NATO PARLIAMENTARY ASSEMBLY

ECONOMICS AND SECURITY COMMITTEE (ESC)

Sub-Committee on Transatlantic Economic Relations (ESCTER)

THE INTERNATIONAL TRADING SYSTEM AT RISK AND THE NEED TO RETURN TO FIRST PRINCIPLES

Report

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I. INTRODUCTION

1. This Sub-Committee on Transatlantic Economic Relations (ESCTER) was created soon after the fall of the Berlin Wall to ensure that international and transatlantic trade issues would remain a central plank of the NATO Parliamentary Assembly's (NATO PA) agenda. The thinking then was that the liberal trading system established after World War II had not only contributed to an unprecedented rise of prosperity on both sides of the Atlantic, pulled millions out of poverty, and encouraged the diffusion of technology and ideas, it had also reinforced the security order. In fact, security, democracy and free trade proved mutually reinforcing. Indeed, an enduring Soviet threat encouraged allied nations to contain potential trade disputes and to move steadily in the direction of trade liberalisation. Those who built the Bretton Woods system knew full well that during the 1930s an array of "beggar thy neighbour" protectionist measures had contributed to the Great Depression, poisoned inter-state relations and had doubtless been a central factor in the descent into World War II. Their instinct to reject those policies proved prescient and highly beneficial.

2. The concern after the end of the Cold War, expressed clearly by members of the US delegation to the NATO PA, was that in the absence of an abiding Soviet threat, Allied countries might be less focused on containing narrow trade grievances. The political will to defend a trade order that had fostered so much prosperity would accordingly weaken. That concern, which has long animated this Sub-Committee, seems to have been entirely justified. Today, the global economy is threatened on many fronts. The campaign for trade liberalisation has suffered myriad setbacks, and the situation could worsen. Job-creating trade is now seen by many voters and politicians as job-killing rather than job-creating. No global agreement on trade liberalisation has been signed since 1995. The United States has pulled out of the Trans-Pacific Partnership (TPP) talks it was leading, the United Kingdom will soon leave the European Union and its future financial and trading arrangement with that bloc is uncertain, the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the EU is in remission and the recent G7 Summit meeting ended in unprecedented transatlantic acrimony over US tariffs on steel and aluminium and the promise of retaliation on the part of America's trading partners.

3. In 2016, 571 of the 771 trade interventions tracked by Global Trade Alert were characterised as discriminatory and only 200 as liberalising. The trend continued in 2017 with an increase of 26% in US trade actions against its G20 partners (World Economic Forum, 2018). Perhaps not coincidentally, the World Trade Organization (WTO) forecasts that the volume of world trade will grow by only 2.8% in 2018, the fifth consecutive year that it has increased by less than 3%. Rising trade tensions are also undermining long-term cross-border investment by companies worldwide. Foreign direct investment globally fell by 23% in 2017 according to the UN's latest World Investment Report. US-China and US-EU trade tensions appear to be driving this decline (Donnan, June 2018). Meanwhile a 2016 YouGov/Economist poll found that less than half of US, British and French citizens see globalisation as a "force for good" (Hu and Spence, 2017). This sentiment is also reflected in the growing appeal of populist and ultra-nationalist movements and parties that are challenging other fundamental liberal democratic norms.

4. Indeed, the very notion of a global economy today is under attack. Trade, immigration, and the movement of capital across borders have all been subject to populist backlashes (Hu and Spence, 2017). Some Western governments have begun to temper their support for trade liberalisation and seem ever more circumspect about the promise of globalisation. The Trump Administration has openly expressed its scepticism of the benefits of free trade and the logic of multilateral trading arrangements, and there is concern that without the leadership of the world's strongest democracy, the international trading system will turn to protectionism and managed trade. Most analysts believe that for a liberal free trade order to flourish, it is essential to have a free-trading "hegemon" to lead it. Fortunately, many in the US Congress support this perspective on US leadership.

5. It is unlikely that either Europe or China is prepared to act as the chief promoter of a global free-trading order should the United States retreat from this historic role. China retains a strong

mercantilist impulse, although it has rhetorically pushed for the preservation of an open global system. It fails to respect some of the key norms that would be required of a free trade hegemon including intellectual property protection and equal treatment for foreign companies. Its financial system remains underdeveloped and vulnerable to shock. Mounting protectionist sentiment is also evident in some EU countries. This has been fuelled by economic stagnation in some regions, exchange rate and fiscal adjustment inadequacies, the migrant crisis and the growing power of nativist politics. Moreover, one of Europe's strongest free trade advocates, the United Kingdom, is set to leave the Union, and its traditional free trade views will no longer be part of the internal EU discussion on trade matters.

6. The international institutions created to help govern the international economic system are also in crisis. Organisations like the International Monetary Fund (IMF), the World Bank and the WTO have had difficulties adjusting to the growing economic clout of developing countries. These important institutions have become the target of political forces that find it convenient to blame them for various economic challenges rather than empowering them to act as effective shock absorbers and rule makers within the international economic space (Hu and Spence, 2017).

7. Of course, it would be misleading to argue that trade and globalisation have not had disruptive effects despite their central contributions to prosperity. There is little question, for example, that trade has been one of several factors responsible for the losses experienced by older manufacturing sectors in developed countries, even if technological developments are a far more powerful driver of these losses. One US study suggests that while trade may account for as much as 13% of all manufacturing job losses in the United States, the rest is linked to productivity gains resulting from automation (Miller, 2016). Manufacturing output has increased in many OECD countries, while the number of factory jobs has shrunk due to technology-driven productivity increases. Technology, of course, creates new jobs in other sectors, but older displaced workers can confront difficulties changing careers, particularly if there are inadequate social and educational support systems to facilitate the transition.

8. Still, this is cold comfort for the millions in the West who have lost jobs and who believe that trade may be a factor in their declining fortunes. Between 2000 and 2016 the United States shed close to 7 million manufacturing jobs, many operating in the tradeable goods sector. The most dynamic job-creating sectors in that same period have been the non-tradable sectors, which generated 25 million jobs, many in the category of lowly paid medium- and low-skilled workers. Wages and benefits in this period stagnated, while inequality rose dramatically in some countries and continues to do so even as the global economy recovers (Hu and Spence, 2017). Across the OECD area, the average income for the wealthiest 10% of the population is now more than nine times that of the poorest 10%, up from seven times 25 years ago (OECD, 2017). In some countries, less progressive tax policies will exacerbate the equity problem induced by technology change, although this phenomenon is often misleadingly attributed to the trading system.

9. Wealth is also concentrating geographically, with one in four OECD citizens living in regions that are increasingly left behind in terms of productivity growth and income and where opportunities to move into more productive sectors are very limited. Such problems can mount over time. Regions with easy access to digital services tend to be better off economically and are better able to move up the production ladder. Regions without that access move downward. But over the long term, the digital economy might ultimately lead to more job losses across a wider spectrum of professions. Not surprisingly, the global financial crisis that began in 2008 accelerated a number of these trends. This triggered a backlash not only against trade, but also against other manifestations of globalisation including immigration, alliances, trans-border financial flows, international economic cooperation and the rules and institutions needed to administer the global economic order.

10. There are certainly legitimate arguments for developing countries to take a cautious approach to trade liberalisation, although embracing it as a goal and moving in a liberalising direction invariably benefits emerging countries. That said, trade liberalisation can produce adjustment costs for

developing countries such as the loss of reliable revenue for the state (from tariff collection), labour shocks made worse by poor social protection for those who lose work as a result of trade, and inadequate financing for restructuring economies suddenly exposed to international competition. Coping with these challenges requires subtle, sequential and well-planned approaches to trade liberalisation (Stiglitz and Charlton, 2005).

