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In Politique étrangère 2019/1 Spring Issue, pages 57 to 69
Publisher Institut français des relations internationales

ISSN 0032-342X
ISBN 9791037300003
DOI 10.3917/pe.191.0057

International Trade Disagreements: Beyond Trump

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Translated from French by Cadenza Academic Translations.

The trade war between the United States and China is not only due to Donald Trump's impulsiveness. Its roots are in fact profound and follow three structural changes in the multilateral trading system: the reversal of comparative advantages, the now central role of certain developing countries, and the re-balancing of power that makes coordination between states difficult. In this context, the future of world trade has yet to be written.

politique étrangère

International trade relations are in a state of tension that has not been seen since the Second World War and that is characterized by major increases in unilateral sanctions, reprisals, and threats, against a backdrop of profound and paralyzing challenges to the World Trade Organization (WTO).

The ostensible cause is the Trump administration's trade policy. Quite apart from the sums involved,[1] the destabilizing nature of this policy is related to the nature of the instruments used and the rhetoric accompanying them. The policy represents a major break from the norms upon which the multilateral trading system is based, and of which the United States has historically been both architect and leader. Protectionist measures, obviously motivated by economic concerns, have been justified by the argument of national security, which places them *de facto* outside the remit of the multilateral trading system. Donald Trump repeatedly

1. The protectionism of the Reagan administration, mainly aimed at Japan, affected a larger share of US imports of goods: 21% in 1984, compared to only 13% on January 1, 2019. D. A. Irwin, *Clashing over Commerce*, Chicago: The University of Chicago Press, 2017, p. 574.

blames all imaginable ills on the WTO, an organization that is directed by its members and that cannot function unless they respect its legitimacy.

While it is necessary to study the Trump administration's policy in order to understand the current state of international trade relations and their possible future development, this is only a starting point. The causes of the tensions observed go beyond the whims of an unpredictable president; international trade has changed profoundly over the last twenty-five years, and this has presented its institutional foundation with three structural problems: the reversal of comparative advantages in a context in which trade agreements cover goods much more effectively than services or investment; the major emerging economies' status as latecomers to the trading system, which creates an asymmetry of commitment compared to countries that have long been full members; and multipolarity, which leaves the system without a dominant power able to play the role of constructive leader.

These problems present challenges to the stability and relevance of the multilateral trading system, which is why the political dimension is currently coming to the fore in structuring exchanges. This perspective suggests that the shift in the way the US treats these issues is likely to continue and presents challenges of both a political and economic nature. Nevertheless, the constraints of the globalized economy are strong and place clear limits on what is likely to develop in the future.

What is Trump's protectionism saying "no" to?

The American president's overall objectives were clearly stated in his campaign slogan, *America First*, which echoed as a resounding "no" to multilateralism and has been manifested in the priority given to security and national sovereignty, in the confrontation with China, and in the reindustrialization of the United States. On the economic front, his speech on June 28, 2016 in Monessen (Pennsylvania) entitled "Declaring America's Economic Independence," introduced many of the measures to come, notably withdrawal from the Trans-Pacific Partnership, renegotiation of the North American Free Trade Agreement (NAFTA), safeguard measures against China, "tough" trade negotiations, and tax reforms.

The tax reforms, passed by Congress in December 2017 and evidence of an overall strategy, include several questionable provisions relating to US international commitments. The new provisions aim to encourage the creation of businesses on American soil and to prevent erosion of the tax base. The Global Intangible Low-taxed Income (GILTI) provision imposes a minimum tax on earnings abroad, while the Base Erosion and Anti-abuse Tax (BEAT) tax impacts transfers between subsidiaries considered to be involved in the erosion of the tax base. In both cases, the provisions imposed by the United States on their trade partners are radically new in the landscape of international rules and are likely to exert a lasting influence.

Even so, the Trump administration's trade strategy remains nebulous and its objectives are yet to be clearly defined. Donald Trump's long-held obsession with trade deficits is obviously part of it, but to date he has not hit his target: the US trade deficit increased by some 10% in 2018, and even more in relation to China alone. And, moreover, the target is not the right one, as the deficit comes from insufficient savings (worsened here by the tax reforms) and not from trade policy. There is an occasional temptation to draw back from globalization, but this is not consistent: a taste for customs duty is combined with demands for the suppression of barriers to trade, while the desire to project US economic power around the world is still evident.

