In Case You Missed it: Trump's trade fight

As tensions mount between Beijing and Washington, ING economists unanimously agree, a tit-for-tat trade war would be damaging for everybody

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By Warren Patterson

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According to President Trump, there isn't a level playing field between the US and many of its trading partners. For example, China doesn't...

Article | 6 April 2018 **United States**

Why the US trade deficit is heading the wrong way

Macroeconomic policy, not just trade barriers, affects the trade deficit. Trump's tariff policy is trying to swim against an economic tide

Source: Shutterstock

For Trump, it's all about tariffs

President Trump's aggressive stance on trade policy has put the spotlight firmly on the US' trade balance, which continues to worsen as February's trade balance of -$57.2bn was the worst since 2008. The US administration argues that unfair trading practices by other countries, and especially China, causes persistent US deficits.

There may be something to that argument, in particular when it comes to some of China's policies. But by focusing on tariffs and other trade-related measures, the Trump administration risks ignoring other factors that influence the trade balance.

$57.2bn

Monthly US trade balance in February 2018

Largest deficit since 2008

Worse than expected

But trade policy is just one piece of the puzzle

When economists think about current account balance, they tend to frame it as a question of relative demand for a country's imports and exports. US tariffs and other trade barriers increase the price of foreign goods, and so reduce demand for imports. That would improve the US trade balance. Of course, if other countries retaliate with their tariffs, this reduces the demand for US goods, pushing the trade balance back down.

But trade policy is just one variable that influences demand for imports and exports. Three other key factors include:

1. Overall economic growth: this matters a lot because when an economy is growing faster than its trade partners, its demand for imports tends to grow faster than demand for its exports.

2. The currency: when the US dollar appreciates, that makes US exports more expensive for foreigners and imports cheaper for Americans, worsening the trade balance. A depreciation has the opposite effect.

3. Finally, savings and investment decisions affect the current account because an economy that saves a higher share of its income necessarily consumes less and vice versa. That means it imports less. So a higher/lower savings rate leads to an increase/decrease in the current account.

In terms of policy, this means fiscal and monetary policy are vital levers that affect trade balance because they influence overall economic growth as well as the value of the currency and the incentives for saving and investing.

And overall US policies are not helping the trade deficit

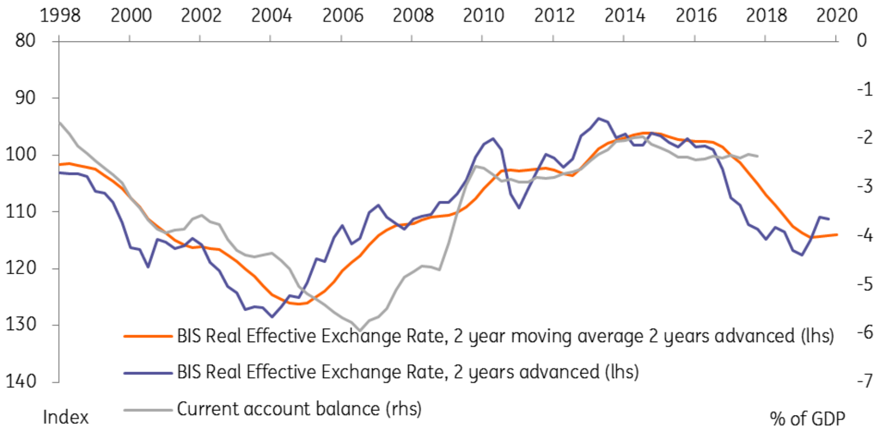
Regardless of what the US may or may not achieve with its newly aggressive trade policy, these broader macroeconomic factors generally point to an increase, not a decrease, in the US deficit over the next couple of years.

That is partly a function of the US economy's (relative) outperformance over the past few years: the US recovered faster from the 2008-09 financial crisis than its trading partners, especially in Europe, which means US demand for imports has grown faster than foreign demand for exports.

In turn, the stronger US economy meant that the Federal Reserve began tightening monetary policy in 2014, even as its counterparts in Europe and Japan were loosening policy. This divergence, combined with the collapse in commodity prices from mid-2014 and the associated slowdown in key emerging markets, caused the dollar to appreciate sharply.

From mid-2014 to early 2017 the US's real effective exchange rate appreciated by nearly 20%. Though the dollar has depreciated a bit over the past year, the exchange rate tends to affect the trade balance with quite a long lag. We think most of the 2014-17 appreciation is yet to be seen in the current account. A simple mapping from the exchange rate to the current account suggest the current account could fall to around -4% by 2019. Indeed, monthly trade data suggest the US is on track for a deficit of around 3.5% in 2018.

