

Trump and Trade

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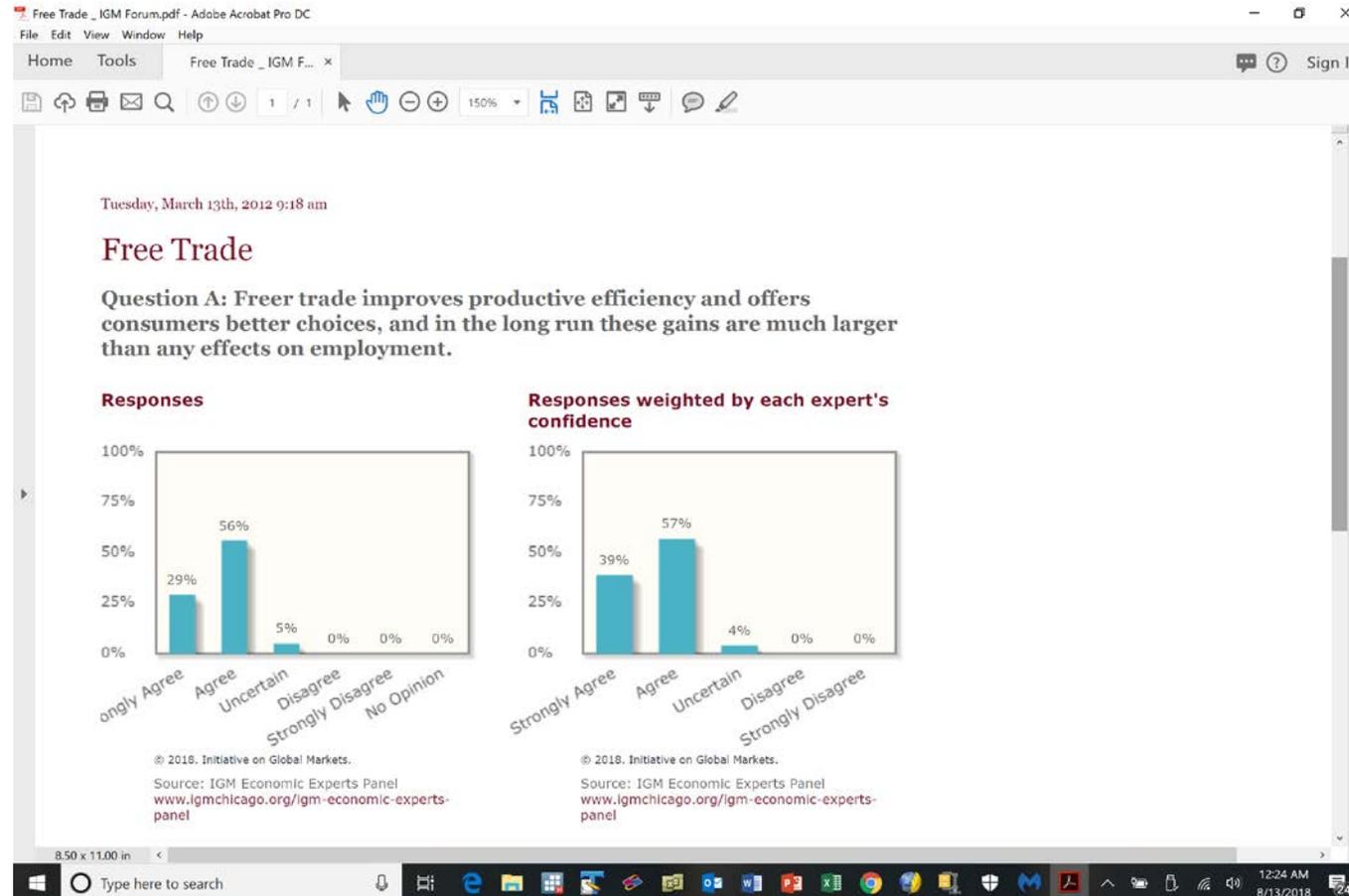
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Today's Agenda

1. What Do Economists Think of Protectionism and Why?
 - Costs of Trump's Protectionism
2. What Effect is Trump *Himself* Having on American Exports?
 - New Research linking "Soft Power" to Trade

Free Trade Best: Essentially all Economists



Why do Essentially all Economists Agree?

