

US PROTECTIONISM – HOW FAR WILL TRUMP GO?

THE US PRESIDENT'S PROPOSED TARIFFS ARE LIKELY TO PROVE A FRUSTRATION RATHER THAN A FULL THREAT TO ECONOMIC PERFORMANCE

Economics is not a perfect science. Economists often disagree over the same facts. However, there are a few key issues, such as the benefits of trade, over which there is little disagreement. It is no coincidence that rapid growth in the global economy in recent decades, which has lifted billions out of poverty, has gone hand in hand with globalisation and growth in international trade.

While the EU and China come close to the US in terms of size, Washington remains the conductor of the global economic orchestra. That the US, under the leadership of Donald Trump, an unusual president to say the least, is taking steps to reverse globalisation and undermine the institutions that promote trade and global cooperation is a worrying prospect. It could have major repercussions for the global economy.

International trade is not a zero-sum game. It increases the size of the global economic pie by enabling companies and countries to specialise in what they do best. More trade means more productivity. Typically, the rising business activity and confidence that comes from stronger trade encourages higher spending on productivity-enhancing capital investment, driving up total wealth.

Of course, change causes frictions. Although the vast majority of workers in the developed world benefit from globalisation through better goods at lower prices, the concentrated costs to those workers who lose their job in the process are highly visible.

Governments need to address the grievances of these disenfranchised workers. However, President Trump's decision to raise tariffs on trade to try to reduce the US trade deficit reflects economic ignorance of the worst kind.

A country's trade balance does not represent either profit or loss. By viewing the US trade deficit as a loss to the US, Trump misses the point. The benefit from trade is not what a country sells, but what



By viewing the US trade deficit as a loss to the US, Trump misses the point

it buys. Exports simply reflect surplus production at home.

The major aim of trade, as economist and philosopher Adam Smith argued some 250 years ago, is to export as little as possible in exchange for importing as much as possible. In some cases then, trade deficits ought to be viewed positively. American workers benefit in the long run if they can permanently acquire German cars and Chinese electronics that cost more than the American-made goods they send to Germany and China.

Rich countries like the US can afford to permanently run modest trade deficits because foreigners are willing to continue to supply the US with surplus cash via investment or credit. The US enjoys the highest foreign direct investment in the world because, thanks to its strong economy, it has a risk/return profile that attracts foreign investors. US households benefit from this through higher consumption by way of trade.

The US does not lose out in terms of jobs or economic growth by running a trade deficit. Compare the US and the UK to Germany and Japan. All are highly developed economies. All enjoy low unemployment. And yet, the US and UK, with their persistent trade deficits, tend to enjoy faster economic growth, on average, than Germany and Japan.

The lesson of history is clear. In 1930, the US started a global trade war with its Smoot-Hawley tariffs, raising almost 900 import duties. By the mid-1930s, global trade had halved. A misguided policy intended to support US domestic industries worsened the Great Depression.

In terms of sheer numbers, the currently planned US tariffs, including on steel and aluminium, are too small to matter for the economic outlook. The key issue is how far the ensuing tit-for-tat spiral will turn. While other countries will retaliate, we expect them to do so in a restrained manner. If Congress then prevents Trump from taking the conflict much further, the overall economic damage will be small, with probably no more than a temporary hit to confidence.

Congress seems to be more sensible when it comes to protectionism than the current president. The backlash in Congress against the Trump tariffs probably means the trade row will not escalate to such an extent as to materially damage the ongoing healthy global economic upswing – but frustratingly, it now poses a risk that we need to watch more closely than before. ♥



Kallum Pickering
is senior UK
economist at
Berenberg Bank