The US current account doesn't (yet) reflect the 2014-17 dollar appreciation

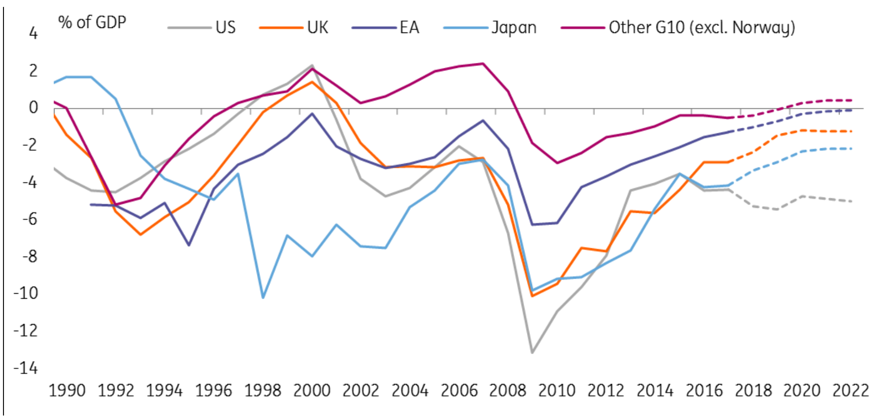


Source: Macrobond

While the divergence in monetary policy is less stark today, with ECB and BoJ tightening finally on the horizon, it is now US fiscal policy that has become the anomaly. Whereas most advanced countries are decreasing their fiscal deficits as their economies strengthen, the tax cuts and fiscal spending passed by Congress recently means that the US' deficit is set to increase towards 5% of GDP. That puts more money in the pockets of US consumers, which will increase demand for foreign goods and widen the trade deficit further.

Fiscal policy divergence

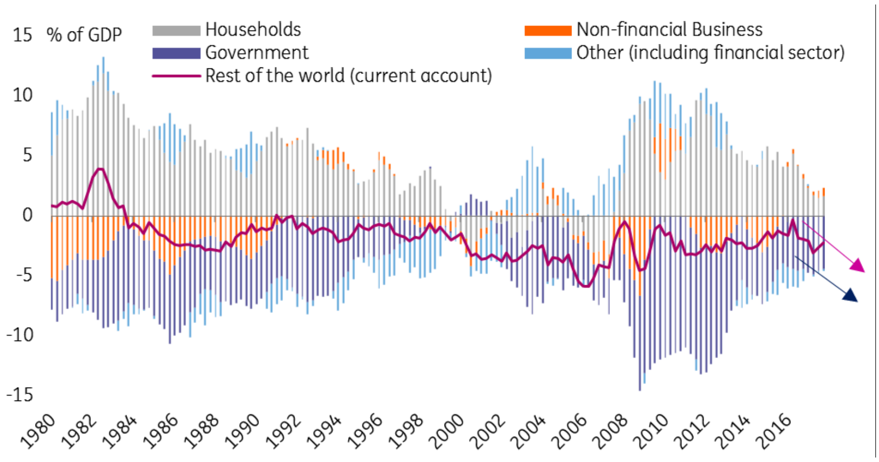
Actual and IMF 2017 October WEO projections, adjusted for US tax cuts



Source: Macrobond

Finally, the trend in US household savings has been steadily downwards since 2012, adding to demand for imports. Until recently that was off-set by the falling fiscal deficit (i.e. higher government saving). Now that the government's deficit is set to increase, will households start saving more? That's far from clear. Given the buoyant US economy and high consumer confidence, we think US households are unlikely to tighten their belts in the near term.

US households saving less and spending more: Net lending/borrowing by sector



Source: Macrobond

As the deficit worsens, will Trump switch tracks?

Overall, the trend in the US trade deficit is heading in the wrong direction. Several fundamental factors argue for a wider deficit over the next couple of years, not the narrowing that the Trump administration is looking for.

This could well fuel further aggressive steps to raise trade barriers. But as the administration is finding out, other countries can play tough too. A trade war risks hurting the US economy ahead of the mid-term elections this autumn, without doing much to improve the trade deficit.

A different approach would be to tackle to the macroeconomic fundamentals driving the trade deficit wider. That would suggest less expansive domestic economic policy in the US while encouraging a more trade-friendly policy mix (more fiscal spending and less currency intervention) among trade partners. The recent agreement between the US and South Korea on increased FX transparency, tied to the renegotiated KORUS free-trade deal, is a step in this direction, though it may prove difficult to replicate on a wider scale.

There are a couple of potential vehicles for widening the discussion around trade imbalances coming up. The US Treasury's report on Foreign Exchange Policies is expected this month, and the IMF Spring meetings take place in a couple of weeks' time. But in the current climate, the risk is clearly that rather than constructive discussions, these occasions spark further recriminations and increased tension.

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Is anyone playing by the rules of global trade?