(Noting how rare such agreement is)

- *If unrestricted markets are typically good, then protectionism is bad for the same reason*
 - Absent a distortion/externality/market failure, one should let markets rule
 - Trade is a positive sum game, the way domestic transactions are
 - Who takes advantage of whom in a mutually agreed transaction (absent constraints, information asymmetries, etc.)?
- Of course ...
 - Free trade *doesn't* help *everyone* in theory or practice; some factors of production can lose

There are sometimes market failures

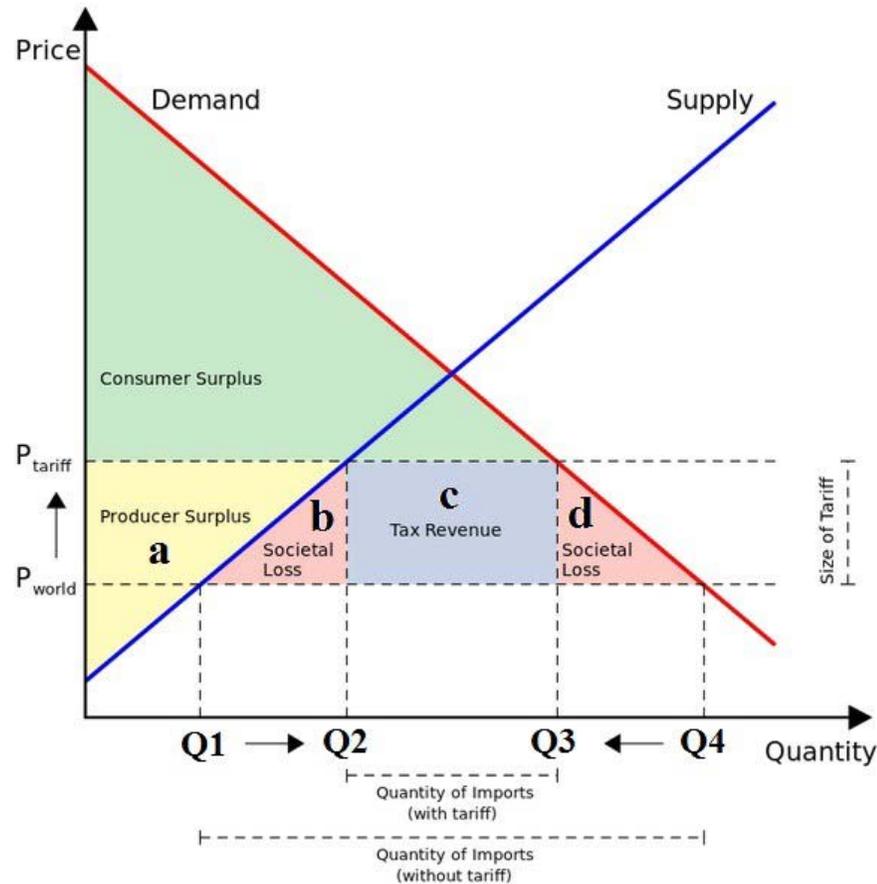
1. But tariffs are almost never a targeted solution

- One can find almost always find other policy tools with fewer side effects
 - Ex: if job losses painful, should assist transition across space/industry/occupation
 - Hence existence of social safety net; facilitates adjustment (counter to Trump policies)
- Other trade barriers (quotas, NTBs, VERs) are worse than tariffs

2. Tariffs (as all taxes) create microeconomic distortions, inefficiency

- **Consumers lose** (pay more) **more than producers gain** (higher prices)
- “Harberger Triangles” are small ... but add up over long periods of time
- Trade is often “deflected” or “redirected”
 - What is a “German” car? BMWs produced in America?

Traditional Analysis of Tariff (Harberger Triangles)



Economists and Free Trade, continued

3. Imports are often intermediate inputs, so raise costs
 - Especially true in Asia ... and with commodities ... like steel, aluminum
4. Tariffs redistribute “the wrong way”
 - From many consumers (some poor) to a few producers (usually rich)
 - Corrupt customs officials and smugglers benefit
5. Tariffs create wasteful vested interests, so hard to eliminate
 - Agriculture in rich countries
6. Tariffs invite retaliation
 - Especially with legacy of national humiliation – Chinese “Unequal Treaties” after Opium Wars
7. Tariffs have minor macroeconomic effects, especially with floating exchange rates (which tend to offset)
 - Without changing savings or investment, protectionism can’t change current account

Economists and Free Trade, more

8. No special concern about trade *deficit*

- A country is not a company (Krugman); trade balance is *not* bottom line akin to business
- Adam Smith: both sides gain *even if trade is balanced*
- Trade deficit results from consumption > production, not “bad trade deals”
- In any case, US is different:
 - US\$ has three special roles as a currency of choice for: a) trade invoicing, b) official reserves, and c) debt issuance.
 - Issuing “safe assets” delivers “exorbitant privilege”

More on Capital Flows and Exchange Rates

- American fiscal expansion pushing up US interest rates
- Similarly, monetary tightening is also raising US rates
- Both serve to attract capital inflows, appreciate US\$
 - Appreciation of dollar, *worsening* of US current account seems likely
 - Will affect all countries in American sphere of financial influence – especially developing and emerging markets in Latin America, Caribbean, Asia-Pacific
 - Because of special role of US\$ and resulting currency mismatch, US\$ appreciation and access to US markets often leads to problems in developing countries (Turkey!)
 - Trump concern with current account deficit (\equiv Savings – Investment) means that savings should *rise* not fall to lower current account deficit

