DEMYSTIFYING U.S. GLOBAL TRADE POLICY

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MY PERSONAL BIAS: GOOD PUBLIC POLICY SHOULD BALANCE THE NEEDS AND DESIRES OF ALL FREEDOM-LOVING STAKEHOLDERS

- Consumers (many of whom are investors and all of whom are shoppers)
- Workers
- Companies (large/medium-sized/small manufacturers, middlemen, financial intermediaries, transporters, law firms etc.)
- Sustainable welfare of society at large (all ages, ethnicities, genders, religious beliefs, races, nationalities, language speakers, levels of education, professions etc.)
SO THE WE ARE ON THE SAME “PAGE,” HERE ARE SOME BASIC DEFINITIONS:

- Trade – traditionally refers to trade of tangible (physical) goods but has been extended to trade in intangible services including those that facilitate the movement of people
- International – across at least one international border
- Regional – across several international borders typically of neighboring nations or of those bordering a common body of water
- Multinational – across borders of several nations that are not bound to the regional definition above
- Global – across borders of all major continents
GLOBALIZATION

• While the underlying concept has existed since the first humans ventured out of Africa onto the Eurasian landmass and later to the Western Hemisphere, the term was popularized in the world media in the 1990s after the fall of the Soviet Empire and the advent of capitalist business practices in China.

• A globalist favors the improvement of welfare of people around the world regardless of their race, language, religion, gender or national origin. The individual globalist views international exchanges as non zero games (I win. You win.)

• Globalization with respect to trade refers to globalist thinking when developing government policy (e.g., government regulations affecting trade among sovereign nations)
ON LINE HANDOUT

• Today’s national and global political and cultural landscape involves a conflict between globalist and nationalistic (sometimes called “tribalistic”) viewpoints.

• My first graduate assistant at the University of Michigan (Farok Contractor) came from Bombay, India and had just received his undergraduate degree in engineering. He ultimately earned his PhD from the Wharton School (Trump’s alma mater) and has since become one of the world’s most respected international business scholars. He teaches at Rutgers.

• I have provided you with an essay he wrote last year that provides helpful facts and concepts that complement this course. For more from Farok, go to www.globalbusiness.blog
BEFORE WE GET STARTED, TEST YOURSELF: ARE YOU PRONE TO BE A GLOBALIST?

- Do you enjoy learning about the histories and cultures of other countries?
- Do you enjoy learning and speaking foreign languages?
- Have you had pleasant experiences studying and/or living abroad (especially as a civilian?)
- Have you enjoyed traveling to a variety of foreign countries?
- Have you had enjoyable internationally oriented work experiences?
- Do you have international friends and/or family members?
AND/OR PERHAPS YOU STUDIED WITH PROFESSORS WHO TAUGHT YOU TO THINK ABOUT THE WORLD “OUTSIDE THE BOX”
PERHAPS YOUR PARENTS INSTILLED IN YOU A LOVE FOR FOREIGN LANGUAGES, GLOBAL GEOGRAPHY AND TRAVEL
OR PERHAPS YOUR GLOBAL VIEWS ARE REINFORCED BY FRIENDS AND COLLEAGUES
TODAY’S TOPIC AS BEEN IN THE HEADLINES

• The USA withdrew from the Trans Pacific Partnership. (Both 2016 presidential candidates agreed.)
• NAFTA is still being renegotiated. Will it increase inflation?
• BREXIT: The United Kingdom voted to withdraw from the European Union.
• Trump put Section 301 tariffs of $50 billion on components and industrial products from China as well as national defense related tariffs on steel and aluminum from everywhere.”
• Other recent headlines include limiting immigration, erecting a wall at the US/Mexico border and withdrawing from the Paris climate accords.
MOREOVER,

- The European Union added restrictions on import of U.S. beef. U.S. retaliated with high duties on Perrier water, Vespa scooters and Roquefort cheese.

- The U.S. added large duties on imported Chinese washing machines, clothes dryers and solar equipment. (Yet Chinese-owned Haier bought GE appliances.)

- Trump threatens tariffs on another $200 billion of Chinese goods. The Chinese have threatened to counter.