An occasional temptation to draw back from globalization

Two years after the inauguration of the Trump presidency, the clearest objective is the reorientation of US trade policy with regard to strategic competition with China, highlighted in the National Security Strategy published in December 2017. This goal has since received widespread support among political leaders from both parties, as well as economic elites. Even the iconic champion of Sino-American relations, Henry Paulson, declared in November 2018 that certain Chinese trade practices are "simply unacceptable" and that "de-integration is inevitable, and even necessary, in some areas."[2] Paradoxically, even though the way it is formulated and the tools employed are different, this goal is also the least novel, as the Obama administration had already made a political priority of the so-called "Pivot to Asia," which involved the containment of China's economic and strategic competition. This objective was also manifested in the increase in safeguard or anti-dumping measures, the submission of numerous disputes to the WTO, the increasingly close scrutiny of Chinese investment projects in the United States, and the negotiation of the Transatlantic Trade and Investment Partnership.

2. Opening speech at *Bloomberg New Economy Forum*, Singapore, November 6, 2018, available at: <www.paulsoninstitute.org>.

Thus, behind the froth caused by Trump's whims and provocations, there is a general increase in tension that is destabilizing international trade relations by subordinating them to strategic competition between the United States and China. If US policy has been disrupted in this way, it is because international trade has changed profoundly since the creation of the WTO, and this calls into question the foundations of that policy.

International trade: what has changed

The multilateral trading system in its current form is based essentially on the Marrakech Agreement, signed in April 1994. The reality of world trade has changed considerably since then, with an almost doubling of the world trade openness index and a tripling of foreign direct investment stocks as a share of world income between 1993 and 2008.[3] In a geopolitical context defined by US domination and the opening of China and the countries of the ex-Soviet bloc, a new phase of globalization was initiated at the beginning of the 1990s, based on the revolution in information and communication technologies and on institutions designed to facilitate international commercial and financial relations.

In *The Great Convergence*, Richard Baldwin describes this phase as the "second unbundling": while nineteenth-century technological progress had made it possible to separate the place of production from the place of consumption, at the end of the twentieth century, reductions in the cost of transmitting ideas made it possible to decouple work from knowledge.[4] This meant production sites in a developing country could benefit from the technology and management of rich countries. Major development of global value chains ensued, with multinational corporations able to implement ever more finely-honed international specialization.

This shake-up also meant a reshuffling of the cards of world economic power. Whether reflected in GDP at current prices or exports of goods excluding energy and extraction, the rich countries of the Organization for Economic Cooperation and Development (OECD) saw their global share go down from 80% at the end of the 1980s to about 55% in 2017 – a spectacular and historic fall. China, since 2009 the world's largest exporter of goods, has since 2014 been the leading economy in the world according to GDP estimates expressed in purchasing power parity.[5] Technological

3. M. Fouquin, J. Hugot, and S. Jean, "Une brève histoire des mondialisations commerciales," in *L'Économie mondiale 2017*, Paris: La Découverte, 2016, pp. 22-38, available at: <www.cepii.fr>.
4. R. Baldwin, *The Great Convergence*, Harvard: The Belknap Press of Harvard University Press, 2016.
5. I. Bensidoun and J. Couppey-Soubeyran, (eds.), *Carnets graphiques. L'économie mondiale dévoile ses courbes*, Paris: CEPII, 2018, available at: <www.cepii.fr>.

progress has also transformed international trade in a number of ways, notably with the increasing importance of corporate services and the explosion of data exchange and e-commerce.

The global financial crisis of 2007-2009 caused a hiatus in this huge shake-up.[6] World trade has never returned to its pre-crisis rate of growth, although it seems to continue to grow at a rate similar to world income. Foreign direct investment stocks continue to increase in line with world GDP, but flows have gone down compared to their peak. As for international financial flows, they have been hit by the disinvestment of European banks, although it should be noted that international foreign currency debt has continued to grow sharply. International economic interdependence has not gone down significantly, but it has plateaued.