Back to Economists and Free Trade

- To avoid protectionism, need *sustainable institutional* commitment to liberal trade
 - Rules (on protectionism, dispute settlement, etc.) better than discretion
 - Uncertainty critical to encourage costly investment (but Trump likes uncertainty ...)
 - Institutions are better than individuals
 - But the WTO, regional trade agreements (like NAFTA), and the rules-based trade institutions are being undermined by Team Trump
 - Belief that US can win more concessions unilaterally
 - Little supporting evidence thus far

Regional Trade Liberalization

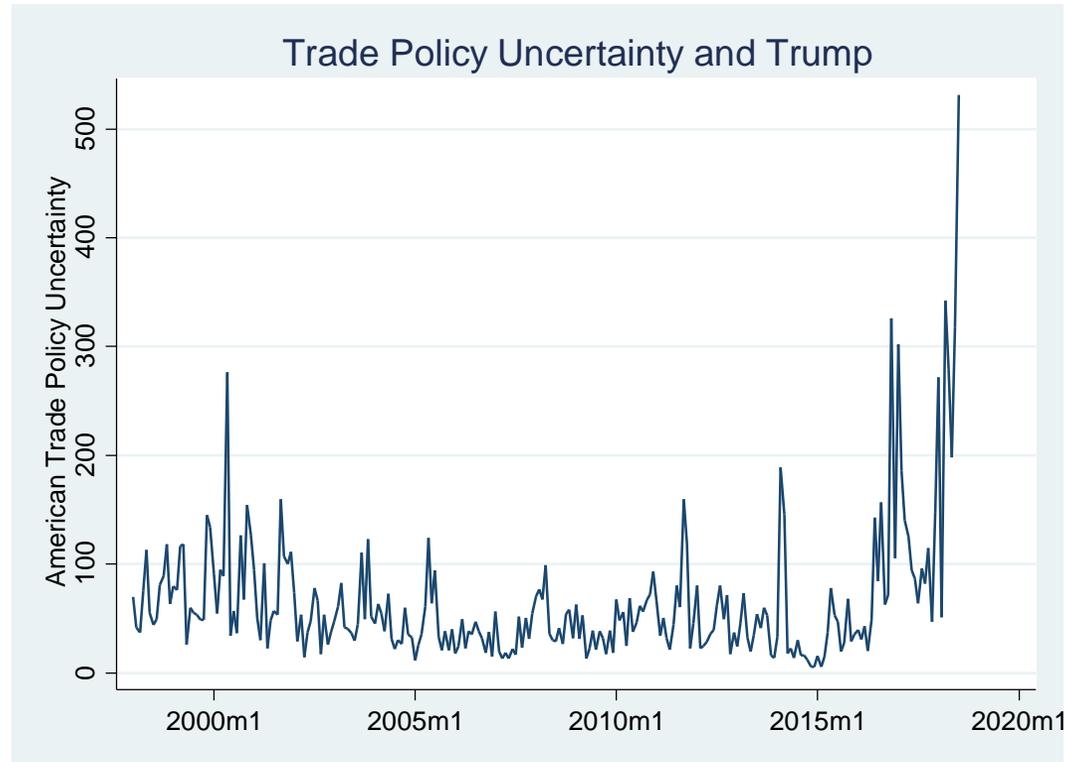
- Multilateral WTO-lead rounds currently dead (Doha)
- Hence Regional Trade Agreements proliferating
 - Even better for Team Trump to push America's weight around
 - Traditionally US more liberal than partners; lower American barriers *less*
 - And if old deals were so bad, why aren't newer better deals easy to sign?
- One "success" thus far: KORUS
 - Renegotiation trivial
 - Reduced Korean steel exports, maintain US tariffs on small trucks [that Korea doesn't export] and raise Korean car import limits [that Koreans don't buy].
 - Likely because of North Korean nuclear disarmament drive

Special Trumpian Points

1. Focusing on trade in *goods*, ignoring services is just dumb
 - What's special about something you can drop on your foot?
2. Thinking of a G&S surplus as "*good*" is just dumb
 - Especially to potential defaulters ... like Trump ...
 - Think of a trade balance after a typical currency crisis ... or Japan ... or my trade balance with my son ... or my son's with UChicago ...
3. Focus on *bilateral* trade balance is just dumb
 - Think of my trade balance with my barber
4. One can understand protectionism during bad times like the early 1980s (even if don't agree). But protectionism during good times is especially perplexing
5. Liking strong US\$ *and* trade surplus is contradictory and dumb

Trump Induces Trade Policy Uncertainty

- Who gains?



