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Trump, 2018 Trade War Edition: An Analysis Through the Political and Economic Perspectives

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Abstract

President Trump's presidency can be characterized as unpredictable, controversial, and unconventional. One such instance is America's departure from decades of free-trade advocacy under his administration and engagement in trade disputes with numerous nations. By viewing the 2018 trade dispute through the political and economic perspectives, this thesis aims to understand what the motivating factors are for Trump and his administration to pursue such extensive protectionist policies. The author analyzes the tariffs through two main categories: those that target an adversarial power, China, and those that target traditional allies like Canada, Mexico, and the European Union. The thesis finds that, politically and economically, the protectionist policies have a low likelihood of yielding a substantial payout for the Trump administration. They also potentially threaten to undermine the U.S-built world order.

Table of Contents

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Chapter 1 – The Art of Trade

"Trade wars are good, and easy to win."[1]

This is one of the more peculiar tweets in President Trump's collection of strange tweets on his social media. However, this tweet represents the Trump administration's stark departure from decades of American-advocacy on free-trade. On the one hand, it is tempting for many to dismiss this statement as one of the President's more unusual statements. After all, many Americans have become numb to their President's behavior on Twitter. On the other hand, his supporters can excuse this statement as part of Trump's larger plan of negotiating more favorable trade deals. They can point to his book, *The Art of the Deal* and claim these tweets and the overall larger trade disputes levied on China and allies are all part of the plan. However, Trump's actions suggest a much bleaker picture.

President Trump understands that for all his bravado and hyperbolic statements throughout his 2016 campaign, he needs to keep at least some of his promises. As his book notes, "you can't con people, at least not for long … if you don't deliver the [results], people will eventually catch on."[2] Indeed, one of Trump's major foreign policy platforms in 2016 was on trade and the unfair advantages that other countries have in free trade deals with the United States. He has also promised to negotiate much fairer deals so that other countries can no longer exploit America. Therefore, the President is incentivized to deliver results to his supporters.

However, there are legitimate concerns as to whether this trade dispute will be politically and economically effective and beneficial in the long run. Perhaps for Trump, the toughest

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[1] Donald J. Trump, "When a Country (USA) Is Losing Many Billions of Dollars on Trade," Tweet, *@realDonaldTrump,* March 2, 2018.
[2] Donald Trump and Tony Schwartz, *Trump: The Art of the Deal*, 1st ed. (New York: Random House, 1988).

enemies are those who have read his book. His protectionist policies have faced numerous retaliatory tariffs that pose a serious threat to undermining global trade and compromising the U.S. – built world order. For instance, when attempting to persuade French President Macron to convince the E.U. to negotiate with the U.S. over trade measures, Macron referenced *The Art of the Deal* and said that he knows that they "need to retaliate first [to have] some leverage in the negotiation."[3]

The primary goal of this thesis is to primarily answer the question of what factors drove President Trump to depart from decades of free-trade precedents. It also assesses whether there are genuine benefits to pursuing protectionist policies. Chapter two begins with an analysis of the political reasons for Trump to engage in trade disputes with numerous countries. Namely, it examines the benefits of fulfilling campaign promises. This is examined through two major tariff targets: China and the rest of North America. It offers an explanation on why trade protectionism against both adversaries and allies may pose serious political risks to the President in the long-run.

Chapter three addresses the question of whether the trade dispute will result in tangible economic benefits. The first half of the chapter begins with a historical lesson on America's last major protectionist policy and moves to clarify the administration's apparent misunderstanding of trade deficit. The second half examines the economic reasonings of levying tariffs on China and long-standing American allies. It finds that there are some legitimate reasons to target China. However, there are dangerous risks to act the same way against allies.

[3] Rosie Perper, "France's Macron Reportedly Referenced 'The Art of the Deal' to Clap Back at Trump over an EU Trade Dispute," *Business Insider*.

Finally, the last chapter will assess the President's claim that trade wars are good and easy to win. By culminating evidence introduced in the previous two chapters, this thesis concludes that trade wars are much more nuanced than the President has put it. There are some merits to the current path the administration follows but also legitimate concerns that may bring serious consequences to the U.S. and the world

Chapter 2 – Driven by Campaign Promises

During his 2016 presidential campaign, Donald Trump made many controversial comments. Many of them revolved around trade. A constant theme on his campaign trail is how many of the country's trade deals have been "bad." From calling NAFTA the "worst trade deal the U.S. ever signed"[4] to claiming that the TPP "is an attack on America's business,"[5] Trump has a strong disliking to many significant trade deals. However, while some critics have been quick to dismiss the President's comments as part of his overall unpredictable and unconventional behavior, there are underlying political motives for him to instigate the 2018 trade dispute, whether that is the renegotiation of NAFTA or the withdrawal from the TPP.

Simply put, Trump's 2018 trade dispute is an attempt to secure domestic political gains by fulfilling his campaign promises. The trade disputes are used as a tactic to secure support from his critical support base through protectionist policies. Fulfilling his campaign promises will provide the President with political capital for future elections. However, while the administration's intention may be to secure political advantages, it is also critical to examine whether the desired effect has been achieved. This chapter first analyzes how fulfilled campaign promises will provide political gains. It then examines the effects of the Chinese trade dispute and the renegotiation of NAFTA, determining whether the fulfilled campaign promises will reap long-term benefits.

[4] Heather Gandel. "Fact Check: Trump Says NAFTA Was the Worst Trade Deal the U.S. Ever Signed." *Fortune*.
[5] Adam Taylor. "Analysis | A Timeline of Trump's Complicated Relationship with the TPP." *Washington Post*.

The benefits of campaign promises

In economic theory, there are two primary benefits of protectionist trade policies: boosting less competitive domestic industries and creating jobs for domestic workers.[6] These two economic advantages in some ways generate domestic political gains. By erecting protectionist policies as the administration has done with tariffs, the President is seeking to protect critical U.S. industry such as manufacturing that has been at a disadvantage due to globalization. With globalization, more people and companies can interact with foreign entities. With the U.S. being a developed country, it has highly established institutions such as labor unions and environmental regulations that sometimes make it costlier for firms to operate. Thus, firms move abroad to developing countries where they may find cheaper labor or more lax regulations to reduce their costs.

As a result, it creates a decrease in domestic working opportunities. Protectionist policies reverse this by making it more attractive for firms to stay home through methods such as domestic subsidies to offset the higher costs and taxes to discourage firms from moving abroad. Therefore, by helping previously neglected industries to boom again, it creates an increased need for new workers to satisfy the new demand, which leads to new employment opportunities. For the Trump administration, his support base has been one of the main victims of globalization and the outflow of employment opportunities. He also understands that their support is critical to future political success. Thus, he has elected to protect his voters' vital industries.

Throughout the campaign trail, the President continuously echoed the message that previous administrations had neglected domestic industries and allowed them to fall behind

[6] Kimberly Amadeo. "Why Protectionism Feels So Good, But Is So Wrong." *The Balance*.

international competitors.[7] In turn, he pledged to punish countries that cheat trade deals with tariffs. The recent trade disputes with China and traditional allies demonstrate his commitment to fulfill these promises. This strengthens Trump supporters' belief that the President will follow through on more of his campaign promises[8] that he may not have had the chance to complete before the end of his first term. As a result, future voters will view the President in a more favorable perspective as he has kept his promise[9] and more willing to support him on his next campaign.

On the one hand, since the tariffs do not appear to have a negative influence on the President's approval rating,[10] it will only exemplify the positives of him keeping his word. This is because Trump gains much more when he keeps his promise in districts that disproportionately agree with and support him.[11] On the other hand, had the President failed to uphold his promises, he would have likely lost future voters since they would react harshly.[12] Overall, this strategy is politically logical as it provides the President with positive gains.

