



Nobody Wins in Global Trade War

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Australia has much to lose in the looming global trade war, writes Matthew Lesh.

Protectionist rhetoric by United States President Donald Trump threatens a new global trade war on a scale not seen since the 1930s.

Trump's push for aluminium and steel tariffs and retaliatory tariffs against China are the biggest threat to global prosperity since the US imposed the Smoot–Hawley Tariff that led to retaliatory tariffs by other countries, slashing global trade and exacerbating the Great Depression.

Complaining that globalisation produces 'nothing but poverty and heartache', Trump develops policies driven by a misunderstanding of the 'trade deficit' concept. This misunderstanding is compounded by Trump's mindset of mercantilism, the idea that trade only brings wealth for a country able to accumulate profitable balances.

Trump's pronouncements, however, are nothing new. Trade has attracted opposition throughout

history because it creates winners and losers, generates anxieties towards interaction with outsiders, and raises questions of sovereignty and control. These concerns are based largely on the perception that free trade is bad, ignoring the real long-term benefits.

Pro-trade advocates must find new ways to promote the benefits of free trade across borders and defend its power as one of the best-tested economic concepts in history. Trade has helped lift hundreds of millions of people out of poverty and has created a more peaceful and stable world. The movement of goods and services, and the new knowledge that travels with them, is the central driver of modern prosperity. We must restate the dangers of protectionism while simultaneously addressing the genuine uncertainty that trade brings.

WHY DO WE TRADE?

Mathematician Stanislaw Ulam once challenged Nobel-prize winning economist Paul Samuelson to name a single proposition in social sciences that was both true and non-trivial. Samuelson's answer was the theory of comparative advantage, developed by British economist David Ricardo in the 19th century. Building on earlier ideas of specialisation by the father of modern economics Adam Smith, the theory of comparative advantage argues that a country should trade even when it appears to be the most productive in each category of goods. The archetypal example is the boss who is faster at typing than the assistant, but who still gets the assistant to do all the typing because the boss's time is better spent elsewhere. This insight is counterintuitive but extremely important.

Countries, like individuals, should specialise in what they are best at relative to their trading partners, and use the profits from that to buy other products. Australia produces and exports beef to the US (\$1.5 billion in 2016-17), which is our comparative advantage, and imports cars from the US (\$2.2 billion in 2016-17). These trades are mutually beneficial – the US receives more beef than it would be able to produce independently, and Australians access more and cheaper cars. Applying this concept across all goods and services has a simple unwavering upshot: mutually beneficial trade.

NOSTALGIA AND TRANSITION

In 2014, the Pew Research Center found that 50 per cent of Americans think trade leads to job losses, and just 20 per cent believe it creates jobs. Australians tend to be more positively disposed towards free trade. The 2017 Lowy Poll found that 78 per cent of Australians believe globalisation is 'mostly good for Australia', and 55 per cent believe trade is good for jobs while 35 per cent think trade is bad for jobs. Both answers are, in a sense, correct: trade both creates and destroys jobs. It is no secret that trade creates winners and losers.

The problem is that the benefits of trade are dispersed and felt over a longer time frame: cheaper innovative products, the emergence of new industries, and the creation of new well-paid jobs.

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The costs, however, are immediate and condensed, such as job losses in manufacturing due to overseas competition. The expectation (or hope) of classic trade theory is that laid off workers will find new employment in an expanding section of the economy, but the reality is more difficult.

Economists David Autor, David Dorn and Gordon Hanson have found that people who lose their job are worse off than previously thought. Their study finds that immobile workers who live in import impacted regions in the US (such as the mid west and south east) suffer from high levels of unemployment and lower wages because of Chinese competition. These workers have been unable to transition and are worse off than expected. Such findings raise questions about the cost-benefit equation for freer trade, particularly when it comes to jobs, and the phenomenon it describes has been linked to support for Trump.

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But the negative impact of trade should not be exaggerated. Trade is often the scapegoat rather than the cause of job losses. In the US, more than four million people lose their jobs every year. In Australia, 1.1 million change jobs every year. The bulk of these are not directly due to trade, but due to technological changes that require fewer workers to achieve higher outputs, business failure, and changing consumer demand. For instance, a 2013 study by Hicks and Devaraj estimates that 85 per cent of job losses in manufacturing are due to technology, and just 13 per cent are due to trade. Trade competition is often wrongly blamed. It is much easier to blame foreigners taking jobs than it is to acknowledge business failure.

