How to lose a trade war

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The Trump administration's imposition of so-called safeguard tariffs on imports of solar panels and washing machines is directed mainly at China and South Korea. But, while neither country is responsible for America's large trade deficit, further protectionist measures seem certain – and will leave US consumers worse off.

Protectionist from the start, US President Donald Trump's administration has now moved from rhetoric to action in its avowed campaign to defend US workers from what Trump calls the "carnage" of "terrible trade deals." Unfortunately, this approach is backward-looking at best. At worst, it could very well spark retaliatory measures that will only exacerbate the plight of beleaguered middle-class American consumers. This is exactly how trade wars begin.

China is clearly the target. The January 23 imposition of so-called safeguard tariffs on imports of solar panels and washing machines under Section 201 of the US Trade Act of 1974 is directed mainly at China and South Korea. Significantly, the move could be the opening salvo in a series of measures.

Last August, the US Trade Representative launched Section 301 investigations against China in three broad areas: intellectual property rights, innovation, and technology development. This is likely to lead to follow-up sanctions. Moreover, a so-called Section 232 investigation into the national security threat posed by unfair steel imports also takes dead aim at China as the world's largest steel producer.

These actions hardly come as a surprise for a president who promised in his inaugural address a year ago to "…protect [America's] borders from the ravages of other countries making our products, stealing our companies, and destroying our jobs." But that's precisely the problem. Notwithstanding the Trump administration's *cri de coeur* of America First, the US could well find itself on the losing side of a trade war.

For starters, tariffs on solar panels and washing machines are hopelessly out of step with transformative shifts in the global supply chains of both industries. Solar panel production has long been moving from China to places like Malaysia, South Korea, and Vietnam, which now collectively account for about two-thirds of America's total solar imports. And Samsung, a leading foreign supplier of washing machines, has recently opened a new appliance factory in South Carolina.

Moreover, the Trump administration's narrow fixation on an outsize bilateral trade imbalance with China continues to miss the far broader macroeconomic forces that have spawned a US multilateral trade deficit with 101 countries. Lacking in domestic saving and wanting to consume and grow, America must import surplus saving from abroad and run massive current-account and trade deficits to attract the foreign capital.

Consequently, going after China, or any other country, without addressing the root cause of low saving is like squeezing one end of a water balloon: the water simply sloshes to the other end. With US budget deficits likely to widen by at least $1 trillion over the next ten years, owing to the recent tax cuts, pressures on domestic saving will only intensify. In this context, protectionist policies pose a serious threat to America's already-daunting external funding requirements – putting pressure on US interest rates, the dollar's exchange rate, or both.

In addition, America's trading partners can be expected to respond in kind, putting export-led US economic growth at serious risk. For example, retaliatory tariffs by China – the third-largest and fastest-growing US export market – could put a real crimp in America's leading exports to the country: soybeans, aircraft, a broad array of machinery, and motor vehicles parts. And, of course, China could always curtail its purchases of US Treasuries, with serious consequences for financial asset prices.

Finally, one must consider the price adjustments that are likely to arise from the inertia of existing trade flows. Competitive pressures from low-cost foreign production have driven down the average cost of solar installation in the US by 70% since 2010. The new tariffs will boost the price of foreign-made solar panels – the functional equivalent of a tax hike on energy consumers and a setback for efforts to boost reliance on non-carbon fuels. A similar response can be expected from producers of imported washing machines; LG Electronics, a leading foreign supplier, has just announced a price increase of $50 per unit in response to the imposition of US tariffs. American consumers are already on the losing end in the Trump administration's first skirmishes.

Contrary to Trump's tough talk, there is no winning strategy in a trade war. That doesn't mean US policymakers should shy away from addressing unfair trading practices. The dispute-resolution mechanism of the World Trade Organization was designed with precisely that aim in mind, and it has worked quite effectively to America's advantage over the years. Since the WTO's inception in 1995, the US has filed 123 of the 537 disputes that have been brought before the body – including 21 lodged against China. While WTO adjudication takes time and effort, more often than not the rulings have favored the US.

As a nation of laws, the US can hardly afford to operate outside the scope of a rules-based global trading system. If anything, that underscores the tragedy of the Trump administration's withdrawal from the Trans-Pacific Partnership, which would have provided a new and powerful framework to address concerns over Chinese trading practices.

At the same time, the US has every right to insist on fair access for its multinational corporations to operate in foreign markets; over the years, more than 3,000 bilateral investment treaties have been signed around the world to guarantee such equitable treatment. The lack of such a treaty between the US and China is a glaring exception, with the unfortunate effect of limiting of US companies' opportunities to participate in the rapid expansion of China's domestic consumer market. With trade tensions now mounting, hopes of a breakthrough on a US-China investment treaty have been all but dashed.

Trade wars are for losers. Perhaps that is the ultimate irony for a president who promised America it would start "winning" again. Senator Reed Smoot and Representative Willis Hawley made the same empty promise in 1930, leading to protectionist tariffs that exacerbated the Great Depression and destabilized the international order. Sadly, one of the most painful lessons of modern history has been all but forgotten.

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