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TRADE WAR: IS THERE AN ECONOMIC JUSTIFICATION?

United States currently definitely conducting a trade war. It is attempting to change the international trading conditions which it perceives as disadvantageous to United States. In the short term it is clear that everyone will be worse off, but, at this stage, it appears that the loser is unlikely to be decided by the agreed umpire, the World Trade Organisation.

A trade war exists between two nations when each takes new steps to make the other worse off using international trade and financial flows. This can be done by the domestic country, e.g. the USA, raising tariffs on imports to make the exporting country’s goods, e.g. China’s, more expensive in its market. However, to inflame a war, the exporting country, China, then puts higher tariffs on the goods that it imports from the original country, the USA. This is what has happened twice between the USA and China in 2018. The United States has targeted other countries as well, such as those in the European Union, Mexico, Turkey and Canada. Some of the countries involved in the trade war are the US’s closest allies and have strong bilateral trade agreements with the US.

This article attempts to:

- examine the context of the trade war
- identify the main stages in the trade war
- discuss the stated justifications for the trade war with China.

Context of the trade war

In the distant past major countries traded within their colonies quite freely, but often restricted their trade with other countries. However, the world wars upset this trading system and each country, major and minor, imposed greater trade barriers in order to become more self-sufficient in the production of goods that it requires in war time. Producing the goods domestically was seen as preferable to depending on the arrival of imported goods that may have to pass through war zones. Trade barriers were also seen a useful way to create jobs for the service men and women who had been fighting in the war.

Australia decided to industrialise from the 1920s to the 1960s. Tariffs and other barriers to trade were imposed to make domestically produced goods more attractive to domestic consumers. However, especially after the end of the Korean War, the decline in the Cold War and the end of the Vietnam War, countries decided to reduce their trade barriers in bilateral and multilateral agreements.

The Uruguay Round of the General Agreement on Tariffs and Trade from 1986 to 1994, became the most successful series of multilateral trade agreements and led the world economy into a period of rapid globalisation. Countries had decided that the gains from free trade were more desirable than the inefficiency that arises from trade barriers.

In this period many of the world’s developing countries were permitted more favourable trading conditions than the developed countries. For example, most of the countries in Asia received most favoured nation status and were granted lower tariff barriers than the richer countries. Those developing economies are now industrialising at a rapid pace and several have lost their most favoured nation status.

To help it industrialise, and care for its massive population, China was granted many informal concessions by the developed nations. And being a socialist economy, there are many large state-owned (government) enterprises that can receive government concessions in terms of subsidies and favourable laws and regulations.

To date, China has resisted attempts to wind back the concessions granted to it by the world community. It is these concessions, formal and informal, that United States is attempting to modify and/or remove.

Essentially, United States is accusing that the World Trade Organisation (WTO), the successor of the General Agreement on Tariffs and Trade, is not doing its job and is unable to successfully resolve many of the trade disputes lodged with it by the United States. However, the WTO was not very successful with the Doha Round of negotiations that started in 2001. On this occasion the developing countries objected to the extent of agricultural subsidies in the USA and European Union as well as the tightened global rules on the transfer intellectual property. They wanted easier access to new technologies and to distribute medicines more freely to their people.

Unfortunately, the decline in the power of the WTO has been accompanied by an increasing resistance to globalisation and therefore free trade. Many people in the developed world have observed:
• the distribution of income and wealth in their country move to favouring the very rich, who are in the top 5% to 10% of households

• their incomes stagnate, especially in the United States where real incomes have not risen much for low and middle income earners over the last 20 years

• structural change, mainly the decline of manufacturing, leading to massive job losses and those jobs moving to the former developing economies, which are now known as emerging economies

• governments trying to reduce their spending on services in an attempt to reduce government debt

• immigration and refugee programs appear to provide a supply of new workers that could displace previously employed workers.

Therefore, the developed economies failed to share the benefits of globalisation fairly with their people.