But Trump *really REALLY* cares about Trade

- Reducing US bilateral trade deficits is the *one* national “issue” Trump has consistently cared about
 - “Other countries are taking advantage of us”
 - “The United States has trade deficits with many, many countries, and we cannot allow that to continue”
 - “Trade wars are good and easy to win”
 - US is being “ripped off so badly” and “losing billions”

The Big Mystery

- Why has my president found such a large audience?
 - Why no political cost from raising taxes?
 - Why protect inputs, focus on bilateral deficits, ...?
 - Why has the profession failed?

Because ... the Trade War *is* Here

- Ironic that USA, creator of rules-based system, now undermining it
 - Violating old agreements raises geopolitical tension
 - Ex: Iran nuclear deal and Korean denuclearization
- Also, ironic to have *any* focus on trade for US
 - Trade matters for employment, wages ... but not that much
 - “China shock” well documented but finite and unusual
 - Consensus that automation matters much more over long periods of time
 - Trade just isn’t that important for US
 - Ordinarily, international is a backwater for American economists

Trade War, continued

- Has it started already?
 - No *official* declaration; tariffs often raised/lowered
 - Trump's steel/aluminum tariffs (Spring 2018), <5% US imports
 - Has *not* exempted allies (Canada, EU, Mexico)
 - WTO ignored, national security rationalization (section 232) a new (low) first
 - Little stock market reaction as of now
 - Canada, EU, Mexico, China *have* retaliated to steel/aluminum tariffs
 - Trump threatening further retaliation ... and more on European autos
 - Trump paying farmers for lost sales
 - China's response calibrated, restrained thus far ... but ... spiraling escalation?

US-China Trade War

- China runs bilateral surplus, hence more to lose
 - (Similar to saying one country can lose more from nuclear exchange)
 - Hence Chinese responses targeted (pork, bourbon, soybeans, narrow body airframes, ...)
 - Can do *much* more (iPhone assembly: a national security threat?) Sales of US firms in China
- China has higher Export/GDP
 - Hence interested in preserving WTO, rules-based trading system
 - Also Chinese use of WTO helps other countries, provides soft power for China to pursue other initiatives (Taiwan, South China sea, etc.)
- China can affect exchange rate (as they have historically)
- China owns > \$1 trillion of US treasuries
 - Unconventional weapon (harms China)

US-China Trade War, continued

- Consensus that China *does* violate letter and spirit of intellectual property agreements in WTO. (Not everything Trump does is wrong!)
 - Industrial espionage, forced licensing and joint ventures
 - But ineffectual US response; more effective to create WTO-based coalition
 - Timing unfortunate; steel/aluminum were first, but are minor and divisive
 - Ironic that TPP intended to harness China, *but Trump left*
- All in all VERY frustrating for economists!