II. COMMON MISPERCEPTIONS OF TRADE

11. Public misperceptions about the international trading system allow those opposed to open trade to blame it for a range of ills besetting national economies. Among these misunderstandings is the notion that some countries invariably win and others lose from trade. This zero-sum game vision of trade is inherently mistaken and runs against all evidence regarding the shared benefits of trade. It is also often stated that trade deficits are, in themselves, a bad thing, and that they are primarily the product of “unfair” trade policies carried out by other countries. Another often-heard argument is that workers are better served by protectionist regimes rather than by the open liberal trading order. Finally, there is the traditionally mercantilist national security argument that rendering a country dependent on the international trading system somehow reduces its capacity to act autonomously to defend its core security interests.

12. None of these charges hold up to scrutiny. David Ricardo was the first economist to demonstrate systematically that trade in aggregate is generally a win-win proposition. His simple but highly insightful models suggested that trade allows countries to specialise in the production of those things that they produce the most efficiently while importing those products that they make the least efficiently. Although trade would prove a boon to the trading countries’ most efficient trading sectors and a bust to the less competitive sectors, each country would unambiguously be better off by specialising in those industries to which it is best suited, importing those items which it makes least efficiently and reallocating capital and labour accordingly. Economic modelling has since become far more complex, but David Ricardo’s fundamental insights remain largely valid. It is hardly surprising that trade has been such a compelling driver of economic growth in countries like India that came around to the view that lowering tariffs could be helpful.

13. Countries that engage in the trading system are able to consume more at a lower cost than they would if they were to operate in autarchy. Trade expands markets for domestically produced goods, thereby increasing rewards to both the owners of those exporting firms and their workers. But these are only the most visible impacts. There are also dynamic and often hidden impacts linked to trade. Participating in a liberal trading order generally lowers the cost of inputs of domestically produced goods that can then be exported. In an increasingly integrated world economy tied together by vital global value chains, three quarters of trade today consist of firms purchasing inputs, capital goods or services that contribute to their production. In effect, many leading export firms are also significant importers and gain enormous competitive advantage by sourcing internationally (OECD, 2018).

14. Trade also has powerful impacts on productivity as it unleashes competition which helps to advance organisation, information, knowledge, technology and efficiency among competing firms. Firms operating in more autarchic settings are far less likely to be innovative simply because they face less competition, are less exposed to the winds of change, and enjoy access to fixed, albeit undynamic, markets. Firms seeking market expansion are inclined to see trade as potentially beneficial. Consumers are naturally attracted to a diverse choice of high-quality low-cost goods and should understand that the competition of imports drives down prices and raises quality. When foreign competitors enjoy price and quality advantages, this can compel domestic firms to raise their own level of productivity as a competitive response. This dynamic accords advantages to the firm both in domestic and international markets, while also benefitting consumers. Enhanced productivity will make that firm more competitive internationally and help increase sales in local and international markets. It is not simply the importation of goods that triggers price/quality improvements. The

presence of competitively-priced foreign goods in a particular market can be a significant impetus for local producers to become more efficient. Protectionism has just the opposite impact. It lowers the impetus for domestic firms to raise their productivity thereby making protected companies ever less capable of selling in global markets. Consumers are stuck with higher bills, and over time, job losses mount.

15. Not surprisingly, therefore, open economies tend to grow more quickly than closed economies. Salaries and working conditions are generally higher in companies that trade freely, and there are also correlations between economic openness and productivity growth. Regions undergoing productivity increases tend to have forged important links to the world economy. But perhaps the simplest demonstration that trade is economically beneficial is that countries, and by extension, their firms and consumers, willingly participate in it as they see commercial opportunities that would not exist in strictly autarchic settings. Trade is thus the ultimate expression of commercial freedom. The OECD recently conducted a study in which China, Europe and the United States each imposed a hypothetical 10% tariff on all traded goods. The result was a 1.4% decline in global GDP and a 6% fall in global trade. Importantly, the countries that imposed the trade barrier in the model suffered the worst impacts.

16. It is also grossly misleading to suggest that trade deficits or surpluses are the product of unfair trade practices. Trade balances are essentially determined by national savings rates. A large trade deficit simply suggests that either public or private savings (or both) are negative. This is a hard and fast accounting identity. Domestic savings rates correlate with current account balances which include the trade balance. The United States, for example, has long been a low-saving (high public deficits) high-consuming country, and this is reflected in the negative current account balances it has run since 1981 (Irwin, 2016). It has effectively opted to consume more than it invests, and this decision is partly reflected in low taxes relative to public spending, significant foreign borrowing to underwrite the resulting shortfall, and large trade deficits. Reducing the trade deficit would therefore ultimately require the United States to increase savings by consuming and borrowing less, for example by raising taxes and lowering government spending. This might entail slashing substantial public budget deficits, raising private and public savings, cutting the sale of Treasury Bills to foreign Central Banks (those of China and Japan for example) and/or significantly raising interest rates.

17. According to the US Commerce Department, the US trade deficit grew 12.1% or USD 61.2 billion in 2017, reaching USD 566 billion—a nine year high. The 2018 tax and budget bills are likely to drive this number upward. Deficits are slated to reach USD 1 trillion by 2020, according to the Congressional Budget Office, and US public debt will reach USD 20 trillion by 2020 (Wasson and McGregor, 2018). The US economy has been growing at a healthy clip and this has been expressed, in part, through significant consumer and firm demand for imports. All of these factors will drive trade deficits upwards. Indeed, the United States is slated to enter a period of high dissavings that will invariably be reflected in a significant influx of foreign goods and increased foreign borrowing (Tully, 2018). Bilateral trade arrangements and new tariff regimes cannot impede the onset of this fundamental accounting identity. Protectionist measures could actually have the effect of worsening the trade deficit by raising domestic prices and making exporters even less competitive or more inclined towards offshore production. In any case, significant tax cuts without significant public spending cuts will be reflected in a rising inflow of goods and services. The trade deficit could rise by an additional 5-6% in 2018 as a result.

18. Some might find it ironic that growth in the United States seems correlated to increases in the trade deficit. Although the US current deficit fell from 5.8% of GDP to 2.7% in 2009, millions of jobs were lost in that same period. In the same way, Japan has run current account surpluses for 30 years, but its economy grew very slowly over that entire period. Since 2009, the United States has embarked on a slow but steady economic recovery and the current account deficit has remained at a sustainable 3% of GDP in this period. Thus, the notion that the country has been flooded with imports over the last decade does not hold up to scrutiny. The trade deficit will now increase as the savings rate falls.

19. Some developing countries undergoing rapid growth often run deficits as they need to import substantial capital equipment in order to sustain economic take-off. This is hardly a sign of an unhealthy trade position. A direct correlation between trade surpluses and overall economic health is more fiction than reality. Whether or not surpluses or deficits are a good thing depends very much on particular conditions prevailing in a given country. Perhaps the most important question is whether a current account deficit is sustainable over the long term and whether it reflects an inherently healthy economy that is increasingly productive or one that is suffering structural difficulties.

20. The United States derives unique benefits from the fact that the dollar remains the world's reserve currency of choice. This reduces the burden of internal adjustment because central banks and other economic actors will willingly hold dollars, even though the United States runs persistent current account deficits at levels that would be worryingly unsustainable for other countries. For a less powerful country, running sustained current account deficits would trigger a massive flight out of the national currency. The central place of the dollar in the international monetary order, however, accords the United States far more leverage and flexibility than other countries running long-term budget and trade deficits.

21. It is noteworthy that Germany, Europe's most dynamic economy, has a significantly different macroeconomic and trading profile than the United States. It is a high-savings economy with a very competitive export sector. In 2017, its exports rose 6.3% to EUR 1.28 trillion while imports rose 8.3% to EUR 1.03 trillion. This drove its trade surplus down to EUR 244.9 billion, from a record EUR 248.9 billion surplus in 2016 (Samson, 2018). Because the euro tends to align with Germany's natural exchange rate, the country enjoys a certain exporting advantage over some of its EU trading partners that no longer have devaluation in their toolbox or are less productive than Germany but nonetheless share the same currency. This implicit exchange rate misalignment has been a factor in the rising backlash against free trade in parts of Europe, and the Trump Administration has also cited this in its criticism of Germany's export position.

