Insight

Trade Policy under President Trump

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Donald Trump built his much of his presidential campaign on criticisms of the global trading system. He declared his candidacy with the argument that China, Japan, and Mexico are “beating us” at trade. He subsequently branded the North American Free Trade Agreement (NAFTA) “the worst trade deal in history,” the Trans-Pacific Partnership (TPP) “a disaster,” and China’s entrance into the World Trade Organization “the greatest job theft in history.” Now that he is president-elect, Trump and his economic advisors have laid out a plan to renegotiate or withdraw from NAFTA within the first 200 days of his presidency and withdraw from TPP within the first 100.

It is not surprising that Trump is following through on the changes to trade policy he spoke so passionately about during his campaign. But what exactly constitutes a better trade deal, and how would he negotiate one? The following paper examines Trump’s main criticisms of trade and which policy changes, if any, he should pursue in office.

Currency Manipulation

Donald Trump frequently accuses China of cheating by artificially devaluing its currency. This practice, called currency manipulation, seeks to lower the relative price of Chinese goods in order to boost Chinese exports to the United States. This could make U.S. goods relatively more expensive than Chinese goods, which would hurt U.S. exporters. Currency manipulation is an important issue to the president-elect: Trump devoted an entire section to it in his economic plan and consequently pledged to declare China a currency manipulator on his first day in office. This would trigger “enhanced bilateral engagement” between the United States and China. If the issue cannot be resolved in bilateral talks, the United States may seek remedial action.

Currency manipulation is a serious issue that deserves attention. However, levying tariffs on Chinese imports is only logical if Chinese officials are actually intervening to lower the value of the yuan. This is no longer the case: China abandoned its fixed interest rate in 2005 for a system in which the yuan fluctuates relative to a basket of currencies. Since then, the real value of the yuan has increased and it is no longer considered to be undervalued. In fact, China has recently been intervening to prevent its currency from losing too much value – the exact opposite of traditional currency manipulation. While currency manipulation should continue to be discouraged, there is little reason for Trump to target China on this particular issue.

Steel Dumping

Trump has also criticized the Chinese government for illegally subsidizing the production of crude steel. This has led to excess Chinese steel production, some of which is exported to the United States at prices below fair-market value. It has also led China to rapidly expand its steelmaking capacity: China now produces half of the world’s steel and has caused global steelmaking capacity to more than double between 2000 and 2014. A simultaneous drop in the global demand for steel has led to overcapacity, which Trump and his advisors view as a threat to U.S. steel producers.

The Obama administration responded by imposing anti-dumping and anti-subsidy tariffs of up to 500 percent on Chinese steel earlier this year. Dan DiMicco, one of Trump's top trade advisors and former CEO of the largest steel producer in the United States, also advocated for emergency tariffs on steel during the Bush administration. Trump has indicated that he would take similar steps to protect the U.S. steel industry as president; however, protectionist measures like these can unintentionally hurt American consumers.

Tariffs are taxes on U.S. imports. Policymakers impose them in order to encourage domestic production, but businesses often pass these costs straight to consumers. Therefore, increasing taxes on imports increases costs for businesses and thus prices for consumers. The reverse is also true: U.S. businesses benefit from lower input costs and consumers gain more purchasing power as global steel prices fall.

These effects are evident in the producer price index (PPI) for steel. The PPI for U.S. steel manufactures who utilize purchased steel has fallen nearly 16 percent over the last five years. However, when new steel tariffs were imposed last May, this index climbed 3.5 percent in just one month. Given that both businesses and consumers benefit from lower steel prices, Trump should reconsider retaliating with tariffs.

Value-Added Taxes and Border Adjustments

One substantive criticism that Trump has voiced about NAFTA involves value added taxes (VATs). Interestingly, this is an issue of tax policy, not trade policy.

VAT is a system utilized by many of our trading partners but not by the United States. It involves taxes which are levied at every stage of production; producers throughout the supply chain pay taxes to their suppliers on the value that they alone added to the product (revenue minus purchase price). Those taxes are then remitted to the government. Consumers of final goods pay taxes on the value added specifically by retailers.

With international trade, producers and consumers are not located in the same country and therefore are not taxed the same way. For instance, under a destination-based VAT system like in Canada or Mexico, producers of imported goods who are located abroad do not pay a tax. Similarly, international consumers of exports do not pay a tax. To account for this, border adjustments are applied: rebates are given to exporters who cannot collect a VAT, and taxes are levied on imports from other nations.

Trump and his advisors argue that NAFTA was poorly negotiated because it allows both Mexico and Canada to impose a VAT on imports from the United States. In reality, this is simply a border adjustment that ensures goods produced both domestically and internationally receive the same tax treatment. Without this adjustment, consumers would be biased against domestic production because imports would not be subject to VATs while domestically-produced goods would be. Border adjustments level the playing field for domestic and overseas competition.

VATs do not influence trade. Because imports are taxed and exports are subsidized at the same rate, exchange rates adjust to prevent the balance of trade from being affected. This is because, as demand for a country's exports increases, demand for its currency increases as well. Therefore, currency appreciation absorbs any benefits a nation would receive from subsidizing exports. Trump's advisors recognize this fact – but contend that our trading partners manipulate their currencies to affect trade flows (even though neither Mexico nor

Canada has been accused of currency manipulation). In response, they propose that NAFTA be renegotiated so that U.S. exports are exempt from border adjustments. However, there is a smarter alternative.

House Republicans recently drafted a plan to shift from a corporate income tax to a business cash flow tax that is border adjustable. This way, instead of demanding that U.S. exports be exempt from border adjustments, the United States would benefit from instituting border adjustments of its own. The details of a cash flow tax are not identical to a VAT, but the effects are largely similar: it would encourage domestic investment, benefit the owners of U.S. assets as the value of the dollar rises, and remove current incentives for companies to relocate abroad and export back to the United States. The United States, a net importer, would also profit from taxes collected on imports. Trump should support this tax reform as it would not discourage trade but spur economic growth.

Bilateral Trade Agreements

The final trade policy change that Trump pledged to pursue under his administration is to abandon multilateral trade agreements for bilateral deals. Trump's Secretary of Commerce, Wilbur Ross, recently explained this position: "The problem with regional trade agreements is you get picked apart by the first country. Then you go to the second, you get picked apart. And you go to the third one. You get picked apart again."

Ross's argument against multilateral trade agreements is not completely accurate. To the contrary, regional negotiations have resulted in greater market access for the United States than bilateral deals. This is because, in multilateral deals, the pressure is not solely on the United States to make concessions. Trade partners work together by each giving up some of their preferences, and concessions are spread across a greater number of nations.

Excluding the United States from multilateral trade agreements would also threaten our global standing. For example, Trump's plan to withdraw from TPP is poor strategic policy. China is eager to fill the global leadership vacuum left by the United States if TPP fails. Furthermore, in the absence of TPP, China will continue to gain economic influence in the Asia Pacific while U.S. influence fades. Trump should weigh the strategic and economic pros and cons of all trade agreements equally instead of needlessly confining the United States to bilateral negotiations.

Conclusion

President-Elect Trump has a difficult task ahead of him. He must preserve U.S. global leadership in trade while supporting domestic production and job growth. To do this, he should consider the merits of trade agreements and negotiate those that eliminate as many trade barriers as possible. This will benefit both businesses and consumers in America. It will expand market access for U.S. exporters, lower the costs of imports used in U.S. manufacturing, and give U.S. consumers access to a wide variety of competitively priced products from around the globe.