The three phenomena destabilizing the multilateral trading system

In principle, this new state of affairs is not incompatible with the multilateral trading system: its rules are not supposed to vary according to the relative weight of its constituent economies, the sectoral composition of its flows, or the trade growth rate, as all of these elements have changed in numerous ways since the Second World War. It is, however, profoundly destabilizing for three key reasons.

The reversal of comparative advantages

Reciprocity is one of the founding principles of the multilateral trading system, but its translation into trade deals depends on partners' competitive capacities. Existing trade agreements were signed at a time when rich countries had a major comparative advantage in most manufacturing sectors except for the light manufacturing industry, with developing countries' advantage lying mainly in agriculture and textiles/clothing. The result was on average a much lower level of protection in rich countries. The developing countries were not in a position to benefit from this, however, as the only sectors in which protection was high were the sectors in which they had a comparative advantage. The shake-up of the structure of comparative advantages that accompanied the new phase of globalization has upset this balance.

The comparative advantages of rich countries now lie above all in services and in the patents and technology of multinational corporations that can gain value from them throughout the world. The case of the United

6. S. Jean, "La démondialisation n'aura pas lieu," in *L'économie mondiale 2018*, Paris: La Découverte, 2017, available at: <www.cepii.fr>.

States is particularly striking: in 2017, the United States registered a trade deficit in goods of 807 billion dollars, while posting a trade surplus in services of 255 billion dollars, with net income from foreign direct investment amounting to 217 billion dollars. The ability to derive value from these comparative advantages depends mainly on access to service markets, on protecting investment, and on technology and intellectual property rights. These are all areas, however, in which the WTO agreements are much less binding than in the opening of markets for industrial products, which is essential for China.

Moreover, technological progress has made an impact on the nature of competition. The growing importance of intangible capital has meant much higher non-recoverable fixed costs than marginal costs in many sectors, as well as strong synergies between economic actors.[7] This context, in which the winner often takes all, makes subsidies a particularly effective and powerful tool, as they may be the means of dominating the market to the detriment of competitors. Models demonstrating the strategic use of subsidies in an international context,[8] developed in the 1980s to illustrate situations such as the competition between Airbus and Boeing, have come back into fashion: a subsidy may be a beneficial economic policy for a country if it is the only one to apply it – or if it can exceed the others in terms of scale –, as the profits that it enables more than compensate for the distorting effects on public finances; the corollary is that countries competing in the sectors concerned undergo a net loss. Yet commitments on subsidies also raise problems: it is hard to police agreements on subsidies and compensatory measures in China, for example, where they are hard to identify due to diffuse and protean state aid.[9]

For this reason, agreements that may have seemed balanced when they were signed no longer seem so today. Developed countries may easily conclude that their concessions represent much greater value than those made by emerging countries.

The problem of the "latecomers" at the negotiating table

The major emerging economies were still developing countries during the Uruguay Round negotiations. As such, they benefited from special and differential treatment, which considerably limited the extent of

7. J. Haskel and S. Westlake, *Capitalism without Capital*, Princeton: Princeton University Press, 2018.
8. In particular, J. A. Brander and B. J. Spencer, "Export Subsidies and International Market Share Rivalry," *Journal of International Economics* 18, No. 1-2, 1985, pp. 83-100.
9. M. Wu, "The 'China, Inc.' Challenge to Global Trade Governance," in *Harvard International Law Journal* 57, 2016, pp. 1001-1063.

the commitments required from them, but also restricted their own ability to obtain concessions from their partners, as demonstrated by their weak and delayed liberalization of agriculture and the textile and clothing industries. In other words, as developing countries, they gave little but also gained little; they didn't really have their own place at the negotiating table. The accession of certain emerging economies to the rank of major trading power raises two questions: first, should they continue to benefit from this special and differential treatment? And second, how should their late arrival at the negotiating table be managed?