III. TRADE IN PUBLIC OPINION

22. A quick survey of the contemporary press would give an impression that the public harbours deep suspicion of trade and little or no appreciation for the benefits that it confers. But public opinion surveys belie this perception. Although US support for trade declined rather precipitously during the 2016 presidential campaign, perhaps as a result of the rhetoric employed by some candidates in both parties, US public support for open trading relations has begun to rebound. A Pew Research Center poll taken in April 2017 found that 52% of US citizens believe that free trade agreements between the United States and other countries are a good thing, while 40% see them as bad. Support for trade had troughed in October 2016, when only 45% of the public expressed a positive view of trade. By April 2017, 44% of surveyed US citizens said that trade had definitely or probably helped their financial situation, while 38% said that trade had definitely or probably hurt their situation. These numbers differ only slightly from polling in 2015, and the pro-trade outlook is substantially higher than in 2010 when, in the midst of the global recession, 26% of those polled said that trade agreements had helped their finances, while 46% said they had had a negative impact (Jones, 2017).

23. Perhaps more worrying is the degree to which trade has become a partisan issue in US politics. The positions of party voters have swung wildly over the past decade. In October 2016, 29% of Republicans and Republican-leaning independents claimed that trade was good for the United States. A year and a half before that poll, the figure stood at 56%. By April 2017, Republican support for trade had slightly rebounded to 36%. Democrats, by contrast, have now adopted a far more generous view of trade and have moved away from more protectionist sentiments. In April 2017, 67% of Democrats and Democrat-leaners claimed that free trade agreements have been good for the United States, up from 59% in October 2016. During the Bush Administration, however, Republicans were significantly more supportive of trade than Democrats. In 2006, for example, 44%

of Republicans saw trade as beneficial to their financial situation, while only 31% of Democrats did (Jones, 2017). All of this suggests that support for trade in the United States can be highly volatile and that political, labour and media leadership matters a great deal on these issues.

24. Large majorities of Democrats now support the North American Free Trade Agreement (NAFTA) while a significant majority of Republicans say that this trilateral trade agreement has been bad for the United States. This is the sharpest area of trade discord among the US public (Kull, 2017). Indeed, 51% of US citizens polled in May 2016 saw NAFTA as favourable to US interests, compared to 74% of Canadians and 60% of Mexicans. It is important to note here that in 2016 the United States ran a USD 74 billion trade deficit with the other two NAFTA signatories, and this has been a source of particular US public disquiet (Stokes, 2017). What is often not reported is the fact that these trade flows involve US companies moving components across borders, often multiple times, as part of the manufacturing process.

25. A University of Maryland poll released in October 2017 found that large majorities approve of the United States reciprocally removing trade barriers with other countries and a majority of US citizens favour allowing trade to grow and lowering trade barriers. Large majorities also support trade adjustment assistance programmes for workers who lose their jobs as a result of trade. They also want labour standards included in trade deals. A generational gap is apparent with 67% of US citizens under 30 and 58% of those between 30 and 49 seeing trade as good for the country. Only 41% of those over 50, however, hold a positive view of trade. Older people, of course, confront more barriers to retraining and are often not well positioned to make career changes to adjust to rapidly shifting market conditions. Education is another divider with 61% of those with a postgraduate degree viewing trade positively, while opinion is more evenly divided among those without a university degree. This is not surprising as less educated people have suffered more economic setbacks in recent years.

26. European public opinion on trade matters is also complex and sometimes contradictory. A 2015 YouGov poll revealed that, as in the United States, Europeans harboured concerns and doubts about trade. Although the governments of both Germany and France favoured the TTIP, 43% of the German public felt that further liberalisation of trade with the United States would be bad for their country while 26% believed it would be positive. Despite the pro-TTIP stance of the French government, the French also opposed the idea of that agreement by 30% to 24%. By contrast, a strong majority of US citizens (68%) had no opinion on the TTIP – and those who did were divided. Regarding the specific benefits or downsides of free trade agreements in general, the French and the Germans were divided in 2015, if not slightly negative. The British were more supportive of free trade, with 50% believing that policies leading to lower tariffs and common standards at home and abroad would help rather than hurt British businesses. Moreover, 44% of the British public were also generally positive about the number of British jobs resulting from increased trade. Those living in Sweden, Denmark and Finland shared this kind of optimism (YouGov, 2015).

27. The sharpest critics of trade on both sides of the Atlantic are those who have a sense that the international trading order has not served their personal interests. Such views are particularly salient among sectors where jobs are in sharp decline either because of technological evolution or market changes or because of trade patterns which have made those jobs redundant. In these sectors, the narrative that trade has led to a degradation of living standards and lower growth is most commonly accepted and reiterated. This has created an opening for anti-trade politics. Although technological change rather than trade is actually the leading driver of job loss, it is politically easier to blame trading partners for domestic economic difficulties. Slowing the evolution of technology, by contrast, is not an end with easy political fixes. Tariffs and the erection of non-tariff barriers, however, are part of most states' conventional policy arsenal.

28. Trade theory does provide one explanation for the dissatisfaction of certain groups with the current trading order. In a very important paper published in 1941, Wolfgang Stolper and Paul Samuelson noted that when a country that is relatively better-endowed with capital trades with

a country that is relatively well-endowed with labour, both countries will benefit. But the owners of capital in the country more endowed with capital will be disproportionally rewarded and the return to labour in that country will be relatively less. In the labour-intensive country, the opposite will hold, and labour will be disproportionately rewarded. Although the model seeks to simplify a highly complex set of phenomena, there is some evidence that this "Stolper-Samuelson" effect has been operational in the world economy. In labour-rich China, for example, wages have soared, particularly in the industrialised coastal regions, as China has opened its economy to global trade. It is often said that never before in human history have more people been raised out of poverty more quickly than in China over the past 25 years. In the capital-intensive West, educated workers along with the owners of capital have clearly benefitted from trade. Education is indeed a form of capital so the rewards from trade in the West have generally also accrued to those most endowed with capital in some form including those who are highly educated. Well-trained factory workers in advanced technology industries as well as those with a university degree can be included in the category of beneficiaries.

29. With this in mind, we can see how the rise of China has proven a boon to Western economies even though the benefits have not been evenly shared. Many Western firms have benefitted from access to vast Chinese markets. Western firms that manufacture in China have tapped into a productive Chinese labour market and Western consumers have seen prices fall. China's relatively low wage structure, infrastructure endowments and organisational sophistication have helped drive down production costs globally. This has not benefitted all Western workers, particularly those directly competing against Chinese labour. Moreover, as many displaced Western workers are located in regions with a heavy concentration of older industries including textiles, clothing, steel and furniture, entire regions, like parts of the American Midwest or older industrial regions in Europe, have suffered as a result of competition from producers in low labour-cost countries like China.

30. An oft-cited paper by David Autor of the Massachusetts Institute of Technology (MIT), David Dorn of the University of Zurich and Gordon Hanson of the University of California, San Diego, suggests that 44% of the decline in manufacturing in the United States between 1990 and 2007 might be attributed to competition from Chinese imports. Between 1992 and 2008, 20-40% of the US current account deficit could be attributed to trade with China as China was not importing nearly as much as it was exporting to the United States. That paper noted: "Adjustment in local labour markets is remarkably slow, with wages and labour-force participation rates depressed and unemployment rates remaining elevated for at least a full decade after the China trade shock commences. Exposed workers experience greater job churning and reduced lifetime income. At the national level, employment has fallen in those US industries more exposed to import competition, as expected, but offsetting employment gains in other industries have yet to materialise" (Autor et al., 2016). The study suggests that there is a link between job losses in some older industrial sectors and trade with China. Employment losses resulting from trade to China largely occurred as imports from that country to the United States soared. Interestingly, however, the market share of Chinese goods in the US market has largely remained constant since 2010, while its rate of domestic economic growth has slowed considerably as its own economy has matured, its wage costs risen, and population aged. In this sense, the greatest changes in the balance of trade between the two countries may have already occurred by now (Irwin, 2016). That China is a major purchaser of US Treasury Bills is not at all incidental to this. Chinese lending helps finance US budget deficits, but it also contributes to a depreciation of the renminbi relative to the dollar which, in turn, is expressed in US current account deficits.