China vs. promises: which will prevail?

One of the major aspects during the 2018 trade dispute has been the ongoing trade rift with China. As of November 2018, there has been a total of $250 billion worth of U.S. tariffs exclusively applied to China.[13] These tariffs were imposed in three rounds. The first round saw a 25 percent tariff on $34 billion of Chinese good that includes industry parts, vehicles, and

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[7] Kelsey Rupp. "Trump's pro-American Trade Policy Is Just What He Promised." Text. *TheHill*.
[8] Tabitha Bonilla. *The Strategy of Campaign Promises*.
[9] Ibid.
[10] Scott Clement and Heather Long. "Analysis | Trump Voters Hit Hard by Tariffs Are Standing by Him — for Now." *Washington Post*.
[11] Tabitha Bonilla. *The Strategy of Campaign Promises*.
[12] Ibid.
[13] "The US-China Trade War: A Timeline." *China Briefing News*. Last modified September 26, 2018.

chemicals. The second round placed a 25 percent tariff on $16 billion of Chinese goods that include semiconductors, plastics, and electric scooters. Finally, another 10 percent that would transition to 25 percent tariff was placed on $200 billion of Chinese goods that range from electronics, food, tools, and housewares. With more threats of taxing nearly all Chinese imports,[14] the tension with China is arguably the most significant. As the two countries are the world's two largest economies, the outcome of this dispute may have widespread ramifications for the current world order.

When the President referred to "America first" during his presidential campaign, he meant a restoration of American pride in global politics. To his supporters, this was one of his big selling points. After all, the motto of "Make America Great Again" has arguably become synonymous with the President and administration. Upon taking office, Trump withdrew from the Trans-Pacific-Partnership, a deal that took the Obama administration six years to craft and negotiate.[15] This is a move that signaled to both China as well as other countries that the U.S. will be taking a radically different stance on free trade. It also sets the impression that the President is trustworthy to his supporters as he committed to following through with his view of the TPP.

As a result of pursuing America first policies in international trade, the administration slapped tariffs on many Chinese imports to counter China's aggressive geopolitical expansion ambitions. Throughout his campaign, Trump attacked China numerous times, claiming that the country has crippled, taken advantage, and "raped" the US.[16] He accused previous

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[14] "Trump Ready to Tax Virtually All Chinese Imports to US." *VOA*.
[15] Ann M Simmons. "Why the Obama Administration Thinks the Trans-Pacific Partnership Is a Good Deal." *Latimes.Com*.
[16] Veronica Stracqualursi. News, A. B. C. "10 Times Trump Attacked China." *ABC News*.

administrations of failing to stand up to China, allowing the U.S. to lose its prestigious status. This is another move that attempts to amplify his trustworthiness by committing to his campaign promise: punishing those that attempt to take advantage of the country.

As a result, it appears that Trump has secured short-term political gains for the future. However, there are doubts as to whether these moves will bring long-term political benefits. It is interesting to note that regarding his America first stance, the President never meant it as an isolationist position.[17] Nonetheless, throughout his presidency, the country has become increasingly isolated. From power vacuums in the Middle East to retreat on human rights issues,[18] the country has radically changed its stance in international politics compared to prior administrations. The tariffs may bring unbearable long-term consequences at the cost of his supporters. Furthermore, its decision to withdraw from the TPP may bring more harm than good in the long run.

On the one hand, the TPP was designed to bring benefits to the machinery, auto, plastics, and agricultural industries.[19] Many of these industries are also the ones that supported Trump pledged to protect. For industrial America, on the other hand, it was more ambivalent towards the deal.[20] However, for industries like agriculture, the deal would have brought $10 billion worth of output over 15 years.[21] By withdrawing from the TPP, the President is sacrificing his supporters to keep a promise that has more uncertain consequences and unclear benefits. Furthermore, by withdrawing from the TPP, the President provided room for other rival

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[17] Doyle McManus. "Trump Says He Stands for 'America First.' What Does That Mean?" *Latimes.Com*.
[18] Michael Birnbaum and Griff White. "A Year of Trump's 'America First' Agenda Has Radically Changed the U.S. Role in the World." *Washington Post*.
[19] Kimberly Amadeo. "Trump Wants Back Into TPP." *The Balance*
[20] Catherine Boudreau. "Trump Country Hit Hard by Chinese Tariffs." *POLITICO*.
[21] Ibid.

exporters to negotiate new deals that may lead to a higher competitive advantage over U.S. exports.[22] Indeed, it appears that the President has sacrificed the long-term wellbeing of many of his supporters to fulfill his campaign promise.

For the tariffs on Chinese goods, it appears to be mostly a similar story. To counter the decrease in domestic competitive advantage, Trump initiated a series of tariffs to protect these industries. However, in response to these tariffs, the Chinese have enacted retaliatory tariffs that profoundly impact many of the President's supporters.[23] While there has been a lack of hostile response from those impacted, it is because many have not yet felt the impact. For instance, many of the farmers who produce products affected by the retaliatory tariffs signed contracts before the tariffs were implemented. In other words, they sold their products at higher prices with more favorable terms.[24] As a result, many are waiting to see how the tariffs will affect their contracts next year before deciding their stance.

Moreover, many of the Chinese tariffs were designed to cause tension between Trump and his supporters. According to the Brookings Institute, 82% of the counties with tariff-impacted employment positions voted for Trump.[25] As such, it is impractical to prolong the tariffs since the Chinese have been very strategic in their response. It is also doubted that many of those impacted can endure a period of rising production costs and lower selling prices. Therefore, it is still ambiguous as to whether the pain[26] that the President has urged his

[22] Ibid.
[23] Adam Behsudi. "Trump's Trade Pullout Roils Rural America." *POLITICO Magazine*.
[24] Scott Clement and Heather Long. "Analysis | Trump Voters Hit Hard by Tariffs Are Standing by Him — for Now." *Washington Post*.
[25] Robert Maxim, Mark Muro, and Jacob Whiton. "How China's Proposed Tariffs Could Affect U.S. Workers and Industries." *Brookings*, April 9, 2018.
[26] Heather Long. "Analysis | Trump Is Betting American Families Are Willing to Pay for His Trade War." *Washington Post*.

supporters to bear is genuinely short-term. If the dispute with China does not conclude soon, the situation will become much more difficult for his supporters – many may struggle to make ends meet as it gets harder to find profitable contracts.

While the President's ability to fulfill his campaign promises may seem to be a political gain at the moment, it may backfire in the long term since these promises come at the potential cost of his supporters' future wellbeing. Furthermore, his America first policy is not even aligned with his intended definition and even lean more towards isolationist policies. China's strategic response only decreases the likelihood that his political gains will stand to last as more of his supporters feel the negative consequences. Overall, there are serious risks in prolonging the Chinese dispute if Trump wishes to accrue long-term political capital.

Promise fulfilled but little change

Besides targeting rivals in the trade dispute, the administration has also attacked traditional allies. It seems strange for the United States to place tariffs on strategic long-standing geopolitical allies like Canada and Mexico. In fact, the U.S. has placed more tariffs on allies than it has on China.[27] However, it can be understood as an attempt to secure his campaign promise of resurrecting the American manufacturing industry[28] and prevent American companies from moving their productions abroad. In other words, the surprising move to target allies is arguably a decision to boost Trump's domestic credibility and trustworthiness. With a new trade deal in place among Canada, United States, and Mexico, it seems that the administration's bold moves

[27] Heather Long. "Analysis | Trump Has Officially Put More Tariffs on U.S. Allies than on China." *Washington Post*.
[28] Steven Minter. "The Great Manufacturing Employment Challenge." *IndustryWeek*.

have paid some dividends. Regardless, these unusual moves come at significant risk and cost – it may end up hurting the administration and the President's credibility in the long run.

