

U.S. actions damaging world trade order

The U.S. administration is waging a trade war on the world. The European Union and Canada have begun imposing retaliatory tariffs on U.S. products in response to U.S. President Donald Trump's earlier move to levy tariffs on imported steel and aluminum. For its part, Japan is set to hold bilateral trade talks



INSIGHTS
into the
WORLD

By Motohige Ito

Trade (GATT) in 1948 as a post-World War II pact prohibiting unilateral tariff increases and the imposition of tariffs aimed at specific countries. These global trade principles have been carried on by GATT's successor, the World Trade Organization, since 1995.

Thanks to the GATT/WTO regime, which has contributed to global trade growth, until very recent months almost no countries in the postwar era had resorted to unilateral across-the-board or country-specific punitive tariffs. Those measures differ from internationally agreed trade remedies, such as antidumping and safeguard procedures, that WTO member countries may exercise.

Therefore, Trump's decision to unilaterally impose massive tariffs exclusively on Chinese products, even in the name of protecting U.S. intellectual property, threatens to destroy the trade order that the world has maintained in the postwar era. In other words, the Trump administration is moving to do away with the WTO framework, of which the United States has been the leading custodian. News reports have said the U.S. president even wants to withdraw from the world trade watchdog.

China's responsibility

Market participants have taken the U.S.-China clash over trade issues quite seriously, as they're afraid that Washington is unlikely to simply abandon its aggressive stance toward Beijing.

If we can apply game theory, what's happening now between the United States and China is like a game of chicken. Two young men drive their cars at full speed toward the edge of a seaside cliff. If they don't hit the brakes, both cars will plunge fatally into the sea. If one of them chooses to slow his car and swerve ahead of the other man, he's called a chicken, meaning a coward.

Rational people are expected to avert plunging into the sea. As for the U.S.-China trade tit-for-tat, one nation may opt to compromise if it realizes that it's suffering greater damage than the other from the tariff war. So, let's wait and see which side is more likely to do so earlier.

Beijing may not compromise easily, given its years of enduring the hardships caused by economic sanctions the international community imposed against China in the wake of the Tiananmen Square incident of 1989. However, Trump, who triggered the tariff war, is unlikely to compromise easily,

either. Will the United States and China continue to pursue their game of chicken for a while? Or will the world economy eventually plunge into the sea? I'm anxious about what exactly will result from the U.S.-China discord.

When we reexamine why Trump launched the tariff war, we don't find any factor that suggests the confrontation over trade issues will easily come to an end.

As argued by Trump, China may not have been playing fair on trade with the United States. Why did China levy a 25 percent tariff on imported cars until the outbreak of the latest tariff war, while the comparable U.S. tariff rate was 2.5 percent? Why does China require foreign companies to set up joint ventures with local ones, while Chinese companies can freely invest in the United States? In addition, the president has alleged that China has been stealing technology from U.S. companies.

The United States also insists that the country has been suffering from huge trade deficits with China owing to the Asian country's unfair systems and that U.S.-China rivalry for technological supremacy will intensify further with the

United States being forced to endure unfair competition.

When China was still a developing country, it was inevitably eligible to enjoy preferential treatment in trade and investment to a certain extent. But the country is now the second-largest economy after the United States in terms of gross domestic product, expecting to compete shoulder-to-shoulder with the United States for global hegemony. So the Trump administration believes there is no reason anymore to grant such a powerful economy preferential treatment.

To facilitate an early end to the U.S.-China tariff war, it is thought

to be necessary for China to compromise first on the trade confrontation in a way acceptable to the United States. But the hurdle is very high.

Similarity to Nixon shock

Trump's recent measures to restrict trade also remind me of the so-called Nixon shock of 1971. Then U.S. President Richard Nixon unilaterally ended the direct international convertibility of the U.S. dollar to gold and imposed an import surcharge of 10 percent. His actions marked the beginning of the collapse of the postwar regime of fixed foreign exchange rates, known as the Bretton Woods system. The

world was utterly in turmoil. The United States dismantled the fixed foreign exchange rate system it had created.

However, in hindsight, breaking with the fixed exchange rate system was the right move, given the prevailing circumstances at the time. There is a Japanese proverb that says: "Adversity strengthens the foundation." The Nixon shock was "adversity," indeed, but it eventually facilitated the shift to a floating rate system, which "strengthened the foundations" of the world — economic interdependence.

Now, let me touch on China and the WTO. China's industrial policies and the free trade regime pursued by the WTO are incompatible. Also, as the WTO's core system of promoting free trade centers on the lowering of tariffs, it's not easy for the organization to formulate a set of rules to manage rivalry for technological supremacy. The more globalization advances and technological innovation gathers speed, the more up-to-date the global trade system should be to handle such progress. It seems difficult for the world to return to its original point in the aftermath of the U.S.-China trade dispute. The world should now begin looking for a more constructive trade system, although it will be a long-term process. By this I mean the international community should call on China to adopt adequate trade practices instead of continuing to bemoan Trump's destructive trade initiatives.

In that context, bilateral trade talks between Japan and the United States to be held late this month will be an important event, depending on what issues the two countries take up. I want the talks to focus on specific ways to stop a chain of protectionist measures and build a more forward-looking, fair and free international trade system. To prevent the international trade system from being weakened further, I also want such a system to be strengthened by the Trans-Pacific Partnership (TPP) free trade agreement, the Japan-European Union economic partnership agreement and the proposed Regional Comprehensive Economic Partnership (RCEP) agreement involving the 10 member states of the Association of Southeast Asian Nations and six Indo-Pacific countries, including Japan and China.

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with the United States in late July and close attention will be paid to what kind of demands Washington will make.

In the ongoing round of multifaceted trade conflicts between the United States and a number of other countries, the trade war between the United States and China is expected to have a far greater global impact. Considering that Washington's punitive tariffs and Beijing's retaliatory tariffs are affecting a significantly wide range of products, escalation of the confrontation between the world's No. 1 and No. 2 economies will rattle the global economy as a whole. Japan's trade will likely be affected, but I worry more about possible repercussions on the yen's exchange rate and Japanese stock prices. Likewise, a close eye will have to be kept on the exchange rate for the Chinese yuan.

The U.S.-triggered trade tensions are reminiscent of the tariff war of the 1930s, which sent the world into the Great Depression.

At that time, the United States kicked off the tariff war by adopting the Smoot-Hawley Tariff Act of 1930 to raise tariffs on a wide variety of imported products by a stiff 40 percent on average. But these trade restriction measures were implemented to protect domestic industries and did not target any specific countries. European countries responded in kind by raising their tariff rates.

As a result, world trade continued to severely contract month after month, exacerbating the then-ongoing global recession.

Reflecting on the 1930s experiences, the international community formed the General Agreement on Tariffs and