Trade Wars: What do they mean? Why are they happening now? What are the costs?

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When a country Taxes our products coming in at, say, 50%, and we Tax the same product coming into our country at ZERO, not fair or smart. We will soon be starting RECIPROCAL TAXES so that we will charge the same thing as they charge us. $800 Billion Trade Deficit-have no choice!

8:57 AM - Mar 2, 2018

❤️ 27.5K  🔄 14.3K people are talking …
What do these trade wars mean? A popular view

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- There is also a logical consequence of this view
  - in the event that these trade wars do lead to more open markets,
  - the tactics must be regarded as a success
An alternative interpretation

- Here we describe an alternative interpretation

According to this interpretation it is possible to see a logic to these actions. The United States is initiating a change from "rules-based" to "power-based" tariff bargaining and is selecting countries with which it runs bilateral trade deficits as suitable targets of its bargaining tariffs. The costs of these trade tactics cannot be avoided even if they happen to deliver lower tariffs. The main costs will arise from the use of the tactics themselves and from the damage to the rules-based multilateral trading system.
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Trade wars and the rules-based multilateral trading system

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- MFN embodies the nondiscrimination principle:
  - imports of the same product from different countries have the right to face the same (MFN) treatment in a given market.

- Reciprocity refers to the notion that bargains should be balanced; a country can anticipate an increase in the volume of its exports that is roughly equivalent in value to the increase in the volume of its imports. These rules constrain the exercise of power in tariff bargaining.

- Third-party spillovers from MFN dilute the gains for a powerful country to pressure bargaining partners to lower their tariffs. Reciprocity further neutralizes the exercise of power in tariff bargains, because it establishes an expectation of balanced terms for the bargain.

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Bargaining Tariffs

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*Donald J. Trump*

We have large trade deficits with Mexico and Canada. NAFTA, which is under renegotiation right now, has been a bad deal for U.S.A. Massive relocation of companies & jobs. Tariffs on Steel and Aluminum will only come off if new & fair NAFTA agreement is signed. Also, Canada must..

6:47 AM - Mar 5, 2018

❤️ 47.1K  🗣 19.4K people are talking about this
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And why choose as targets of its bargaining tariffs countries with which the United States runs large bilateral trade deficits?
- bilateral trade deficits signify trading partners with whom U.S. bargaining tariffs create the strongest threat point
Why are these trade wars happening now?

- In 1947, the United States was the unquestioned hegemon of the world economy and played a central role in the creation of the GATT.
- And it can be in a hegemon’s enlightened self-interest to support a rules-based system that limits its ability to exercise power.

More broadly, historian/commentator Robert Kagan sees the rules-based international order as “a historical anomaly” made possible by U.S. leadership and now collapsing, “returning the world to its natural state - a dark jungle of competing interests, clashing nationalism, tribalism and self-interest.”
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- The WTO may need a new hegemon to support it.
The threat to globalization may be a historical inevitability

Shifts in trade shares and changes in policy stance

The UK and US Share of World Trade, 1800-2016
Why are these trade wars happening now?

- A key distinction between ex-ante and ex-post threat points (e.g., McLaren, 1996)
  - bargaining outcomes hinge on ex-post threat points
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  - but as the hegemon's dominance wanes, weak country participation guaranteed
Figure 2. Hegemonic Transition: Equilibrium Payoffs

Payoff

China Nash

U.S. Nash

U.S. Hegemony  →  U.S. Dominance  →  China Dominance  →  China Hegemony
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- Regime change under hegemonic transition
  - U.S. Hegemony: United States supports rules-based regime to ensure participation of the weak
  - U.S. Dominance: United States finds power-based tariff bargaining more attractive
Figure 2. Hegemonic Transition: Equilibrium Payoffs

Payoff

Rules-Based: U.S. & China

U.S. Nash Ex Ante

China Nash Ex Ante

China Nash Ex Post

Power-Based: China

Power-Based: U.S.

U.S. Hegemony

U.S. Dominance

China Dominance

China Hegemony

Rules-Based System

Power-Based System

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Rules-Based System
What are the costs of these trade wars?

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- There is evidence that rules-based tariff bargaining is more efficient than power-based tariff bargaining
  - MFN and reciprocity can mitigate strategic behavior and the bargaining frictions that can accompany such behavior
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- Rules-Based: U.S. & China
- Power-Based: U.S.
- Power-Based: China

Payoff Matrix:

- U.S. Hegemony
  - Rules-Based System
  - U.S. Nash Ex Ante
  - China Nash Ex Ante
- U.S. Dominance
  - Power-Based System
  - U.S. Nash Ex Ante
- China Dominance
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  - China Nash Ex Ante
- China Hegemony
  - Rules-Based System
  - China Nash Ex Post
Figure 3. Hegemonic Transition: Equilibrium Payoffs

- **U.S. Hegemony**: Rules-Based System
- **U.S. Dominance**: Power-Based System
- **China Dominance**: Power-Based System
- **China Hegemony**: Rules-Based System
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- ∴ A less myopic view would dictate greater U.S. restraint