31. Unfortunately for less skilled Western workers, the most dynamic part of the job market has been in positions requiring higher levels of education. The less skilled have been the most hurt by a globalising economy. As suggested above, many job losses are also linked to technological change and attendant job-shedding productivity gains, but it is far more difficult politically to rail against technology than it is to complain about the unfair trade practices of foreign countries. There is thus a tendency on both sides of the Atlantic to blame trade disproportionately for the woes that have beset Western industrial workers over the last 20 years. Countervailing arguments regarding the

gains from trade tend to be discounted. These include benefits to consumers who pay lower prices for a greater variety of goods and services made available as a result of trade, dynamic gains to productivity, falling input prices, job creation in emerging sectors, and overall competitiveness of the export sector.

IV. PROACTIVE LONG-TERM STRATEGIES FOR COPING WITH THE GLOBAL ECONOMY: THE EDUCATION DIMENSION

32. A number of European countries typically respond to upheavals in the job market both by redistributing income through the fiscal system and social safety programmes and by supporting education and job training. These policies have counteracted some of the distributional impacts associated with maintaining an open economy by redistributing some of the gains from trade through public budgets. It is interesting that countries that position themselves to benefit from trade while actively generalising at least part of those gains face less resistance to free trade than those societies where such policies are not in place. Governments can soften the harder edges of the global economy by sharing out part of the gains to the broader society. This works best when this partial redistribution aims above all to raise worker productivity and flexibility while improving international competitiveness. Properly calibrated public policy can work to ensure that societies are better positioned to cope with globalisation and the rapid technological, managerial, and educational changes that must be undertaken if that society is to flourish while embracing inevitable change.

33. The OECD has produced an important report, *Making Trade Work for All*, that provides a kind of manual of best practices for governments intent on ensuring that some of the gains from trade are broadly shared in a way to enhance productivity. The report suggests that providing re-employment and basic income support through unemployment insurance schemes and active labour market programmes will not only build public support for open trade but also help countries flourish in international markets. OECD studies suggest that generalising these policies rather than focusing only on workers displaced by trade constitutes the most effective approach. This gets the state out of the tricky business of determining precisely which workers have lost jobs due to trade and provides a modicum of social protection and support to those knocked out of the job market and seeking to re-enter it (OECD, 2017). Obviously, education is critical, and how societies structure their educational systems over the long run conditions how well they manage their economies in an ever more global setting. Technology, communications, migration, environmental change, trade, and investment have all made the world smaller. Students of all ages today require the cultural understanding, linguistic, cognitive and social skills, core knowledge, and technological prowess to flourish in this rapidly evolving economy.

34. For many countries, this will mean updating national and local education systems so that students as well as older "trainees" are equipped with the cognitive and critical capacities as well as social skills and mindset that they need to help themselves and their societies flourish in an ever more international setting (OECD, 2017). This is not, by any means, easy to achieve, for example in isolated heartland communities far from borders. But even these communities are touched by international market changes, and their educational systems need to prepare people from all walks of life for these changes. Moreover, education should no longer be considered the domain of the young. In a very fast-moving global economy, education must be a life-long endeavour. Failure on this front threatens to exacerbate social and generational divisions and to widen the gulf between those regions which have successfully entered the global economy and those that perceive the global economy as a threat that is best wished away. It goes without saying that this latter "head in the sand" approach is doomed to failure.

V. IS A WESTERN RETREAT FROM GLOBALISATION AND THE MULTILATERAL TRADING SYSTEM POSSIBLE?

35. There is little doubt that the international trading order was long driven by a shared transatlantic interest in open trade, international monetary stability and agreed rules of the game. The Bretton Woods system and the institutions needed to uphold it proved highly effective, not only in transforming these aspirations into a reality, but also in providing a vehicle for many other countries to participate in this system. The General Agreement on Tariffs and Trade (GATT) ultimately transformed into the World Trade Organization, while the IMF eventually became an institution dedicated to preserving global monetary stability after the end of the dollar-gold standard. But with parts of the West abandoning the optimism that once infused economic policy making, the rise of new centres of global economic power, and far more vast flows of private capital and complex value chains determining trade flows, the old international commercial order has changed in fundamental ways. The rise of new economic powers has also altered the strategic chessboard. Countries like China now seem to be preparing to assume leadership roles on their own terms and premised on their own values rather than on those of the West.

36. The withdrawal of the United States from the Trans-Pacific Partnership talks has, at least partly, opened up a door for China to become the arbiter of the trading and monetary order in East Asia. China remains committed to a kind of globalisation that differs in important ways from traditional Western views of the concept. It has played a key role in pushing for the creation of the Asian Infrastructure Investment Bank and the New Development Bank, and it is advancing its commercial interests all the way to Europe through its Belt and Road Initiative. The problem from the Western perspective is that China is still a developing country, and an undemocratic one at that. Its approach to the developing world tends to be transactional and it has hardly internalised the notion of playing the role of the benign hegemon, which sometimes requires the sacrifice of immediate national interest for the sake of the broader system – a role that Great Britain had assumed in the 19th century and that the United States played to great effect in the post-war period. China still seems to harbour a zero-sum view of trade, and its push to acquire Western developed technologies, often in ways that violate international commercial norms, suggests that this is not a country prepared to play a systemic leadership role. China also confronts daunting structural difficulties as well as potential domestic political problems that will continue to distract its attention. Its currency is not fully convertible, its capital markets are not sufficiently developed and its banking system is vulnerable, lacks transparency and is subject to political interference. From the perspective of many analysts, its trade policies can seem blatantly mercantilist. China is thus seen with varying degrees of mistrust by some of its neighbours, not all of whom believe that such a thing as a “peaceful rise” to power is possible, particularly given that this has assumed a blatantly military form in the Pacific. Indeed, China’s rapid military build-up and its highly contested claims on the East and South China Seas tend to reinforce those concerns.

37. While it would be difficult for China today to establish itself as a systemic leader of the international trading order, the United States is also altering its approach. In the post-war period, the United States advanced a multilateral vision for an international trading system that promised ever diminishing impediments to free trade. That vision no longer holds. President Donald Trump, his advisor Peter Navarro, Director of the White House National Trade Council, and the Commerce Secretary, Wilbur Ross, have alluded to the possibility of replacing the multilateral trading system with a series of bilaterally negotiated trading agreements. President Trump told Paul Gigot of the Wall Street Journal: “We’ve also withdrawn from the Trans-Pacific Partnership, paving the way for new one-on-one trade deals that protect and defend the American worker. And believe me, we’re going to have a lot of trade deals. But they’ll be one-on-one. There won’t be a whole big mash pot” (Gigot, 2017). If this is the direction in which the Trump Administration moves, and it is not at all clear if this rhetoric will fully translate into policy, it will mark a fundamental change in the US approach to trade policy (Gertz, 2017).

38. This anti-trade rhetoric was transformed into policy on 8 March 2018 when the Trump Administration, despite strong protests from Republican leaders of Congress, invoked a rarely used national security exemption to impose new tariffs on steel and aluminium imports to the United States, although Canada and Mexico were initially exempted pending the outcome of the NAFTA renegotiations. The EU was also given a temporary exemption in the expectation that some kind of deal on steel and aluminium markets could be achieved. That did not transpire and in late May the United States slapped levies on EU, Canadian and Mexican steel and aluminium. The EU issued a statement that expressed "its willingness to discuss current market access issues of interest to both sides, but has also made clear that, as a longstanding partner and friend of the US, we will not negotiate under threat." It announced a series of retaliatory measures against US goods. By contrast, South Korea reached a preliminary deal for a permanent exemption from the steel tariffs because it agreed to cap its exports to the United States at 70% of the average export volume of the previous three years (Cassella, 2018).

