what global trade governance ought to be about.

A great deal of the trade game is no longer played in the WTO ‘courtyard’. Whether in traditional sectors or in new areas such as intellectual property rights, regional or bilateral free trade agreements now cover almost the entire globe.

Dispute settlement-based global law is still a long way off providing a stable equilibrium around which actors’ expectations can happily converge. As a majority of WTO members contemplate the challenges ahead, without further political clarification of current international trade law, they might well conclude that bringing politics back into the process remains the only democratically legitimate and functionally sound option open to them.

So, China is unsatisfied with the degree of accommodation offered by the U.S. and the U.S. is uncomfortable with the strategic demands made by China.

Tensions would be further aggravated if the Chinese Government believes, as some Chinese analysts claim, that the more China “rises”, the harder Washington will resist. Economically, both the U.S. and China would lose from a trade war. Punitive tariffs would push up import prices, dent exports, cost jobs and crimp economic growth. Both sides would do best to avoid an outbreak of hostilities.[138]

And the whole world is watching carefully.

[138] Myers S.L., *Why China Is Confident It Can Beat Trump in a Trade War*, The New York Times, April 5, 2018.

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DEPARTMENT OF MANAGEMENT

Chair of International Economics and Industrial Dynamics

THE ECONOMIC POLICIES OF U.S.A. AND CHINA.

TRUMP versus XI JINPING: "THE DUTIES WAR".

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SUMMARY

International trade also known as ‘foreign trade’ can be defined as “the exchange of products, services, and money across national borders; essentially trade between countries. When consumers in the U.S. purchase Swiss-made watches, Guatemalan-grown fruits, Chinese-made toys and electronics, Japanese-manufactured automobiles they experience the end result of international trade.”

The need for international trade has arisen because the production of different types of goods and services require different kinds of resources (including economic resources) which are used in different proportions, but all these resources are unevenly distributed all over the world and the international mobility of these resources is limited. Land is a major economic resource but it is geographically immobile.

At the vanguard of the globalization movement, it is committed to promotion of free trade by reducing obstacles such as tariffs, quotas and regulations that slow and reduce the movement of goods between different countries.

But, free trade, has its strengths and weaknesses, if it not properly regulated and if the countries don’t respect these rules.

The current U.S. President, Donald Trump, has for years accused the Chinese Government of unfair trade practices, which he says puts the U.S. companies at a disadvantage. Many other foreign leaders have agreed that China unfairly subsidies its businesses and has at times devalued its currency to boost exports.

Under the World Trade Organization (WTO) rules, a developing country is entitled, to a certain extent, to use non-market practices to spur economic development. Since it became an economic power house trailing only the U.S., developed countries want China to follow the same rules and responsibilities as a market economy. While China has significantly liberalized its economic and trade regimes over the past three decades, it continues to maintain or has recently imposed a number of state directed policies that appear to distort trade and investment flows.

But, what is the current weight of China in the international trade?

China is the fastest emerging economy in the world and is also referred as a BRIC economy. (BRIC is a term coined by a US investment bank in the year 2001 to refer to the four countries in the world which are Brazil, Russia, China and India).

China fully opened to international trade when its President Deng Xiaoping announced the ‘open door’ policy in December 1978, before this China was mainly trading with USSR and its satellites (socialist countries). China had some trade links with the capitalist countries but it was the first time that they had opened to the capitalist economy on such a large scale. So the ‘open door’ policy refers to the set of policies adopted by China to develop and expand the economic relations with the capitalist world economy.

China announced the ‘open door’ policy because they had realized that if they want to grow and become a developed country they need western investment and technology and they should also open the door to foreign businesses. The first step China took to attract the foreign investment was authorizing special

economic zones in southern China with incentives such as tax concessions, reductions in land use fees and favorable labour prices. By making these reforms China's economy took off and since 1980s it is said to be the fastest growing economy in the world. Continuing with the reformation process, in 2001 China joined World Trade Organization (WTO) with the hope that its membership will help their economic system to flourish more.

Today, the U.S. and China are the two biggest economies in the world.

A trade war between U.S and China would have very serious repercussions all over the world. It could derail the current global economic expansion and cripple American businesses that depend on business with China. It could also further complicate geopolitical priorities given the Trump administration has enlisted the help of the Chinese in solving the crisis with North Korea.

