

Fair Rules, Not Equal Trade

The president is right to stress reciprocity in trade. His mistake is to focus on the imbalances between countries rather than on the rules of market access.

BY DOUGLAS A. IRWIN

President Donald Trump has often been accused of being a protectionist. During the election campaign, he called for high tariffs on imports from China and Mexico, and in his inaugural address he said that, when it comes to trade, “protection will lead to great strength and prosperity.”

But the president doesn't consider himself a protectionist. “I'm absolutely a free-trader. I'm for open trade, free trade, but I also want smart trade and fair trade,” he recently said. His aim is to replace existing trade deals, which he considers “a disaster” and “one-sided,” and adopt a new approach. As he told leaders in the Asia Pacific region at a November summit, trade arrangements should be based on “fairness and reciprocity.”

In setting out this principle, Mr. Trump joins a long line of American presidents who have endorsed fair trade and reciprocity. But there is a problem with how he frames the issue. Mr. Trump wants to achieve reciprocity not in the rules of the game but in a particular outcome: the balance of trade with individual countries. This is no way for the U.S.—and the world—to prosper.

Economists since Adam Smith have argued that the trade balance, particularly any bilateral surplus or deficit, is not the right measure of trade's benefits. A trade deficit may sound alarming, but it has no significance by itself. What does matter is reciprocity in market access, and this is best achieved in regional and multilateral agreements. By abandoning or undermining these deals, the Trump administration has abdicated U.S. leadership. Even bilateral agreements,

which Mr. Trump touts, may now be out of reach, because other countries are justifiably reluctant to negotiate about outcomes rather than rules.

America's desire for reciprocity in trade goes back to the country's quest for independence. Among the many grievances cited in the Declaration of Independence was the complaint that Britain was “cutting off our trade with all parts of the world” through its mercantilist regulations.

When the U.S. achieved its independence, the country was hopeful that its new standing would usher in an era of free trade. But Britain took a hard line, arguing that the U.S. could not leave the British Empire politically and yet remain a part of it economically.

Multilateral agreements are the best way to secure fair terms for American goods.

In 1793, Secretary of State Thomas Jefferson issued a “Report on Commercial Restrictions” that extolled the idea of free trade but documented the numerous barriers placed on American goods and ships in foreign markets. He proposed achieving reciprocity through a policy of retaliation: “Where a nation imposed high duties on our productions, or prohibits them altogether, it may be proper for us to do the same by theirs.” But the U.S. was too minor an economic power to make good on such threats and, rather than risk a trade war, opted instead for an imperfect agreement with Britain.

For most of the next century, the U.S. abandoned

the quest for reciprocity. Congress set high tariff rates without regard to the rules set by other countries. By the 1890s, however, new developments prompted some to reconsider the wisdom of protectionism. The U.S. had become a net exporter of manufactured goods, and discriminatory trade policies abroad were impeding access to foreign markets.

The prime mover behind a renewed interest in reciprocity was President William McKinley. Speaking at the Pan American Exposition in Buffalo on Sept. 5, 1901, he declared that economic "isolation is no longer possible or desirable." "The period of exclusiveness is past," he said. "Reciprocity treaties are in harmony with the spirit of the times, measures of retaliation are not."

We will never know if President McKinley could have been successful in concluding such treaties because, just a day after delivering this address, he was shot and killed by an assassin. His successor, Theodore Roosevelt, was a passionate progressive reformer in many areas but not when it came to trade. Having repeatedly stated that the tariff "should be decided solely on grounds of expediency," he found it expedient to do nothing.

The last gasp of protectionism came with the infamous Smoot-Hawley tariff increase in 1930. Focused solely on the interests of select domestic producers, Congress gave little heed to foreign protests that came pouring in, let alone to the concerns of U.S. exporters or consumers. Congress ignored warnings of possible foreign retaliation, and the international backlash dealt a swift and devastating

blow to American exports.

The shift toward reciprocity finally came with the election of Franklin D. Roosevelt and his appointment of Cordell Hull as Secretary of State. Hull believed that trade friction between countries bred political friction and conflict, such as World War I. He helped to convince Congress to pass the Reciprocal Trade Agreements Act of 1934, which gave the president the authority to reduce tariffs in trade agreements with other countries. His main goal was to eliminate foreign discrimination against U.S. exports.

