Lettera Club

The European House - Ambrosetti

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The dangerous path to protectionism

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The new, confrontational course of the US trade policy aims to restore American competitiveness through tariffs, investments and trade restrictions and marks a major shift to the economic international relations, reversing an almost three-decade old trend of trade liberalization. A full-fledged trade war is well under way between US and China and the multilateral trading system has not been able to prevent it. How we got there? What will happen if the trend towards protectionism prevails? This Club Letter summarizes some evidences and reflections on cause and consequences of the new world of international trade, by gathering facts and figures on the recent evolution and the current state of trade relations between US - EU and US – China in particular and by analysing the economic impact of import tariffs and their consequences on the international relations. Finally, the Club Letter compiles a set of quotes on the topic that renowned international leaders shared with The European House – Ambrosetti in exclusivity.

HOW WE GOT THERE?

Current world economic outlook is ambivalent and conjugates the positive backdrop of a sustained and widespread growth momentum with intensifying trade tensions and the prospect of a similarly broad-based conflict over international trade. Both the US and the EU international trade policy in past decades has been designed around promoting reciprocal market opening and trade liberalization, creating new opportunities for increased levels of goods and services' trade, investments, innovation and productivity growth.

The prevention of the inefficiencies associated with trade wars has been the fundamental rationale behind cooperation in trade agreements. The two pillars on which the WTO is built, reciprocity and non-discrimination, ensure that the temptation to use tariffs to exploit the importer's market power at the expenses of its export partners gets neutralized, as WTO members are willing to accept not exploiting their market power when setting tariffs as long as other members do the same.

Through a number of rounds of trade negotiations, this has led to an 85% reduction in average tariffs since the creation of the GATT, the predecessor to the WTO, in 1947.

The pre-crisis global economy enjoyed ideal conditions as the quarter-century up to the crisis saw the fastest increase in economic growth, globalization and prosperity in history.

International trade increased sevenfold between **1980** and **2007**, outpacing the increase in world GDP in the same period. World FDIs far outpaced both.

Labour-intensive Asia rose, powered by the global integration of China and, to a lesser extent, India. Resource-abundant Latin America, Africa and the Middle East performed well in a China-led commodity super-cycle.

And the capital and technology abundant West prospered. Rapid globalization had two driving forces: technology and policy liberalization.

Western countries experienced the Reagan, Thatcher and European Single-Market revolutions in the 1980s and early 1990s. Developing countries liberalized massively and integrated into the global economy over the same period, with ex-Soviet economies following immediately after. Average tariffs in developing countries fell from about **30%** in **1985** to just above **10 %** in **2005**.

There were corresponding reductions in non-tariff trade barriers, FDI restrictions and restrictions on trade in services[1]. Despite such achievements, public optimism about the benefits of open economy, liberalization, economic integration and cooperation has been eroded over time and particularly over the last decade in the advanced economies by longstanding trends of job and wage polarization, coupled with persistent subpar growth in median wages. The financial crisis that exploded in September **2008**, preceded by the credit crunch that started a year earlier, transformed a benign global political and economic context into something very different: a sharp contraction in global growth ensued, reinforced by even sharper contractions in trade, FDI and other channels of globalization.

The world suffered its worst "de-globalization" since the WWII.

The global economic crisis triggered a big shift in ideas and policies against free markets and in favour of government interventionism. Pro-market reforms slowed down around the world and a rising scepticism about the liberalization and globalization policies associated with the so-called Washington Consensus aroused.

As a result, multilateral economic cooperation and the rules-based trading system are today under threat by a rising protectionist sentiment and initiatives in nearly all major economies.

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[1] Source: The European House – Ambrosetti on UNCTADstat, WTO, World Bank and other sources, 2018.

In this perspective and within the current radically new context has to be read **the reversal in US trade policy** and its initiative of tariff hikes on imports of steel and aluminium, their extension to additional China's sectors and to cars and car parts from the EU. **The new US trade policy is all focused on trade deficit, interpreted as a threat on US economy and particularly on manufacturing jobs.**

In 2017 the US imported goods worth $ 2.3 trillion but exported only $ 1.5 trillion. Factually, trade deficit is not a sign of weakness but, if anything, the opposite is true: trading partners are willing to keep granting credit to the US, securing a stable demand for dollars as long as the confidence in its status as the major reserve currency remains.

This deal has worked remarkably well for decades, allowing American consumers to buy any fancy imported goods in return, although based on a mounting amount of foreign debt.