Every country in the WTO decides for itself whether to claim the status of developing country and the preferential treatment that goes with it. In theory, the chance of being able to make more of an influence on the outcome of negotiations should encourage developing countries to abandon their special and differential treatment when they reach a certain level of development.[10] This reasoning, however, is not well applied to China: it is now the leading exporter in the world, but it maintains its status as a developing country and it has no need to give up this status in order to carry weight in negotiations. Moreover, the legitimacy of this status is disputed, particularly as China's commercial success can be interpreted in differing ways. For many Westerners, China's development has only been made possible *due to* its accession to the WTO in 2001, which enabled it to gain ready and stable access to the markets of rich countries, while China limited access to its own internal market by undervaluing its currency in the first decade of the twenty-first century, by favoring Chinese companies, and, more generally, by maintaining strict control over the Chinese economy. This is the widely accepted analysis that led to US trade representative Robert Lighthizer stating that "the United States erred in supporting China's entry into the WTO on terms that have proven to be ineffective in securing China's embrace of an open, market-oriented trade regime."[11]

The Chinese government considers, on the contrary, that it made very heavy concessions to obtain accession to the WTO, for example by reducing its bound customs duties (the ceiling that it commits to not exceeding) to an average of 10%, well below the level of other emerging

10. K. Bagwell and R. W. Staiger, "Can the Doha Round Be a Development Round? Setting a Place at the Table," in *Globalization in an Age of Crisis: Multilateral Economic Cooperation in the Twenty-First Century*, edited by Robert C. Feenstra and A. M. Taylor, Chicago: University of Chicago Press, 2013, pp. 91-130.
11. USTR, "2017 Report to Congress On China's WTO Compliance," *United States Trade Representative*, January 2018, available at: <https://ustr.gov>.

economies – 31% for Brazil, for example, or 48% for India.[12] Its trade success, it claims, has been obtained *despite* very demanding commitments to liberalize. The Chinese authorities, moreover, consider the increase in anti-dumping measures against China as unjust, as well as the refusal, de facto or in law, to grant the country the status of market economy, even though the accession protocol envisaged that provisions denying them this right would last no longer than fifteen years.

In short, the West tends to believe that China has benefited considerably from the system and should make concessions, starting by giving up its status as a developing country, while China believes that it is entirely legitimate to keep it. The issue is hard to view objectively, as China remains poor in terms of its average income, three and a half times less than that of the United States, if measured in terms of purchasing power. It is, however, rich in certain regions, and, above all, capable of being a leader in cutting-edge sectors, such as quantum computing. The changing of the status of the major emerging economies in general, and China's in particular, is thus a contentious issue.

The change in status of the major emerging economies is a contentious issue

The second question is not straightforward either. In fact, the major emerging economies do have a place now at the negotiating table, in the sense that no major agreement is possible without them being fully involved as stakeholders. But they are latecomers in the sense that they previously benefited from the status of developing countries, and in that respect, their current commitments are much less binding than those of rich countries. To use the previously cited example of bound customs duties, the average is 5% for the EU, 4.5% for Japan, and 3.5% for the United States. This is the "latecomers problem" at the WTO negotiation table, to use an expression coined by Kyle Bagwell and Robert Staiger.[13] Occupied for decades in exchanging trade concessions, rich countries realize today that they have not kept enough bargaining power to propose balanced and substantive reciprocal exchanges to the major emerging economies – the so-called "latecomers." Given this situation, the paralysis of multilateral trade negotiations is difficult to avoid.

12. Source: WTO, average bound tariff for all products. India is only committed to a ceiling for 74% of its products, while China and Brazil have done so for all their products.
13. K. Bagwell and R. W. Staiger, "Can the Doha Round Be a Development Round? Setting a Place at the Table," *op. cit*.

This "late-coming" causes the same problem with regard to the existing levels of protection, which were negotiated in a framework in which competition was mainly between countries that were industrialized earlier, but now pits them against the new emerging economies. Since the institutional system was conceived specifically to avoid backtracking, rich countries cannot now reduce their commitments, while the changes in global competition could objectively encourage them to do so.