Hull's efforts eventually led, after World War II, to the General Agreement on Tariffs and Trade, the cornerstone of which was reciprocity among members in the rules of the game. While the GATT didn't equalize tariff treatment of goods in all markets, it began to chip away at the discriminatory policies targeted at American exporters.

The U.S. also promoted the formation of the European Economic Community, a precursor of the European Union, in order to strengthen the continent's economies and to make them a more effective bulwark against communism. The EEC removed taxes on trade between members and set a common external tariff. The U.S. worried that this tariff, and the preference for intra-European trade, would be prejudicial to American commerce, so Washington initiated negotiations to reduce the new barriers, resulting in revisions to GATT in 1967.

The U.S. took the lead again a few decades later in pushing other countries to reduce their tariff walls and subsidies, achieving yet another updating of GATT in 1993. This round of changes established the World Trade Organization to protect intellectual property rights and to settle disputes.

The pattern across these historical episodes is clear: The U.S. has been active in promoting free trade when it begins to face discrimination against its commerce abroad. Trade negotiations have been a tool for safeguarding American interests.

Enter now Donald Trump. Much of what the administration is doing on trade is not new. To the extent that it has identified specific policies or practices that violate trade rules, addressing

them is in the tradition of past presidents.

One place, for example, where the administration is on firm ground in complaining about foreign trade policies is China. China's blatantly mercantilist "Made in China 2025" policy, involving local content requirements and the elimination of foreign suppliers, is the antithesis of an open market economy. But thus far, the administration has given China a pass, with the president saying that he "doesn't blame" China for its trade practices.

What is new and unusual is the administration's focus on the trade balance with individual countries. We do in fact have a trade deficit with Mexico, for instance, but the rules of Nafta still hold: Mexico does not impose any duties on U.S. goods just as we do not impose any duties on Mexican goods. The same would have been true under the Trans-Pacific Partnership, from which the Trump administration withdrew U.S. support.

The focus on the trade balance in trade negotiations is misguided. Trade is not like a ledger, where imports are the cost and exports are the benefit, and trade surpluses and deficits do not indicate that one country is "winning" and the other "losing."

The trade deficit is driven by macroeconomic factors, not by trade barriers or trade agreements. The U.S. faced a battery of high trade barriers in the 1950s, when its own market was largely open, and yet it ran trade surpluses. The trade deficit fell sharply in the wake of the financial crisis in 2008, even

though neither the U.S. nor other countries significantly changed their policies regarding imports.

Just last week, the Commerce Department reported that the trade deficit had widened slightly. This is because the economy is doing well and the unemployment rate has fallen to almost 4%. We should not wish for another economic slowdown to put a further dent in the trade deficit.

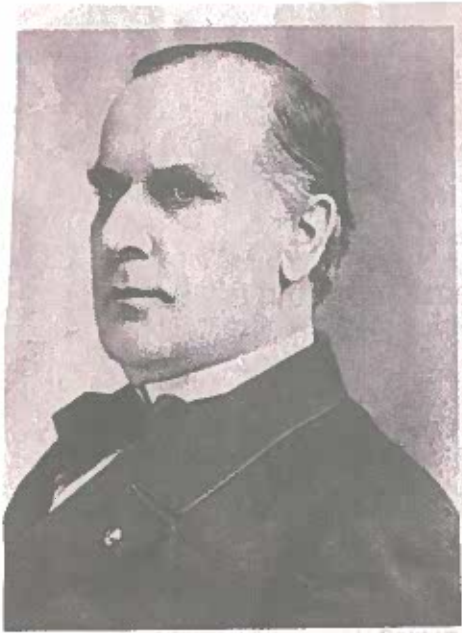
In some circumstances, it may make sense to care about the overall balance of trade. If the trade deficit is viewed as a problem, the solution is for the U.S. to save more and spend less, like countries with trade surpluses, such as China, Germany and Japan. One component of America's poor savings record is the federal budget deficit: When it grows as a share of GDP (due to a decline in revenues or an increase in expenditures), it contributes to the trade deficit.