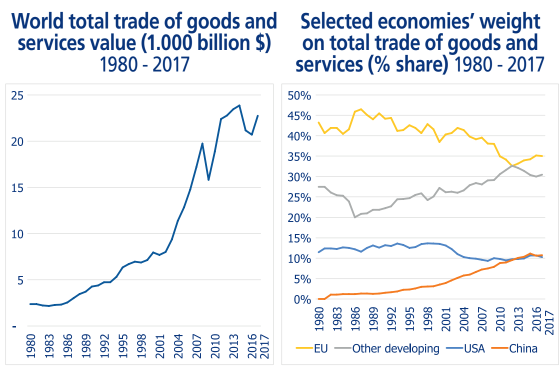
But among the main determinants of Trump election, has been in fact the shock of globalization on the American manufacturing industry[2], especially in terms of imports from China and every trade deficit is now seen as a certain number of factory jobs that are not yet in the US or are no longer there.

Therefore, the current world trade seems about bilateral trials of strength, where the greater your country's trade surplus with the US, the greater the risk that you will be the target of US's import tariffs increase. President Trump already pulled US out of the Trans-Pacific Partnership, insisted on rewriting NAFTA and began a trade war against China and trade tensions with other historical trade partners, undermining the existing multilateral framework and agreements.

INTERNATIONAL TRADE'S STATE OF PLAY

In 2017, the global value of exports of goods and services was $ 22.8 trillion. The highest levels of trade in goods and services were recorded unsurprisingly in some of the biggest economies, as the EU-28 exported more goods and services ($ 7.9 trillion) than any individual country, while the highest level of imports was recorded by the United States ($ 3 trillion)[3].

The **largest trade surplus** for international trade in goods and services **was recorded in the EU-28** ($ 645 billion in 2016), followed by China ($ 236 billion). By contrast, the **largest trade deficit was registered in the United States** ($ 570 billion), followed at some distance by India ($ 118 billion).



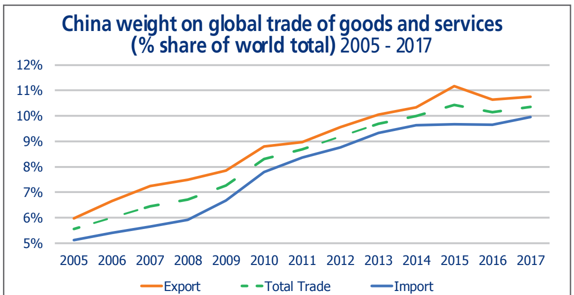
Source: The European House - Ambrosetti elaboration on UNCTADstat data, 2018

Increased trade liberalization from the 1990s onwards provided a stimulus for international trade.

Within the EU-28, the ratio of international trade in goods and services relative to GDP rose from 12.6 % in 2005 to 17.0 % by 2015, growing at a faster pace than the overall EU-28 economy. The ratio of trade in goods and services relative to GDP rose in most of the world's leading economies between 2005 and 2015 and this was particularly the case in Hong Kong, Mexico, South Korea and Turkey. The only exceptions were China (where the domestic economy grew at a faster pace than the value of international trade, even though China captured a growing share of world trade), Singapore, Russia and Canada. This relative shift may, at least in part, be attributed to the growing importance of trade in intermediate goods, which itself was driven by higher levels of international outsourcing as global production chains were established.

The most striking feature concerning developments for international trade in goods and services, however, has been the **steady progression of China as one of the world's leading trading nations**.

China's share of the world exports for goods and services rose from 6.0 % to 10.7% during the period 2005-2017, while its share of imports grew from 5.1% to reach 10 % in the same period.



Source: The European House - Ambrosetti elaboration on UNCTADstat data, 2018.

From a trade law perspective, there are today two main sets of rules governing the world trading system: policy commitments under the WTO and the system of combined sets of rules associated with several multilateral or bilateral Trade Agreements (TAs) currently in force.

The recent wave of TAs is changing the rules of globalization and there are in particular two key areas in which they are pushing beyond the multilateral WTO's commitments.

The first is by reducing import tariffs even lower than WTO levels, albeit on a discriminatory basis.

The second is by negotiating beyond tariffs, directly over new policy instruments.

