The Economic Consequences of Trump's Trade Wa

***e*Research Corporation** is pleased to provide an article contributed by Barry Eichengreen to

PROJECT SYNDICATE
A WORLD OF IDEAS

PROJECT SYNDICATE brings original, engaging, and thought-provoking commentaries by esteemed leaders and thinkers from around the world to readers everywhere. By offering incisive perspectives on our changing world from those who are shaping its economics, politics, science, and culture, **PROJECT SYNDICATE** has created an unrivaled venue for informed public debate.

To see a full listing of **PROJECT SYNDICATE** contributors, **click here**.

If you are an editor or interested in becoming a member, **click here**.

You can access **PROJECT SYNDICATE** at its website: http://www.project-syndicate.org

The current article, starting on the next page, is entitled: **"The Economic Consequences of Trump's Trade War".**

The article begins on the following page, or you can access the article directly at the link provided below.
CLICK HERE FOR ARTICLE

***e*Research** was established in 2000 as Canada's first equity issuer-sponsored research organization. As a primary source for professional investment research, our Subscribers (subscription is free!!!) benefit by having written research on a variety of small- and mid-cap, under-covered companies. We also provide unsponsored research reports on middle and larger-sized companies, using a combination of fundamental and technical analysis. We complement our corporate research coverage with a diversified selection of informative, insightful, and thought-provoking research publications from a wide variety of investment professionals. We provide our professional investment research and analysis directly to our extensive subscriber network of discerning investors, and electronically through our website: www.eResearch.ca.

Bob Weir, CFA
Director of Research

Note: All of the comments, views, opinions, suggestions, recommendations, etc., contained in this Article, and which is distributed by *e*Research Corporation, are strictly those of the Author and do not necessarily reflect those of *e*Research Corporation.

The Economic Consequences of Trump's Trade War

By Barry Eichengreen (short bio at end of article)

July 12, 2018

For those who observe that the economic and financial fallout from U.S. President Donald Trump's trade war has been surprisingly small, the best response is that a lagged effect is exactly what we should expect. So, just wait.

BERKELEY – U.S. President Donald Trump's phony, blowhard's trade war just got real.

The steel and aluminum tariffs that the Trump administration imposed at the beginning of June were important mainly for their symbolic value, not for their real economic impact. While the tariffs signified that the United States was no longer playing by the rules of the world trading system, they targeted just $45 billion of imports, less than 0.25% of GDP in an $18.5 trillion U.S. economy.

On July 6, however, an additional 25% tariff on $34 billion of Chinese exports went into effect, and China retaliated against an equivalent volume of U.S. exports. An angry Trump has ordered the U.S. trade representative to draw up a list of additional Chinese goods, worth more than $400 billion, that could be taxed, and China again vowed to retaliate. Trump has also threatened to impose tariffs on $350 billion worth of imported motor vehicles and parts. If he does, the European Union and others could retaliate against an equal amount of U.S. exports.

We are now talking about real money: nearly $1 trillion of U.S. imports and an equivalent amount of U.S. export sales and foreign investments.

The mystery is why the economic and financial fallout from this escalation has been so limited. The U.S. economy is humming along. The Purchasing Managers' Index was up again in June. Wall Street has wobbled, but there has been nothing resembling its sharp negative reaction to the Smoot-Hawley Tariff of 1930. Emerging markets have suffered capital outflows and currency weakness, but this is more a consequence of Federal Reserve interest-rate hikes than of any announcements emanating from the White House.

There are three possible explanations. First, purchasing managers and stock market investors may be betting that sanity will yet prevail. They may be hoping that Trump's threats are just bluster, or that the objections of the U.S. Chamber of Commerce and other business groups will ultimately register.

But this ignores the fact that Trump's tariff talk is wildly popular with his base. One recent poll found that 66% of Republican voters backed Trump's threatened tariffs against China. Trump ran in 2016 on a protectionist vow that he would no longer allow other countries to "take advantage" of the U.S.A. His voters expect him to deliver on that promise, and he knows it.

Second, the markets may be betting that Trump is right when he says that trade wars are easy to win. Other countries that depend on exports to the U.S. may conclude that it is in their interest to back down. In early July, the European Commission was reportedly contemplating a tariff-cutting deal to address Trump's complaint that the EU taxes American cars at four times the rate the U.S. taxes European sedans.

But China shows no willingness to buckle under U.S. pressure. Canada, that politest of countries, is similarly unwilling to be bullied; it has retaliated with 25% tariffs on $12 billion of U.S. goods. And the EU would contemplate concessions only if the U.S. offers some in return – such as eliminating its prohibitive tariffs on imported light pickup trucks and vans – and only if other exporters like Japan and South Korea go along.

Third, it could be that the macroeconomic effects of even the full panoply of U.S. tariffs, together with foreign retaliation, are relatively small. Leading models of the U.S. economy, in particular, imply that a 10% increase in the cost of imported goods will lead to a one-time increase in inflation of at most 0.7%.

This is simply the law of iterated fractions at work. Imports are 15% of U.S. GDP. Multiply 0.15 by 0.10 (the hypothesized tariff rate), and you get 1.5%. Allow for some substitution away from more expensive imported goods, and the number drops below 1%. And if growth slows because of the higher cost of imported intermediate inputs, the Fed can offset this by raising interest rates more slowly. Foreign central banks can do likewise.

Still, one worries, because the standard economic models are notoriously bad at capturing the macroeconomic effects of uncertainty, which trade wars create with a vengeance. Investment plans are made in advance, so it may take, say, a year for the impact of that uncertainty to materialize – as was the case in the United Kingdom following the 2016 Brexit referendum.

Taxing intermediate inputs will hurt efficiency, while shifting resources away from dynamic high-tech sectors in favor of old-line manufacturing will depress productivity growth, with further negative implications for investment. And these are outcomes that the Fed cannot easily offset.

So, for those who observe that the economic and financial fallout from Trump's trade war has been surprisingly small, the best response is: just wait.

#####

BW: See about the Author below.

Writing for Project Syndicate since **2003**

Barry Eichengreen is Professor of Economics at the University of California, Berkeley, and a former senior policy adviser at the International Monetary Fund. His latest book is *The Populist Temptation: Economic Grievance and Political Reaction in the Modern Era*.