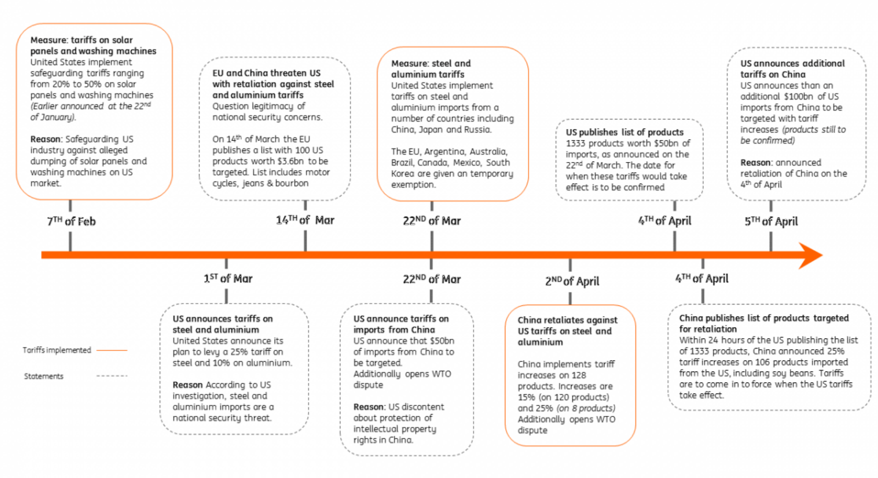
Global trade rules are being used and tested in extreme ways. The US and China have acted before due process has taken place, but each are requesting consultations at the WTO to resolve the disputes

An eye for an eye

In the US's escalating dispute with China about intellectual property practices, both countries are at pains to stress the justification for their actions in the rules of global trade, even if they aren't waiting around for due process.

The US's other recent actions on steel and aluminium imports are outside the rules of global trade, but with cover from the very same rules: the US has invoked the "security exception". A country is allowed to opt out of its commitments under the global trade rules where it judges that the protection of its "essential security interests" are at stake. However, using this exception to raise tariffs on steel and aluminium is widely seen as a pretext for safeguarding domestic industry, and the tariffs as a tactic for forcing concessions in other trade negotiations.

Countries have reaffirmed their commitment to the global trade rules, but their responses to the US have also featured a jab or two below the belt. China has requested consultations with the US at the WTO under its Safeguards Agreement as a first step to claiming compensation for trade losses due to the steel and aluminium tariffs. But well ahead of this process being completed, China has also implemented tariff increases on 128 products it imports from the US, the equivalent of shooting first and asking questions later. In total, over 40 WTO members have raised concerns at the WTO about the US's steel and aluminium tariffs.



Source: ING

Playing by the rules

Taking steel as an example, countries have raised concerns and even entered into disputes at the WTO about the effects of overcapacity in global production over a number of years. Alongside these activities, a forum for taking action on the root causes of the issue has emerged outside the WTO (the G20 Global Forum on Steel Excess Capacity). Rather than a failure of the global trade rules, countries taking justice into their own hands on traded steel is entirely in line with the WTO's approach to disputes. Its process encourages countries to come to the table and have a dialogue about trade disputes, then enter into negotiations, not litigation, to solve them. This is the way that "almost half" of disputes are resolved - through negotiations, without progressing to any of the WTO's further stages of dispute resolution.

The majority of trade disputes are triggered by variants of the same issue, namely a domestic industry being damaged or threatened with damage in a country which has seen an influx of (lower-priced) imports.

> *Global trade rules are being used and tested in extreme ways*

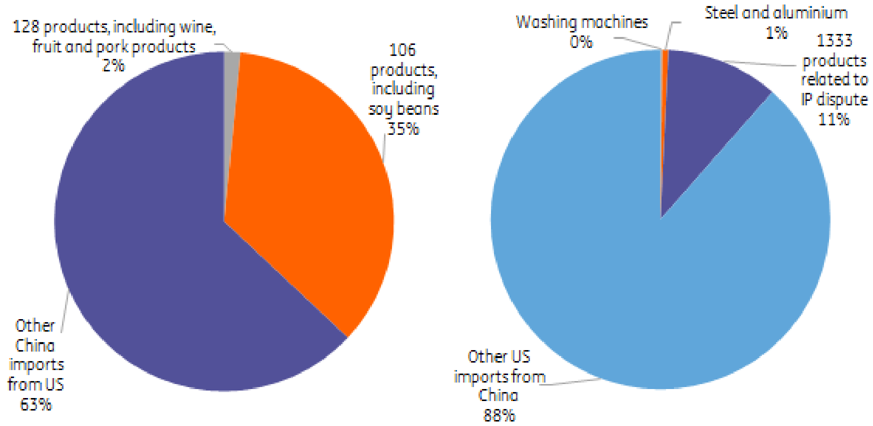
At its most extreme, this is dumping, exporting at unfairly low prices. Where the trade flow doesn't meet the definition of dumping, a country may still seek to mitigate damaging effects on its domestic industry temporarily (to help facilitate improvements in competitiveness or the reallocation of resources). This is known as safeguarding and can involve a country raising tariffs on imports, for a limited period. Importantly, in instances where safeguarding is appropriate (i.e. where domestic industries are being damaged), exporting countries are entitled to compensation for the loss of trade they experience while the import restrictions are in place. If this is not forthcoming, they can take equivalent action, for example by raising their own tariffs on imports. When a country is affected by safeguarding in another country and seeking compensation, it lodges a request at the WTO to enter into "consultations" as a first step.

The US import tariff increases on solar panels and washing machines followed the usual pattern of a safeguarding action. They followed US investigations into the import trends and threats of damage to domestic industries, and are time-limited (effective for 4 years on solar panels and 3 years on washing machines). China, the EU, Switzerland, South Korea, Malaysia and Singapore have expressed concerns about the tariffs, and the US duly entered into consultations with these countries. So far, so good for rules-based international trade, although a report that the consultations have not been conclusive means that countries will now need to escalate the dispute by requesting the formation of a disputes panel, and may also be considering retaliatory measures against the US.