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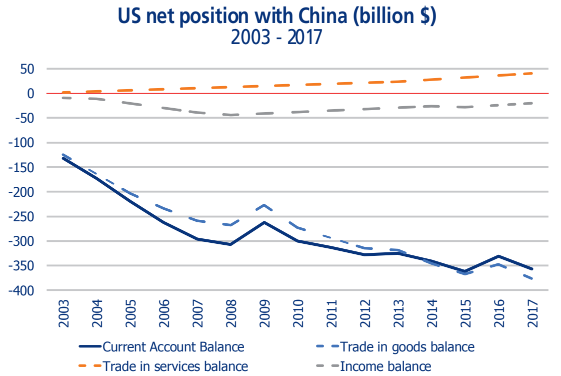
[2] See: David Autor, David Dorn, Gordon Hanson, Kaveh Majlesi: "Importing Political Polarization? The Electoral Consequences of Rising Trade Exposure", MIT Department of Economics and NBER, November 2016, rev January 2017. They find a robust positive effect of rising import competition on Republican vote share gains in US. European authors as well highlighted the "import shock" as a key explaining factor in the success of nationalists and radical right in Europe. See: Italo Colantone, Piero Stanig: "The Trade Origins of Economic Nationalism: Import Competition and Voting Behavior in Western Europe", Bocconi University's BAFFI CAREFIN Centre Research Paper Series No. 2017- 49, July 2016, rev September 2017.

[3] Source: UNCTADstat, 2018.

An increasingly important characteristic of many of the current TAs' negotiations is that they are no longer primarily about tariff liberalization but instead are pushing toward deeper integration that addresses non-tariff and behind-the-border policies.
Just before President Trump's election the WTO and TAs were on different trajectories with stalling WTO negotiations and increasingly important "mega-regional" trade agreements under discussion, such as the TTIP between the US and he EU or the TPP between the United States, Japan, and other Pacific trading partners. **The world trading system seemed to be at a crossroads, apparently experiencing a momentum shift away from the multilateral and non-discriminatory framework of the WTO in favour of discriminatory arenas under the new TAs,** and away from negotiations emphasizing superficial integration and toward negotiations stressing increasingly deep integration.

THE POSITION OF CHINA IN THE TRADE RELATIONS WITH THE US

Looking at the decomposition of the US's trade deficit, China clearly stands out since it is responsible for more than three quarters of it, roughly $ 336 billion, while Chinese trade with the US is indeed pretty much one-way, as current account balance analysis illustrates[4].



Source: The European House - Ambrosetti elaboration on UNCTADstat data, 2018.

The Trump's administration introduced on 6th July 2018 a 25 % tax on imports of $34 billion of goods from China, including machinery and components like semiconductors. China retaliated immediately with a 25 % tariff on imports of soy beans, other agricultural products and automobiles. On 23rd August 2018 import tariffs hike of 25% have been extended from both sides to 279 Chinese products and 114 American ones, reaching $ 100 billion of imports, that is 1/7 of their bilateral total trade exchange.

These moves come on top of tariffs already imposed on steel, aluminium, washing machines and solar panels. The aggregate amount of trade affected is still moderate relative to the US and Chinese economies, but for the US this is the most extensive import protection since the 1930s. President Trump has also threatened a further 10 % import tax in September on a further $200 billion of imports from China. These tariffs have been introduced after the Trump's administration concluded an investigation into some of **China's most controversial trade practices** and is based on the Section 301 of the US Trade Act of 1974, which authorizes the US President to take all appropriate actions, including retaliation, to obtain the removal of any act, policy or practice of a foreign government that violates an international trade agreement or is unjustified, unreasonable or discriminatory, and that burdens or restricts US commerce.
A number of China's commercial practice have given rise to a set of serious complaints: foreign exchange intervention; barriers to produce abroad and sell in China; support to import substitution; introduction of de facto technology transfer requirements, by linking inward investment to technology transfer to Chinese firms; massive domestic subsidies, directly and through state-owned companies; adoption of informal "buy China" policies[5] that force foreign firms to bring production in China. In order to understand the US Administration choice of not challenging China in the WTO for violation of its WTO commitments, one should consider that many of the policies that concern the US aren't necessarily WTO violations. Moreover, as the China accession to the WTO has been mishandled, particularly overlooking the use of special safeguard to face the shock, **significant difficulties do exist in using a set of narrow WTO cases to challenge China for specific violation of its WTO commitment.**