Throughout his campaign, Trump bashed American companies for shifting their productions overseas. Following his America first doctrine, the President vowed to create 25 million jobs.[29] He specifically placed tariffs on steel and aluminum, components critical to the manufacturing industry and the vital support base in the rust belt that helped him win the election. Also, he has continuously called many previous trade deals horrific. Namely, he claimed NAFTA to be "the worst deal in the history of the country."[30] Therefore, for the President, it is important to follow through on his campaign promises of both bringing back overseas jobs as well as renegotiating deals like NAFTA.

One of the initial moves that the President pursued was to levy tariffs on steel and aluminum. Besides citing concerns of national security, he cited unfair trade practices like subsidized production as justification.[31] According to the American Iron and Steel Institute, the President's tariffs on steel have brought job growth to rust belt cities like those in Illinois.[32] In the short term, the administration provided a good message for the Republican party to bring back to the steel-producing states of Pennsylvania, Indiana, and Michigan.[33] For the President himself, he can claim the simple story that he has fulfilled his promise of resurrecting vital American industries like steel. Indeed, the primary beneficiaries of these tariffs are steel corporations. In addition, he managed to renegotiate an allegedly terrible deal to one that he

[29] Heather Long. "Trump Vows 25 Million Jobs, Most of Any President." *CNNMoney*.
[30] Richard Partington. "Nafta: What Is It and Why Is Trump Trying to Renegotiate?" *The Guardian*, August 30, 2018
[31] Thomas Gibson. "Tariffs on Foreign Steel Save American Jobs." *USA TODAY*.
[32] Ibid.
[33] Thomas Biescheuvel and Luis-Ann Javier. "Winners and Losers From Trump's Tariffs on Aluminum and Steel," March 1, 2018.

claims to be more favorable, fulfilling a bedrock campaign promise.[34] Overall, it appears that Trump has succeeded to gain political advantages by keeping his word on campaign promises.

However, similar to the political advantages seemingly harnessed with the Chinese trade dispute, there are more long-term risks that may backfire on the President and the administration. Regarding the tariffs that claim to protect vital domestic industries' interests, they are more complicated than one may perceive. While they provide benefits to steel corporations, whether these benefits will trickle down to its employees is up for debate. Moreover, for domestic corporations that use steel or aluminum as a component like Anheuser-Busch, they may be forced to lay off employees to offset increasing costs.[35] These firms employ more workers than the steel or aluminum industries. As a result, there may be a net loss of jobs with forecasts of nearly 180,000 jobs lost as opposed to only 33,000 jobs gained.[36]

In fact, the steel and aluminum tariffs have been viewed unfavorably with a 50 percent disapproval as opposed to 31 percent approval rating.[37] Furthermore, the decrease in overall manufacturing jobs cannot be solely blamed on unfair trade practices abroad. Over the past decades, there has been a vast increase in worker productivity in the manufacturing sector: shrinking from 25 jobs to 6.5 jobs to create $1 million worth of outputs. It would require an unrealistic increase in worker productivity in a short amount of time to meet Trump's

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[34] Mark Landler and Alan Rappeport. "Trump Hails Revised Nafta Trade Deal, and Sets Up a Showdown With China." *The New York Times*
[35] Biescheuvel and Javier. "Winners and Losers From Trump's Tariffs on Aluminum and Steel,"
[36] Rachel Layne. "President Trump's Steel and Aluminum Tariffs: Winners and Losers."
[37] William A Galston. "Support for Trump's Tariffs Even Lower than His Job Approval Rating." *Brookings*, March 6, 2018.

employment growth targets.[38] Therefore, while there appear to be short-term political benefits with the tariffs, it is likely that these positives will prove to be an overall cost to the country.

With regards to the newly negotiated trade deal for North America, the USMCA, President Trump happily declared the deal as a "historical" transaction. However, there are doubts as to whether serious changes exist with the new deal compared to the ill-received NAFTA.[39] For instance, the significant changes primarily impact automobile manufacturers and dairy farmers. For car makers, they are now required to source 75 percent of materials from North America as opposed to the previous 62.5 percent for the cars to be tariff-free with at least 40 to 45 percent of the parts made by workers earning a $16 minimum wage. For the dairy industry, American dairy farmers now have increased access to the Canadian market that was previously barred with Canadian quotas and import tariffs.[40]

These changes that Trump has called historical, may bring more harm than benefits. For the auto industry, up to 1.6 million vehicles that were tariff-free under NAFTA will be subject to tariffs due to the changed rule of origin.[41] This would mean higher costs for both car manufacturers and consumers with prices for new vehicles rising by $455 to $6875.[42] While Trump has cited this change as a means of incentivizing car manufacturers to stay,[43] it may provide the opposite incentive and lead to job losses. According to the Center for Automotive

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[38] Mark Liu, Muro and Sifan. "Why Trump's Factory Job Promises Won't Pan out—in One Chart." *Brookings*, November 21, 2016.
[39] Anne Applebaum. "Opinion | Trump's New NAFTA Is Pretty Much the Same as the Old One — but at What Cost?" *Washington Post*
[40] Alan Beattie and James Politi, "How Is Donald Trump's USMCA Trade Deal Different from Nafta?", *Financial Times*, October 1, 2018.
[41] "Meet the New NAFTA - USMCA." *Center for Automotive Research*, October 16, 2018.
[42] "Trade Briefing: Consumer Impact of Potential U.S. Section 232 Tariffs & Quotas on Imported Automobiles & Automotive Parts." *Center for Automotive Research*.
[43] "UNITED STATES–MEXICO–CANADA TRADE FACT SHEET Rebalancing Trade to Support Manufacturing" (Office of the United States Trade Representative, October 2018).

Research, the rising prices will lead to a decreased demand of nearly 500,000 to two million vehicles, affecting over 82,000 to 715,000 jobs.[44]

For the dairy industry, the increased access will add about $70 million to the existing $230 million export market. However, it will not offset the Mexican and Chinese retaliatory tariffs – costing American dairy exports $2.7 billion.[45] In addition, the terms are similar to what Canada had offered in another ill-received deal, the TPP.[46] Therefore, the changes in the new deal appear to be rather trivial. At the same time, they may lead to job losses and rising prices for many Americans. Furthermore, the deal does not address the steel and aluminum tariffs that affect Canada and Mexico.

It also is important to keep in mind that most Americans view NAFTA as good for the United States.[47] While more Republicans view NAFTA as a bad deal, this reflects an overall partisan trend in the two parties' views on free trade deals. 67 percent of Democrats are more likely to view free trade deals positively whereas only 36 percent of Republicans believe in the same.[48] However, 56 percent of Americans believe that the pact is beneficial for the United States with only 30 and 20 percent think that the deal is more favorable for Mexico and Canada.[49] Therefore, it seems somewhat unnecessary for Trump to renegotiate the deal. Moreover, across all demographics and age groups, there are more Americans in support of

[44] "Trade Briefing: Consumer Impact." *Center for Automotive Research*
[45] John Brinkley. "USMCA Is Not The Magnificent Trade Deal Trump Says It Is." *Forbes*.
[46] Landler and Rappeport. "Trump Hails Revised Nafta Trade Deal"
[47] Alec Tyson. "Most Americans Say NAFTA Is Good for U.S." *Pew Research Center*
[48] Bradley Jones. "U.S. Support for Free Trade Agreements Rebounds, but Divisions Remain." *Pew Research Center*
[49] Tyson. "Most Americans Say NAFTA Is Good for U.S." *Pew*

NAFTA. It remains to be seen whether this new deal would bring significant positive changes to the country.