The U.S.-China trade rose rapidly after the two nations re-established diplomatic relations in January 1979, signed a bilateral trade agreement in July 1979 and provided mutual most favored nation (MFN) treatment, beginning in 1980. In that year (which was shortly after China's economic reforms began), the total U.S.-China trade (exports plus imports) was approximately $4 billion. In 2017, the total US merchandise trade with China was $636 billion, making China the US' largest trading partner.

On March 8, 2018, the U.S. President Donald Trump announced imposing additional tariffs on China's export of steel and aluminum to USA. On March 22, 2018, President Trump announced plans to enact sanctions against China over its Intellectual Property Rights (IPR) policies that negatively affect the U.S. stakeholders. These sanctions included raising tariffs by 25 percent on selected Chinese products valued at $50 billion to $60 billion. On April 1, China announced that it

had retaliated against the U.S. action by raising tariffs on various American products, such as pork. On April 3, the U.S. administration unveiled a list of 1,333 products worth $50 billion in trade to which it intended to apply a 25 percent tariff. These Chinese goods are in strategic sectors such as information technology, robotics, advanced rail and shipping, new energy vehicles and high-technology medicine and health care. A few hours later, China released its proportional response: 25 percent tariffs on 106 products, also worth $50 billion in trade. Thus, there is a tit-for-tat action going on between China and the U.S. The Trump administration's plans to tax $50 billion worth of Chinese imports was met with threats by the Chinese to subject $50 billion worth of American products to the same. China threatened to retaliate with tariffs on American cars, chemicals and other products.

So far, China's government has reacted to new tariff actions by the Trump administration with relatively restrained words and promises of proportional responses to the American government's actions.

In my graduation thesis I will examine the aspects of international trade and in particular the commercial relations between the two strongest economic powers in the world of our times - U.S. and China - and their trade policies in order to solve their disputes.

I will examine all the possible consequences of a failed agreement between the two parties and I will observe the role of the WTO in resolving international trade disputes: certainly this is the most intricate but also the most interesting of all time.

We are going to see how it will end!

Why do countries trade? Countries trade because they are different. They have different technologies or have a different amount of capital and labor. Or they trade because they produce different varieties of the same good. In the first case trade generates gains because it allows countries to specialize in the production of the good it can produce relatively more efficiently or that it uses intensively the factor that they are more endowed with. In the second case trade generates gains because people love variety and trade provides access to different varieties of goods produced all over the world. By increasing the variety of goods consumers can access and buy, trade makes consumers better off.

The world trade has become harder to characterize in simple terms.

A century ago, each country's exports were obviously shaped in large part by its climate and natural resources. Disputes over trade were also easy to explain: the classic political battles over free trade versus protectionism.

It becomes apparent that opening an economy to trade is likely to generate dynamic gains of two sorts:

- free trade might increase a country's stock of resources as increased supplies of labor and capital from abroad become available for use within the country;
- free trade might also increase the efficiency with which a country uses its resources.

Also, opening an economy to foreign competition might stimulate domestic producers to look for ways to increase their efficiency.

The invisible hand of the market mechanism, rather than government policy, should determine what a country imports and what it exports.

But, what should a nation's trade policy be?

The policies that governments adopt toward international trade involve a number of different actions. These actions include taxes on some international transactions, subsidies for other transactions, legal limits on the value or volume of particular imports, and many other measures (for example, the use of a tariff or an import quota to protect own industries against competition from other countries).

What are the instruments of trade policy? There are many ways in which governments influence trade. In general, any policy-induced trade cost represents a barrier to trade. Following there is a short list of the most know instruments:

- Tariffs: the simplest of trade policies is a tax levied when a good is imported. Specific tariffs are levied as a fixed charge for each unit of goods imported (for example, \$3 per barrel of oil). Ad-valorem tariffs are taxes that are levied as a fraction of the value of the imported goods (for example, a 25 percent U.S. tariff on imported trucks). In either case, the effect of the tariff is to raise the cost of shipping goods to a country. Tariffs are the oldest form of trade policy and have traditionally been used as a source of government income.