39. Canada, Mexico, Japan and the European Union collectively supply roughly one half of US imported metal. In August, President Trump doubled tariffs on Turkish steel and aluminium imports as part of a separate dispute. These decisions represent a sharp escalation of pressure on the global trading system and have had a negative impact on broader transatlantic and hemispheric relations. The tariffs have had an immediate impact on the global steel trade. The users of imported steel, including the US automobile and construction sectors, are also paying a high price for the decision.

40. The economic fallout has been ratcheted upwards due to inevitable countermeasures against US goods. Mexico, for example, announced retaliatory tariffs on bourbon, apples, potatoes, cheese and pork ranging from 15% to 25% (Webber et al., 2018). In anticipation of the US tariffs, the EU had already prepared a list of US products that would be subject to elevated tariffs if the United States went ahead with its tariffs. In June, the European Commission reported that it would apply the tariffs to a list of US goods including whisky, motorcycles and pleasure boats. Duties on EUR 2.8 billion worth of US goods went into force in June 2018.

41. Under the EU's plan, which it says complies with WTO rules, virtually all of the US products on the list face a 25% tariff. The EU estimates that US tariffs on steel and aluminium alone will cost EUR 6 billion in lost exports. The European Commission's Vice President overseeing trade policy has said that Brussels sees the problem as lying with the President and not with Congress, saying: "If you listen to congressman from both parties or American business, they are still in the same traditional line as the United States has always been. So the problem is quite concentrated on the Administration" (Brunsden, June 2018). Both Canada and the EU have vehemently objected to the invocation of national security as a justification for the US tariffs, particularly given that they are close allies of the United States. The Canadian Foreign Minister, Chrystia Freeland, described the security argument as "frankly absurd" (Swanson, 31 May 2018). Indeed, the decision to invoke the steel tariffs has also complicated US-Canadian relations as well as ongoing NAFTA negotiations. Canada announced countermeasures of CAD 16.6 billion in imports of US steel, aluminium and other products, which is the value of 2017 Canadian exports affected by the US tariffs. Both Canada and the EU will also challenge the US action in the WTO as an illegal invocation of the National Security Exception—Article XXI of the General Agreement on Tariffs and Trade.

42. The US Administration has also announced that it plans to undertake a "Section 232" investigation of the trade in automobiles. The prospect of 25% import duties on cars would be far more ruinous than steel tariffs, all the more so as these would be answered with powerful retaliation (Brunsden and Donnan, 2018). The United States imports roughly USD 190 billion of cars annually (Donnan, June 2018). In July, the European Commission announced that, were the Trump Administration to follow through on its threat to impose punitive tariffs on automobile imports, it could expect global retaliation approaching USD 300 billion of US goods across multiple sectors. This was a day after the US President, citing European automobile tariffs, said: "The European Union is possibly as bad as China, just smaller. It is terrible what they do to us." The EU warned that if the

United States were to impose automobile tariffs it would plunge the world economy into a very costly trade war that would hit the US automobile sector which accounts for 4 million jobs. The EU's Ambassador to Washington testified at a public hearing on the matter that the EU believes the "Section 232" steel and aluminium investigation lacks legitimacy and factual basis and would lead the United States into a breach of international law.

43. Other important actors are also strongly opposed to the US Administration's plan. General Motors issued a warning that US automobile tariffs would raise the prices of its cars by thousands of dollars, undermine its competitiveness and lead to substantial US job losses. EU owned car companies account for 25% of US production, much of which is then exported from the United States (Brunsden, June 2018). Of roughly 6 million cars exported by the EU in 2016, more than 1 million – just over 16% of the total – were purchased in the United States. The United States is the EU's largest automobile export market. Of the USD 53.6 billion in US car exports in 2016, USD 11.8 billion were generated in the EU market, which amounts to roughly 22% of total US automobile exports (Turak, 2018).

44. President Trump has complained that the European Union discriminates against US-made cars, arguing that US cars face tariff rates of 10% in EU markets while European made cars enter the US market with only a 2.5% tariff rate. This particular discrepancy could be resolved through negotiations. The EU Trade Commissioner Cecilia Malmström and Japan's Hiroshige Seko warned that if the administration were to move forward with this, it "could lead to the demise of the multilateral trading system based on (WTO) rules". There is an additional risk that other US industries could be inspired to seek similar kinds of protection on national security grounds. This would, of course, open the floodgates and trigger a wave of protectionist measures that would, in turn, trigger retaliation—all at the expense of a mutually enriching liberal trading order (Lynch and Paletta, 28 May 2018).

45. Although there is a discrepancy between US and EU tariff rates on automobiles, US and EU tariff rates are largely similar across a broad array of products. In 2017, the United States ran a trade deficit of roughly USD 152 billion with the EU, up from USD 146 billion in 2016. Early indications are that US deficits with the EU will be even higher in 2018, given strong US growth and tax cuts (United States Census). The discrepancy in relative savings rates is the principal driver of this particular deficit.

46. Trade tensions, however, have also taken on an ideological veneer. President Trump has identified the inherently multilateral European Union itself as antithetical to his nationalist trading vision and complained that it prevents the United States from negotiating bilaterally with individual European countries—although blocking such divide and conquer strategies through the construction of a common market has long been a central premise of the European project. This is also an ambition the United States has supported, as it has maintained a broad strategic interest in a strong, united, self-confident and open Europe.

47. In late July, President Trump and the President of the European Commission, Jean-Claude Juncker, hammered out an agreement to halt the "tit for tat" tariff game and to begin talks to lower tariffs and other trade barriers—a process that had already been launched in the TTIP negotiations. Business communities on both sides of the Atlantic strongly supported those talks, which were nevertheless suspended in 2016. The newly announced US-EU talks are slated to work to lower tariffs and other trade barriers, including bureaucratic roadblocks to industrial goods trade and conflicting regulations on drugs and chemicals. It is a good sign that both sides have, at least temporarily, retreated from the abyss and put an end to further tariff imposition, and are now returning to the negotiating table (Swanson and Ewing, 2018). The stakes are high. In 2017, US firms exported USD 283 billion of goods to the EU, which is double what they exported to China. US consumers purchased USD 435 billion of goods exported from the EU (Lynch and Paletta, 30 May 2018). Investment in the United States from the EU 27 totalled USD 259.6 billion in 2017, down from USD 439.5 billion in 2015, while Canada invested USD 66.2 billion in 2017 (DW, 2017). The EU and

Canada are thus critical investors in the US markets, so the risks of a trade war with it are a source of deep concern on both sides of the Atlantic.

48. Trade in digital services poses a key challenge for policymakers and negotiators, particularly as policy in this realm runs right into the matter of social and cultural preferences. The US Commerce Secretary, Wilbur Ross, has recently argued that the EU's General Data Protection Regulation has protectionist implications. That law requires all companies that use consumers' private information to request explicit permission whenever data is collected and to accord web users the ability to download a copy or have it deleted. Companies that fail to comply with these rules face stiff fines. European authorities have already launched several investigations of US firms that may not be in compliance. There is a very strong preference for privacy protection in Europe and the appeal of such protections appears to be growing in the United States as well, particularly in light of the revelations on how Cambridge Analytica and other companies including smartphone manufacturers used private data gathered from millions of Facebook accounts without the users' consent (Dance et al., 2018). Still, there is a cultural gap on privacy, and it is noteworthy that the conflicting preferences of voters and consumers can, in themselves, generate trade tensions. This can be tricky for government trade negotiators charged with tackling these complex matters.