Overall, Trump may have appeared to be able to fulfill his campaign promises of resurrecting key support bases’ industries and replacing an alleged horrible deal. In the short run, this may bring political gains for the President, but the long-term picture is much murkier. In particular, the steel and aluminum tariffs may bring greater costs to the country since Trump has set unrealistic goals and created the potential for more severe job losses at the expense of fewer gains. With NAFTA, the lack of real change brings doubt as to whether it was necessary for the deal to be re-negotiated. Furthermore, the changes made may also adversely impact average Americans in the long run. Ultimately, there are serious doubts as to whether the targeting of traditional allies will pay long-term political dividends.

Conclusion

Even though President Trump's 2018 trade dispute with traditional allies and China may appear to be a result of his often-unpredictable behavior, there are arguably underlying political motives. Namely, the President may be attempting to secure political advantages for future elections through fulfilling campaign promises to his voter base. Indeed, by following his America first policy as justification for tariffs against China, erecting policies to protect critical American industries, and withdrawing from allegedly terrible deals, it seems that Trump has fulfilled his campaign pledges. As a result, he has boosted his image among his supporters as a trustworthy and credible individual. There may be greater sentiments to re-elect the President to fulfill his other campaign promises that he may not have had the opportunity in his first term.

However, the policies that Trump has pursued may put him at a greater political disadvantage. While there is support for his actions against China, a prolonged tariff battle may become an overwhelming burden for his supporters. By withdrawing from the TPP, he has given leeway for other countries to explore new deals that exclude the US, which may place domestic producers at a competitive disadvantage. Regarding his tariffs that protect his key supporters' industries, there are unrealistic expectations concerning job growth and industry revival. It is unreasonable to blame the decline in these industries to unfair trade practices. For the newly negotiated USCMA, it is unclear whether there will be any real progress as it is largely similar to the old NAFTA.

Chapter 3 – A Lucky Hit and a Puzzling Decision

Even though the 2018 trade dispute originates from President Trump's 2016 campaign promises, the primary justification for initiating such a controversial action has been economic. From citing concerns of the growing U.S. trade deficit to accusing unethical trade practices like stealing intellectual property rights, the administration paints a picture that it must act. While some of Trump's justifications are valid, other reasons that drive the administration's arguments are more dubious. Furthermore, previous protectionist policies have hindered global economic growth and left all parties worse off. In addition, the booming U.S. economy may serve as a disguise – it may only conceal and delay the eventual negative consequences of the tariffs. These misguided reasonings may ultimately harm U.S. and global economic development.

Overall, the administration's use of the trade deficit as a central argument for the dispute is a mistake. The trade deficit exists for much more complex reasons than Trump articulated. This chapter begins with an analysis of what the consequences were after a significant protectionist policy like the Smoot-Hawley Tariff Act. It then looks at how trade deficits work and suggests that the administration lacks an understanding of deficits. It then moves to examine the economic reasoning behind the disputes with China to determine whether there are valid concerns. Finally, the chapter assesses why the administration decided to initiate the puzzling move to engage in trade disputes not just with China but also with strategic U.S. allies.

History lesson with Smoot and Hawley

The Smoot-Hawley Tariff Act was one of the major U.S. tariff acts enacted over the past century. It was passed to mainly respond to overproduction in the global market that squeezed

American producers.[50] Despite over 1,000 prominent economists of the time opposing the measure, Congress approved the tariff anyway.[51] The tariffs increased import duties by about 20 percent on average. Coupled with deflation, the tariffs reduced imports by about 12-20 percent.[52] Other countries like Canada and Europe soon followed suit with retaliatory measures, leading exports to tumble – from $7 billion in 1929 to $2.5 billion in 1932. With exports composing nearly seven percent of national productions in the 1930s, the collapse of international trade had a significant impact on both domestic and international economies.[53]

The tariffs further contributed to the slowdown of the economy and the first stage of the Great Depression. It increased the costs for trade-reliant producers. For example, there were over 500 U.S. plants that employed over 60,000 people to make cheap clothing from imported wool rags. Under the tariff, imported wool rags' price rose by 140 percent, making it prohibitively costlier.[54] Moreover, the reduction in exports meant that fewer U.S. dollars were circulating in the international monetary system. Besides raising the difficulty for foreign countries to repay U.S. debts, it further reduced exports. The high tariffs on foreign goods also meant a decrease in domestic demand for foreign goods and currency. As such, it artificially appreciated the U.S. dollar against foreign currency, which exacerbated the reduction in exports.[55] Overall, global trade fell a staggering 65 percent.[56]

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[50] "Smoot-Hawley Tariff Act | History, Effects, & Facts," *Encyclopedia Britannica*.
[51] "The Battle of Smoot-Hawley," *The Economist*, December 18, 2008.
[52] Douglas A. Irwin. "The Smoot-Hawley Tariff: A Quantitative Assessment." *The Review of Economics and Statistics* 80, no. 2 (1998): 9.
[53] Alan Reynolds, "The Smoot-Hawley Tariff and the Great Depression," *Cato Institute*, last modified May 7, 2016.
[54] Ibid.
[55] Ibid.
[56] Kimberly Amadeo, "Those Who Don't Learn From Smoot-Hawley Are Doomed to Repeat It," *The Balance*.

In terms of the current trade dispute, Smoot-Hawley serves as a good historical lesson: protectionist trade policies incentivize economically inefficient behaviors that can undermine U.S. reputation and growth. In fact, the current trade dispute has the potential to be more devastating than Smoot-Hawley. First, trade barriers encourage other countries to retaliate. Irwin argues that, while the Smoot-Hawley tariffs' impact on trade viewed strictly by itself is relatively minor,[57] the ripple effect of the tariff devasted trade. It led to retaliatory tariffs, which forced many domestic industries to face increased costs. President Trump's tariffs have already led to a myriad of retaliatory tariffs on over $80 billion of U.S. goods.

Second, the post-World War II global trade order was established by the United States through rounds after rounds of free-trade agreement negotiations. Protectionism and retaliation threaten to undercut this U.S. built foundation. In other words, it can hamper U.S. influence in international politics since there is a risk that the American role in global trade is reduced. Third, while the current U.S. economy is unlike that of the 1930s, it does not eliminate the risk of an economic slowdown. For Smoot-Hawley, the immediate onset of the Great Depression helped policymakers realize the strain the tariffs have on domestic producers, hastening its abolishment. The current economic boom actually has the opposite effect – the tariffs' effects may not be felt until a much later date. Moreover, as American exports now comprise 13 percent of GDP[58] as opposed to only 7 percent during the 1930s along with a more integrated global economy such as more interconnected global supply chains, the current trade dispute may have a more severe impact than Smoot-Hawley. In fact, the IMF only projects a 3.7 percent growth on global trade

[57] Irwin. "The Smoot-Hawley Tariff: A Quantitative Assessment." *The Review of Economics and Statistics,* 9.
[58] Amadeo, "Those Who Don't Learn From Smoot-Hawley Are Doomed to Repeat It," *The Balance*.

due to the trade disputes, 0.2 percent lower than last forecasted.[59] Therefore, it is important to draw upon the lessons from Smoot-Hawley and keep in mind that current trade policies have the potential to be even worse than one of the most major protectionist policies in recent American history.