- Customs duties: customs duty is a tax imposed on imports and exports of goods. The rates of customs duties are either specific or on ad valorem basis, that is, it is based on the value of goods. Customs duties may also be levied to protect the domestic industry from foreign competition. In cases foreign producers attempt to subsidize the goods being exported by them so that it causes domestic production to suffer because of a shift in domestic demand towards cheaper imported goods, the government makes mandatory the payment of a "countervailing duty" on the import of such goods to the domestic economy.
- Quotas: the best known form of non-tariff barrier is a quota. This is the maximum quantity of some good that may be imported.
- Export subsidies: they represent an instrument of trade policy, as governments by providing support to the export activity distort trade.

The effects of the major instruments of trade policy are usefully summarized by Table 1.1, which compares the effect of four major kinds of trade policy on the welfare of consumers.

Effects of Alternative Trade Policies

	Tariff	Export Subsidy	Import Quota	Voluntary Export Restraint
Producer surplus	Increases	Increases	Increases	Increases
Consumer surplus	Falls	Falls	Falls	Falls
Government revenue	Increases	Falls (government spending rises)	No change (rents to license holders)	No change (rents to foreigners)
Overall national welfare	Ambiguous (falls for small country)	Falls	Ambiguous (falls for small country)	Falls

Tab. 1.1 *Effects of alternative trade policies*

International trade theory clearly asserts the benefits of free trade and highlights the inefficiency losses of imposing a tariff. In reality, very few countries have adopted total free trade. Most tariffs, import quotas, and other trade policy measures are undertaken primarily to protect the income of particular interest groups.

From the mid-1930s until about 1980, the United States and other advanced countries gradually removed tariffs and some other barriers to trade, and by so doing aided a rapid increase in international integration.

To regulate and to keep watch the international trade agreements and the fair compliance with the rules, there is a world organization, named World Trade Organization (WTO).

The WTO does not tell Governments what to do or how to conduct their trade policies. Rather, it's a "member-driven" organization. That means:

- the rules of the WTO system are agreements resulting from negotiations among member governments,
- the rules are ratified by member's Parliament, and
- decision taken in the WTO are virtually all made by consensus among all members.

The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between Nations. The WTO's creation on 1 January 1995 marked the biggest Reform of international trade since after the Second World War. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible.

"Each member receives guarantees that its exports will be treated fairly and consistently in other members' markets. Each promises to do the same for imports into its own market".

Trade frictions are channeled into the WTO's dispute settlement process, where the focus is on interpreting agreements and commitments and how to ensure that members' trade policies conform with them. That way, the risk of disputes spilling over into political or military conflict is reduced.
There is a WTO Committee on Trade and Development that looks at developing economies' special needs. The WTO agreements are full of provisions taking the interests of development into account, in fact freer trade boosts economic growth and supports development: commerce and development are good for each other. At the same time, whether or not developing countries gain enough from the system is a subject of continuing debate in the WTO.
All WTO agreements contain special provisions for them, including longer time periods to implement commitments, measures to increase their trading opportunities and support to help them build the infrastructure needed to participate in world trade.
There are many economics studies and that show how the international trade led to an economic growth in developing countries. Trade and financial liberalization are prominent features of globalization. International trade has increased dramatically in recent decades, and flows of goods and services are crucial for achieving sustained growth in developing countries.
At first, these success stories involved a group of relatively small East Asian economies: South Korea, Taiwan, Hong Kong, and Singapore. Over time, however, these successes began to spread; today, the list of countries that have experienced startling economic takeoffs includes the world's two most populous nations, China and India.

The China's join the World Trade Organization in 2001 has fostered its trade growth and, as an economy highly integrated into the global trade system, the country benefited from a steady improvement in its terms of trade. International trade is a key component of economics and is the one that has played an important role in the growth of China.

Economic growth soared in the last few decades mainly due to the country's increasing integration into the global economy and the government's bold support for economic activity.

When and how did China fully open to international trade, and what are the benefits they have and problems they are coming across after opening to international trade?

China fully opened to international trade when its President Deng Xiaoping announced the 'open door' policy in December 1978 - it refers to the set of policies adopted by China to develop and expand the economic relations with the capitalist world economy. It also consisted of "a set of sub-policies in the spheres of foreign trade, foreign direct investment and foreign borrowing".