Furthermore, the important 'creative destruction' of the free market, which enables innovation and improves living standards by reallocating resources to their best use, requires job changes over time. Back in 1930, a quarter of Australians were employed in agriculture, compared to 3 per cent today.

THE TRUMP CRITIQUE

Trump appears to have little understanding of the benefits of trade, declaring that 'trade deficits hurt the economy very badly'. This is, to borrow a Trump phrase, 'fake news'. A trade deficit is simply an accounting calculation which indicates American consumers last year purchased US\$566 billion more in goods and services than they sold to the world (down from \$760 billion in 2006.)

By definition, a trade deficit is balanced by a corresponding capital account surplus – other countries investing in the American economy which enables consumers to buy more products. At best a trade deficit should be celebrated for the consumer benefit, and, at worst, viewed with indifference that trade policy can do little to change.

Trump's other major criticism, that China does not 'play fair', has a grain of truth. China used its 'developing nation' status when joining the World Trade Organisation in 2001 to make fewer

commitments to remove trade barriers than would have been the case for a developed country. China has high tariffs, provides state subsidies, has high regulatory barriers for foreign companies, manipulates its currency, suppresses wages, and infringes on intellectual property. The WTO has failed to hold China to account for this unsavoury behaviour.

While putting pressure on China to improve its practices should be welcomed, a protectionist response to China's misdeeds would ultimately be much worse for consumers, producers, and US economic prospects. Putting up barriers to trade to 'punish' China would make American consumers poorer and hurt producers.

Trump's steel tariffs, for example, may help the 150,000 workers in steel production by pushing up prices. However, the tariffs will hurt the 17 million domestic workers in industries that use steel, as well as the hundreds of millions of consumers that buy these products. A study of tariffs placed on steel imports by George W. Bush in 2002 found that it cost 200,000 in lost jobs and \$4 billion in lost wages. The tariffs caused more jobs to be lost than the entire steel industry employs.

TRADE AND DEVELOPMENT

We must not forget that trade also creates jobs. Australia's employment is now dominated by services, increasing from 55 per cent of the workforce in 1930 to 78 per cent today. In the US, exports are estimated to be directly responsible for 11.3 million jobs, while trade is linked to 31 million jobs in the European Union and 2.4 million jobs in Australia. According to the ABS, exporters pay, on average, 60 per cent higher wages than non-exporters.

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In China, more than 800 million people have been lifted out of poverty since 1978. Per capita income in China increased from \$200 in 1990 to \$5,000 in 2010. In the developing world trade is associated with drastically reducing poverty while increasing employment, incomes and nutrition, and delivering longer life expectancy. It has also improved working conditions, reduced child labour, and improved the environment. This growth in the developing world is why, for the first time since the Industrial Revolution, global inequality has decreased. Trade is the best poverty-fighting weapon in our arsenal.

Australia, a small trading nation, has benefited substantially from free trade. Department of Foreign Affairs and Trade modelling from 2017 found that average Australian household incomes have increased by \$8,500 a year following 30 years of trade liberalisation. In real terms, GDP has increased by 5 per cent, consumption by 2 per cent, imports and exports by 29 per cent, and investment by 12 per cent. The same modelling suggests Australia has a lot to lose in a global trade war. A worldwide rollback in trade policy, leading to a 3.5 per cent contraction in economic activity, was projected to cost 270,000 jobs and shrink the economy between 1.8 per cent and 2.2 per cent of GDP.



ADJUSTING TO SHOCKS

Employment shocks are an inevitable part of economic history. New technologies and trade disrupt our working patterns and the types of jobs we do. The luddite solution to employment shocks is to block progress by restricting the trade and technology that make everyone better off. The long-term solution, however, is to deliver policy settings that will drive opportunity. Rather than restricting trade, we must address the issues that are strangling movement between jobs: red tape, high taxes, an inflexible industrial relations system, and a failed welfare state.

Protectionism is not pretty. Tariffs act as a regressive tax on poor domestic consumers, who spend a greater proportion of their income on tariffed goods such as food and clothing.

Trade now makes up an enormous part of the global economy. Trade, as a proportion of global GDP, has grown from 25 per cent in 1960 to 58 per cent in 2015. Australia, as a small, globalised economy, is heavily dependent on trade. Our future prosperity is reliant on not turning against trade. We must relentlessly make the case that trade is essential for driving growth.