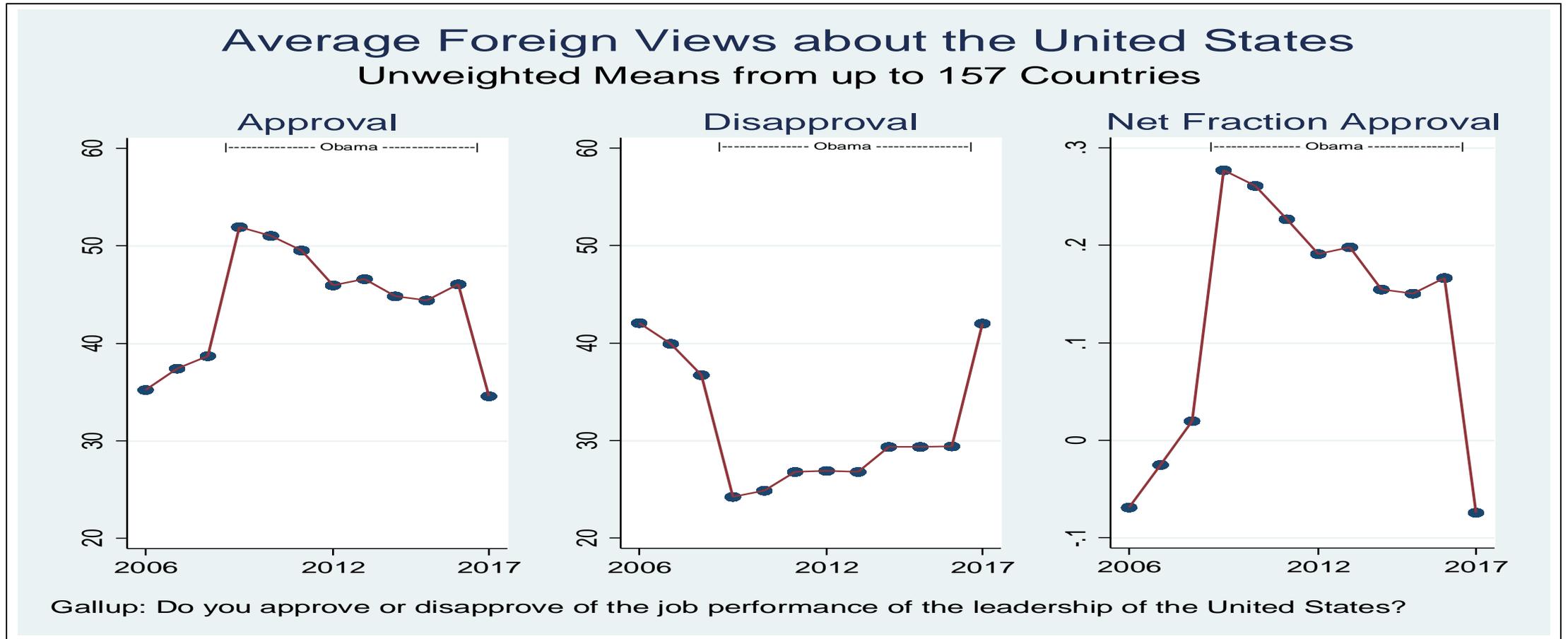
New Research: Soft Power and Trade

- Does Trump's Leadership Style affect trade *in and of itself*?
- Hard power is the ability to coerce
 - Grows out of country's military and economic might
- "Soft Power" (Nye) arises from attractiveness of country's culture, political ideals and policies
 - "... the ability to attract, [since] attraction often leads to acquiescence ... soft power uses a different type of currency (not force, not money) to engender cooperation – an attraction to shared values ..."
- Does Trump's effect on US soft power affect trade?

How is Soft Power Measured?

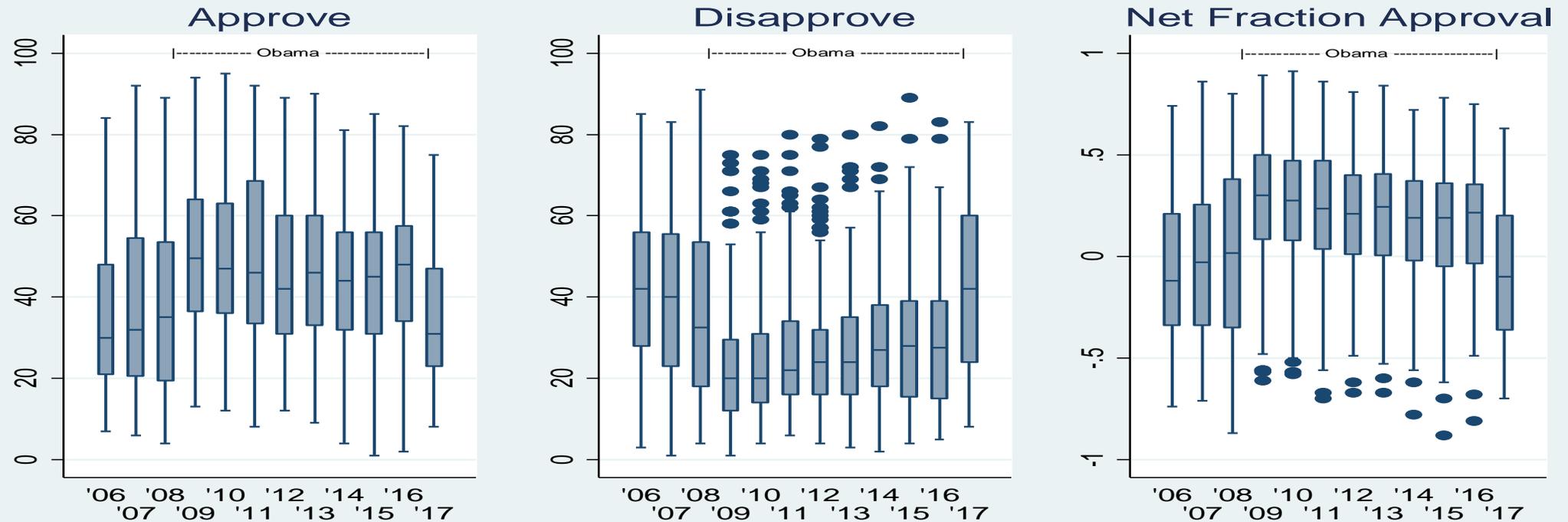
- Gallup asks (≈ 1000) participants in (>150) countries:
 - “Do you approve or disapprove of the job performance of the leadership of China/Germany/Russia/UK/USA”
 - A standard measure of soft power
- Alternatives exist (deliver similar results)
 - BBC asks people in (>40) countries about (17) other countries:
 - “Please tell me if you think each of the following are having a mainly positive or negative influence in the world?”
 - Pew:
 - “Please tell me if you have a very favorable, somewhat favorable, somewhat unfavorable or very unfavorable opinion of _____?”