Trade deficit the scapegoat

President Trump claimed that the country "lost $817 billion on trade last year"[60] on Twitter. He is wrong. The net trade deficit in 2017 was $552 billion.[61] Although it is tempting to dismiss this statement as just one of the President's many controversial and flat-out incorrect tweets, it represents his attempt to mischaracterize and wildly exaggerate what trade deficits are. Simply put, a trade deficit is when one country imports more goods and services than it exports. Conversely, a trade surplus is when one country exports more than it imports. Therefore, a trade deficit is not equal to losing money nor is a trade surplus equal to earning money.[62]

For most economists, trade deficits are neither good or bad. It depends on the circumstances. In other words, they are not inherently bad as Trump has described them to be. To better understand trade deficits, it is necessary to recognize the national accounting measure – the balance of payments. B.O.P. measures the current and capital accounts. The current account refers to goods and services, investment income, and uncompensated transfers like foreign aid. Capital account comprises of investment assets like real estate, stocks, bonds, and government securities.[63] Theoretically, this measure equates to zero because if a country runs a deficit in one

[59] International Monetary Fund, *World Economic Outlook, October 2018: Challenges to Steady Growth.* (S.l.: Intl Monetary Fund, 2018), 1.
[60] Donald J. Trump, "Every Time I See a Weak Politician,"Tweet, *@realDonaldTrump*, July 25, 2018.
[61] *U.S. Trade in Goods and Services - Balance of Payments (BOP) Basis* (United States Census Bureau, June 6, 2018).
[62] Patrick Gillespie, "Why a Trade Deficit Isn't like Losing Money," *CNNMoney*, last modified March 7, 2017.
[63] Daniel Griswold, "America's Misunderstood Trade Deficit," *Cato Institute*, last modified July 22, 1998.

account, it will be made up with a surplus in the other. Therefore, trade deficits are also affected by other macroeconomic factors that include saving and investment rates and currency values. Changing trade policy has minimal effect on the trade deficit.[64]

Regarding saving and investment rates, it is related to exports and imports in that a country will export its excess savings as the net foreign investment, which means a capital account deficit. As the U.S. imports more, it must also experience more investment, leading to more capital imports and a capital account surplus. This excess leads to higher consumption, which is made up by imports of goods and a current account deficit.[65] Currency values also have a major influence. For instance, if there were a flow of net investments into a country, the demand for that country's currency would rise and appreciate. On the one hand, it would mean that the country's exports would become less competitive since they are more expensive. On the other hand, imports would become cheaper. This change in imports and exports would occur until it matches the capital account as foreign investors seek to outbid domestic consumers for the currency until their demand for foreign assets is satisfied.[66]

Consider Germany before and after the Cold War. West Germany consistently had a current account and trade surplus. However, after the Berlin Wall was toppled, Germany's current account suddenly switched into a deficit. This was not because of unfair trade barriers from German trading partners but the reintegration of East Germany. The need to rebuild a relatively backward country led to the need for large domestic investments, causing a decrease in German savings that had been going abroad and, in turn, led to the appreciation of the Deutsche Mark. Therefore, it led to a decrease in exports and a rise in imports as German products became

[64] Ibid.
[65] Ibid.
[66] Ibid.

more expensive, which caused a trade deficit.[67] Similarly, the U.S. trade deficit is not caused by unfair foreign trade practices but by its domestic macroeconomic policies and the dollar's status.

For the U.S., there is a higher demand for capital than the amount of domestic savings. This increased attractiveness for investing leads to higher domestic interest rates, which appreciates the dollar. Furthermore, with free-flowing exchange rates and liberalized capital flow, foreign capital inflow allows Americans to consume more than they produce, which manifest itself in the trade deficit.[68] For other countries, this amount of trade deficit is simply unsustainable. However, as the dollar is the dominant global reserve currency since many believe it a safe asset to hold, it is arguably natural for the U.S. to run such a deficit. Economist Robert Triffin warned that the provider of the global reserve currency would need to run perpetual trade deficits.[69] Furthermore, the dollar's desirability is also driven by the size of the American economy and the ubiquity of the dollar among foreigners.[70] Moreover, foreign countries will have little incentive to change to alternative reserve currencies because this will create instability. Therefore, the dollar's prestigious status places upward pressure on its exchange rate and leads to the U.S. to import more than it exports.[71]

Since the U.S. trade deficit is mostly driven by its domestic macroeconomic policies and the dollar's status, it is doubtful that protectionist policies will effectively reduce the deficit. For instance, tariffs would likely lead to a reduction in American imports, which reduces the number of dollars flowing into the international monetary system and appreciates the dollar. This stronger dollar only means a reduction in exports and an increase in imports until the trade

[67] Ibid.
[68] James K. Jackson, *The U.S. Trade Deficit: An Overview* (Congressional Research Service, July 18, 2018).
[69] Neil Irwin, "What Is the Trade Deficit?," *The New York Times*, June 9, 2018, sec. The Upshot.
[70] Barry Eichengreen, *Exorbitant Privilege* (Oxford University Press, 2010), 125.
[71] Jackson, *The U.S. Trade Deficit: An Overview*.

balance matched the savings and investment balance.[72] Essentially, without changing the savings and investment rates, tariffs would only leave Americans poorer by reducing the volume of exports and imports. This is already taking place with Trump's tariffs. With exports plunging, the trade deficit increased $31 billion (8.6%) compared to the amount a year ago.[73] Indeed, it appears that it is rather ineffective to use tariffs to address the trade deficit since it is a natural manifestation of domestic macroeconomic policy and the dollar's status as the global reserve currency.

The lucky hit

The trade fight between the two largest economies in the world has had a profound effect on the global economy. For the President, it appears that he has the upper hand. The U.S. economy is booming whereas the Chinese economy has shown signs of a slowdown. Trump still has more Chinese imports to tax whereas the Chinese are running out of American imports on which to impose tariffs. While the trade deficit between the two countries has not closed, this is arguably due to the President's misunderstanding of how trade deficits work. The tariffs nonetheless attempt to address a legitimate economic concern: the unfair advantages and disadvantages that Chinese and foreign corporations receive. Namely, this refers to the alleged artificial depreciation of the yuan, the subsidies that boost domestic firms' competitiveness, and the bureaucratic red-tape that foreign firms have to overcome to enter the Chinese market such as forced technology transfers.

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[72] Griswold, "America's Misunderstood Trade Deficit," *Cato Institute.*
[73] Jeff Cox, "US Trade Deficit Keeps Going up despite Tariffs," last modified October 5, 2018.

President Trump has long accused China as a "currency manipulator."[74] By artificially suppressing the yuan's value, the Chinese government can make its exports more competitive in the global market and imports more expensive. It is true that China has been the culprit in manipulating its currency around the turn of the millennium. From 2000 to 2014, China boosted its foreign reserve by $4 trillion, as it readily bought dollars to depreciate the yuan.[75] Until 2005, the yuan was also strictly pegged to the dollar.[76] However, the Chinese government recently shifted away from this practice. Much of the currency manipulation has been actually attempting to appreciate the yuan artificially.

