Trump´s Trade Tactics

How Trump´s agenda is expected to impact on World Economies

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TRUMP'S TRADE TACTICS

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ABSTRACT

The newly elected President of the United States has promised to "Make America Great Again". A major focus of Trump's policies is limiting low cost competition in the manufacturing sector; a sector which has seen many jobs disappear over the past decade. The most widely cited trade policy proposals involve imposing substantial tariffs on imports from China and Mexico, two of America's largest trading partners. These policies have been assessed using a computable general equilibrium model designed for the analysis of preferential trade agreements. The results indicate that whilst a 35 percent tariff on Chinese industrial imports would lead to losses in both countries, it would mean gains to alternative suppliers such as Canada, Korea and Taiwan. Imposing a tariff on imports from Mexico seems more promising because it would drive down the price of imports, as Mexico is very dependent on the US market. Our results assume that neither China nor Mexico would retaliate by raising tariffs of their own.

Donald Trump's victory in the last US presidential election in November 2016 was a surprise to many observers. On reflection, his victory can be partly explained by the disaffection amongst many workers in the manufacturing sector, which has been the most significantly affected by import competition, with the existing political *status quo*. Addressing those feelings, Trump's trade proposals suggested a frontal attack on two of the USA's major sources of imports: China and Mexico. China, with total imports to the United States accounting for USD 503 billion in 2015, is America's main trading partner, representing 22 percent of total imports. On the other side is Mexico, which has come under attack by President Trump on numerous political fronts, including the threat to build a wall along the border, and is the USA's third major source of imports, accounting for USD 297 billion in 2015, representing 13 percent of the US imports[2] (see Figure 1 and Figure 2).

Figure 1 US – China Trade

Source: UN Comtrade

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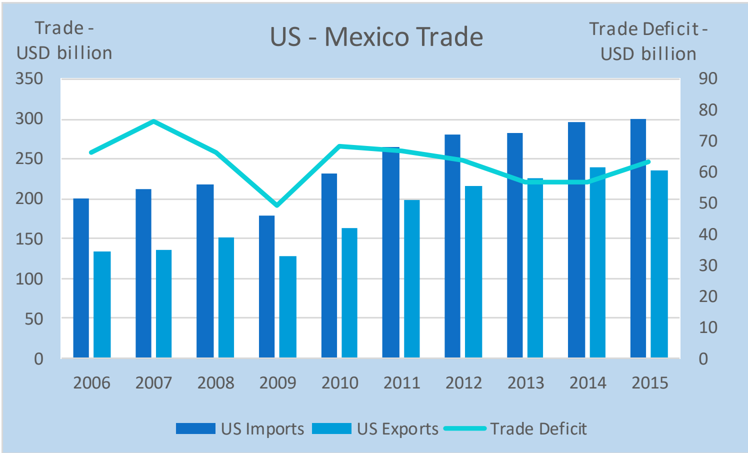
[2] UNSD Comtrade data.

Trump focussed his rhetoric on the existing trade deficit between the US and these two countries, which in 2015 accounted for USD 386 billion in US-China trade, or 77 percent of bilateral trade, and USD 61 billion in the case of US-Mexico trade, representing 21 percent of the countries' bilateral trade.[3]

Figure 2 US – Mexico Trade



Source: UN Comtrade

Many workers, feeling that they have missed out as a result of the different American free trade initiatives, were reportedly attracted to Trump's trade proposals, which included withdrawal from the Trans-Pacific Partnership (TPP), the renegotiation of the North American Free Trade Agreement (NAFTA) with Mexico, and the imposition of a substantial tariff, of approximately 30-45 percent, on imports from China.[4]

Whilst many analysts believed that President Trump would not adopt many, if any, of his more radical promises after he was sworn in as President in January 2017, such as the so-called "*Muslim Ban*" or the construction of the aforementioned wall along the Mexican border, those were precisely among his earliest Executive Orders.[5]

On trade, his policy stance is decidedly protectionist. This was proved by his early decision to withdraw the United States from the TPP. Following this path, and President Trump's clear preference for bilateral rather than multilateral deals[6], there seems to be little chance that the United States will conclude the Transatlantic Trade and Investment Partnership (TTIP), the EU-US trade agreement currently under negotiation,[7] and it seems unlikely that the World Trade Organization's (WTO) Doha Round will make progress without American support behind it.[8]