THE POSITION OF EU IN THE TRADE RELATIONS WITH US

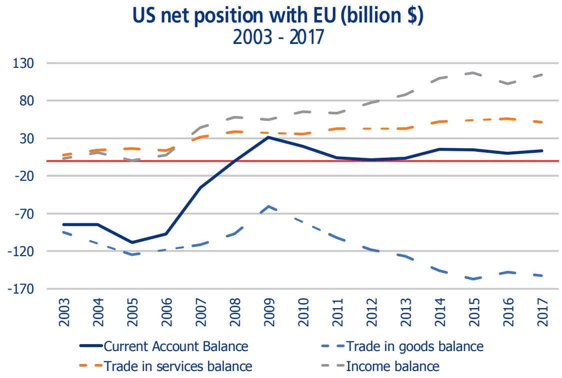
Even the fundamental transatlantic partnership that has allowed mostly positive relations between the EU and the US for decades is today under review by the US Administration. As a consequence, **tariffs and trade-rebalancing measures have been threatened on a variety of EU products as well.** US deficit in goods' trade is currently around $ 150 billion with the EU and this puts the EU in the second spot on President Trump's watch list. Germany alone contributes to this surplus by almost $ 65 billion. Invoking the national security argument the US Administration applied additional customs duties of 25 % on steel imports and 10 % on aluminium imports from the EU on 1 June 2018, amounting to $6.4 billion in total and President Trump threatened to impose tariffs on other key European imports, including cars[6]. However, the **EU has a substantial leverage in trade negotiations with the US,** much stronger than China, because the current account of the EU

[4] Bilateral current account balance equals the sum of bilateral trade in goods balance, trade in services balance and income balance. US does not sell many services to China and neither are they net recipients of investment's income from China. There are some caveats with the data. Bilateral current accounts are notoriously difficult to measure, in particular services and the primary income balance, especially due to tax-driven profit shifting within multinational corporations and is one important reason why economists so far have paid little attention to those balances.

[5] See for instance the "Made in China 2025" program, a Chinese government initiative to transform China into an advanced manufacturing powerhouse.

[6] On August 21, 2018, President Trump confirmed that it is its will to "impose a 25% tariff on all cars coming from the European Union.

with the US is balanced: the $ 150 billion deficit in goods trade is offset by a surplus of roughly $ 50 billion in services and $ 100 billion in primary income, based on a highly profitable portfolio of equity investments. Digital companies, in particular, hold valuable intangible assets in European subsidiaries, such as licenses and patents.



Source: The European House - Ambrosetti elaboration on BEA data, 2018.

To avoid to be caught in the middle of a trade war, European leaders agreed in the last EU summit (June 2018) on a set of proposals to improve the WTO, which should pave the way for finding common ground with US President Donald Trump and de-escalating the ongoing trade dispute, as Jean-Claude Juncker, President of the European Commission, has stated during its visit at the White House on 25 July[7]. He succeeded in the particularly delicate mission of avoiding a full blown trade war, using the meeting as an historic opportunity for the EU to de-dramatize tensions on trade, agreeing on reassessing the protectionist measures taken and engaging into an open, constructive dialogue with the American partner. Moreover the Austria's current EU Presidency while is committed to preserving EU unity on the US trade dispute during its mandate, openly declared the European Commission should prioritize a transatlantic dialogue and avoid escalation.

ASSESSING THE CONSEQUENCES OF THE NEW TRADE ENVIRONMENT

According to US's Department of Commerce, the 25% steel tariffs would bring to a cut in US imports by 38,5 %, while implementing the 10 % aluminum tariffs would cause a reduction in US imports of 17,3 %.
As a consequence, the estimated negative impact on Canada would be of $ 3,2 billion ($ 2 billion for steel and $ 1,2 billion for aluminum); on **EU of $ 2,6 billion ($ 2,4 for steel and $ 0,2 billion for aluminum**), followed by Sud Korea ($ 1,1 billion), Mexico ($ 1 billion), Brazil ($ 965 million) and Russia ($ 823 million). Other countries with relevant losses would be Japan, Taiwan, Turkey, India, United Arab Emirates and Vietnam. The collateral consequences of the so-called trade diversion should be added to such estimations, because in the absence of an important market as the US one, production of exporters will be redirected towards other markets, creating an **excess in supply and price reductions.**
The loss caused at global level has been conservatively estimated in $ 10 billion.
However, the Trump tariffs will hurt as well American consumers and users, as much trade today takes places within production chains shaped across national borders. For example, the steel and aluminum tariffs also hurt US automotive industry and US car buyers, while China's retaliation affects US agriculture and manufacturing. Such complexity should suggest caution, avoiding to consider trade surpluses on specific sectors alone: substituting a home-made final good for an imported one is one thing, while reconfiguring entire supply chains is a completely different endeavour. Therefore the US ambition to repatriate supply chains could also bring productive loss much greater than anticipated.
The comparison with the 1930s, which precipitated the world in a descent towards a straight and strong forms of protectionism, could be highly misleading: then tit-for-tat trade protection rapidly followed the Wall Street crash and the world splintered into warring trade blocs. This has not happened today and it is unlikely to happen anytime soon, since crisis-related protectionism today is remarkably restrained: multilateral trade rules, international policy cooperation and market-led globalization provide defences against a full-fledged descent into 1930s-style protectionism. Current retrenchment is much subtler as the actual dollar amounts of the US's restrictive measures is limited compared to the whole value of its international trade and investments flows.
However, they reinforce a worrying long-term trend towards slowing down globalization and therefore growth in the next decade.
In this sense, a more appropriate comparison could be with the 1970s, when a series of shocks, including the collapse of the Bretton Woods system and the oil-price hikes, triggered more government intervention and capital-market regulations, inducing protectionism: industry after industry, encouraged by government support at home, demanded protection from foreign competition.
The result was a trade-to-GDP ratio shrunk in major Western economies and overall slow GDP growth: 1980s became the lost decade for trade in many Western countries.
Beyond the impact of import tariffs on trade and growth, what is at stake is the real role of the multilateral trading system and the world economic order. The "old world" was characterized by production systems mostly confined within national borders, while obstacles to trade were about protecting domestic producers from foreign competition.
By contrast, the "modern world" is characterized by transnational production along global supply chains of goods and services, where obstacles to trade are focusing on protection of environment and consumer from side risks.
And the last decades in trade policy were indeed about moving from "protection" (quotas, tariffs, and subsidies) to "precaution" (security, safety, health, social and environmental sustainability).
The current reversal could erase such progresses.