49. A third area of serious transatlantic trade tension surrounds the decision by the Trump Administration to pull out of the Iran nuclear deal and reimpose trade sanctions on that country and on non-US companies that continue to do business with Iran. In practical terms, this means that those European firms that trade with Iran will be denied access to the US financial system. This has elicited sharp European complaints of extraterritoriality and further exacerbated mounting trade tensions within the Alliance. The European Commission, which intends to support the JCPOA as long as Iran is complying with its terms, has announced plans to make direct payments for oil to Iran's central bank and to revive a "blocking statute" from the 1990s that allows companies to ignore US sanctions with no consequences in Europe. That statute would prevent EU courts from enforcing US sanctions judgements. It would also allow companies to recover damages arising from sanctions from the person causing them and to offer euro credit lines to compensate for such sanctions. This, however, will probably not be sufficient to encourage large European firms to trade with Iran as many are active in the United States and would willingly pull out of Iran before abandoning the US market. The French oil company, *Total*, for example, will withdraw from Iran's South Pars gasfield unless the US government grants it a waiver (Peel, 2018). By contrast, French carmaker Renault, which does not sell cars in the US, remains in Iran despite the sanctions. European companies are concerned that Asia is poised to seize the Iranian market if the United States successfully manages to push European firms out (Fleming, 2018). This has now become a source of transatlantic tension.

50. Another sanctions crisis has emerged in the bilateral dispute between the United States and Turkey over the fate of a US pastor who has been held in a Turkish jail on charges of terrorism—charges that US officials have called groundless. In August President Trump doubled tariffs on steel and aluminium imports from Turkey and directly linked this action to the dispute. This has only reinforced the notion among many analysts that trade sanctions are now emerging as a "go to" tool of foreign policy. This tendency, in turn, is feeding pessimism about the viability of the current global trading order and its vulnerability to short-term politics (Kwong, 2018).

51. US business leaders are increasingly concerned about mounting tensions with key trade partners and allies. Myron Brilliant, the Executive Vice President of the US Chamber of Commerce, has warned of the risk of alienating US allies and the potential for a boomerang effect on the US economy. US business leaders, except those in the domestic steel and aluminium industry, are well aware that steel and aluminium tariffs have raised prices for a range of products in the automobile, beverage, farm equipment and food packaging sectors. The US steel industry has successfully objected to hundreds of requests for exemptions made by US companies that rely on specialised non- US steel products (Tankersley, 2018). It is worth noting that steel tariffs imposed by President George W. Bush in 2002 resulted in the devastating loss of 200,000 US jobs in steel-consuming and related sectors (Time Magazine, 2018). Many US manufacturers then

confronted difficulties in finding the high quality or specialised steel needed as input for in their production and were compelled to shift to sourcing finished parts from overseas and/or relocating domestic steel consuming facilities abroad (Global Steel Trade Monitor, 2017). Higher steel costs and retaliation by America's trading partners are factoring into decisions, like that taken by Harley Davidson, to offshore some production. A recent report by Trade Partnerships Worldwide, an economic consulting firm in Washington, D.C., found that President Trump's trade penalties and their resulting retaliation by foreign markets could increase the number of jobs in the steel and aluminium manufacturing industry by some 27,000 over the next one to three years. But these gains would be more than offset by a reduced net employment of about 430,000 jobs throughout the rest of the country (Kiley, 2018).

52. House Speaker Paul Ryan and a number of his colleagues on Capitol Hill on both sides of the aisle have openly opposed the recent tariffs and warned of unintended consequences. Addressing the decision to move ahead with tariffs on steel and aluminium imports from the European Union, Canada and Mexico, Mr Ryan said: “I disagree with this decision. Instead of addressing the real problems in the international trade of these products, today's action targets America's allies when we should be working with them to address the unfair trading practices of countries like China… There are better ways to help American workers and consumers. I intend to keep working with the President on those better options" (Watson, 2018). Congress plays a pivotal role in making US trade policy. Article 1, Section 8 of the United States Constitution gives Congress the power “to regulate commerce with foreign nations”. According to this so-called Commerce Clause, the power of Congress in these matters is exclusive. It will be interesting to see how Congress responds if the President opts to follow a protectionist rather than a liberalising course over the coming months. Because neither party is unified on the matter, it is not clear at this juncture if, how or when Congress will ultimately assert its authority on these current disputes.

53. Many of these tensions were revealed at the G7 Summit in Canada in early June when trade moved to the very top of the agenda. The summit was the most divisive in memory. Key US allies, aggrieved that they had suddenly been targeted for tariffs under the rubric of national security, were already in the midst of unveiling a series of retaliatory measures. A chair's summary, released by Canada after meetings between finance ministers and central bankers just prior to the Summit, noted concerns that “the tariffs imposed by the United States on its friends and allies, on the grounds of national security, undermine open trade and confidence in the global economy”. Canada's Finance Minister Morneau added that there had been a consensus among America's G7 partners that US actions had been “destructive to our ability to get things done.” US Treasury Minister Steven Mnuchin was then asked to convey the “regret and disappointment” of the G7 partners to President Trump (Fleming and Shubber, 2018).

54. Some have pointed to this situation as a sign that multilateral trading order is on the ropes and will soon be replaced by bilateral arrangements. But this is highly problematic. Bilateralism in trade lends itself to zero sum calculus when successful negotiations rely on a win-win spirit. Bilateralism also leads to arrangements that are generally trade-diverting rather than trade-creating. Trade diversion occurs when, because of a series of bilateral arrangements, countries lose the opportunity to import from the most competitive suppliers and/or sell to the highest paying customers. Economies as a whole thereby suffer so-called dead-weight losses. Many countries believe that a multilateral setting for talks provides more room for bargaining flexibility and coalition building. Such conditions are far more conducive to actual trade liberalisation. Bilateralism is thus not an attractive option for many states. Trade economists generally see bilateral solutions as inferior to multilateral approaches to trade and blame both the EU and the United States for edging away from multilateral trade negotiations under the auspices of the WTO. A trading system premised on bilateral trade arrangements would lead to all kinds of trade distortions. It would result in a “spaghetti bowl” of costly rules, arbitrary definitions of product origins, and a huge array of tariffs depending on product origin which, itself, is often difficult to determine given the international integration of production lines. Such approaches also undermine the principle of “most favoured nation rules”, “which under the WTO have ensured equal treatment for a broad band of countries” (Bhagwati and Panagariya, 2003).

55. A system of bilateral trading arrangements would also require an enormous bureaucracy to negotiate and administer. Instead of creating an easy way to navigate the international market, an international trading order riddled with bilateral deals would impose a confusing array of rules that would wrap exporters and importers in red tape. Such a system would set aside competition as the driver of trade while elevating the influence of lobbyists and other rent seekers. Since presumably these bilateral deals would not result in similar outcomes, varying tariff and quota requirements would distort trade and lead to sub-optimal outcomes which might compel, say, car companies, to source parts from suppliers which do not offer the best quality-price combinations. Productivity and profitability would suffer enormously as a result.

56. Forging regional blocs has emerged as a superior alternative to bilateralism, although these blocs can have trade-diverting impacts *vis-à-vis* countries outside the bloc. In November 2017, Japan and ten other Pacific countries including Canada agreed to move forward with a vast Pacific regional trading agreement. At Canada's request, the new initiative is called the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), and the initial goal is to fully ratify the deal by 2019. The agreement seeks to eliminate tariffs on 95% of goods traded in a bloc of 500 million consumers that account for USD 13.5 trillion in income today. The agreement has scaled back the investor-state dispute settlement provisions that the United States had been promoting in the TPP talks, and it will afford governments more regulatory leeway than the US had wanted. US companies had been pushing for the right to sue governments, which many governments opposed. The extension of copyright and intellectual property protections, something the United States had long promoted, has also been weakened. If ratified, the CPTPP would be one of the world's most important and comprehensive trade agreements. It is noteworthy that the Pacific region has opted to move ahead without the United States and without some of the principles that the US traditionally advances. The signatories, however, have agreed to leave the door open for the United States to join the arrangement at a later date, although President Trump has indicated that this will not happen during his administration (Donnan, April 2018).