Before this, China was mainly trading with USSR and its satellites (socialist countries). China had some trade links with the capitalist countries but it was the first time that they had opened to the capitalist economy on such a large scale.

China realized that if it want to grow and become a developed country it need western investment and technology and it should also open the door to foreign businesses. The first step China took to attract the foreign investment was authorizing special economic zones in southern China with incentives such as tax concessions, reductions in land use fees and favorable labor prices. By making these reforms China's economy took off and since 1980s it is said to be the fastest growing economy in the world.

We saw that there are many benefits which are associated to international trade like, by doing business with other regions and countries a business or a country learns a great deal about the product development strategies and technologies, and also there is always an opportunity for them to make more profit, sell more, increase productivity and remove seasonal fluctuations of supply and demand. International trade also leads to more and better choices of goods and services for consumers; increase in competition leads to competitive prices in domestic and international markets which again are good for consumers. Competition will also lead to, better quality products, reduction in unemployment and poverty level and a rise in the GDP (Gross Domestic Product) level. Consequently this leads to maturity and growth of a country's economy including its businesses.

China has grown at a rapid pace after opening to international trade making it a manufacturing hub of the world. According to some reports between 1990-2004 China's economy grew at an average rate of 10 percent per annum which was the highest growth rate in the world and substantial part of this growth was international trade as 45 percent of growth came from exports. China also has surpassed Germany recently to become the world's second largest trading nation. Total foreign trade in China in the year 2007 was estimated to be $2.17 trillion which was an enormous increase from 1978 when total international trade estimated was $21 billion. According to one report from World Bank in 2001 China contributed 21 percent to global trade growth.

Moving on with the benefits of trade, by opening to foreign trade China's technological expertise and firms have been open to increased technological and business exposure and this has enabled China to acquire some highly sophisticated technology helping them to built a number of advanced manufacturing plants producing a large range of sophisticated equipment such as satellites and nuclear weapons making China and its domestic firms more competitive at international level.

Another advantage of trade is that it has increased the variety of goods and services available to the Chinese consumers, and at the same time it has also increased the competition level in the local markets. As multinational firms have entered into the Chinese markets, prices have become more competitive again benefiting the consumers as they are able to buy products at lower prices.

The 2016 presidential election, in which Republican candidate Donald J. Trump was elected president on an explicitly protectionist platform, marks a potential turning point where the Unites States could reserve course on 80 years of movement toward freer trade and enhanced multilateral cooperation.

Asia figures prominently in these developments.

Protecting American industry, especially steel, was a centerpiece of Trump's 2016 campaign.

"It will be American steel that will fortify America's crumbling bridges"

Donald J. Trump

Steel employment has fallen from nearly 650,000 workers in the 1950s to some 140,000 today, with many of the closed mills in swing states such as Pennsylvania.

Many steel and aluminum producers around the world have long blamed the Chinese government for subsidizing production of the metals in violation of global trade rules, which many analysts say has flooded the global market with low-cost product and sent prices plunging. U.S. producers have clamored for protection from such "dumping" via tariffs or quotas, which previous administrations have provided in limited cases.

Over the past two generations, the U.S. economy has experienced a tremendous increase in globalization. That expansion of trade has largely been driven by falling transportation and communications costs and rising incomes, but supportive trade policies has also played a role. Asia has been an important part of this process, accounting for more than one-third of U.S. trade for the last 30 years.

Expansion of international trade - in particular the so-called "China shock" of the 1990s and the granting of permanent normal trade relations following China's accession to the World Trade Organization (WTO) in 2001, together with a period of Chinese currency undervaluation - contributed to a surge in manufactured imports with adverse consequences for US manufacturing employment. But that period of rapid increase in import penetration has passed and the productivity change accounted for 88 percent of the job losses.

Instead, the Trump administration is responding with protectionist trade policy. Since the 1930s, when a global drive to raise trade barriers deepened the Great Depression, U.S. specialists and the public at large have shared the belief that a liberal U.S.- led rules (based international trade regime is in the United States' national interest). Trade policy has thus seldom, if ever, risen to a top-tier issue in electoral politics.
During the campaign, President Donald Trump has emphasized three recurring themes regarding trade policy:

- the importance of trade balances, including bilateral trade balances (in this view, a major challenge facing the U.S. in its $500 billion merchandise trade deficit, around half of which is whit China, with Japan and Korea also contributing);
- currency manipulation to gain unfair advantage in trade, and
- "disastrous" trade agreements.