[7] See: Center for Strategic and International Studies, "Transatlantic Relations at a Crossroads: A Conversation with European Commission President Jean-Claude Juncker", CSIS Headquarters, Washington, D.C. July 25, 2018.

HOW TO OVERCOME THE CURRENT TREND TOWARDS PROTECTIONISM

The principles of the post-war trading system are not merely a technical matter, nor they are just about liberalizing trade important though that could be.
They have a higher significance, because their purpose is to protect the market from arbitrary government intervention and so protect states from one another.
They aim to maintain a predictable economic order in the mutual interests of states, companies and private individuals and the quest for a predictable international economic environment remains critically important.
Overall, we consider the American tariffs as the wrong answer to the right issues of how we can deal with overproduction on the global market and unfair trade practices.
The right answer in our view is not new barriers to trade, but renewed negotiations on how to rationalize global production and how to avoid unfair behaviours in the global economy.
Such type of negotiations can be painstaking, but the bottom line is that they do pay off, because this is how global progress has been made in the past 70 years: from the UN to the EU, from NATO to the ILO and WTO, multilateral cooperation has been a driver for peace and prosperity.
The fact that President Trump is now on many fronts trying to undermine that post-WWII world order, is an evolution we can only regret, because **the challenges we face today, are still challenges that often need international and multilateral solutions**, like climate change, infectious diseases, cybersecurity, corporate taxation and control of corruption among others.
Global interdependence will only continue to grow and unless countries face it in a spirit of collaboration, the world economy cannot prosper.
Instead of sacrificing what has been achieved in the past decades, **a better strategy to improve the existing governance of international trade should be pursued.**
A priority, 17 years after the accession of China into the WTO, should be to address meaningful complaints against Beijing unfair trade practice and higher pressure should be applied to China.
The necessary reforms to enhance WTO effectiveness should be swiftly implemented.
Surplus based economies should reconsider their growth model and strengthen domestic investment and demand, reaching a balanced economy capable to perform also in uncertain times, without relying on credits and imbalances of partner economies.
There is certainly room to strengthen the multilateral trading system in several dimensions, but we should not forget it has been a significant support for world growth in the entire post-war period not only in the advanced economies but also favouring convergence in emerging and low-income economies, with incredible advances in the eradication of poverty and increasing a number of metrics of human welfare.

ADDENDUM: LEADERS' EXCLUSIVE COMMENTS ON THE TRADE WAR

In this section we collected a few exclusive statements from a select group of outstanding European personalities, to whom we asked answering the following three questions: how do you assess the trade war initiated by President Trump? Which countries and sectors will be in your view most affected and which, if any, may benefit from it? How the EU should react?

*"Since its foundation, the EU has probably been to most ardent supporter of an open, rules-based and fair trade and we remain so today more than ever. We indeed believe that this is the best way to promote mutual prosperity, competitiveness and job creation globally.
The success of EU's internal market for our Member States is a proof of this.
Conversely, protectionism doesn't work in the long run as we have seen in the past.
This is why we have been worried by temptations to resort to it that emerged recently, notably in the US. Fortunately, after the meeting of Presidents Trump and Juncker in Washington on 25 July, we have agreed to launch a new phase in the EU-US relationship and to focus on further opening up our markets, avoiding new tariffs, and enhance regulatory cooperation.
This is the right direction to deepen our economic partnership in a mutually supportive way.
US tariffs on EU exports of steel and aluminum and EU rebalancing measures are still in place but we hope to be able to find a solution to lift them in the future. As to US-China relations, we are worried by the adoption of tariffs in their bilateral trade as this can destroy wealth globally and disrupt global value chains.
We rather favor cooperation and joint work to ensure a level playing field and eliminate unfair practices and economic distortions such as intellectual property theft, forced technology transfer or industrial subsidies that can contribute to overcapacity.
We will work with the US, China and others to do something concrete about this, and notably to upgrade WTO rules in this respect".*