- And yet, without the USA, other nations hope soon to ratify a Trans Pacific Partnership. Also, the EU has negotiated a free trade pact with Japan.
SO WHAT’S THE IMPACT?

- China does have an enormous trade surplus with the US (plus the rest of the world) and often “cheats” on the rules (especially with respect to violating intellectual property protection.)

- China, the EU and Canada have added tariffs on US soybeans, Harley Davidson motorcycles, Kentucky bourbon, Maine lobsters and Wisconsin cheese. These could impact the welfare of some Trump base voters and GOP leaders in Wisconsin (Speaker Paul Ryan), Kentucky (Senator Mitch McConnell), Tennessee (Senators Bob Corker and Lamar Alexander), Indiana (Vice President Pence), Maine (Senator Susan Collins), Iowa, Nebraska (Senator Ben Sasse) as well as Democratic majority states like Illinois and Minnesota.

- The aluminum and steel tariffs could have a positive impact on 150,000 jobs but hurt 6.5 million others. CNN reported that Ford and GM each could lose $1 billion in revenues later this year.
HOW STEEL AND ALUMINUM PRODUCERS ARE RESPONDING TO TARIFFS (ACCORDING TO THE ECONOMIST)

• No significant investments in new plants and up to date technology for fear that tariff protection will be short term

• Recycle used metal parts by melting them in existing foundries

• Reopen old production facilities to produce raw steel and aluminum

• Hence no current U.S. company strategy assures long term global competitiveness vs. countries whose plants employ more modern technologies and production systems
DO ELECTORAL POLITICS PLAY A ROLE?

• How much do current negotiation issues relate to re-election politics (e.g. auto parts manufacturers in Ohio and Michigan, dairy farmers in Wisconsin and Quebec province)?

• Campaign “promises” to renegotiate “bad” trade deals?

• Are current tariffs just “negotiation” ploys resulting in temporary hardships that will ultimately lead to better living standards? (paraphrased from Fox News commentators)
WHAT DOES THIS TELL YOU?
IS THIS HAPPENING?
ARE TRUMP AND XI “SHOOTING THEMSELVES IN THE FEET” WITH THEIR TARIFF WARS?
TOPICS FOR THE THREE SESSIONS

• Today – What are the pros and cons of free trade versus protectionism?

• Session 2 – How is trade policy developed – bilateral versus multilateral (the GATT and the WTO)?

• Session 3 – What are some of the issues facing regional economic agreement regimes such as the European Union and NAFTA (plus several others)?
PROTECTIONISM (ALIAS MERCANTILISM)

• Trade is a zero sum game where one nation wins and the other loses. It’s not a “two way street.”

• The great explorers of the 1400s and 1500s were looking for gold, silver, spices and furs to enrich Europe’s kings, queens and nobility (as well as a handful of merchant traders.)

• Mercantilist thinking was dominant throughout history until about the time of the Declaration of Independence.

• To some extent, it has still not gone away (especially in the rhetoric of populist politicians.)
IS RECENT PROTECTIONISM ANOTHER PHASE IN A LONG TERM GLOBALIZATION CYCLE?

• Boom 1 (1870-1913) – Mass industrialization, steam power, European imperialism

• Bust 1 (1913-1950) – World wars, Great Depression, isolationism

• Boom 2 (1950-1973) – Global trade and finance organizations founded (GATT, IBRD, IMF)

• Bust 2 (1973-1988) – Energy supply crises, high inflation rates

• Boom 3 (1988-2008) – End of cold war, rise of China, EU expands, creation of NAFTA

• Bust 3 (2008-today) – Great Recession, stagnation on global trade and lending, populism, slowdown in new multilateral agreements
HOW WOULD A TRADE WAR IMPACT THE USA?