Trump withdrew the United States from the Trans-Pacific Partnership, is increasing contingent or process protection, demanding the renegotiation under duress of the North American Free Trade Agreement (NAFTA) and the Korea-United States Free Trade Agreement (KORUS FTA).
In April 2017, the Commerce Department of U.S. launched an investigation into Chinese trade policies regarding intellectual property: in particular into whether steel and aluminum imports "impaired national security". It concluded in early 2018.
This allowed president Trump to apply tariffs (the Reciprocal Trade Agreement Act of 1934 was the first law giving the president power to create tariffs on imported goods. Section 232 of a later law, the Trade Expansion Act of 1962, gave the president the ability to impose a tariff on items imported into the U.S. that are a threat to national security).
It imposed tariffs on billions of dollars worth of Chinese products last year (2018), and Beijing retaliated in kind. China has targeted products including chemicals, coal and medical equipment with levies that range from 5% to 25%. It has strategically targeted products made in Republican districts, and goods that can be purchased elsewhere, like soybeans.

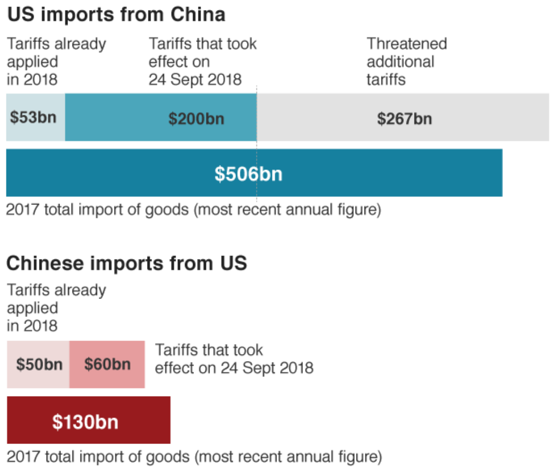

Fig. 3.2 *US and China tariffs against each other*

After months of hostilities, a breakthrough of sorts came in December 2018.

Both countries agreed to halt new trade tariffs for 90 days to allow for talks. China and the US have agreed to immediately begin negotiations on structural changes with respect to forced technology transfer, intellectual property protection, non-tariff barriers, cyber intrusions and cyber theft, services and agriculture.

They imposed a deadline of early March 2019 to resolve their differences, or the battle may heat up again.

The 2018 steel and aluminum tariffs - sometimes known as the "Trump Tariffs" - aren't the first time in recent history a U.S. president has imposed tariffs on imports of the metals. In 2002, then-President George W. Bush put a tax on steel imports. The tariffs took effect in March of that year and were scheduled to last until 2005. Bush ended up lifting the tariffs in December 2003.

The big story between the United States and China right now was supposed to be the critical round of trade talks taking place in Washington, as negotiators race against a March 2 deadline for the Trump administration to further increase tariffs on Chinese imports.

Instead, on the eve of the negotiations the Justice Department on Jan. 28 revealed indictments against Chinese telecommunications giant Huawei Technologies, charging the company's leaders with deliberately evading U.S. sanctions on Iran and orchestrating a campaign to steal trade secrets from U.S. competitors.

Huawei is one of the largest telecommunications equipment and services providers in the world, recently passing Apple to become the second biggest smartphone maker by volume after Samsung.

Huawei is what the Chinese call a national champion. A private firm, tasked with China's ambitions to go into the world and lead the way.

But the U.S. and other Western nations have been concerned that the Chinese government could use Huawei's technology to expand its spying ability, although the firm insists there is no government control.

The arrest of Ms Meng, the daughter of Huawei's founder, infuriated China.

She was arrested on 1 December 2018 in Canada's western city of Vancouver at the request of the U.S.

She was later granted a C$10m bail by a local court. But she is under surveillance 24 hours a day and must wear an electronic ankle.

Chinese telecoms giant Huawei has denied any wrongdoing after U.S. prosecutors filed a host of criminal charges against the firm. The charges filed against Huawei in the U.S. include bank fraud, obstruction of justice and theft of technology. The case could escalate tensions between China and the US. In a statement, Huawei said it was "disappointed to learn of the charges brought against the company today".