[3] UNSD Comtrade data.
[4] See, for example, Campbell, C. (2016). TRUMP: Let's slap a 45% tariff on Chinese imports. *Business Insider*, January 7. Available at: http://www.businessinsider.com/donald-trump-45-tariff-chinese-imports-china-2016-1
[5] 'First 100 days: What executive actions has Trump taken?' (2017). *BBC News*, January 30. Available at: http://www.bbc.com/news/world-us-canada-38695593
[6] Here, 'multilateral deals' make reference to those agreements with more than two parties, such as the TPP. In this sense, see 'Trump says plans lots of bilateral trade deals with quick termination clauses' (2017) *Reuters*, January 26. Available at: http://www.reuters.com/article/us-usa-trump-trade-idUSKBN15A2MP?feedType=RSS&feedName=politicsNews
[7] See Bradshaw, J. (2016). What's the difference between TTIP and TPP and why does Donald Trump want them scrapped?. *The Telegraph*, November 22. Available at: http://www.telegraph.co.uk/business/2016/11/22/difference-ttip-tpp-does-donald-drump-want-scrapped/
[8] President Trump also threatened to leave the WTO. See: Da Costa, P. N. & Cimino-Isaacs, C. (2016). US Exit From WTO Would Unravel Global Trade. *Peterson Institute for International Economics*, July 26. Available at: https://piie.com/blogs/trade-investment-policy-watch/us-exit-wto-would-unravel-global-trade. See also: Schonfeld, B. (2016). Why the U.S. needs the World Trade Organization. *The Washington Post*, September 20. Available at: https://www.washingtonpost.com/news/monkey-cage/wp/2016/09/20/would-the-u-s-be-better-off-without-the-wto-not-when-the-wto-guides-98-percent-of-global-trade/?utm_term=.ef7f74875569

While trade is important, other policies also matter. Trump's policies include the plan to build up infrastructure and to reduce taxes, including company taxes.[9] President Trump also promised to reduce the trade deficit, accounting for USD 803 billion in 2015,[10] although it remains unclear how he will reach this target.[11] Reducing taxes and increasing spending on infrastructure would, in the short run, stimulate the economy, but the blow-out in the budget deficit would need to be repaid at some stage, and this is likely to stifle growth at some point in the future.[12] How far away this reckoning would be depends on the country's capacity to attract inward flows of foreign investment.

This paper aims, with the help of the well-known global computable general equilibrium (CGE) model, Global Trade Analysis Project (GTAP), to provide an analysis of the impacts on developing countries of the following two scenarios:

(i) The raising of US tariffs on imports from Mexico to the MFN level; and

(ii) Setting tariffs on US imports of manufactured goods from China at 35 percent.

Although these measures are likely to trigger a "*trade war*",[13] here it is assumed that the affected countries would not retaliate by imposing additional tariffs at their end. The effect of these policy changes would depend on: (a) the trade flows and the respective changes in tariffs applied by the United States; and (b) the substitution between imports from different countries. For example, if Chinese television sets become more expensive for US consumers, as producers would pass any additional tax on to final consumers, these would switch to Korean sets or imports from other countries. Likewise, if China cannot sell to the USA, it would sell to other countries, perhaps Korea, the EU, etc. Thus, the net loss is not as great as it may seem at first. This also means that American workers in the *Rust Belt*[14] are not as protected as promised, and that the unemployed population in the USA would be worse off due to the higher prices of consumer goods.

METHODOLOGY

The methodology used in this paper is straightforward: the potential impacts of tariff changes have been analysed using GTAP. GTAP traces bilateral trade data and tariffs, and it is ideally suited to analyse those situations where there is a change in tariffs with specific trading partners. In addition, the database contains parameters indicating the degree of substitution between imports

[9] See Lawder, D. (2017). IMF boosts U.S. growth forecasts on Trump spending, tax plans. *Reuters*, January 16. Available at: http://www.reuters.com/article/us-imf-growth-idUSKBN1501P9

[10] UNSD Comtrade data.