War of words?

The products threatened with tariff increases in the dispute about intellectual property practices (1333 products from China and 106 US products) represent much more significant shares of US-China trade than US imports of Chinese aluminium and steel, and China's retaliatory increases on 128 products.

US and China imports affected by tariff increases and threats



Source: ING

While further tariff increases remain threats, the dispute about intellectual property is still (just about) proceeding through WTO channels. The US has requested consultations with China at the WTO, which would allow the two countries to discuss the US's concerns about China violating global trade rules on intellectual property. The EU and Japan have requested to join the talks, having said they share the US's concerns, though they have also stressed that any action taken should be consistent with WTO agreements.

The global trade rules are being used and tested in extreme ways. In using the security exception, the US has been cynical in its use of the global trade rules in the eyes of other countries. By retaliating against the US steel and aluminium tariffs with its own increases, China has acted before due process has been allowed to take place. The tariff increases that are currently being threatened in the IP dispute would be another serious step towards sidelining the WTO, if they are implemented. But all the while, the US, China and other countries have been at pains to stress that they are playing by the rules of the system, and anticipating, rather than rejecting, the enforcement of rules of global trade. Playing by WTO rules requires countries to enter into dialogues with one another about issues in trade, and allows for – indeed encourages – them to reach settlements "out of court". If the dispute about intellectual property sees China and US come to the table to discuss their dispute along with the EU and Japan, this would be in the best traditions of rules-based international trade.

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Opinion | 4 April 2018

FX | Video

A tit-for-tat trade war not enough to take global markets down

All eyes were on President Trump's Twitter feed this morning, and he did not disappoint. Now, the question is whether the US chooses to escalate this trade fight further. If it does, it would be a paradigm shift for global markets - one that could see a sustained sell-off in risky assets, as well as a broader flight-to-safety in FX and bond markets

Source: Shutterstock

A trade war is the number one risk for global markets

Watch video

Fears of a trade war between the world's two largest economies seemed to have returned today as President Trump tweeted this morning, "We are not in a trade war with China, that war was lost many years ago by the foolish, or incompetent, people who represented the US. Now we have a trade deficit of $500 billion a year, with intellectual property theft of another $300 billion. We cannot let this continue!"

But after Beijing's response earlier today of a reciprocal 25% tariff package on US imports including soybeans, aeroplanes and automobiles - we're now in TradeWar Scenario 2.

In isolation, trade wars don't cause a global downturn - nor a sustained sell-off in risky assets

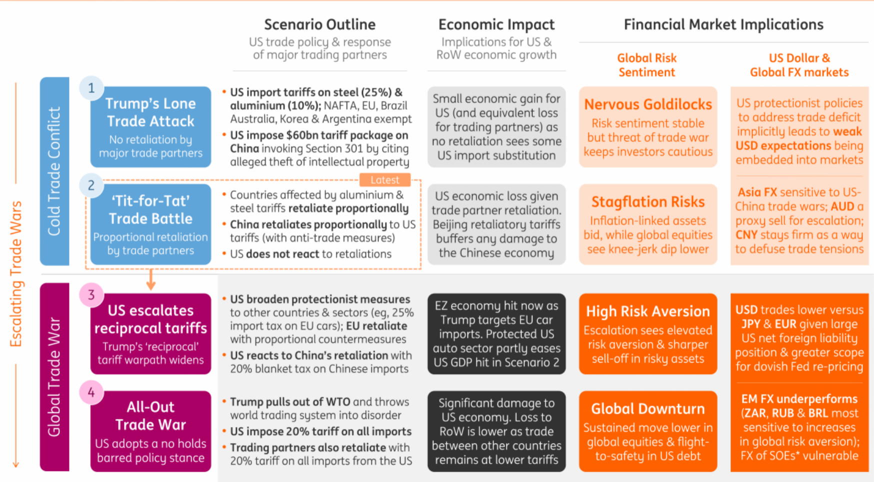
Anyone who thought China would bow to a protectionist US administration only needs to look at how quick the response came. It looks like major trading partners are ready to react even to the detriment of their own economy and global markets. But it's worth bearing in mind that trade wars are a lose-lose situation because political logic is usually dictating rather than any economic rationale.

Our immediate reaction to China news corroborates what we expected for currency markets in a cold trade conflict:

- The Japanese yen seems to be the best vehicle to hedge for escalating TradeWar (target 100)
- The Swiss franc, euro, and sterling are up against a politically weak dollar
- The Australian and Canadian dollar are a proxy sell for US-China trade tensions while the New Zeland dollar is a relative haven in the commodity space

Other markets showed a typical risk-off response initially: Treasury yields were lower, gold went higher, US stocks declined by around 1.5-2.0% on open. However, the follow through to FX markets has been limited.