Trump has Certainly Harmed US Soft Power



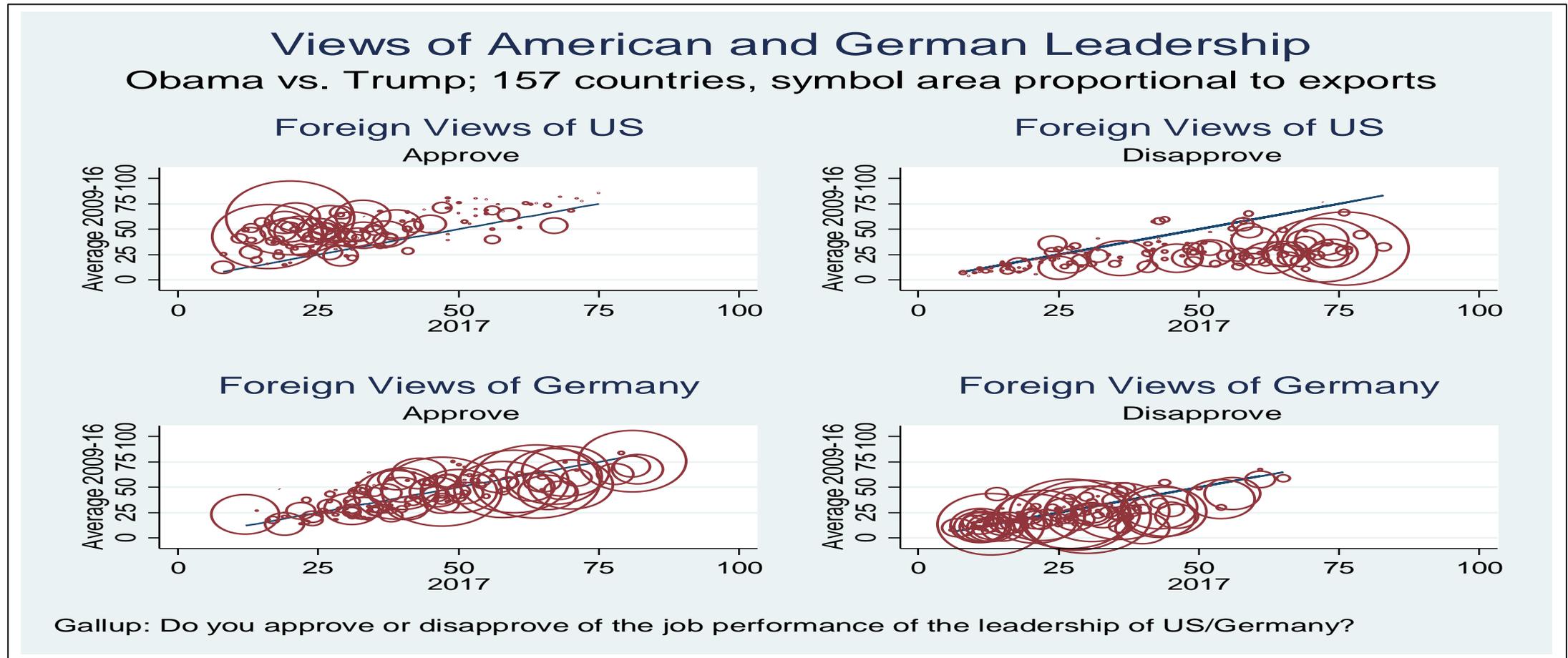
Still, a Range of Views Across Countries

Foreign Views about American Leadership
Box Plots of Surveys from up to 157 Countries



Gallup: Do you approve or disapprove of the job performance of the leadership of the United States?

Importers of US Goods Preferred Obama



But Does Soft Power Actually Affect Exports?

- Need to control for other export determinants via “Gravity Model”
 - One country (e.g., US) trades more with countries which are:
 - *Larger* in economic mass (GDP)
 - *Closer*
 - Geographically: distance, common land border
 - Culturally: share language, colonial heritage
 - Politically: regional trade agreement
- Gravity: a (rare) example of an economic model that works well in both theory and practice
 - Fits well; large and similar (across study) effects of income, distance
 - Heritage of Tinbergen (and Newton)

Methodology

I estimate:

$$\ln(X_{ijt}) = \gamma \text{SOFTPOWER}_{ijt} + \beta_1 \ln(D_{ij}) + \beta_2 \text{Lang}_{ij} + \beta_3 \text{Cont}_{ij} + \beta_4 \text{RTA}_{ijt} + \beta_5 \text{Colony}_{ij} \\ + \{\lambda_{it}\} + \{\psi_{jt}\} + \varepsilon_{ijt}$$

- Bilateral data, 55 Exporter-Year/1426 Importer-Year FE; 2006-17, for 5 exporters, 157 importers, 6,331 observations, LS estimation

Soft Power Has a *Big* Effect!