[11] See, for example, Drezner, D. W. (2016). How Donald Trump would worsen America's trade deficit. *The Washington Post*, September 28. Available at: https://www.washingtonpost.com/posteverything/wp/2016/09/28/how-donald-trump-would-worsen-americas-trade-deficit/?utm_term=.fc6e7cc59f13

[12] See Nussbaum, M. & Weyl, B. (2016). Trump's Budget: Making the deficit great again. *Politico*, November 7. Available at: http://www.politico.com/story/2016/07/donald-trump-budget-deficit-225389

[13] See Goodman, P. S. (2017). Trump's Trade War May Have Already Begun. *The New York Times*, January 30. Available at: https://www.nytimes.com/2017/01/30/business/economy/trumps-mexico-china-tariff-trade.html?_r=0

[14] See, for example, Pickard, L. (2016). What is the Rust Belt? Everything you need to know about the region key to winning the US election. *Independent*, November 8. Available at: http://www.independent.co.uk/news/world/americas/us-elections/rust-belt-what-is-it-us-ohio-michigan-pennsylvania-election-2016-donald-trump-hillary-clinton-a7405141.html

from various sources, such as imports of motor vehicles from China as opposed to Japan or Korea.[15]

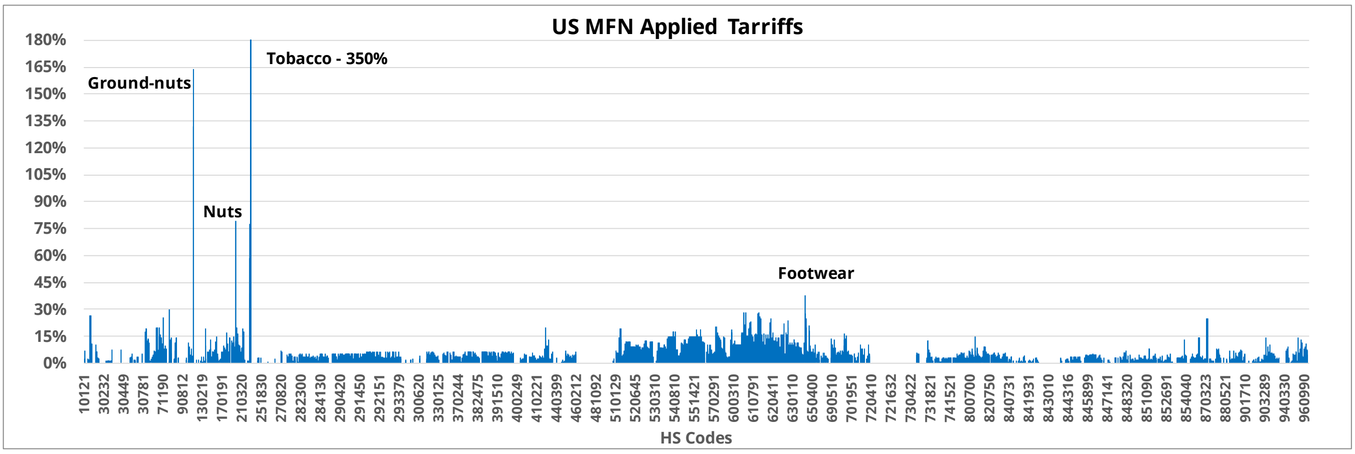
Whilst the GTAP database contains trade and tariff data from 2011, this paper has simulated the economy forward to 2015, and then run a simulation including changes to the relevant tariffs. Subsequently, changes in trade flows, national output and incomes, and real wages are reported. The most affected sectors are also identified.

However, the paper does not attempt to model any changes in barriers to trade in services, non-tariff barriers (NTBs), migration, or investment flows. It is important to note that several dynamic elements are ignored here, such as the impact of trade on productivity, investment, competition, and the use of technology, in addition to certain adjustment costs. Nevertheless, the results give an indication of the direction and magnitude of the impacts of Trump's most clearly stated trade policies.

PEAKS AND TROUGHS

The USA's most-favoured nation (MFN) tariff schedule is characterised by generally low tariffs with occasional peaks on ground nuts and tobacco products (see Figure 3). Additionally, the US has regional trade agreements with 20 trading partners. One of these agreements is NAFTA, which allows, with certain exceptions (see Figure 4), the free movement of goods and capital across the borders of Mexico, the United States, and Canada.