Separating security and economics is going to become far harder in the future relationship with China. It is already a major technology exporter, and Chinese operations are integrated into the global supply chains of many leading western companies.

Another big issue is China's market economy status in the WTO. When China joined the WTO it was classified as a non-market economy (NME), which allows the Department of Commerce to use very elastic procedures in anti-dumping investigations. China understandably wants to constrain this discretion, and under its WTO accession agreement, NME status was to end in December 2016.

If the Trump administration continues to treat China as an NME in anti-dumping investigations, China could probably take the United States to the WTO on the issue of market economy status and win, and indeed it has already initiated a complaint.

But going the WTO route would take a couple of years and might erode U.S. support for the whole WTO system, which has benefitted China greatly, especially in light of President Trump's periodic threats to ignore the WTO or withdraw the United States entirely.

It might be preferable to enter into negotiations to strike a balance between China's desires for improved market access and U.S. concerns about market access in China. Sectoral market economy status might be one component of an overall accommodation.

Trade liberalization ought to be about agreed-upon principles and rules to govern transborder exchanges that are legitimate as norms, and thus defendable as something other than concessions made by some members in return for gains in other areas. Proponents of this vision often advocate the 'constitutionalization' of the WTO; that is, a global pact on global economic governance which would be stable over time and protected from political vagaries.

Many perceive China as failing to play by the international trading rules, even as it embraces the WTO.

The US, for instance, has repeatedly brought WTO cases against China over its support for various export industries, including one in early 2017 alleging that Beijing unfairly subsidises aluminum producers. Although the case has not been decided, yet the Trump administration has already retaliated by unilaterally imposing tariffs on some Chinese aluminum producers. China has stolen the US intellectual property rights and violated other trade obligations to the US. The Trump administration's policy on this subject has to deal with the following aspects:

- Launch a WTO complaint about 'coerced transfers', or China's act of coercing intellectual property transfers by the US firms operating in that country. The Trump administration has shown little patience to go through a WTO process to address that.

- The Trump administration's response to China's alleged trade agreement violations with import tariffs.
- Restricting Chinese foreign investment in the U.S.

The U.S. has two options to retaliate against another country for violating trade treaty obligations:

- **The Legal Route**. It involves raising a complaint at the World Trade Organization, which would mean litigation to prove to a WTO panel that the other country violated a trade agreement, followed by a similar process at an appellate body. If the charge is proved, the other country would then be given a chance to comply with the rules. If it fails to comply, the appellate body would approve specific retaliation, all of which generally take about four years.
- **Not Following the WTO Process**. It risks pushing everyone into a trade war and a seriously dangerous downward spiral. Trump's memorandum on the tariffs gives the US trade representative that option of pursuing the four year process, even if his rhetoric did not indicate that.

The trend towards using legal proceedings to resolve disputes (known as 'judicialisation') in global trade governance may be the most significant revolution in today's trade world. Indeed, it could be argued that political negotiations, on the one hand, and judicial settlement, on the other, have long constituted two alternative avenues for decision-making in trade governance; and that, faced with political stalemate, judicialization is increasingly superseding political bargaining as the major way of reaching decisions in this area.

However, today the real tension is between two very different visions of what global trade governance ought to be about.

A great deal of the trade game is no longer played in the WTO 'courtyard'. Whether in traditional sectors or in new areas such as intellectual property rights, regional or bilateral free trade agreements now cover almost the entire globe.

Dispute settlement-based global law is still a long way off providing a stable equilibrium around which actors' expectations can happily converge. As a majority of WTO members contemplate the challenges ahead, without further political clarification of current international trade law, they might well conclude that bringing politics back into the process remains the only democratically legitimate and functionally sound option open to them.

So, China is unsatisfied with the degree of accommodation offered by the U.S. and the U.S. is uncomfortable with the strategic demands made by China.

Tensions would be further aggravated if the Chinese Government believes, as some Chinese analysts claim, that the more China "rises", the harder Washington will resist. Economically, both the U.S. and China would lose from a trade war. Punitive tariffs would push up import prices, dent exports, cost jobs and crimp economic growth. Both sides would do best to avoid an outbreak of hostilities.

And the whole world is watching carefully.