ING's Trade War Scenarios – Transitioning from a Cold Trade Conflict to a Global Trade War



Source: ING FX Strategy. *SOEs = Small Open Economies

Tit-for-tat tariffs still keep us in the realms of Defcon 3 when it comes to trade wars - or what we like to call a cold trade conflict as explained in scenario 2 in our graphic.

But for global market dynamics to transition from a cold trade conflict to an actual global trade war, we need to see either:

(1) A broadening of current US protectionist measures to other countries and sectors – and here we highlight US tariffs on EU car imports as the flagship policy.

(2) The US administration reacting to any retaliatory tariffs from China – by imposing larger and potentially blanket tariffs on all Chinese imported goods.

Either of these would be a substantial rise in the average world tariff rate in a way that requires global markets to take significant notice.

> In isolation, trade wars don't cause a global downturn - nor a sustained sell-off in risky assets. But what has typically amplified the risks around a trade war is if it coincides with either rise in geopolitical or foreign policy risks or if increased protectionism occurs alongside a slowdown in the global economy. We would put the first as a bigger risk than the latter, though neither are non-negligible.
>
> It is the signalling channel of US trade policy that has been the key driver for the USD in prior 'trade war' episodes. Protectionist measures implicitly signal the US administration's desire for a weaker USD – and such expectations are likely to be entrenched in FX markets until credibly broken.

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Opinion | 4 April 2018

Will Trump outsmart us all?

As threats of a trade war heat up, is President Trump actually playing a very canny game?

Source: Shutterstock

Does President Trump really not understand that a trade war is a lose-lose situation or is he playing a smart strategic game? There are indications the latter is the case. Trump has exempted many trading partners of the US and given them the possibility of negotiating a deal that gives them an extension of the exemption. Trump wants these trade partners to moderate their exports to the US and stimulate their imports from the US.

South Korea has already complied with this demand and agreed to a voluntary export restraint for steel, a further opening of their market for American cars and a slower phasing out of the limits on exports of Korean pickup trucks to the US.

> *Trump is playing a dangerous game, but a potentially rewarding one*

These are exactly the kind of results that Trump needs. To avoid American steelworkers feeling betrayed by so many exemptions, the voluntary export restraint is a welcome sacrifice. And the deal on cars addresses the complaints in the American automobile industry that tariffs on steel and aluminium drive up the price of American vehicles and thereby put jobs in this industry in danger.

It is very well possible that other countries will also give in to Trump. Trade partners such as Canada, Mexico, but also China, depend much more on American demand for their products than the other way around. US demand for Mexican and Chinese products contributes respectively twenty and five times as much to their GDP as their demand for US products adds to US GDP. Also, Canada has much more to lose in a bilateral trade war with the US than the Americans.

It is very well possible that other countries will also give in to Trump

China seems to blow up Trump's strategy to blackmail US trade partners into granting the US more favourable conditions of trade so he can avoid a real trade war but get something done at the same time. The Chinese have drawn up their own list of products to incur tariffs in retaliation to the $50bn tax that Trump will levy on Chinese goods as punishment for alleged theft of intellectual property and limits on foreign investments. But, it is no coincidence that the Chinese have not yet set the date when these new tariffs will become effective. This means they still see room for extending the current negotiations. Given the relatively large dependency of the Chinese economy on American demand, it is likely that China will, in the end, cut its losses and be willing to give Trump something.

The EU is the other risk for Trump's strategy. The mutual economic dependency is about the same which means that Trump can be less sure that his blackmail approach will work. Nevertheless, it is possible that the EU will give in as well. After all, the EU has, just like the US, nothing to gain from a trade war which is very likely to emerge if Europe does not give in and retaliates against the tariffs on steel and aluminium.

The EU is the other risk for Trump's strategy

President Trump has already made clear that, in that case, the European car industry is next in line to be targeted with higher import tariffs. The EU has, in the person of the French President Macron, already made clear they will not be blackmailed into trade concessions. So it would lose face if it granted the US better terms of trade without getting something in return. However, President Trump seems to have anticipated that and has already provided a way out for the EU. Not only countries that trade 'fairly' with the US can get an extension of the exemption, countries that pay their 'fair' share of the military costs of defending the West can count on leniency from the President.

It is morally much harder for Europe to object to a higher contribution for its own protection than objecting to blackmailing practices.

The American president is playing a dangerous game but a potentially rewarding one for the US. If Trump succeeds in getting more favourable terms of trade from his trading partners, along with perhaps relief on his defence budget, he will emerge as the winner in the noisiest trade quarrel the world has seen in the last couple of decades. This would get him in the voters' good books in the run-up to the midterm elections in the US in November.

