

World needs to restore free and fair trade system

A phenomenon known as the “weaponization” of trade policy is spreading around the world. The administration of U.S. President Donald Trump has been using the threat of higher import tariffs to force concessions from foreign countries in negotiations, an effective tactic because those countries would suffer if they lost their profits from the massive U.S. market.

Japan’s ultimate goal in the tough negotiations with the United States over Trump’s tariffs was to avoid losing the key export market for Japanese cars due to the U.S. president’s plans to impose sharply increased tariffs on them.

The United States achieved a major success in the bilateral negotiations by making Japan increase its U.S.-bound investments. In other words, Trump successfully earned profits by utilizing trade policy as a weapon.

The United States is not the only country to do this. China has used restrictions on exports of rare earths, known as the strategically important “vitamins of industry,” thereby ensuring that trade negotiations with the United States would go in its favor. If China’s rare earth shipments were to stop, the immediate consequence would be that the manufacturing of many products in the United States would come to a halt.

China has a high share of the global output of rare earths, so it has resorted to using this choke point as a weapon. When the issue of the Senkaku Islands came to the fore in 2010, China wielded the threat of restricting rare earth exports to pressure Japan.

The advancement of globalization has heightened many countries’ dependence on exporting their goods abroad and importing raw materials. This, in turn, has made them vulnerable to significant economic harm from restrictions on exports and imports.

The weaponization of trade policy is rampant, therefore, as nations take advantage of this situation. Major powers like the United States and China are especially prone to using trade policy this way.

The fundamental idea behind the World Trade Organization is to prevent countries from unilaterally imposing trade restrictions. When this rule functioned effectively, global trade kept growing, with each country benefiting from it.

Irony of globalization

It is ironic that as countries have become increasingly dependent on foreign trade amid glo-



INSIGHTS INTO THE WORLD

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balization, major powers have found the leeway to weaponize their trade policies.

The progress in economic globalization has become a double-edged sword, simultaneously leading to increased cross-border trade on the positive side and to the greater risk of weaponizing trade policy. It is not easy to stop the major powers from engaging in such weaponization.

The concept of “optimal tariffs,” which has been employed by the Trump administration in tariff negotiations, is noteworthy in terms of the strategic use of trade policy by a major power.

Optimal tariffs are an economic theory that describes a situation in which a major power can influence trade prices in its favor if it can restrict imports through tariffs. Let’s look at Japan-U.S. trade in automobiles as an example.

The United States initially announced plans to impose a 27.5% tariff on Japanese cars. In theory, Japanese automakers had a variety of options, ranging from maintaining their cars’ export prices while adding the tariff rate to those cars’ U.S. prices, to lowering their export prices by the amount of the tariff to keep their U.S. sticker prices unchanged. So, how did Japanese companies actually respond in their pricing strategies?

Many chose to reduce export prices and leave their U.S. prices unchanged, in an apparent bid to not put themselves at a competitive disadvantage in the U.S. market. Additionally, Japanese automakers opted not to change U.S. sticker prices too often because while Japan-U.S. negotiations were underway, it was believed that the 27.5% rate was only provisional.

For the United States, the Japanese companies’ decision to forego price increases in the U.S. market meant the burden on the U.S. consumer would not increase and higher tariff revenue would go to U.S. government coffers. In other words, the United States was able to make a profit from increased tariffs. Of course, if this situation continues for a long time, Japanese manufacturers may finally raise their U.S. prices.

The tariff rate on Japanese cars was eventually cut to 15% following further rounds of negotiations. Even so, it is unlikely that the U.S. prices of Japanese cars will be raised by a full 15%. According to the theory of optimal tariffs, only part of the tariff rate will be passed on to prices in the United States because Japanese makers will lower export prices by trimming their profits. Therefore, the increase in the burden on U.S. consumers will be limited, and the tariff revenue will benefit the United States.

Trump then drew the public’s attention by floating the idea of paying \$2,000 to every American from the tariffs collected. Regardless of whether the money will be actually paid, the revenue from Trump’s tariffs is that large.

The point of the theory of optimal tariffs is that for major powers, free trade with zero tar-

“*The weaponization of trade policy and the beggar-thy-neighbor policy ... cannot generate long-term prosperity*”

iffs cannot be said to be the best choice. Major powers feel tempted to impose tariffs for various reasons.

If a foreign country levies retaliatory tariffs in response to a major power’s move to raise its tariffs, both countries will end up suffering harm. In the case of small countries, it is not realistic to charge retaliatory tariffs on U.S. goods.

Reject beggar-thy-neighbor policy

Thinking in terms of the theory of optimal tariffs, the best situation for small countries is one in which every country keeps tariff rates low. If this is what is conceived as free trade, it can be said to be the most desirable situation for both small countries and the world economy as well.

However, China is not a small country. If Washington weaponizes trade policy, it is possible for Beijing to retaliate against the United

States. Using such choke points as rare earth shipments, China can maintain negotiating power with the United States.

The problem with free trade is that major powers can benefit by breaking its rules. This is called the beggar-thy-neighbor policy, as a country seeks to gain profits by forcing sacrifices on other countries. The Trump tariffs fall into this category, and there are similar aspects to China’s policy of disrupting global competitive conditions through excessive subsidies to domestic firms.

If major powers take the beggaring approach, prompting the entire world to lean toward protectionism, many small countries as well as major ones will face adverse effects.

This is exactly why international organizations such as the WTO were established, setting rules to prevent the implementation of the beggar-thy-neighbor policy by any country and playing an important role in protecting free trade. Thanks to these rules, world trade continued to expand. The United States was for many years instrumental in running the WTO.

However, the expansion of free trade has given rise to the weaponization of trade policy, leading to the adoption of the beggaring policy. The Trump administration is implementing policies that undermine the WTO system.

The weaponization of trade policy and the beggar-thy-neighbor policy bring short-term benefits to major powers, but they cannot generate long-term prosperity. It will not be an easy thing to do, but we must strive to rebuild a free and fair trade system, including restoring the function of the WTO.

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