But it makes no sense to care about balancing trade bilaterally with individual countries. A household may care about whether its overall spending exceeds its income, but it doesn't care about balancing each component in its budget. Everyone runs a trade surplus with his or her employer. Everyone runs a trade deficit with the grocery store, except for the people who work there. It is nonsensical to balance your checkbook bilaterally; just try doing that with Amazon or Costco.

The problem with negotiating about outcomes rather than rules, focusing on the trade balance rather than on market access, is that it can lead to managed trade. That happened in the 1980s, when the U.S. was worried about the trade deficit with Japan. Managed trade is the opposite of the goal of establishing freer and fairer trade around the world.

President Trump has complained about supposedly unfair trade deals with Japan, Mexico and Canada without ever really saying what they have done wrong—aside from the imbalance in our bilateral trade with them. With Canada, the U.S. does indeed have a trade deficit in goods, but it has an even larger trade surplus in services. Is this "very unfair" to Canada? Are we "taking advantage" of our longtime ally? What would Mr. Trump say if Canada said that we are obligated to intervene to reduce our surplus?

Other countries are baffled by Trump's fixation on trade balances.



FROM LEFT: JI VINTAGE/EVERETT COLLECTION; HULTON ARCHIVE/GETTY IMAGES

PRESIDENT MCKINLEY sought reciprocity in tariffs, but President Roosevelt would have none of it.

The fixation on outcomes rather than on rules has distorted the U.S. negotiating position. The Trump administration's aggressive "win-lose" rhetoric not only puts other countries on the defensive but also baffles them, because the trade balance is not something that governments directly control. Emphasizing deficits and surpluses has made our trading partners less willing to negotiate and to make concessions on issues of market access. And Mr. Trump's precipitous decision to pull out of the TPP and his threats to withdraw from Nafta mean that the U.S. is now viewed as an unreliable partner.

The administration has even criticized Mexico and Canada's other trade deals. Commerce Secretary Wilbur Ross complains that cars assembled in Mexico receive better treatment in the EU than those produced in the U.S. The reason is simple: Mexico has a free-trade agreement with the EU, and the U.S. does not. Canada also just recently concluded a comprehensive trade

agreement with the EU. Both countries now have a leg up over the U.S. in exporting to the EU. The remedy is not to berate the EU for treating the U.S. unfairly but to conclude a trade agreement with the EU as other countries have.

In withdrawing from the Trans-Pacific Partnership, the Trump administration promised instead to conclude many bilateral agreements in Asia. But after seeing how the U.S. has treated its Nafta trading partners, other countries have not been eager to sign up for talks. Japan has already demurred, even though just last week Tokyo was able to reach a major trade deal with the EU. The administration professes to want bilateral agreements, but it will not get them if other countries are reluctant to negotiate.

As a result, the rest of the world will move on and continue to reach trade agreements that exclude the U.S. The 11 nations of the TPP have already gone ahead to conclude the agreement without the U.S. That will subject U.S. exporters to discrimination in other markets. Japanese cars will receive tariff concessions in Vietnam, Australian beef will be treated better than American beef in Japan, and so forth.

And therein, perhaps, lies the silver lining. The more the U.S. stands apart from these trade negotiations, the more U.S. exporters will face discrimination in foreign markets. President Trump or his successor will eventually have to play catch up to restore the equal access that American businesses will demand.

Mr. Irwin is the John French Professor of Economics at Dartmouth College. This essay is adapted from his new book, "Clashing Over Commerce: A History of U.S. Trade Policy," published by the University of Chicago Press.

Trade Rules vs. Imbalances

Read the Fair Rules, Not Equal Trade article and respond to the questions below. This assignment is worth 20 points. Provide thoughtful responses for full credit.

1. What did you learn from reading the article?
2. Do you agree or disagree with the author that rules based trade is superior to outcomes based trade? Explain your response.
3. What approach would you bring to opening foreign markets to goods and services your country has to offer?
4. Do you agree with Cordell Hull's opinion on the relationship between trade and conflict? Explain your response.
5. Granted that the United States promoted a rules based global trading system out of self-interest, what is your opinion of the result? Has this approach resulted in greater political and economic stability and the reduction of poverty compared to the previous approach of protectionism?