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Article | 4 April 2018

China hits back where it hurts - soybeans

China said it would retaliate against US tariffs, and that is exactly what they did today. But to the surprise of many, they included US soybeans in the reciprocal tariffs, which sent the soybean market plunging downwards. If these tariffs stick, expect further pressure

Source: Shutterstock

A blow for US soybean farmers

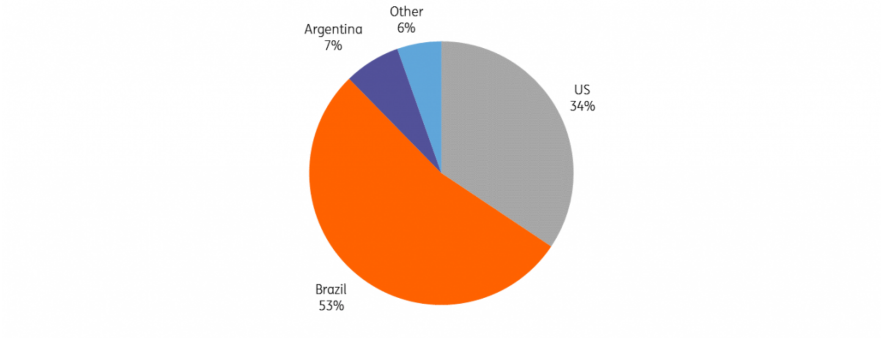
China is the world's largest soybean consumer, with the country estimated to consume around 111 million tonnes (mt) of soybeans over 2017/18, which is equivalent to 32% of total global soybean consumption. The bulk of this demand is met by imports, with the country estimated to import 97mt over 2017/18. This is a significant number when you consider that global import demand totals around 151mt.

Developments between the US and China will certainly play into the hands of Brazilian farmers

The US is the largest soybean producer in the world and a key supplier of soybeans to China. Historically the US was the largest supplier to China, although over recent years this has changed, with China increasingly turning to South America, due to the strong growth in Brazilian soybean output. In 2010, the US met 43% of Chinese import demand, however, this fell to 34% in 2017.

Now with US soybeans set to attract a further 25% import tariff, the trend that we have seen over the last few years, is likely to pick-up in pace, with Chinese buyers turning as much as they can to alternative supplies.

China soybean imports by origin (%)



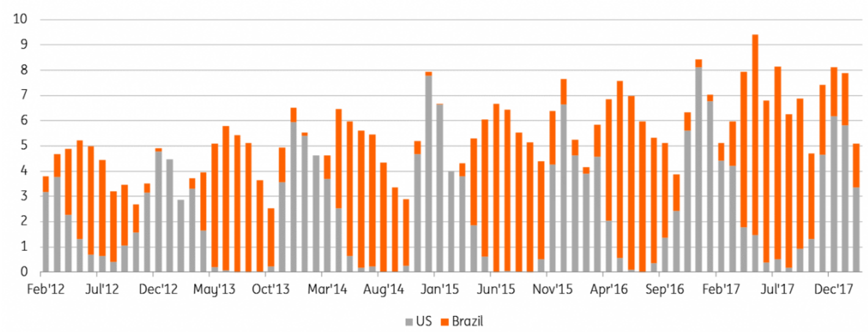
Source: Bloomberg, ING Research

For the US this trend is clearly not good news, with farmers finding it more difficult to find homes for their beans. The US exported 49.1mt between January and November 2017, of which 27.9mt went to China. The next biggest buyer is the EU, in a distant second, importing just 4.05mt over the same period.

However, seasonality in northern and southern hemisphere supply should offer some respite to US farmers. The bulk of Brazilian supply is exported over the northern hemisphere summer, while US export supply is at its peak over the northern hemisphere winter. So Chinese buyers will still need to turn to the US during the low point in Brazilian supply. Although we think Chinese buyers will try stock up on South American soybeans as much as possible during the peak of supply from the region.

Seasonality in Chinese soybean imports

US vs. Brazil in million tonnes



Source: Bloomberg, ING Research

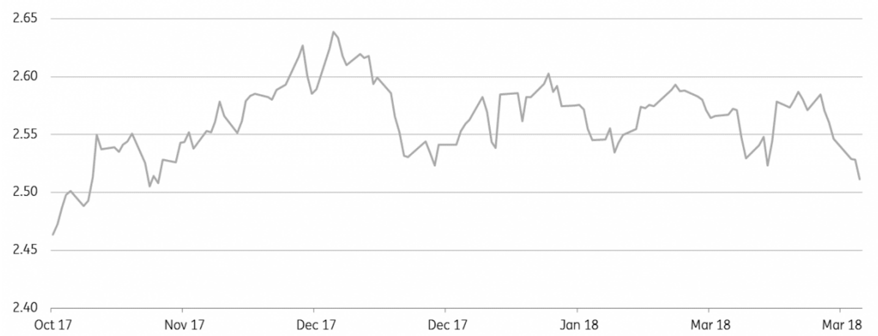
Potential for US farmers to reduce soybean area

In the United States Department of Agriculture (USDA) Prospective Plantings report last week, the agency estimated that planted soybean area in the US would exceed corn area. The soybean/corn ratio gave a clear sign to farmers to plant more soybeans. However this latest development should mean further pressure on Chicago Board of Trade (CBOT) soybeans, leading to a weakening in the soybean/corn ratio moving forward, this should see some farmers revise their planting intentions, and instead look to plant more corn at the expense of soybeans.

It will be tight for some farmers, as many would have made the decision and the commitment already to plant soybeans, but those with flexibility will likely reassess their planting ideas for the upcoming crop.