Figure 3 US MFN Applied Tariffs

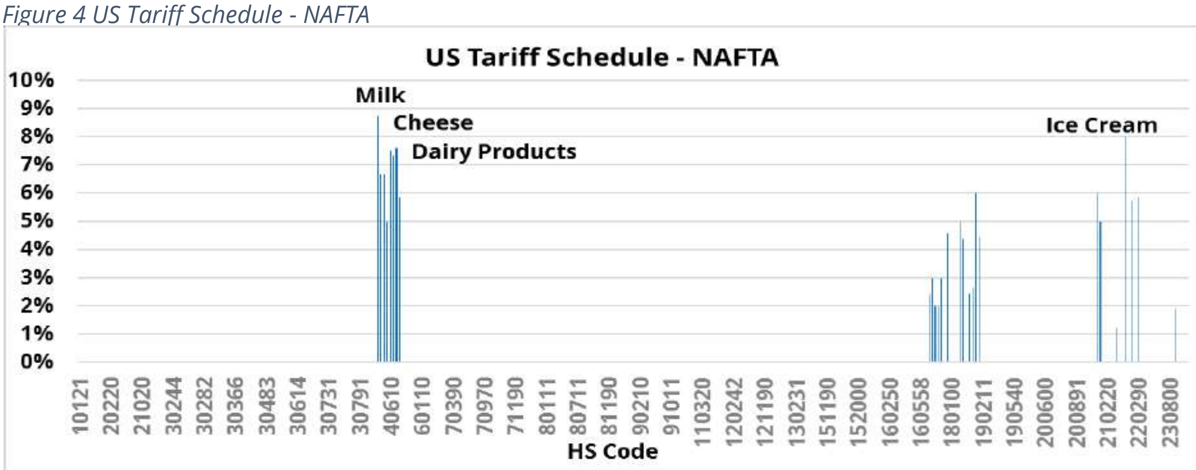


Source: World Bank's WITS

As stated above, in 2015, Mexican exports to the United States accounted for 13 percent of US merchandise imports, with the main imports being motor cars, crude petroleum, furniture, and vegetables, among others. Of specific importance for the manufacturing sector are Mexican imports of motor vehicles and parts and televisions, which accounted in 2015 for 26 and 19 percent of total imports of those products, respectively.[16] It is worth noting the existence of strict rules of origin regulations on some products, particularly textiles, to avoid circumvention through Mexico.

[15] See Hertel, T.W. (1997) (ed.). Global Trade Analysis: Modeling and Applications. *Cambridge University Press.*
[16] UNSD Comtrade data.

Figure 4 US Tariff Schedule - NAFTA



Source: World Bank WITS. Note: no additional tariffs are applied by the United States under the NAFTA schedule between Chapter HS 24 and HS 99.

Looking at US-China trade relations, there is currently no trade agreement between these two countries, meaning that trade between them is subject to their respective MFN tariffs (see Figure 3 for the US MFN schedule). In addition, it is worth mentioning that in recent years, Chinese products have been a recurrent target of US anti-dumping and countervailing duties, with the imposition of 207 percent tariffs on imports of Chinese ammonium sulphate,[17] among others.

One of the problems for the countervailing duties in imposing high tariffs on its trading partners is the value-added content of their exports. Let's take Apple's iPhone as an example. Despite being assembled in China, the country adds very small value to the final product: with a total cost of USD 187, Chinese workers contribute only USD 6.50 to the value of an iPhone, whilst Korea contributes USD 80.05, Chinese Taipei USD 20.75, and Germany USD 16.08.[18] In China, over one third of exports include foreign content, and this figure is closer to 55 percent in the ICT and electronics sector, which dominates Chinese exports to the US.[19] By shutting off imports from China, the United States is harming its own export industries that supply intermediate inputs in the production of Chinese exports.