Log(Approval)	.66** (.12)		
Log(Disapproval)		-.35** (.10)	
Net Fraction Approval			.91** (.20)
Log Distance	-.77** (.09)	-.89** (.09)	-.83** (.09)
Common Language	.39* (.17)	.38* (.18)	.35* (.18)
Common Border	.76** (.29)	.82** (.30)	.79** (.30)
Regional Trade Agreement	.52** (.19)	.60** (.20)	.54** (.19)
Colonial Relationship	.81** (.20)	.88** (.20)	.83** (.02)
Observations	6,331	6,331	6,331
R ²	.87	.87	.87

How Big is the Trump Effect on Exports?

- A 1 percentage point improvement in leadership approval raises exports by $\approx .1\%$
- Average net approval by foreigners of the American leadership fell from +16.6% in 2016 (Obama's final year in office) to -7.4% in 2017 (the first year of the Trump presidency)
 - Swing of 24 percentage points in average net approval lowers American exports by $(.24 * .91 * \$1.45\text{tn} \approx) .22\%$ or **\$3.3 billion**
 - Probably more because both Canada and Mexico (largest US importers) had >50% declines in net American leadership approval
 - Long run effects bigger than short run effects

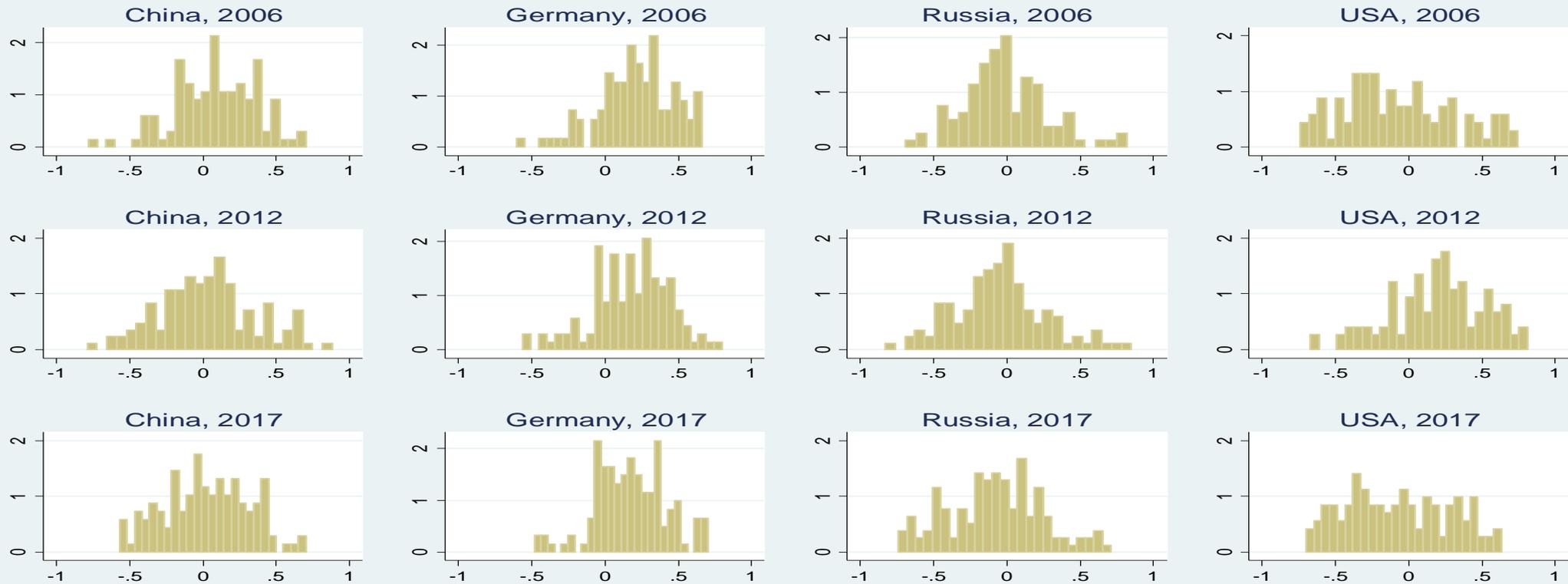
Summary

- Trump has had a large negative effect on global and American trade
 - Wrong-minded fixation on a) **bilateral** b) **deficits** in c) **goods**
 - Ignores economic and political benefits of trade, costs of protectionism, causes of aggregate deficit
 - Inducing retaliation and dollar appreciation
 - Undermining rules-based international order in trade (and security)
 - Ironically reducing American soft-power lowers US exports
- Fundamental Problem: protectionism seems to be a “solution” in search of a problem
 - Incoherence stems from inability to answer: What is the American objective?
- Worse to come likely!