Read USDA's full report here

CBOT soybean/corn ratio



Source: Bloomberg, ING Research

A windfall for Brazilian farmers

Brazil is looking at another strong soybean harvest this season. Last season they produced a record 114mt, and in Companhia Nacional de Abastecimento's (CONAB) latest estimates for the 2017/18, they expect output to total 113mt. It does seem as though there is upside to this number, with the agency having revised higher the crop several times, while some other analysts are forecasting that Brazil will actually set a new record this season.

So developments between the US and China will certainly play into the hands of Brazilian farmers, with China increasingly turning towards them. Given the strong crop last year, stocks within Brazil are at elevated levels, and with another strong crop expected, export availability is set to increase.

Where to next?

It is important to remember that these planned tariffs from China have not been implemented yet, and we may see China and the US trying to negotiate broader trade issues between them. US farmers will certainly lobby the government quite hard to ease some of the tariffs on China, in the hope that the Chinese will also soften their stance.

Failing to agree, and the implementation of this tariff should mean further pressure on CBOT soybeans. We would need to see CBOT trade to levels where US farmers start to switch area from soybeans to corn.

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Unfair trade: Does President Trump have a point?

According to President Trump, there isn't a level playing field between the US and many of its trading partners. For example, China doesn't protect the intellectual property of foreign firms and on average levies higher import tariffs. Does he have a point?

Source: Shutterstock

Investment restrictions and the theft of intellectual property

"A historic move against economic aggression", is what the White House called it when announcing a 25% tariff targeting US$50-60bn of imports from China. This follows frequent complaints about the abuse of intellectual property rights by China and the restrictions on foreign investments in China. According to President Trump, the US trade deficit is the result of unfair trade policies by other countries.He refers to unequal tariffs, like those in the automobile industry, complaints about unequal restrictions for foreign investments in China and the abuse of intellectual property.

The new US tariffs on imports from China have been announced, citing the section 301[1] investigation into alleged intellectual property theft by China. Does Trump have a point here? According to the European IPR SME help desk, there are indications for this. IFR SME puts forward that plant inspections in China, which are required for certifying products for sale on the Chinese market, are not uncommonly carried out by inspectors from competing for Chinese firms.

[1] Section 301 of the 1974 Trade Act allows the President to retaliate against countries if they violate international trade agreements, act unjustifiable, and, or, burden US commerce.

Source: Elon Musk, Twitter

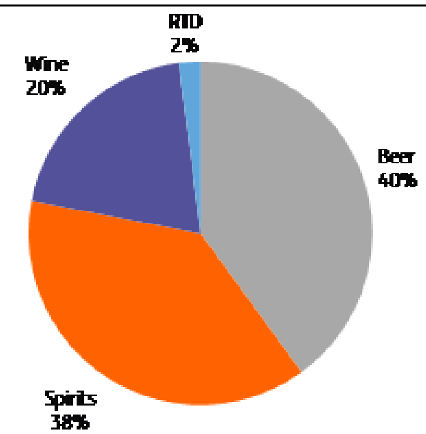
Chinese companies are often accused of counterfeiting brand names, patents, and the theft of technology. Market access is often restricted, and technology transfers are sometimes demanded to gain access to the Chinese market.

The Chinese government has selected specific sectors in which technology transfers and localisation strategies are to be implemented. For those sectors, including car manufacturing, China does not allow full foreign ownership. This means that often foreign companies can only enter the Chinese markets through a joint venture.

Chinese tariffs are significantly higher than US tariffs

Applied WTO goods tariffs

Simple averages: data from 2016 computed by the WTO. Trade weighted averages are computed aggregated on a 6 digit scale using 2017 data.



When comparing the WTO[1] applied tariff profiles of the US with China and the EU, Chinese tariffs immediately catch the eye (Figure 1). As a simple average, China's import tariffs are 9.9% while those of the US are 3.5%. This does not only concern agricultural tariffs, but also tariffs on the import of manufacturing such as transport equipment, electrical machinery, and clothing (Figure 2). The EU levies higher tariffs than the US on most of its imports as well, albeit those differences are relatively small (less than 2 percentage points for most product groups, see Figure 2). European import tariffs on agricultural products are significantly higher than those levied by the US.

[1] It is important to keep in mind that these tariffs are not specifically levied on imports originating from the United States. These tariffs are levied on imports from all countries. Therefore access to the Chinese market is just as restricted for European firms as for US firms.

Tariff differences, the US vs China and EU

Difference in simple averages measured in percentage points, positive number implies that US are lower.

Source: Data WTO, calculations by ING

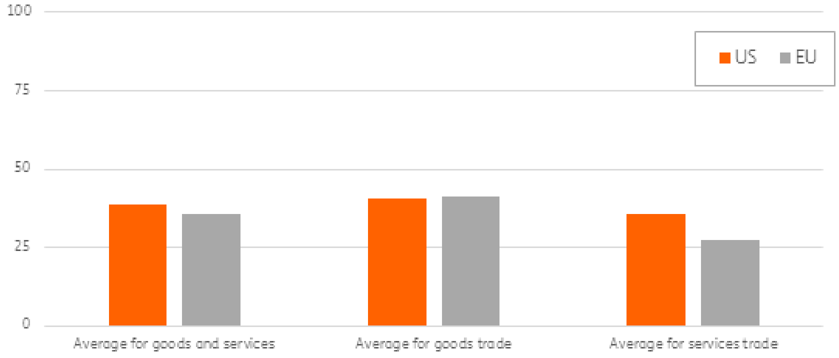
The higher tariffs charged by the EU and China doesn't necessarily mean that the US is treated unfairly. Non-tariff barriers are as important as the level of trade restrictions.