All has not been lost, however. Many new bilateral trade agreements have emerged over the past two decades and several regional trade agreements have been strengthened and, some agreements have faltered. The British people have voted to leave the European Union (EU) and renegotiate their trade agreements with the EU members. Similarly, the people of the United States voted Donald Trump into the position of President who promised to renegotiate the various trade agreements which were agreed to by former administrations.

The main stages in trade war

In his presidential campaign Donald Trump portrayed himself as a successful businessman who could apply accepted business techniques to achieve better results for the American people – especially those who saw themselves as losing from globalisation. His logo was initially ‘Make America Great Again” and moved to ‘America First’. He undertook to either withdraw from some trade agreements or renegotiate others. His main position on trade in the election campaign was that countries, such as China, were unfair in the way that they traded with America and implied that the adverse effects of globalisation, that are listed above, could be wound back if he made America’s trading relationships fair.

People voted in the USA to improve their economic situation by achieving new trade deals. Promises for tax cuts together with review of trade deals, appeared to be a win for the low and middle income earners.

On gaining office new US administration:

• took action to reduce America’s immigration intake

• questioned the extent of America’s funding for many international organisations, such as the United Nations and the North Atlantic Treaty Organisation (NATO)

• started a process for renegotiating America’s trade agreements.

The Trans-Pacific Partnership

Later on, an intention was expressed to withdraw America from the Trans-Pacific Partnership (TPP), a free trade agreement involving Australia and the major nations bordering the Pacific Ocean, including Japan, but excluding China. USA formally withdrew from the TPP on the 23rd January, 2017 claiming that the TPP:

• will squeeze our manufacturing sector

• lead to even greater unemployment

• is a bad, bad deal for American businesses, for workers, for taxpayers

• is a huge set of handouts for a few insiders that don’t even care about our great, great America

• is another disaster done and pushed by special interests who want to rape our country, just continuing to rape our country.

Source: Tweets by President Trump

Nevertheless, in April 2018, after the other participating nations finalised a deal, USA considered rejoining the TPP. The reasoning was that the USA already had bilateral deals with six of the eleven nations and that the US is currently attempting to finalise a bilateral deal with Japan. It is ironic that Trump pulled the USA out of a regional agreement that had an indirect goal of reducing the economic power of China and cementing the global leadership role of the US.

North American Free Trade Agreement

USA unleashed a similar argument against the North American Free Trade Agreement (NAFTA). Earlier this year the USA started charging levies on the imports of steel and aluminium from Mexico and Canada. The rates were 25 percent and 10 percent respectively. Both countries were surprised and responded with retaliatory tariffs on imports from the USA.

By late August 2018 the USA had concluded a new deal with Mexico and soon after started serious negotiations with Canada.

Steel and aluminium tariffs

Similarly, and at roughly the same time, Trump imposed 25 percent tariffs on steel and 10 percent on aluminium imports from all countries except South Korea, Argentina, Australia and Brazil. The European Union responded with retaliatory tariffs. And more recently the US has imposed higher tariffs on steel and aluminium imports from Turkey. Trump had branded Turkey a currency
manipulator.

China and the EU have lodged a complaint with the WTO about the US steel and aluminium tariffs.

Washing machines and solar panels

USA also imposed tariffs on all imports of solar panels and washing machines in January 2018. The rates of these tariffs vary according to a variety of factors.

China

The real trade war, however, is with China. Both countries have now imposed additional 25 percent tariffs specifically on each other’s goods on two separate occasions and on quite a large percentage of each country’s exports. There have been many announcements from both sides but the following is the result:

• the first lot of tariffs were imposed in July on goods worth $US34 billion
• the second lot, worth $US16 billion, were imposed in August
• a proposal by the US to levy tariffs of up to 20 percent on all $US200 billions of US imports from China. China’s exports to the US are only worth $US130 billion so China would be not able to retaliate with further tariffs.

The USA claims that its additional tariffs are:

• commensurate with the harm caused to the US economy resulting from China’s unfair practices.