Supplementary

Histograms of Gallup Net Approval

Foreign Views about the Leadership of Four Exporters Histograms of net fraction approval, up to 157 countries

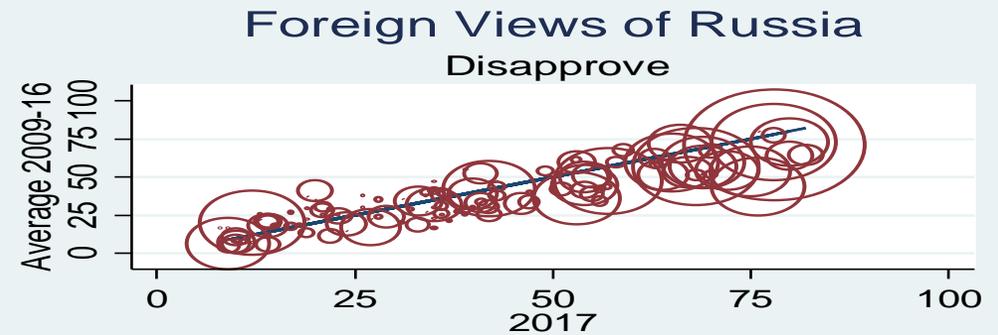
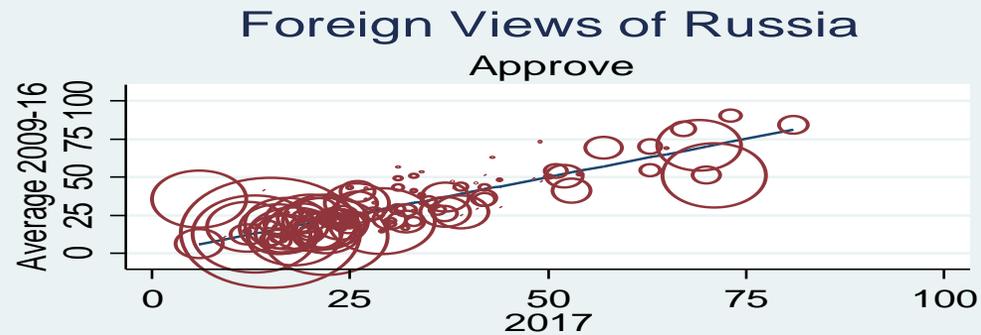
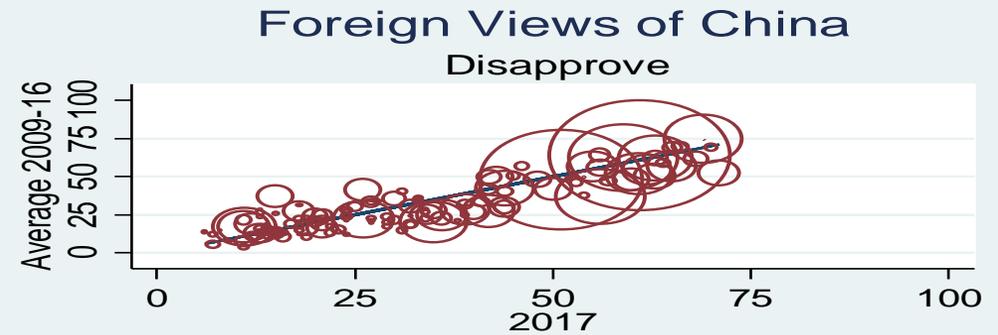
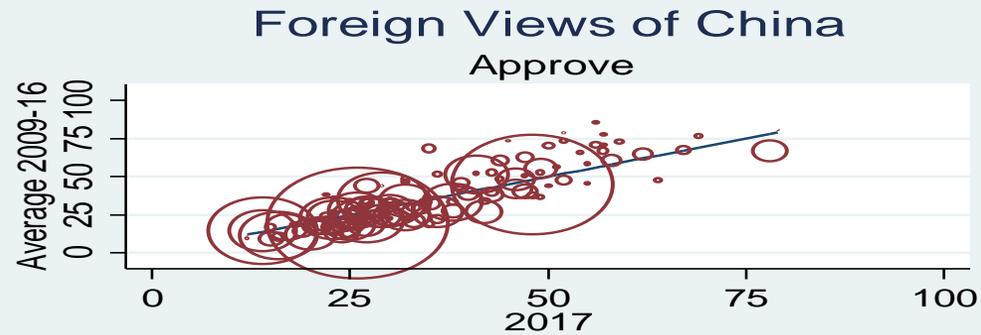


Gallup: Do you approve or disapprove of the job performance of the leadership of _____?

China and Russia

Views of Chinese and Russian Leadership

Obama vs. Trump; 157 countries, symbol area proportional to exports



Gallup: Do you approve or disapprove of the job performance of the leadership of China/Russia?

Different Measures of Soft Power

	Good	Bad	Net	Observations
Lag of Approval, Gallup	.70** (.12)	-.38** (.10)	1.02** (.20)	5,812
Current+1 st +2 nd Lags, (χ^2 (1)), Gallup	.78** (27.8)	-.41** (11.5)	1.08** (20.8)	4,166
Log (Positive Influence), BBC	.48** (.13)	-.30** (.10)	.77** (.22)	3,369
Log (Favorable Opinion), Pew	.55** (.17)	-.31* (.12)	.62** (.22)	1,946