A fundamental aspect to take into consideration is whether the measures proposed by Trump would be consistent with the American commitments under the WTO.[20]Imposing a flat tariff across the board on imports from one member country is clearly inconsistent with the WTO most favoured nation rule, which stipulates that importers must not discriminate by source. However, there are exception to this rule. For example, a country can "*raise barriers against products that are considered to be traded unfairly from specific countries*".[21] Trump and other observers have long maintained that China has had an artificially low exchange rate for many years.

[17] International Trade Administration (2017). Fact Sheet – Commerce Finds Countervailable Subsidization of Imports of Amminium Sulfate from the People's Republic of China. *US Department of Commerce*, January 10. Available at: http://enforcement.trade.gov/download/factsheets/factsheet-ammonium-sulfate-cvd-prc-invest-final-01102017.pdf

[18] Thompson, L. (2013). Profiting from trade in value added. *OECD Observer No. 295, Quarter 2*. Available at: http://oecdobserver.org/news/fullstory.php/aid/4121/Profiting_from_trade_in_value_added.html.

[19] OECD (2015). Trade in Value Added: China. *OECD-WTO*, October. Available at: http://www.oecd.org/sti/ind/tiva/CN_2015_China.pdf

[20] Bergin, T. & Morgan, D. (2017). 'U.S. tax plan would break WTO rules, lawyers say, as EU business frets. *Reuters*, February 1. Available at: http://www.reuters.com/article/us-trump-usa-tax-trade-idUSKBN15G5EH

[21] WTO (2016). Principles of the trading system. Available at: https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm

WINNERS AND LOSERS

The more immediate effect of higher tariffs will be a reduction of imports. Nevertheless, Trump's supporters will most likely be interested in employment, real wages and, perhaps, national income. These results are shown in Table 1.

Table 1 Impacts of the different scenarios

	Scenario 1 Mexico	Scenario 2 China
	$m	$m
Welfare	3,303	-36,725
Change in trade balance	-179	23,283
	%	%
Imports	-0.2	-3.4
Exports	-0.3	-3.9
Real wages	0.0	-0.4
Exchange rate	0.04	0.5
National output (GDP)	0.1	0.7

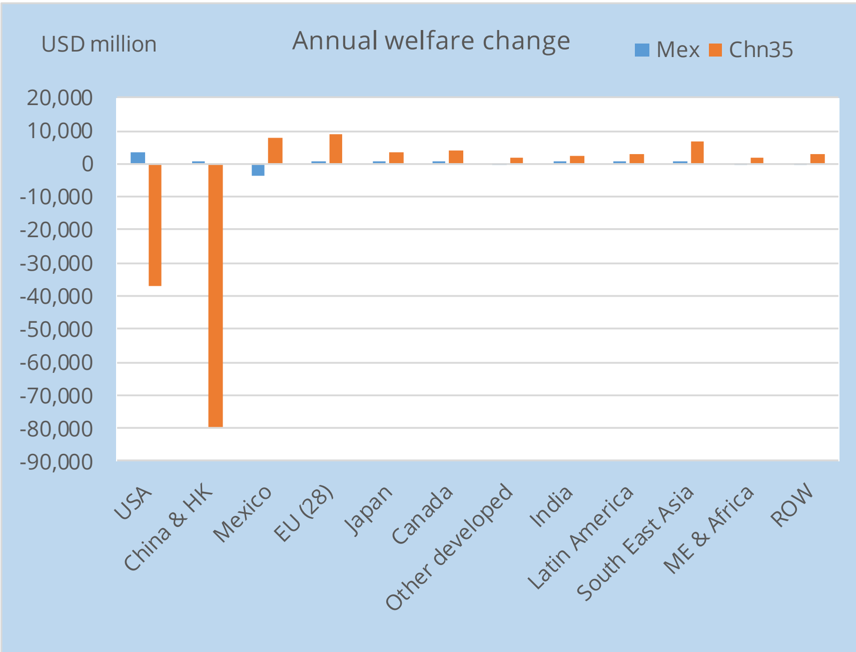
Source: GTAP simulations.