Multipolarity

The global economy has become multipolar. The United States remains the leading world power in many areas, particularly financial and military, but its advantage is clearly much less overwhelming than in the years that followed the fall of the Iron Curtain. The United States no longer has the capacity – or the will, as far as the current administration is concerned – to assume a leadership role, taking responsibility for certain global constraints. Coordination among states has become very difficult. There are many major players, but they have differing interests, have no incentive to be the first to make concessions, and are not in a position to apply pressure.[14] Problems of governance (not dealt with in this paper) intrinsic to the WTO (decision by consensus and absence of leadership power for the secretariat, in particular), only make this difficulty worse.

The problem of coordination is particularly acute in trade, as multilateral agreements are not complete contracts. Not only are many areas – services, investments, subsidies, etc. – dealt with in a very partial and non-binding manner, but the implementation of numerous commitments cannot be supervised strictly and requires the good will of the partners. Solemn commitments from the members of the G20 to refrain from resorting to protectionism, made, for example, at the end of the London Summit in April 2009, demonstrate this: there would be no point in these commitments if the institutional framework was binding. The multilateral framework incentivizes good will: a country that is lacking in good will in a dispute with another country damages its reputation and exposes itself to the risk of subsequently being treated in a less cooperative way by third countries. But this mechanism only works if third countries are in a position to exert this kind of pressure.[15] This is not the case when the dispute concerns two countries who are both in a strong position with regard to others. The leaders in this

14. Z. Laïdi, "Comment la multipolarité déconstruit le multilatéralisme," *Le Débat* 201, No. 4, 2018, pp. 36-46.
15. G. Maggi, "The Role of Multilateral Institutions in International Trade Cooperation," *American Economic Review*, Vol. 89, No. 1, 1999, pp. 190-214.

kind of game may force others to play according to the rules, but no one can make them do so if they do not wish to. The multilateral framework is not designed to resolve the Sino-American dispute.

The burden of legacy

The multilateral trading system is based on an agreement (in fact, a set of agreements) in which signatory countries agree on the rules and exchange reciprocal and enforceable concessions. As it is an agreement between sovereign states, it is essential that (as a self-enforcing agreement) it includes incentives to ensure that it is applied, with no country gaining from leaving it or not respecting its rules. Although the WTO has been far from perfect in its functioning, it has generally provided these incentives since its creation in 1995, if judged by the steady increase in its number of members (164 today including the EU, while there were only 124 signatories of the Marrakech agreement), and by the effectiveness of its dispute settlement system.

However, the structural problems described above cause one to doubt that these incentives will continue to be effective, especially in the case of the United States. The reversal of comparative advantages may lead them to consider that this set of agreements is no longer beneficial, as the country may better assert its interests in a bilateral framework. The emerging economies' status as developing countries makes them latecomers at the table of trade negotiations and thus the conditions are not in place for a balanced renegotiation of commitments. Multipolarity places the United States in a position of strategic rivalry with China, which prompts it to refuse to continue to assume the role of leader of the system, with all that that implies in terms of costs and internalization of rules.

From this point of view, it is not entirely surprising that Washington is calling into question the relevance of the multilateral trading system. This is particularly so, as, ironically, it is the existing multilateral agreements that prevent the creation of a new one. In fact, an agreement based on a clean slate would be mutually profitable if it were preferable to the absence of an agreement for both of the partners; in the current context, however, it has to be preferable to the status quo for both of them. But the status quo is highly satisfactory for China, making another agreement improbable. Within the context of the WTO, the areas that are most favorable for negotiations are those that are free, or nearly free, of commitments, such as information technology, services, or e-commerce. The agreements inherited from past rounds act as a burden on the WTO and prevent negotiation of the commitments of tomorrow.

The future of world trade

The aggressive trade strategy of the Trump administration can thus be interpreted as aiming to make the status quo impossible in order to recreate the conditions for a mutually beneficial agreement with China, the two main levers to bring about this clean slate being unilateral tariffs and the neutralization of the appeals body for the settlement of disputes. The threat of a trade war that would only create losers seems to be the only way out of a deplorable imbalance, and, ultimately, could act as a strategy of transition toward new agreements. This strategy is particularly risky, as nothing guarantees that a large-scale trade war can be avoided, or that the conditions for new agreements can be met. In this analysis, two elements, however, do seem crucial for the future of the multilateral trading system.