57. There is also uncertainty about the future of NAFTA, which has bound Canada, Mexico and the United States in a very open trading arrangement since 1994. President Trump has stated that the United States hopes not to have to pull out of the agreement but has been very critical of its terms. Negotiations are underway to update NAFTA, although there has been little apparent progress. The primary focus of talks involves rules of origin and how to measure the trade balance among member countries, dispute settlement mechanisms and a sunset clause which would see the agreement expire after five years unless the parties explicitly agree to extend it. The Trump Administration supports stricter rules of origin clauses and the inclusion of a sunset clause while opposing dispute settlement panels. Both Mexico and Canada have warned that a sunset clause would undermine investor confidence as investors work on time horizons that significantly exceed five years. Canada and Mexico both feel that abandoning dispute settlement panels would undermine the enforcement of agreed trading rules. Currently, for goods to qualify for NAFTA's duty exemptions, roughly 60% of the product's inputs must be from North America. The US Administration has called for a minimal level of US content—something again that both Mexico and Canada oppose.

58. It is not clear that there is strong support for these initiatives in the United States either. The automobile industry is particularly opposed to the proposed changes that would radically undercut their current supply chains models, and the US Chamber of Commerce has warned against "poison pill" proposals that might undermine the entire NAFTA agreement (Carmichael, 2017). The Trump Administration's imposition of steel and aluminium tariffs on Canada and Mexico has further setback NAFTA talks and has elicited retaliatory measures from both countries. Moreover, several days after those tariffs were announced, the Trump Administration revealed that it would henceforward seek to deal with Canada and Mexico bilaterally rather than in tripartite talks—something again that both Mexico and Canada vigorously oppose (Swanson and Tankersley, 2018). It is worth noting that the Congress has not granted President Trump the Trade Promotion Authority necessary to negotiate

bilaterally with Canada and Mexico in the context of NAFTA and that the President is therefore is not currently authorised to conduct bilateral talks with them (Webber, 2018).

59. The US Administration has also communicated to its hemispheric partners that if it leaves NAFTA, it will not resort to WTO trading rules and that both Mexico and Canada will therefore confront significantly higher tariffs on goods exported to the United States. The Canadian negotiating team refused to include a non-conforming measure that would have compelled Canada to apply the “most favoured nation” principle to its NAFTA partners.

60. This apparent move away from structures that have so ably facilitated international trade liberalisation has also raised questions about the future of the WTO. The US Administration has been particularly critical of the WTO panel system that adjudicates trade disputes among WTO members. Panel decisions are binding—something that US Trade Representative Robert Lighthizer and the administration strongly oppose. The United States has blocked two appointments to the appellate court, and this triggered a warning from EU Trade Commissioner, Cecilia Malmström, that the administration policy could result in “killing the W.T.O. from the inside” (Porter, 2017). Although the United States has won more than 90% of disputes it has had adjudicated at the WTO, it has lost a similar percentage of cases launched against it. Robert Lighthizer has also declared that the WTO has failed to rein in China’s mercantilist policies and its refusal to uphold patent protections (Donnan, 10 November 2017).

VI. TRADE AND SECURITY

61. Although trade is largely about economics, it also concerns state relations and security. The conduct of trade demands a modicum of good relations among trading partners as well as a shared agreement on the rules of the game. Mutually beneficial trade relations help bind together the state system. As President Franklin Roosevelt’s long serving Secretary of State Cordell Hull once recalled: “When the war came in 1914, I was very soon impressed with two points. [...] I saw that you could not separate the idea of commerce from the idea of war and peace [...] [and] that wars were often largely caused by economic rivalry conducted unfairly. [...] to me, unhampered trade dovetailed with peace; high tariffs, trade barriers, and unfair economic competition, with war. Though realising that many other factors were involved, I reasoned that, if we could get a freer flow of trade—freer in the sense of fewer discriminations and obstructions—so that one country would not be deadly jealous of another and the living standards of all countries might rise, thereby eliminating the economic dissatisfaction that breeds war, we might have a reasonable chance for lasting peace” (Hurlburt, 2016)

62. Cordell Hull and the architects of the post-war international order recognised that protectionism had been a critical factor in deteriorating diplomatic relations in the run-up to World War II. They were determined to make free trade a central plank of the emerging global security order. The Cold War only reaffirmed the importance of open trading relations among Allies. With strong US leadership, tariffs and quotas were progressively reduced both in Europe and in North America. Trade became a critical engine of extraordinarily rapid economic recovery which, in turn, made it possible to underwrite expensive national defense programmes. The newly formed European Communities made trade among Allies a central plank of reconciliation on the continent. As for Asia, US leaders recognised how crucial Japanese recovery would be to Asian stability and the degree to which open trade would be essential to this project. The GATT system ultimately helped multilateralise these liberalising trends both by managing trade disputes and by ensuring that the benefits of free trade could be extended across the world. The genius of US policy was that it recognised that the prosperity created by a free trade order would both foster political stability and lower international tension. As long as this win-win dynamic was in place, there would be a reduced incentive to upend the international order.

63. Unfortunately, over the last 20 years, the perception that trade constitutes a win-win proposition and naturally bolsters domestic and international security has waned. Job losses in the manufacturing sector in industrialised countries are increasingly blamed on trade, even when trade is often not the determining factor. Moreover, some of the greatest beneficiaries of international trade today are considered rivals rather than partners.

64. China, for example, has greatly benefitted from the international trading order. But trade and prosperity have not made China democratic, even if that country is decidedly more plural than it was during the so-called Cultural Revolution. Trade has, however, increased China's stake in a stable international economic order even if it remains a formidable rival to the West and one now capable of financing its very large military complex. NATO countries are all concerned about its poor record on intellectual property protection and its implicit state subsidies to some of its industries. But trade tensions between the United States and its allies make it far more difficult to focus on the challenge from China, at least in a collective fashion. China is demanding a greater say in international economic institutions—many would argue rightfully so given its weight in the international economy— and it will also likely become a far more powerful shaper of the East Asian economic order after the United States pull out of the Trans-Pacific Partnership trade talks, and agreement that also excludes China. So the Chinese example of how trade and security interact provides a mixed message. It has both increased China's stake in the international order while empowering it to shape that order to better conform to its interests, for example, through the One Belt One Road Initiative or through its cooperation with the members of the Association of Southeast Asian Nations (ASEAN) and the Regional Comprehensive Economic Partnership (RCEP) (Hurlburt, 2016).

65. Even though the TPP and TTIP were informed by compelling strategic visions, in practical terms they focused on reducing impediments to trade. Still, each offered new ways to manage diplomatic relations among allies and partners. East Asia, for example, is a highly fragmented region lacking an overarching alliance framework capable of containing rivalries and building stability. Over decades, the United States instead erected a series of bilateral security partnerships for that purpose. But it was long felt that a broader multilateral approach that extended into economic policy was needed to foster a shared-stake regional security, particularly in the face of a rising China. The TPP, which excluded China, offered a framework, at least, for regional commercial cooperation. But the hope was that the habit of working together would spill over to the diplomatic and security realms. The Trump Administration, however, has now adopted a bilateral approach to trade in the Pacific (Donnan and Sevastopulo, 2018).

66. The situation for the transatlantic space is significantly different. NATO has long provided a common security framework for the United States, Canada and much of Europe. At the same time, multilateral trade deals have lowered barriers to trade between Europe and the United States, while NAFTA has done the same for the United States, Canada and Mexico. In the case of the now-suspended TTIP talks, the goal had been to reinforce the transatlantic relationship by further deepening trade ties between the United States and the EU. Unfortunately, strong resistance on both sides of the Atlantic emerged, in part, because these talks addressed issues that traditionally are not considered trade matters as such, but rather concern regulatory issues which can also be construed as non-tariff barriers. Those talks focused on three main areas: market access, specific technical regulations and broader trading rules. The British decision to leave the EU and mounting public opposition to TTIP led to a halt in the talks in 2016. In Europe, a coalition of populists, farm groups, environmentalists and anti-globalisation activists drove the opposition to the talks (Barker, 2016). As suggested above, the recent meeting between President Trump and Jean-Claude Juncker has for the moment eased mounting transatlantic trade tensions with the promise of new talks. But the specific form these take and the outlook for progress remain to be seen. It is worth noting here that Canada and the EU have completed a free trade agreement—the so-called EU Canada Comprehensive Economic and Trade Agreement (CETA) —which provisionally entered into force in September 2017.