It is significant that:

• both countries were in trade talks in August, but there was not a positive result
• the US lodged a dispute with the WTO and is seeking other countries to join it.

Justifications for the trade war with China

It is generally accepted that the United States has lower average tariff levels than its trading partners, especially China. Therefore, just on tariffs alone the USA has some justification to get China to lower its tariff barriers.

But these are not the only barriers to trade that the United States wants changed. The USA alleges that:

Numerous acts, policies and practices of the government of China related to technology transfer, intellectual property and innovation are unreasonable or discriminatory and burden or restrict US commerce.

Specifically, the USA alleges that:

• China uses joint venture requirements, foreign investment restrictions and administrative review and licensing process to require or pressure technology transfer from US companies.
• China deprives US companies of the ability to set market-based terms in licensing and other technology-related negotiations.
• China directs and unfairly facilitates the systematic investment in, and acquisition of US companies and assets to generate large-scale technology transfer.
• China conducts and supports cyber intrusions into US computer networks to gain unauthorized access to commercially-valuable business information.

Source: President, United States, Executive Office, Section 301 Investigation Fact Sheet, June 2018

These allegations were compiled from an investigation by the USA Trade Representative from August 2017. They tend to confirm stories about China that appear regularly in the business pages of major newspapers. All countries are affected by China’s actions. One proposed justification for the trade war with China, however, is that the USA has a trade deficit with China.

Response of Australia during the trade war

As USA is planning to adjust its trading policies and rapid fall out of WTO systems, Australia is also considering measures to keep the economy stable. One of the findings from Australia’s recent diplomatic efforts indicates strengthening bilateral ties within the Indo-Pacific region compared to larger trading partners.

New bilateral trade and investment partnerships can be better suited than the uncertain WTO initiatives to maximise Australia’s economic condition in this not so liberal trade relations among nations.

Initial signs of Australian policymakers to reposition life after the WTO is evident. During recent discussions in Buenos Aires between Group of 20 finance ministers, Treasurer Scott Morrison (now Prime Minister of Australia) called for a revamp of the WTO system, as it “failed to deal with long-standing issues” and was “built for a different time”.

Conclusion

So, is the trade war a political action to boost opinion of disadvantaged people to get elected or is it justified on the grounds that China’s actions are unfair?

Imposing tariffs and renegotiating trade agreements might help number of jobs in the short term but it will not ensure the international competitiveness of manufacturing. To remain in business many manufacturers may require further tariff protection in the future. Moreover, parties of a trade war may end up spending large proportion of its revenue compensating affected industries. For example, American farmers caught in the crossfire of the Trump administration’s
trade war are to receive $4.7bn in compensation. The aid package was announced in response to recent trade war damages. The vast majority of this compensation will go to soybean farmers, who have been hard hit by retaliatory tariffs by China. Pork, dairy and wheat producers are among those sharing the rest.

In the short-term effects of a trade war will harm all of us, and if the tariffs initiate a return to protectionism then we will all lose in the long run too. Unfortunately, the WTO has been largely ineffective in ensuring that international trade is free and fair. Similarly, the USA has largely been ineffective in ensuring that the benefits of globalisation have been shared fairly among its businesses and its people.

**Student activities**

1. What is a trade war?
2. List the main countries involved in the current trade war.
3. Why did countries introduce tariff protection for their industries following World War 1 and World War 2?
4. What factors contributed to the recent period of globalisation?
5. How has globalisation helped the developing countries to industrialise?
6. Why, in recent years, has there been an increasing resistance in the developed world to globalisation?
7. How economic policies may help win election?
8. Briefly describe recent USA’s trade policies on:
   - the Trans-Pacific Partnership
   - the North American Free Trade Agreement
   - imports of steel and aluminium into the USA
   - imports of washing machines and solar panels into the USA.
9. Explain the recent actions of the USA and China in their trade war.
10. Essay: Discuss the advantages and disadvantages of conducting a trade war to ensure greater fairness in the global trading system. What are the alternatives?