On the one hand, the return to the status quo is out of the question. The legitimacy of the institutional architecture has deteriorated too far and the underlying structural factors that have caused the US reaction will come to the surface in one way or another if it is not reformed. In the absence of improbable ambitious advances, there will be a relative disappearance of the rules, to the extent that, in the years to come, trade exchanges will be more closely dependent on political relations.

On the other hand, the strategic rivalry between Washington and Beijing will occupy a central position in international politics and, consequently, the structure of trade. While this pushes certain observers to announce the beginning of a new economic cold war, it could also be managed in a more cooperative manner. In fact, the current era is characterized by the close economic interdependence of these two powers, as has been illustrated by two cases: the inability of the Chinese corporation ZTE to withstand for more than a few weeks the prohibition imposed on American businesses on supplying ZTE with microprocessors; and the difficulties encountered by Apple in finding an ideal environment for assembling their products outside of China.[16]

The lure of economic "decoupling" is evident, both in the United States and in China, but it is easier to argue in favor of it than to implement it. Moreover, the relative decline of US power, the unpredictable policies of the current administration, and the increasing use of its monetary influence as a means of coercion reinforce questions about the international role of the dollar. Even if no currency seems in a position to replace it

16. J. Nicas, "A Tiny Screw Shows Why iPhones Won't Be 'Assembled in U.S.A'," *The New York Times*, January 28, 2019, available at: <www.nytimes.com>.

as the reference currency, a less powerful dollar could give way to a regionalization of the monetary system, which itself would have a profound impact on trade.

These elements are not enough to make it possible to predict the future of trade relations, but three schematic scenarios may be envisaged. The first is that of continuity, characterized by strong and persistent political tensions between the United States and China, but under control. In this scenario, the WTO remains the main organizer of "fair-weather" international exchanges, that is, those that do not concern subjects and periods of acute political tension. When these tensions arise, there is an increase in infringements of international commitments in the form of exceptional protectionist measures or administered trade agreements. US and Chinese value chains become gradually decoupled in the most strategically sensitive sectors, but only partially and only in those cases. There is a return to a form of GATT (General Agreement on Tariffs and Trade), with a trade system that is not binding. Unlike GATT, however, the determining strategic rivalry will be expressed within the trade system, which will put it under more pressure. In such a scenario, it seems likely that there will be a moderate slowdown in world trade, especially in its interregional component.

The lure of economic "decoupling" is evident

The second scenario is that of confrontation, marked by an escalation in trade sanctions. This economic cold war may take many different, unforeseeable forms, but it would be in all cases extremely costly and destabilizing for international relations. It would probably lead to the United States doing as much as it can to decouple its trade from China and incentivizing its businesses and their suppliers to minimize their links with China. A divide would gradually be formed in world trade, with a partial divergence in international rules. Third countries, especially in Asia, but also in Europe, would be exposed to intense pressure and significant additional costs. There may be a major slowdown in international trade, accompanied by certain activities being relocated and a much larger regional element of international trade.

Pascal Lamy has pointed out that by putting China under severe pressure, the protectionism of Trump may paradoxically save the WTO.[17] This would require a political agreement between the great powers and a reform of certain WTO rules, in particular those affecting subsidies to

17. P. Lamy, "Trump's Protectionism Might Just Save the WTO," *The World Post*, November 12, 2018, available at: <https://onlinelibrary.wiley.com>.

industry and the status of developing countries, as well as those covering technology transfers. A multilateral agreement seems out of reach, but it is not essential, as a combination of plurilateral initiatives and amendments at the margins of existing agreements may be sufficient. Actually, the European Union is trying to make such solutions possible. One can only support these efforts, as this last scenario is clearly preferable, both for the EU and for the stability of international relations in general. As Jean Monnet said on the subject of European construction, "we can only choose between the changes we would be dragged toward and those that we desire and make ourselves." The growing influence of politics challenges Europeans to find a unified approach if they are serious about making an impact on the evolution of international trade relations.

Keywords
International trade
World Trade Organization
Trade war
Multilateralism