Jyrki Katainen

European Commission Vice-President for Jobs, Growth, Investment and Competitiveness

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*"Trade wars are always negative.
Not only do they have a detrimental effect on trade but they impede business confidence, thereby negatively impacting growth and employment.
The current anti-trade rhetoric and measures from the U.S. Administration are largely based on political and electoral motives and, unquestionably, they create serious risks in what is otherwise a broadly positive economic outlook.
Beyond what has already been announced,*

an important matter of concern is the general tone of the U.S. Administration's refrain. It appears to be against the multilateral order and longstanding existing institutions of global trade. Beyond the clear general negative impact, the countries and sectors that are affected very much depend on what concrete measures have been and will be adopted. We have already seen this, for example, in the aluminium and steel sectors which have been impacted by the tariffs imposed by the U.S. Administration. American industry is also feeling the negative consequences of these measures and some of the counter measures which have been implemented. I believe that in a trade war no one is ever a winner and for that reason we should try to do all we can to avoid them. The EU should first of all show its commitment to the multilateral order on trade, not only by supporting the agreements and institutions already in place but by deepening its trade relations with other partners. In fact, we are already seeing this happen through agreements the EU has concluded or which are currently being negotiated and pursued with real commitment. One such example is Japan, where talks recently resulted in an agreement that is very good news from a trade liberalization point of view. The EU should not give up on the U.S.There are many political forces in the U.S. that support free trade, including in the majority party and the EU should continue to engage not only with President Trump but with Congress, the business sector and all relevant stakeholders. It is critically important, from both an economic and political perspective, that the U.S. maintains a positive approach to global trade. But if some measures, like the tariffs we have recently seen, are implemented against European interests, my view is that the EU should react proportionately, whilst always keeping the door open for further negotiation. By and large, it seems to me that the EU has reacted in an appropriate manner to the U.S.' position and the measures which have been imposed. Indeed, its response has been fitting of its duty to be the defenders of a global order based on free and fair trade".

José Manuel Barroso

European Commission's former President

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"Trump's big mistake is to attack friends and foes alike and simultaneously. The duties he decided on Chinese good follow a rationale, more than 95% are with respect to technologically advanced products. The dishwashers are the eye-catcher, but it is not about dishwashers, it's about Xi's 2025 plan. The duties on European steel for example make no sense at all and hurt the American industry more than the EU. If not Trump himself, the industrial and financial community have understood and are critical at least. It's no wonder the EU and the US decided a truce as a result of Trump and Juncker meeting in Washington. For Trump it was a decent way out and I expect no further action of the US against the EU. On a number of issues, the EU and the US have the same interest with respect to China: lack of level playing field, theft of intellectual property, subsidies, SOE's, no reciprocity in market access for services. But we have to tackle this together, on substance and strategically. Lastly, it will be very difficult if not impossible to reach an EU-US FTA-type agreement limited to goods for a lack of checks and balances".

Karel De Gucht

Former Commissioner for Trade
from 2010 to 2014

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"The trade war initiated by President Trump is a loose-loose game. Wrong target (reducing US trade deficit). Wrong instruments (tariffs). Will hopefully backfire soon enough not to create too much damage (escalation). The EU should take the lead of a coalition to address existing flaws in global trade rules and bring both US and China at the negotiating table".

Pascal Lamy

Former Director-General of the World Trade Organization
from 2005 to 2013

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"The tensions on trade policy are at the heart of the US-EU current confrontation because they affect key aspects of our international relations, particularly with reference to the three dimensions: the multilateral rule-based world order, the European "business model" relying on trade surplus and the trade rules protecting mature and innovative productions. Such tensions are a source of great concern and requires from the EU the necessary firm and tough reaction, the deepening of its relations with Asia and India, the continued support to multilateral fora where the trade issues are linked to the wider concerns about sustainability and a renewed outreach to EU citizens, in order to effectively communicate the benefits of opening markets".

Enrico Letta

Former Prime Minister of Italy
from 2013 to 2014

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"This is a fundamental issue: the entire Western world benefited widely from the post-war global order and therefore it is extremely concerning that there are external and internal forces trying to move from a rules-based into a deal-based order. The current international trading system is not perfect but they are multilateral efforts that are needed to improve it.Present trade policy challenges provide a great opportunity for the European union to demonstrate its relevance and importance for the member states. While the risk of the real trade war is still low, the present trend is definitely dangerous.