After the effects of the 2008 global recession improved, the yuan steadily declined as foreign investors sought better opportunities elsewhere and the Federal Reserve announced rate hikes.[77] To counteract a severe currency depreciation, the Chinese have been selling off its dollar reserve. As of October 2018, it has fallen nearly $1 trillion from its peak of $4 trillion.[78] As a result, the yuan appreciated 10 percent over 2017.[79] Moreover, to reduce the risk of capital flight, the government has clamped down on the ability to move the yuan across borders. For instance, the government implemented a new policy that prohibits individual citizens from moving more

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[74] Donald J. Trump, "Russia and China Are Playing the Currency Devaluation Game,"Tweet, *@realDonaldTrump*, April 16, 2018.
[75]Eduardo Porter, "Trump Isn't Wrong on China Currency Manipulation, Just Late," *The New York Times*, April 11, 2017, sec. Business.
[76] David Barboza and Joseph Kahn, "China Says It Will No Longer Peg Its Currency to the U.S. Dollar," *The New York Times*, July 21, 2005, sec. International Business.
[77] Ana Maria Santacreu and Zhu Heting. "Causes and Effects of China's Falling Foreign Reserves," *St. Louis Federal Reserve*.
[78] "China Foreign Exchange Reserves | 1980-2018 | Data | Chart | Calendar," *Trading Economics*.
[79] Huileng Tan, "Chinese Yuan against the Dollar: China Currency Appreciation," *CNBC*, last modified February 22, 2018.

than $50,000 out of the country annually.[80] In effect, the authorities are trying to limit the amount of yuan that can circulate in the global monetary exchange to drive up its value.

To complicate matters further, China does not fit the criteria of currency manipulation under the 2015 Trade Enforcement Act. To qualify, a country needs to have a large overall current account surplus, a large bilateral trade surplus with the United States, and engage in persistent one-sided intervention in its currency market to prevent appreciation.[81] Currently, China only meets one of these criteria – a large trade surplus. Moreover, its current account surplus has switched to a deficit[82] as Chinese authorities try to combat the market-driven depreciation of the yuan. Therefore, it is difficult to label China as the "grand champion of currency manipulation" as Trump claimed.[83] The country was guilty, but that was more than ten years ago.

Even though it may be difficult to label China as a currency manipulator, the country's extensive use of subsidies and tariffs that favor domestic firms are well-documented. In a joint statement issued by the U.S., Japan, and the E.U., it called for new rules to regulate industrial subsidies and State-Owned Enterprises (SOEs). The three countries also barely veiled their discontent with China, calling it "an advanced WTO Members claiming developing country status" and urging the Chinese government to shoulder more responsibilities.[84] SOEs can also be seen as an extension of these subsidies as they have the entire government to fall back on.

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[80] Keith Bradsher, "China Tightens Controls on Overseas Use of Its Currency," *The New York Times*, November 29, 2016, sec. Business.
[81] Meg Lundsager, "Is China Manipulating Its Currency?," *Wilson Center*, last modified January 26, 2017.
[82] "China Reports a Rare Current Account Deficit for First Quarter," *Reuters*, June 29, 2018.
[83] Steve Holland and David Lawder, "Exclusive: Trump Calls Chinese 'grand Champions' of Currency...," *Reuters*, February 24, 2017.
[84] "Joint Statement on Trilateral Meeting of the Trade Ministers of the United States, Japan, and the European Union | United States Trade Representative."

Indeed, these industrial subsidies shield many domestic industries from global competition and hide some firms' economic inefficiencies.

Regarding industrial subsidies, China has protected domestic industries and boosted exports. For instance, subsidies with export share requirements (ESR), where firms must meet a certain export threshold for their production, have had a great effect on Chinese firms. China has a staggering number of exporters eligible for ESR subsidies: half of all exporting firms in China are eligible as they sell more than 70 percent of their products abroad. This means that an extensive percentage of Chinese producers are protected even if they have low-profitability.[85] For example, in the solar industry, government subsidies have helped China's industry grow ten times while depressing world price by 75 percent due to the flooding of solar panels in the global market.[86] These subsidies have helped to artificially lower the prices by 25 to 30 percent of comparable products from the U.S. or the E.U.

China's electric vehicle (EVs) industry is also one of the government's favorite target for generous subsidies. In 2017, about 770,000 EVs were produced and sold in China, a 53 percent increase from last year and about four times the amount sold in the United States. This growth is largely attributed to generous government subsidies. To consumers, the government provides $10,000 worth of subsidies per EV purchased along with attractive policies like assured license plates that have a 0.1 percent issue rate in some provinces. To EV producers, government subsidies account for more than 50 percent of the cost of the batteries. For example, government subsidies and grants have accounted for nearly 19 percent of Geely's, a leading Chinese

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[85] Fabrice Defever and Alejandro Riaño, "Subsidies with Export Share Requirements in China," *Journal of Development Economics* 126 (May 2017): 33–51.
[86] Usha C. V. Haley and George T. Haley, "How Chinese Subsidies Changed the World," *Harvard Business Review*, April 25, 2013.

automobile manufacturer, gross profit at one point.[87] It is projected that the total number of EVs in China will reach 2 million in 2020.[88] In other words, the government has been covering the economic inefficiencies of domestic companies that would have been otherwise exposed by the market and artificially boosting industries that would have been unprofitable in the short run. Consequently, when government subsidies for the solar industry declined, many solar-panel producing firms, particularly those unprofitable, defaulted on their loans.[89] When government subsidies for EV manufacturers declined, sales for carmakers like BYD fell 20 percent.[90]

In terms of SOEs, they are protected by the government from competition and even bankruptcy.[91] This is accomplished primarily through an assured market share for these firms. Non-state-owned enterprises are prohibited from expanding beyond a certain position.[92] For instance, the Chinese aviation industry is primarily comprised of three major state-owned airlines: China Southern, China Eastern, and Air China. Together, they account for a domestic market share of 77 percent.[93] The fourth largest and privately-owned airline, Hainan Airlines, only accounts for 7 percent of the market share.[94] In contrast, the three big U.S. airlines – American, Delta, and United Continental take up only 50 percent of the market share.[95] It is also doubtful whether competition can genuinely exist between these state enterprises. It is a common practice for the state to appoint Communist Party officials to senior executive positions in these

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[87] Anjani Trivedi, "In Trump's China, Industrial Subsidies Loom Large," *Wall Street Journal*, November 16, 2016, sec. Markets.
[88] Jack Perkowski, "What China's Shifting Subsidies Could Mean For Its Electric Vehicle Industry," *Forbes*
[89] Haley and Haley, "How Chinese Subsidies Changed the World," *Harvard Business Review*.
[90] Charles Clover, "Subsidies Help China Sell the Most Electric Cars," *Financial Times*.
[91] Derek Scissors, "The Facts About China's Currency, Chinese Subsidies, and American Jobs," *The Heritage Foundation*.
[92] Ibid.
[93] Paul Yong, *China/HK Airlines Sector* (DBS Group Research, January 31, 2018), 22.
[94] Ibid.
[95] Adam L. Rothman, "Analyzing Southwest Airlines' Market Share (LUV)," *Investopedia*, last modified February 12, 2016.