The Mexican scenario is somewhat counter-intuitive. By imposing MFN tariffs to American imports from Mexico, the US would gain due to the change in terms of trade effects produced by a fall in the price of imports, mainly motor vehicle parts and components, electronics, and mineral products. This is because the US is the principal market for Mexico, absorbing 81 percent of Mexican exports to the world, so the tariffs have a significant terms of trade effect. US gains would be approximately equal to Mexican losses. Globally, terms of trade sum to zero, because a fall in export prices in one country is equal to the fall in import prices in another. Looking at the impact on third countries, Canada is the major beneficiary, although several Asian and African countries competing with Mexico are worse off, because of the lower prices. In the US, national output (GDP) increases, as domestic production replaces imports, although there is no change in estimated real wages.

In the China scenario, the predictable decline in imports would improve the US trade balance and increase the national output, but real wages would decline as nominal prices rise faster than wages. Overall, annual US welfare would decline by USD 37 billion, or about 0.2 percent of the GDP.

The restriction of imports would also lead to trade diversion. While China and the US would lose from the increase in American tariffs, the rest of the world

Figure 5 Welfare impacts on all countries



Source: GTAP simulations.

would gain, as Chinese exports are replaced by exports from third countries (see Figure 5). In this scenario, Mexico, the European Union, Japan and Canada are the major beneficiaries. However, due to the impact on the US and China, global gains are negative, with a global net loss of USD 73 billion.

IMPLICATIONS AND LIMITATIONS

In summary, the estimated results show that when the United States imposes tariffs against China, both countries are worse off. Other countries, such as Canada, Japan and Korea, would benefit due to the absence of competition from China, which diverts trade away from China to other countries. Overall, losses would outweigh gains.

For NAFTA, however, the results indicate that the United States would gain at the expense of Mexico and several other countries, as the new tariffs force down the price of exports from Mexico to the US.

These results assume President Trump's proposals are implemented as modelled here. However, there are obvious difficulties in renegotiating NAFTA, and raising tariffs across the board against China is not only inconsistent with WTO commitments but is likely to invite retaliation, which is not modelled here. Nonetheless, our simulations highlight the scale of the problem. While the US is much more dependent on China than on Mexico, the effects of large tariffs would appear to be manageable rather than catastrophic. National production would increase, even though real wages might not. The effect of policy uncertainty on investment is, probably, much greater than the tariff and trade effects.

How individuals in the selected countries are affected depends on their consumption patterns. Those who enjoy mobile phones and colour televisions will suffer more than others, as their goods are made more expensive. US workers in the textile and electronics sectors would gain, with output increasing 6-7 percent in these sectors. According to the analysis from the US Bureau of Labour, the poorest households are affected disproportionately more by tariffs than richer households.[22]

Table 1 Effect of Trump Tariffs on China, Mexico and Japan, on households over five years

Item	All households ($56,437 mean after-tax Income)	Lowest 10 % ($5,348 mean after-tax Income)	Second 10 % ($15,182 mean after-tax Income)	Fifth 10% ($38,735 mean after-tax Income)	Ninth 10% ($97,430 mean after-tax Income)	Highest 10% ($172,669 mean after-tax Income)
Tariff burden ($)	$11,100	$4,670	$4,830	$8,430	$17,390	$25,005
Percentage of mean after-tax Income	4%	18%	6%	4%	4%	3%

Source: U.S. Bureau of Labor Statistics, Consumer Expenditure Survey, 2015. Calculation of cost increase for imported goods.

[22] Tuerck, D. G., Bachman, P. & F. Conte (2016). The Trump Tariffs: a bad deal for Americans. *NFAP Policy Brief*, May.

There seems little doubt that Trump will not hesitate to adopt protectionist measures and policies. If implemented, his trade policies will have negative effects on the US and the rest of the world. At an individual level, there will of course be winners and losers, although it is almost certain that the latter will overshadow the former.

ABBREVIATIONS

CGE	Computable General Equilibrium	**NAFTA**	North Africa Free Trade Agreement
EU	European Union	**NTB**	Non-Tariff Barrier
GDP	Gross Domestic Product	**ROW**	Rest of the World
GTAP	Global Trade Analysis Project	**TPP**	Trans-Pacific Partnership
HK	Hong-Kong	**TTIP**	Transatlantic Trade and Investment Partnership
ICT	Information and Communication Technology	**UN**	United Nations
ME	Middle East	**US/USA**	United States / United States of America
MFN	Most-Favoured Nation	**WTO**	World Trade Organization

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