Potential for escalation is real. What makes things even more risky, is the fact that simultaneously several major economies suffer from low growth and domestic structural problems. In present circumstances, it is easy to blame free trade and globalization and initiate populistic protectionist policies. After all I'm optimist that after the US mid-term elections things will be changed into better direction. At least there will be an opportunity for President Trump and his administration to move from the campaign mode into the governance mode".

Esko Aho

Former Prime Minister of Finland
from 1991 to 1995

"Most concerning is the growing uncertainty. The President's tweets influence the shares' price, let currencies tumble and shift investments. And it's just the beginning.
The IMF already estimates the loss of global GDP between 0,3-0,5%. Free trade as such will suffer and so all countries with open market policy.
In the short run there may be some winners, but in the end all economies will feel negative effects.
Let us not forget: free trade reduced poverty, raised average incomes and improved our life quality. We are not in a position to win a trade war. The EU's current account surplus with the world of nearly 4% makes us vulnerable.
So, let us respond with care.
A shift to more domestic investment and boosting defense spending could kill two birds with one stone: meeting NATO's 2% target and cutting the current account surplus. Would this appease Trump? I doubt, but it would strengthen Europe!".

Wolfgang Schüssel

Former Chancellor of Austria
from 2000 to 2007

"Aside from its obvious negative economic harm, the biggest challenge posed by the Trump administration's trade brinkmanship is the apparent absence of a clear de-escalation or exit strategy. This is an administration that shows unprecedented willingness to raise the stakes in its trade disputes without ever defining its end goal in practical terms.
The Trump administration's focus on ill-defined totemic issues such as the US's trade deficit and 'level playing field' creates an ever-shifting negotiating baseline for its interlocutors, where only major concessions appear to secure momentary relief from ad-hoc tariff threats.
This suggests we are looking at a large-scale and protracted series of trade conflicts, with a highly uncertain outcome.
The 1930s provide ample evidence of the potential devastating economic harm from unchecked tit-for-tat tariff escalation, both domestically and globally.
In the US, the Trump administration's initial focus on intermediate industrial good tariffs has somewhat delayed the impact of tariffs on consumer good prices. There is evidence that this has started to change as producers pass creeping production costs on to consumers and emblematic consumer goods imported from China find their way into new USTR tariff lists.
Most global economic heavyweights stand to be affected by Washington's protectionist push. This is especially the case for those countries that have long relied on the US export market as a driver of growth, such as Canada, Mexico, China and Germany – all of which would be directly and significantly impacted by the Trump administration's plans to impose tariffs on all Chinese and automotive imports into the US.
Notwithstanding its far-reaching economic costs, tit-for-tat tariff disputes often create localized 'trade displacement' opportunities for third parties. For instance, there is some evidence that Beijing's imposition of retaliatory tariffs on US products.
It is important to understand that these opportunities are the result of costly market distortions created by new tariffs, rather than from a levelling of the competitive playing field intended by the Trump administration.
In the sort-term, there are only unsatisfactory options for the EU. Avoiding further unilateral tariffs from Trump could mean offering immediate concessions, but this would be a costly short-term fix and an invitation to Trump to ask for more in future. Alternatively, it could mean coming to the negotiating table under coercion as Juncker did in July. In both cases, it largely validates Trump's choice to operate outside the boundaries of WTO rules.The better prospect of a long-term solution to address current tensions and imbalances in the global trade system is WTO reform. The EU and the US agree on their diagnosis of how China's trade practices are harming fairness in global trade, but the challenge for Brussels is to convince Washington that beefing up WTO rules is the best way to solve the crisis, rather than unilateral sanctions which only serve to undermine the rules-based order. This presents a critical juncture for the EU. Brussels has long endorsed the multilateral trade order but this is the first time the EU has come across a revisionist US Administration that seeks to undermine it — now is the time to assume greater responsibility for saving the WTO and strengthening the trade system. The EU has kickstarted this process by opening up WTO reform talks with the US, China and Japan. But this is not enough: Brussels must show even stronger global leadership and muster a multilateralist coalition behind a clearly defined strategy to take those talks in the right direction and to a higher level.
They will otherwise be driven by US and Chinese interests towards weaker binding rules and a gradual slide towards the unravelling of rules-based trade.
Allowing the law of the jungle to encroach on this system is in no one's long-term interest".