SOEs. In effect, the Party is coordinating large and key sectors to work together, running the country like a business.[96] Therefore, the extensive market consolidation in China, and a lack of real competition, insulates SOEs and arguably creates state monopolies.[97]

Perhaps the coercive technology transfer practice has been the most contentious issue for the Trump administration. The White House claims that China has been one of the main culprits of intellectual property theft and accounts for 87 percent of counterfeit goods seized entering the United States.[98] It identified forced technology transfer, licensing at less than economic value, state-directed acquisition of sensitive U.S. technology, and outright cyber theft as egregious policies that risk 44 million American technology jobs. Specifically, for forced technology transfers, the administration claims that China uses foreign restrictions, administration review, and licensing processes to acquire these technologies.[99] The Chinese have rejected the argument, claiming that the U.S. argument is pure speculation and based on a presumption of guilt.[100]

Forced technology transfers refer to situations when foreign firms are coerced by the government through exploitative policies to transfer strategically significant technology to independent domestic entities. In China's case, the government utilizes its attractive market size as leverage to "convince" foreign firms to hand over their technologies if they want to enter the market. For instance, as many strategic industries in China are dominated by the state, foreign firms in these industries that want to gain market access will have to work with domestic SOEs. As these industries follow government orders, which have gradually pivoted to purchasing more Chinese products, they increasingly insist foreign firms transfer their technologies to nascent

[96] Richard McGregor, "The Party: The Secret World of China's Communist Rulers" (Harper, 2012), 37.
[97] Scissors, "The Facts About China's Currency," *The Heritage Foundation*.
[98] "President Donald J. Trump Is Confronting China's Unfair Trade Policies," *The White House*.
[99] Ibid.
[100] Tom Miles, "U.S. and China Clash over 'technology Transfer' at WTO," *Reuters*, May 29, 2018

domestic companies as a precondition. This is done in the hope that domestic companies will learn and develop the capabilities to produce these products in the future, eventually eliminating the need to rely on foreign technologies.

While some have dismissed this issue as overstated for the U.S. and the benefits exaggerated for China,[101] there is real harm of such coercive technology transfers to global innovation spirit. According to the Coase Theorem, low transaction costs and well-defined property rights are the fundamental building blocks to maximize efficiency. Similarly, well-defined and enforced intellectual property rights are also key incentives for individuals and firms to innovate. Furthermore, forced technology transfers may bring unexpected long-term costs to the firm.

A good case study to understand the negative consequences of forced technology transfers is with the Japanese firm, Kawasaki. Capturing the Chinese government's desire to modernize its mass-transportation system, Kawasaki established a joint-venture with Chinese manufacturers to construct a high-speed rail system, which is a key strategic industry to the government. While the contracts were enticing, Kawasaki also feared that it would lose its competitive edge if it chose not to participate in the Chinese market. However, it also did not realize that after Chinese manufacturers had acquired and learned the technology, Kawasaki would be phased out of the Chinese rail industry. Furthermore, these domestic firms like the state-owned CRH would become fierce competitors on the global stage, working on projects in Venezuela and Turkey while bidding for contracts in the U.S., Brazil, and Russia. The Chinese

[101] Daniel Gros, "The Myth of China's Forced Technology Transfer," *Project Syndicate*.

manufacturers also misled Kawasaki: they filed for patents that were intended solely for domestic use.[102]

In the EV auto industry, there also exists the potential for similar exploits. For foreign automakers to enter the Chinese market, they have to conduct joint-ventures with domestic producers as the majority owner. The government also requires foreign automakers to incorporate new EV technologies in any production of EVs.[103] For instance, in late 2016, a new Chinese law mandates that all EV producers demonstrate that they own the technology to produce the entire vehicle. However, foreign-owned technology cannot be counted. Essentially, it requires foreign companies to transfer their foreign technology to the domestic entities for it to obey the law and continue production.[104] As seen through Kawasaki's example, these technology transfers often do not end positively in the long run.

Moreover, mandatory technology audits prior to mass production begins appear to be fraudulent. Foreign carmakers have accused Chinese auditing teams and domestic carmakers of collusion: "when the audit begins, the inspectors asked for only the blueprints of the EV components that the foreign company was striving to protect from its Chinese JV partner."[105] However, these practices do not appear to drive foreign carmakers away. Franco-Japanese company Renault-Nissan recently signed an EV JV with Chinese company Dongfeng Motors. Ford also partnered with Zotye Autos to produce EVs.[106] These partnerships in existing

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[102] Joe Massie, "Digestion and Re-Innovation: A Lesson Learned from China´s High-Speed Rail Technology-Transfer Agreements," *American University Intellectual Property Brief*, August 7, 2011.
[103] Ashley Feng and Sagatom Saha, "China Is Poised to Take Over This Industry. America Can't Let It Happen.," *Fortune*.
[104] Charles Clover, "Beijing's Uneasy Deals with Overseas Car Groups under Strain," *Financial Times*, last modified September 1, 2017.
[105] Lingling Wei and Bob Davis, "How China Systematically Pries Technology From U.S. Companies," *Wall Street Journal*, September 26, 2018, sec. Business.
[106] Clover, "Beijing's Uneasy Deals with Overseas Car Groups under Strain," *Financial Times.*

conditions create risky situations in which foreign companies may follow a similar path as Kawasaki. As such, the firm that transfers the technology may find the initial deal lucrative and entry to a new market tempting. However, once the transfer is complete, new competitors may emerge that pose a serious threat in the long run. Overall, the lax intellectual property protection laws as well as the forced technology transfers are the primary drivers that both discourage innovation and harm firms in the future.

Ultimately, industrial subsidies and forced technology transfers are legitimate sources of concern for the U.S. in contrast to concerns over currency manipulation. On the one hand, the extensive subsidies protect unprofitable firms while the hyper-consolidated SOEs create real concern for fair trade terms. In particular, the insulation from global protection places U.S. firms at a disadvantage. On the other hand, the forced technology transfers harm not only U.S. but also global innovation sentiment. The lax IP law enforcement creates a situation in which foreign firms can be misled to share technologies that will be detrimental to their future wellbeing.

The puzzling move

While President Trump's trade battle with China has some logic, his decision to attack long-standing allies is more puzzling. Specifically, Trump has placed tariffs on steel and aluminum coming from Europe and North America using the justification of protecting national security. However, the reasoning and the tariff targets are misplaced. In the long run, these tariffs will damage not only the U.S.' reputation but also the global economy. As such, imposing these tariffs based on incorrect reasoning is a dangerous gamble for the Trump administration.

In June 2018, the U.S. announced steel and aluminum tariffs of 25 and 10 percent respectively on the EU, Canada, and Mexico. It also offered few details on what these countries could do to end these tariffs.[107] The President justified them as measures to protect national security. However, the definition of it was rather broad. Commerce Secretary Ross believes that "national security is broadly defined to include the economy, to include the impact on employment [and that] economic security is military security."[108] A Commerce Department investigation also reports that the current quantities of steel imports weaken the economy and the lack of domestic aluminum production may decrease U.S. military manufacturing independence. However, while the Secretary of Defense acknowledges the decline of domestic manufacturing, he also notes that the military's requirement for steel and aluminum only represent about three percent of U.S. production and current capabilities do not affect DoD's ability to acquire the necessary steel and aluminum.[109] Therefore, current production capabilities are adequate.