• Exports are only 8 percent of the US GDP

• Products impacted by proposed tariffs on imports (mostly from China) are just a small part of this amount

• The current worst case scenario suggests a decline of about a half percent in annual GDP growth

• However, over reactions based on fears by corporate investors could result in a declining stock market as well as new investment domestically and globally. The situation could be worsened if the Federal Reserve raises interest rates too rapidly.
RATIONALE FOR FREE TRADE POLICIES

• Comparative and Absolute Advantage: Economics of Specialization: Comparative Labor Productivity Concepts (with Several Assumptions)
• Reciprocity: Bilateral versus Multilateral
• Non Zero Sum Game: Both or all parties win
• Trading is better than fighting
• Policies evolve over time from isolationist self-centered (populist) mercantilism to regionalization to multinationalism to globalization
TWO MEN WITH THEORETICAL IDEAS: ADAM SMITH AND DAVID RICARDO
ADAM SMITH: ABSOLUTE ADVANTAGE IN WEALTH OF THE NATIONS 1776

- The invisible hand of competition based on enlightened self-interest governs the most efficient economic system

- Specialize in making (or growing) and trading whatever you can do faster and better than someone else

- World markets will purchase everything that is made or grown. Nothing goes to waste.
• Absolute advantage says you export what you are most efficient at producing and import what you are less efficient at producing. Comparative advantage says that you can gain from trade even if you have an absolute advantage in two or more products. You export goods for which your production is relatively more efficient.

• For example, Ricardo might have assumed that Portuguese workers were more efficient (faster) at producing both cloth and wine than the English. But the Portuguese were relatively faster and better at producing wine than at producing cloth. The reverse was true in England. So England should trade cloth for Portuguese wine and vice versa. (This was at the very beginning of the industrial revolution before English mills got heavily mechanized.)

• For the past two centuries, this principle or theory has been used to justify free international trade. But is it really true?
BUT RICARDO’S THEORY HAS ASSUMPTIONS

• 1. Only two products and two countries. (Research shows that the principle still applies with multiple products and multiple countries.)

• 2. The world operates on a barter system and the only unique input into production is labor. Products should be exported from countries in which labor to make them is relatively most efficient. (This still makes sense when other costs don’t change.)

• 3. Technology never changes. (Comparative advantage exists during a snapshot of time and the countries that specialize in selected exports can change over time.)
MORE ASSUMPTIONS

• 4. Labor skills never change but laborers can move freely from industry to industry. (Technical advancement and worker retraining are very important in determining exportability of products.)

• 5. There is no change in product costs with increased output. (This is false today – especially in an era of large multinational corporations whose existence depends on economies of scale.)

• 6. Although producers seek to maximize profits and consumers seek to maximize their satisfaction with their purchases, no producer or consumer is large enough to influence market prices. (This is false today in light of large multinationals who use administered not market prices as well as giant global suppliers who can influence “acceptable” purchase prices. They all earn “monopoly rents.”)
STILL MORE ASSUMPTIONS

• 7. There is no transportation cost. Largely false – but less of a concern for industries that sell lightweight, light bulk and relatively expensive products – like diamonds that lose weight as a result of the production process (separation from ore as well as left over shavings from polishing process. Transportation cost also helps explain why so much trade takes place between neighboring countries.

• 8. No foreign exchange market: Everything traded internationally is sold based on a barter system rather than on money. (In the real world, money is used as a means of exchange and standard of value. In today’s world economy, that’s okay if currency values are allowed to fluctuate freely. But fixed exchange rates can be manipulated by governments and result in “lumpy” measures of value at best.)
ASSUMPTIONS BEYOND THOSE CITED IN MANY ECONOMICS TEXTBOOKS

• 9. Price is all that matters. Wrong… It’s all about marketing (product/service uniqueness, brand names, supply chain services, consumer perceptions based on promotional strategies). (I got in “trouble” with this one when I wrote my doctoral dissertation. One of my committee members did not believe in comparative advantage.

• 10. Repetitive manufacturing processes matter. Partly wrong in a digital age… Easily transmitted “tailor made” pattern recognition software (3D printing etc.) allows small scale manufacturing.