Peter Mandelson

Former Commissioner for Trade
from 2004 to 2008

THE DANGEROUS PATH TO PROTECTIONISM

In the past decades, since the 50s, global economy has benefitted from a steady and generalized growth in trade, enabled by liberalization of trade in goods and services under WTO governance

- Since 1947, with the General Agreement on Tariffs and Trade (GATT) and then with its development in the WTO, global economy has experienced a reduction of average tariffs on trade by 85%
- International trade increased tenfold between 1980 and today, outpacing world GDP growth. Global FDIs growth outpaced both
- Average tariffs in developed countries fell from about 30% in 1985 to just above 10% in 2005, together with corresponding reductions in non-tariff trade barriers, FDIs restrictions and restrictions to trade in services
- In 2017 the global value of trade in goods and services reached 22.8 trillion Dollars
- Considering individual economies, ratio of trade value on GDP has grown steadily everywhere but in China, Singapore, Russia and Canada
- European Union affirms today as the area with largest trade surplus (considering both goods and services), followed by China
- US has today the largest trade deficit, followed by India

In the past decade the global trade scenario experienced some major changes

- During the last decade, global governance of world trade has progressively shifted from WTO-only policy commitments to a double pillar environment: WTO rules and Bilateral Trade Agreements
  - Bilateral Trade Agreements such as TTIP and TPP were developing in order to go beyond WTO commitments, pushing tariffs levels even lower than WTO agreements, albeit on bilateral basis, and pushing toward deeper integration addressing non-tariff barriers and behind the border policies
- 2008 crisis transformed a benign global political and economic context, resulting in a sharp contraction of global trade and FDIs flows, with the world suffering its worst deglobalization since WWII

Within this context, US new Administration's trade policy has changed, stressing the importance of reducing US trade deficit

- US new trade doctrine considers trade deficit as a threat to US economy and jobs and a weakness of US economy and US global stance
- As a result, current trade scenario is getting more and more characterized by bilateral trials of strength, menacing existing multilateral governance and hindering past decades progresses towards trade and investments liberalization
- Trump Administration already pulled out major bilateral trade agreements (e.g. TPP and TTIP) and insisted on rewriting existing agreements (e.g. NAFTA)

US also initiated a "Trade War", which main targets are those countries with relevant trade surplus vs. US, mainly China and EU

China:

- In the past decade the country has affirmed one of the world leading trading nations. Its world share of export rose from 6% in 2005 to 10.7% in 2017
- China is responsible for almost 350 billion $ trade deficit with US
- US introduced 25 % tax on imports of $34 billion of goods from China. China retaliated with a 25 % tariff on imports of agricultural products and automobiles. US tariffs on steel, aluminum, washing machines and solar panels adds
- In August import tariffs hike of 25% have been extended from both sides to 279 Chinese products and 114 American ones, reaching $ 100 billion of imports, that is 1/7 of their bilateral total trade exchange
- The rationale for US action has been identified in several Chinese commercial practices judged as unfair, but not addressable within WTO

EU:

- TTIP has already been canceled by US administration
- US deficit in goods trade is currently around $ 150 billion with the EU. Germany alone contributes to this surplus by almost $ 65 billion
- US Administration applied additional customs duties of 25 % on steel imports and 10 % on aluminum imports from the EU, amounting to $6.4 billion in total
- President Trump also threatened to impose tariffs on other key European imports, including cars
- Differently from China, EU holds a stronger position in trade negotiations with the US, thanks to the leverage offered by a balanced current account vs. the US
- In June 2018 EU leaders agreed on a set of proposals to improve WTO, in order to find common ground with President Trump and de-escalating ongoing trade disputes

Global economy loss due to such trade developments has already been estimated in over 100 billion dollars, given so, a de-escalation of tensions should be pursued

- Multilateralism should be preferred to bilateral negotiations stemming from power plays
- Meaningful complaints towards China should bring to an improvement of WTO and multilateral governance, implementing the required reforms swiftly. In this process, EU can take the leadership.

The European House-Ambrosetti Club Lettera draws on the analysis, theses and solutions developed as part of Club activities and, more generally, the professional activity of The European House-Ambrosetti Group. We are aware that we offer an observatory of information and relation network, including on an international level, that is extremely high-level, but at the same time we are cognizant of the fact that we are not the sole "repositories of truth". In order to be of assistance to Italy and Europe—one of our key commitments—we sincerely hope that each Lettera will provide the basis for a large number of critical suggestions, both in terms of content and more generally, from those who receive it. Please send your suggestions and comments to letteraclub@ambrosetti.eu. We thank you in advance for your invaluable collaboration.

If you are interested in the activities of Ambrosetti Club, please contact Silvia Lovati by e-mail at club@ambrosetti.eu or call +39 02 46753 1

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