In addition to the negligible impact that steel and aluminum imports have on the military, it is also unclear the national security threat that traditional allies pose. Canada is the largest source of steel and aluminum imports, accounting for 17 percent of steel and 36 percent of aluminum for 2017.[110] The administration's reasoning on how Canada would constitute a national security threat – in this case, by failing to provide the necessary aluminum and steel – is unclear. The logic is further muddled when Canada is formally considered a part of the American technology and industrial base. Under Title 10 of the U.S. code, items are considered foreign when they are not sourced from the United States or Canada.[111] Therefore, these tariffs are

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[107] "U.S. Hits EU, Canada and Mexico with Steel, Aluminum Tariffs," *Reuters*, May 31, 2018
[108] Menzie Chinn, "What Is the National Security Rationale for Steel, Aluminum and Automobile Protection?," *Econofact*, June 6, 2018.
[109] Ibid.
[110] Ibid.
[111] "10 U.S. Code § 2505 - National Technology and Industrial Base: Periodic Defense Capability Assessments," *LII / Legal Information Institute*

confusing and harm the relationship with long-standing U.S. allies. As Canadian Prime Minister Justin Trudeau puts it:

> Our soldiers who had fought and died together on the beaches of World War II, on the mountains of Afghanistan and have stood shoulder-to-shoulder in some of the most difficult places in the world, that are always there for each other, [the idea that Canada is a national security threat] is insulting to them.[112]

While U.S. allies find it absurd to see themselves referenced as national security threats, they nonetheless initiated retaliatory tariffs. The EU, Mexico, and Canada have all filed complaints in the WTO regarding U.S. actions. The E.U. placed a 25 percent tariffs on iconic American goods like whiskey, tobacco, and Harley Davidson products worth about $3.2 billion.[113] Mexico's retaliatory tariff focused on U.S. agricultural exports like apples and cranberries as well as American steel products. It imposed a tariff between 15 and 25 percent that will cover nearly $3 billion goods.[114] Canada imposed 10 and 25 percent tariffs on U.S. aluminum and steel imports worth about $13 billion.[115]

The tariffs and retaliatory tariffs also pose significant harm to the U.S. and global economy. Even though these tariffs may benefit domestic steel and aluminum manufacturers, it will harm the downstream producers that rely on these products as these products are now more expensive. For instance, forecasts show that the auto industry, which relies on steel, can expect declining sales that potentially lead to job losses of up to 40,000 – nearly a third of the entire steel industry workforce. In short, the auto industry's job losses would nullify any job gains in

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[112] Jane C. Timm, "Trudeau: Trump's Tariffs Are 'Insulting and Unacceptable,'" *NBC News*
[113] Emily Shugerman, "EU Slaps Retaliatory Tariffs on US Goods," *The Independent*, last modified June 22, 2018.
[114] Sabrina Rodriguez, "Mexico Imposes Retaliatory Tariffs on Dozens of U.S. Goods," *POLITICO*
[115] Kevin Breuninger, "Canada Announces Retaliatory Tariffs on Steel and Aluminum," *CNBC*, last modified May 31, 2018

the steel industry.[116] Overall, it is estimated that for every steel or aluminum job gained, sixteen would be lost in return. According to consulting firm Trade Partnership Worldwide, the President's steel and aluminum tariffs would lead to a net job loss of over 400,000.[117]

To complicate matters further, Trump's tariffs are also hitting the wrong targets. There is a significant issue with global steel trade: overcapacity, which refers to when a domestic manufacturer produces more than its domestic consumers can absorb and is incentivized through unfair trade practices to sell internationally. However, steel overcapacity is not caused by the E.U., Canada, or Mexico. China causes it. Chinese steel overcapacity is roughly 130 million tons, which is 65 percent higher than total U.S. crude steel production in 2016.[118] As such, Trump's tariffs hit close allies like Canada and Mexico harder than the real culprit. Furthermore, the new USMCA does not address these tariffs, putting the retaliatory tariff in place for the time being. Therefore, there continues to exist a threat to the economy and key sectors like the automobile industry. Coupled with the stricter criteria for automobiles to be tariff-free, it increases the difficulty for car makers to produce USMCA-eligible cars.

Ultimately, President Trump's steel and aluminum tariffs are confusing and dangerous. They are misdirected and do not truly address the problem of global steel overcapacity. They pose significant risks to the U.S. economy in the form of job losses that outweigh any job gains in the aluminum and steel sectors. They also can adversely affect U.S. relationships with long-standing allies that find it insulting to be considered national security risks. Overall, the steel and

[116] Benn Steil and Benjamin Della Rocca, "Trump Steel Tariffs Could Kill Up to 40,000 Auto Jobs, Equal to Nearly One-Third of Steel Workforce," *Council on Foreign Relations*.
[117] Joseph Francois, Laura M. Baughman, and Daniel Anthony, *Policy Brief Round 3: 'Trade Discussion' or 'Trade War'? The Estimated Impacts of Tariffs on Steel and Aluminum* (Trade Partnership Worldwide, LLC/ The Trade Partnership, June 5, 2018), 2.
[118] Zhiyao Lu, "China's Excess Capacity in Steel: A Fresh Look," *PIIE*, last modified June 29, 2017.

aluminum tariffs on close allies do not make sense – it poses long-term risks that may only undermine the U.S. economy while failing to address the actual problem.

Conclusion

President Trump's primary economic argument for the 2018 trade dispute is misdirected. By citing a large trade deficit as justification demonstrates a lack of understanding from this administration. This is both dangerous and inefficient. Furthermore, it is arguably natural for the U.S. to have a large trade deficit due to its large economy and the dollars' prestige and safety. If Trump genuinely wants to address the deficit, he should enact policies that target the investment and savings rate. Using tariffs as tools have indirect effects at best and bring about a host of other economic problems. The Smoot-Hawley Tariff Act serves a historical precedent and lesson – its effect led to a collapse of global trade and a decline of overall living standards. The current trade dispute has the potential to be even more devastating than one of the largest protectionist policies the U.S. has ever pursued.

That said, Trump's tariffs on China do address some of China's unfair practices. Even though China no longer manipulates its currency to boost its exports, the country's practice of generous state subsidies and lax intellectual property protection pose serious harm to American producers. These are valid concerns and are legitimate for the President to address. However, using similar tariffs to target long-standing allies pose more risks than benefits. By citing national security reasons as for the steel and aluminum tariffs, it damages the relationship with key allies that have supported the U.S. in many international fronts and can lead to severe economic consequences in the form of job losses. Ultimately, there are both legitimate and misdirected economic reasoning to Trump's 2018 trade dispute.

Chapter 4 – The Art of the Deal?

It is tempting to dismiss President Trump's view on the 2018 trade dispute as a part of his overall unpredictable behavior. However, by looking through the disputes in the political and economic perspectives, it is easy to see that his view on trade is rather dangerous. Frankly, the evidence analyzed in this thesis serves as a direct rebuttal to his assertion that trade wars are good and easy to win. From a political perspective, the long-term outlook for this trade war appears to be bleak. While there are short-term gains by fulfilling campaign promises, American voters will still catch on when conditions turn dire. More specifically, the retaliatory tariffs disproportionately affect his supporters, who have not yet felt the effects. In other words, the President is running a serious political gamble with the trade disputes that may backfire. His initial supporters may abandon him as the trade disputes harm their livelihood and become too overwhelming.

From an economic perspective, the President demonstrates his apparent misunderstanding about trade, which may have contributed to his idea of trade wars being good and easy to win. By not fully understanding how deficits work, it casts a cloud of doubt over the administration's other policies since many may deem them untrustworthy and uncapable. Nonetheless, there are still legitimate reasons for utilizing protectionist policies on China as the Chinese have demonstrated a knack for pursuing policies such as generous state subsidies and forced technology transfers to gain unfair advantages. However, the U.S. should not go down this route with allies. Besides being politically damaging, the tariffs on allies do not address the true problem.

Overall, trade wars are far more nuanced and sophisticated than the President believes. The stark departure from decades of free-trade advocacy serves as the potential to shake the foundation of U.S.-led global order. However, it is important for many to keep in mind that this trade dispute should not be seen as an apocalyptic event. For many allies, while the President's rhetoric and some of his policies have damaged relations, the ultimate target is China.

For the current administration, although it is correct in targeting China, it must also remember the harm that a trade dispute with the second largest economy in the world can bring. Trump must also clarify his justifications as some are incorrect and only undermine his legitimacy. The President must realize the political risks of engaging in a sustained dispute and understand the correct economic reasons for engaging in such a trade war. Only then can he truly demonstrate to his critics that his bombastic tweets are just a part of the larger plan to achieve a better deal.

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