Research from Ecorys shows that while the EU levies higher tariffs on goods, the US is more restrictive than the EU when it comes to non-tariff barriers as (Figure 3). The US non-tariff barriers are about the same for goods but significantly higher for services. So higher European tariffs could well be offset by lower non-tariff barriers in the EU given the fact that non-tariff barriers are increasingly important nowadays. According to Ecorys[1], non-tariff barriers are in many cases even more important than tariffs nowadays. This implies that the EU-US playing field is quite level. So, contrary to China, Trump does not have a point when it comes to Europe.

[1] Berden, K.G., J. Francois, S. Tamminen, M. Thelle and P. Wymenga (2009), "Non-Tariff Measures

in EU-US Trade and Investment – An Economic Analysis", Ecorys report prepared for the European Commission, Reference OJ 2007/S180-219493

Non-tariff measures between the US and EU (a simple average)

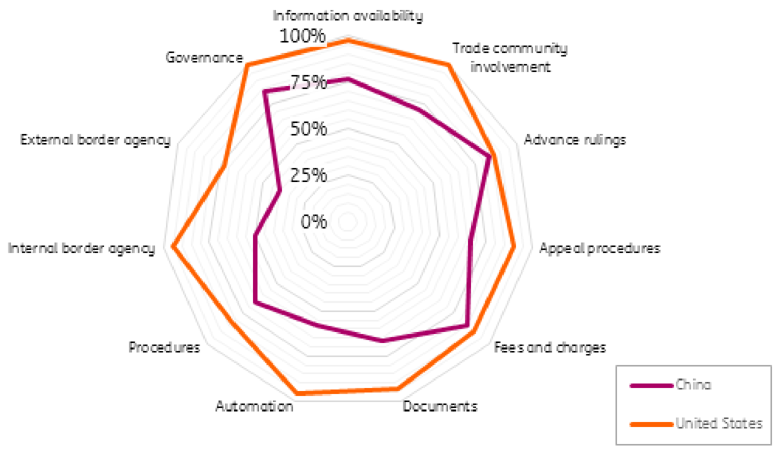


Source: Berden et al 2009

Trade restrictiveness on a scale from 0 to 100 (survey results).

To our knowledge, an overview of the level of non-tariff barriers in China compared to those in the US is not available. However, trade facilitation is related to non-tariff barriers. When looking at trade facilitation, China is more restrictive than the US as the figure below shows. Add this to the higher levels of tariffs in China; President Trump does seem to have a point when complaining about Chinese trade policy.

Trade facilitation between the US and China



Source: OECD 2018, edited by ING (100% equates to the maximum achievable performance)

Does the difference in protectionism matter?

Although President Trump does have a point when complaining about China's protectionism level, it doesn't mean that bilateral trade deficits are always due to differences in protection of domestic industries.

Firstly, bilateral trades the result of specialisation differences due to comparative advantages, for example, the availability of cheap labour in one country and a high level of technology in another country. Taking advantage of specialisation differences is nothing else than rational economic thinking. Even if the level of all tariffs and non-tariff barriers were the same in all countries, bilateral deficits and surpluses would occur due to differences in industry competitiveness caused by different specialisation processes.

The overall trade deficit of the US is first of all a reflection of US over-consumption, in other words, a lack of national savings. National production in the US cannot keep up with the consumption and investments of the private and public sector. So, even though improving the competitiveness of the US can improve bilateral trade balances, the overall trade deficit of the US will only diminish if the American private and/ or public sector increase their savings.

Moreover, trying to equalise bilateral trade balances by raising American import tariffs can increase domestic production, but this has negative side effects. Not only does it drive up consumer price inflation, but it also drives up the cost for exporters. Many US exports contain imported components such as iron or steel, therefore, raising tariffs on these goods harms US exports. The damage will increase further if countries hit by higher US tariffs would retaliate.

As far as creating a level playing field improves bilateral trade balances for the US, it can best be done by trying to persuade trade partners to lower their import tariffs because this leads to lower prices. Thus it increases the purchasing power in the destination countries for US exports and thereby increases demand.

Read our earlier piece: Trade Wars: Episode 1 - The Presidential Menace

In conclusion

Chinese import tariffs are much higher than US import tariffs and in terms of trade facilitation, China is less open than the US, which is why we feel that President Trump does have a point when complaining about Chinese tariffs. He also has a point about China being notoriously weak in protecting intellectual property.

However, raising US import tariffs to address these concerns may not be the best policy response, because it runs the risk of retaliation by China which would be the start of a trade war that would be damaging for both countries.

On net, protectionist measures by the US and the EU are roughly in balance. So raising US tariffs on imports from the EU cannot be justified by referring to higher tariffs in sectors like the automobile industry or agriculture.

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