Trade War: the clash of economic systems endangering global prosperity

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Part 1: An introduction to the multilateral World Trading System
- Overlapping and asymmetric trade agreements
- Flexibilities to restrict trade

Part 2: The origins of the current US-China trade conflict
- China’s rise as a trading nation
- Manufacturing job loss in America
- The WTO Dispute Settlement Crisis

Part 3: The future of the multilateral system
- Establishing new rules for subsidies and competition policy
- Rebalancing the commitments to market access
Part 1: The World Trading System
What is the World Trading System?

- an overlapping network of international agreements that establish rules for trade in goods (and services) under the umbrella of the World Trade Organization (WTO)

What does this cover?

- a multilateral agreement of tariff reductions, quota rules, subsidy rules, and exceptions to rules (GATT/WTO)
- plurilateral agreements over government procurement and specific sectors like civil aviation (WTO)
- large multiparty agreements over tariff reductions, domestic issues like competition policy or labour markets (EU, TPP, NAFTA)
- bilateral agreements over tariff reductions, investment rules (US-Korea FTA, Canada-EU FTA, etc.)
- other issues: trade-related investment measures and intellectual property rules; state-to-state or investor-state dispute settlement
Market access for goods under the WTO

Import tariff rates (trade taxes) against other WTO members, 2015

Source: https://www.wto.org
Flexibilities as part of a liberal trading system

Today, trade policy in many countries is characterized by low or zero tariff rates on most products and high tariffs or other import restrictions on a small subset of products.

For the US, the simple average of MFN tariff rates in 2010 was 3.6%. However, the US imposed WTO-permitted temporary trade barriers on 5.7% of imported products in the same year.
Terms of Trade Theory

Economists argue countries come together and negotiate tariff reductions to improve their mutual welfare.

- However, a short term change in import demand or export supply can reduce the incentive to cooperate with low tariffs.

- Thus, flexibility provisions allowing short term tariff increases in limited circumstances are a necessary feature of any sustainable trade agreement.

It is important to understand what types of shocks drive the use of “contingent” temporary trade barriers so that we can design appropriate trade agreements.
## Does a broad commitment to liberal trade...

### Applied and Bound Import Tariffs, 2013

<table>
<thead>
<tr>
<th>Country/territory</th>
<th>MFN applied rate, simple average (1)</th>
<th>WTO binding rate, simple average (2)</th>
<th>Products with binding coverage (3)</th>
<th>Products with applied duties &gt; 15% (4)</th>
<th>Products with binding rates &gt; 15% (5)</th>
<th>Maximum MFN applied rate (6)</th>
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Source: Bown and Crowley (2016)
...rely on a trade agreement’s flexibility?
Percent of HS06 products subject to a temporary trade barrier, 1990-2013

Source: Bown and Crowley (2016)
The use of temporary trade barriers

Economic studies have found that WTO members respond to economic shocks with increased temporary trade barriers.

Import volume shocks (increases) in the US over 1997-2006 led the US to increase the likelihood of an antidumping duty by about one-third (Bown and Crowley, AER, 2013).

High- and middle-income countries use product level trade barriers to mitigate adverse aggregate shocks (Bown and Crowley, JIE, 2013 and JDE, 2014).
Temporary Trade Barriers and Macro Shocks
High-Income WTO members, 1988-2008

Source: Bown and Crowley (2013)
Part 2: Origins of the US-China Trade Conflict
China’s rise as an economic power

Handley and Limao (2017): one-third of growth of Chinese export value to the US over 2000-2005 was due to certainty over future tariffs (reduced threat of trade war) due to WTO accession.


Corsetti, Crowley, Han, and Song (2019): Roughly half of Chinese exports over 2000-2014 originate from Foreign-Invested Enterprises
The growth of exporting enterprises in China: 2000-2014

Numbers of firms by registration type, Source: Corsetti, Crowley, Han, and Song (2019)
The growth of export value from China: 2000-2014
Source: Corsetti, Crowley, Han, and Song (2019)
Foreign-invested enterprises exporting from China
Export share by registration type, Source: Corsetti, Crowley, Han, and Song (2019)
China and US Manufacturing Employment

Source: Autor, Dorn and Hanson (2013)

Figure 1. Import penetration ratio for US imports from China (left scale), and share of US working-age population employed in manufacturing (right scale)

Rising imports from China explains 55% of the decline in US manufacturing employment 2000-2007
Concerns with the WTO system

- US claim that global trade rules are unfairly tilted against high-income countries (and lead to job loss)

- A changing political economy related to the rise of global supply chains and the denationalization of comparative advantage

- Concerns over sovereignty/freedom of control over domestic policy

- WTO rules on State Aid and industrial policy are insufficient for addressing State-capitalism
WTO Dispute Resolution Crisis

The US has been successful in “winning” most cases at the WTO, but...

1. Antidumping: The WTO chipped away at US discretion to restrict imports from “anti-competitive” firms.
2. Subsidies/state support I: Industrial policy use by China creating global overcapacity (steel)
3. Subsidies/state support II: “Public body” ruling by WTO killed prospect of challenging China’s industrial policy as unfair.

⇒ Trump administration sidelines the WTO entirely to push for change, but a bilateral agreement is unlikely to lead to substantive reforms
Costs of the conflict

Who pays the cost of an import tariff?

Ossa (2019): Small countries lose – in an all-out global trade war, US, EU and China lose 2% of GDP, but Switzerland loses 14% and Mexico and Canada lose 7%.

Amiti, et. al. (2019) and Fajgelbaum, et. al. (2019): to date, the cost of US tariffs has been borne by Americans, but as time progresses, tariffs are expected to exert downward pressure on global prices.

Huang et. al. (2019): US firms exposed to Chinese supply chains have lost stock market value.

Anecdotal evidence that US firms are seeking new suppliers outside of China.
Part 3: The future of the multilateral system
The future of multilateralism?

The rules-based multilateral system was reasonably effective at leveling the playing field and promoting a globally efficient allocation of resources.

The WTO system can no longer deliver “fair” competition:

1. A clash of economic systems – free market laissez-faire v. state-directed capitalism
2. China reliance on and commitment to state support for industry
3. Technology transfer requirements/ intellectual property protection

Sidenote: Aggressive American unilateralism will not be effective in delivering fair competition in a multilateral world.
The challenges ahead

The small challenges: Fixing the WTO
- Create tools in the WTO to
  - respond to industrial/export promotion policies
  - enforce intellectual property protection

The bigger challenges: Creating a level playing field
- Global rules for “fair competition” are needed to solve many problems, but require a loss of sovereignty
- At what level – national, regional, global – should competition policy target market power?
- International tax competition erodes the tax base and creates “unfair” advantages.
Steps toward a solution?

Option 1: Disengagement between the US and China

Option 2: Bilateral US-China negotiations to rebalance market access
 ⇒ Supported by multilateral engagement with major economies

Option 3: “Small” multilateral negotiations among major economies to rebalance the system