• 11. Products and their components are made in only one country. (Today there is globalization of component sourcing and final assembly locations, i.e. global supply chains)
FORCES THAT BRING ABOUT COMPETITIVE ADVANTAGES OF NATIONS (MICHAEL PORTER’S “DIAMOND”)

• Plentiful availability of specialized inputs and technologies plus related education and training (technically referred to by economists as factor inputs)

• A significant number of high quality suppliers of inputs of components and technologies (agglomeration areas like Silicon Valley)

• A significant number of competitors (rivals) in the domestic market enable a relatively large number of domestic customers to make sophisticated purchase decisions after considering a variety of options (substitutes.)
INTERNATIONAL TRADE THEORY DOES NOT ADDRESS:

- Geopolitical military threats such as the spread of nuclear weapons and delivery systems (and offsetting sanctions)

- Distribution of the gains from trade within countries (Who is affected and how? Owners and managers of capital, shoppers for goods/services and various members of the workforce)

- Economic development results that can favor foreign investors who might have long term absolute advantages over domestic producers and who control technologies that support political priorities (e.g. China’s goals to build its internal personal consumption economy and its external One Road-One Belt Initiative)
SO WHY DO PEOPLE STILL BELIEVE IN FREE TRADE?

• 1. Jobs and profitability in export oriented industries and their suppliers. Moreover, competition and an agglomeration of members of the supply chain in the home market can make a company more efficient and a better global marketer.

• 2. The perceived total value concept: Price differences matter – but so does the rest of the marketing mix (promotional image, product/service uniqueness, convenient and on-time delivery.) The internet gives global customers the ability to compare multiple options based on instant information flows.

• 3. Customers are largely indifferent about locations of manufacture as long as they receive excellent marketing value. (There are some exceptions – e.g. reputations of outstanding wines.)

• 4. Trade restrictions can lead to trade wars that ultimately hurt the majority and can magnify the effects of economic crises.
WHO BENEFITS FROM FREE TRADE

- Consumers – greater variety of products and services at lower prices
- Multinational firms, their suppliers and their shareholders
- Small and medium sized exporters (including the “born globals”)
- Companies in the distributive trades that handle both exports and imports
- Society at large – if you are trading, you are probably not fighting
WHO GETS HURT BY FREE TRADE

• Workers whose jobs have been outsourced or replaced by imports. (Note that research shows that more jobs are lost because of automation than are lost because of imports.)

• Companies in “declining industries” whose products have lost their global competitive uniqueness

• Individuals who feel that their culture has been threatened by global forces and changes beyond their control, comprehension or past experience

• Politicians who perceive that their re election relates to protecting those who get hurt by free trade policies
WHAT IS THE DIFFERENCE BETWEEN FREE TRADE AND FAIR TRADE?

- **Free trade** assumes that all of the participants in international economic exchanges will “play by the rules.”

- **Fair trade** assumes that regulations including trade policies need to be put in place to protect various stakeholder groups from participants in the global economic system who do not play by the rules.

- China joined the World Trade Organization after several successful rounds of negotiations had taken place. It earned advantages of membership without having to make concessions (partly because it entered as a non market economy with developing country status.)
TO SUMMARIZE

- The following protectionism arguments can be offset by gains from increased efficiency and better standards of living for consumers:
  - Job losses
  - Cheap foreign labor
  - Unfair trading practices
  - Declining demand for goods produced by less efficient domestic industries
ARE THERE VALID ARGUMENTS FOR PROTECTIONISM?

• Infant industries (high costs for startups) – OK, but for how long?
• National defense – which industries qualify?

• MOREOVER – Experts have been saying for more than a half century that adjustment assistance is far better than a tariff or a quota.
WHERE DO WE STAND TODAY?

• U.S. average duties are low compared with other trading partners: USA 2.5%, Japan 4%, EU 5.1%, China 9.9%

• China is still listed as a “non market country” and operates under different rules. Under WTO rules, the USA can continue to impose higher duties on China’s imports than those we impose on imports from other major trading partners

• Current NAFTA renegotiations focus on illegal drugs and local North American content agreements in selected industries (e.g. automotive)

• Brexit might increase US trade with the UK via Canada (a member of the Commonwealth). Britain could divert some of its trade from EU member countries to Switzerland, Norway, Japan, South Korea, Singapore etc.
IN OUR NEXT SESSION, WELL DISCUSS

- How the World Trade Organization (and its predecessor the General Agreement on Trade and Tariffs or the GATT) develops rules for free trading that have resulted in significant opening of world markets

- How US trade policy fits into the global arena – especially commercial relationships with other members of the World Trade Organization