67. A number of strategic analysts worry that the foundations of the security-trade nexus are now under pressure. Whereas trade and security were once generally seen as mutually reinforcing—particularly among allies and friends—that relationship today seems less firm. Recent tensions over steel and aluminium could mark a paradigmatic shift in how trade and security are linked in North America and Europe. Much will depend on how the politics are handled.

VII. RECOMMENDATIONS

68. The Western commitment to open trade unambiguously diminished after the financial crisis of 2008. From a position of confidence and strength, many countries in the West appear to have adopted more tentative and defensive postures toward international trade. Although this view belies the preponderance of evidence, it has increasingly captured the imagination of some voters who have suffered economically as a result of shifting economic paradigms, technological advances, educational shortcomings and, more generally, sub-optimal public policy. The risk is that trade protectionism, unilateralism and mercantilism could inspire wealth-destroying policies that would shrink trade, undermine investment, raise prices, kill jobs and poison international relations.

69. Leadership truly matters. The failure of national political leaders to build and sustain a new consensus around the virtues of trade and to construct commercial policies premised on those virtues could have devastating economic impacts.

70. The invocation of protectionist policies invariably triggers retaliation. Trade disputes tend to ratchet upward, particularly when the protectionist impulse is seeping into national politics. Burgeoning trade battles would also have a devastating impact on the global economy and would trigger new geopolitical tensions while weakening solidarity among allies. Moreover, all evidence suggests that poorer people would suffer the most in such a scenario (Fajbelbaum and Khandelwal, 2016). An all-out effort is therefore needed now to prevent a trade war over steel, aluminium and automobiles. Going down that path would be very harmful to the United States and its allies and it would move the world economy in precisely the wrong direction.

71. It is high time to recall the basic principles of international trade. Firstly, a trade deficit is not in itself a bad thing. It can simply be a manifestation of rapid economic growth or restructuring, which requires significant importation of capital goods. Trade balances reflect broader macro-economic phenomena related to savings and investment and are a natural consequence of dissavings and borrowing. Trade balances can also be shaped by misaligned exchange rates by focusing policy on trade balances, *per se*, one thus risks targeting the manifestation of the illness (or source of health) rather than the cure. To assume otherwise is to dismiss overwhelming evidence that trade is a generator of prosperity, jobs and economic dynamism. Citing trade imbalances as the source of economic woes and calling for protectionist solutions can be politically popular even if protectionism might best be characterised as a shortcut to economic ruin. Economists often argue that when seeking to resolve market deficiencies, policymakers are better off focusing their efforts most directly on the source of the problem. Restricting trade to reduce unemployment in a given sector, for example, is the equivalent of using a sledgehammer to crack a nut. The long-term damage will far outweigh any short-term sectoral benefits. Far more nuanced approaches are needed, such as long-term strategies to raise productivity.

72. Indeed, “whole of government” approaches are needed. Trade policy is no longer the domain of trade ministers alone. Redistributing some of the benefits of trade, for example, to underwrite education and training programmes can help prepare workers for future markets rather than leaving them untrained and vulnerable to paradigmatic changes in global markets. Ensuring the public’s skillset is relevant to market conditions, for example, will help position societies to exploit the full potential gains to be had from trade.

73. Those workers who lose in trade thus need access to the tools and resources to reset their careers. Life-long education is increasingly recognised as a vital pillar of a successful internationally oriented economy. A working population that knows that society has its back as it participates in the wealth-generating global economy is more likely to embrace rather than fear that economy. This is precisely the spirit that animates the globally-oriented Nordic countries. These countries welcome rather than fear the world economy, and they benefit enormously as a result. Their high-quality education systems are structured to teach citizens how to flourish in this global setting. These countries ensure that those who suffer setbacks in the dynamic and competitive global market are both taken care of in the very short term and helped to adjust to paradigmatic economic change over the longer term. In this way, social spending to support the safety net might be best seen as an investment, the rewards for which are reaped in the global economy. Social anxieties are also a primary hindrance to the societal embrace of trade. And while those anxieties are a tempting target for political opportunists, it is actually far better to relieve them through innovative and proactive policies rather than undercutting the trading systems which actually generate prosperity. The OECD report, "Making Trade Work for All", provides some very practical guidance on how states might best structure these approaches.

74. Education and training are key to building societies that approach globalisation with confidence. Students need to develop the analytical, linguistic, and cultural skills for the future economy. This requires a leap of imagination on the part of educators and policymakers. In 2018, the OECD will launch an international assessment of how school systems across member countries and beyond are faring in developing global competencies in young people. This will provide an initial assessment on how education systems are preparing students to function in a more integrated world. Policymakers should pay attention to the results once the assessment is concluded. It will provide a valuable evidence-based yardstick for governments and educators seeking to make school curricula relevant to societies that aspire to flourish in an integrated global economic system. It will also provide broad guidance on best practices that could be useful to school administrators, teachers and policymakers alike.

75. It is also important to develop programmes and networks to help small and medium firms exploit international market opportunities. These firms often lack the know-how, connections and staffing to operate in international markets and, not surprisingly, they are underrepresented in the global economy. Much can be done to reverse this, including reducing burdensome regulations that effectively price these firms out of those markets. Organisational structures that help these firms pool resources to facilitate access to international markets can be particularly fruitful. Related to this is the need for readily accessible infrastructure that facilitates participation in global markets (OECD, 2018).

76. Trade policy is no longer simply the responsibility of trade ministers alone. They are in no position to conduct labour, education, migration, development, tax and environmental policies on their own. All these sectors bear directly or indirectly on how countries manage trade policy and conduct trade negotiations. Whole of government approaches are needed to build an open global economy. This is also in keeping with emerging approaches to growth including inclusive and sustainable development frameworks. When the benefits of economic growth accrue to an increasingly narrow sector of society, the risk of social and political tensions mounts, and economies begin to underperform. Rising economic inequality places a cap on growth potential simply because this becomes a constraint on aggregate demand. Macroeconomic, financial and trade policies can be structured to create the conditions for more inclusive, broadly-based and sustainable growth. This is all the more important at a moment when recent technology trends appear to be concentrating rather than diffusing wealth. Preparing society for the nascent fourth industrial revolution may be the most effective means to ensure that the gains from trade and economic growth are widely shared rather than narrowly hoarded (World Economic Forum, 2018).

77. Most economists would argue that moving away from a multilateral trading order towards bilateralism would be a mistake. It would burden the global trading system with red tape, undercut global value chains and trigger trade diversion, all of which would limit the full prosperity-generating potential of trade. Bilateralism, moreover, will never resolve structural trade imbalances that simply reflect savings-investment imbalances. It is thus time to revitalise multilateral trade negotiations to give a long-term boost to global growth.

78. Multilateral trading arrangements need strong institutions to uphold the rules of the game. Although it is not perfect, the WTO and its panel-based dispute resolution system is charged with upholding this pillar of a rules-based global economic system. If it did not exist, it would have to be invented. This organisation is now under attack by some who reject the very principle of multilateralism. Those who recognise that the multilateral trading system represents a critical catalyst for growth, innovation and peaceful win-win interaction among states need to be prepared to defend it with great vigour and a degree of imagination. Of course, that does not rule out the desirability of meaningful reform. The WTO needs to cope with many of the new challenges to the global trading order including the rising importance of digital economy. A strong rules-based order will only enhance the leverage of states and market actors who are victims of unfair trade practices. Along these lines, North American and European concerns about property rights protection, industry subsides and overcapacity in countries like China are legitimate and merit attention (May, 2018). The Global Forum on Steel Excess Capacity, created by the G20, has offered a new model for how to manage such disputes without resorting to trade wars. It has worked for the removal of subsidies and other market distorting measures that have created a glut of steel in world markets, which has been a source of mounting trade tension.

79. Efforts should be made to improve international trading rules in order to expand the beneficiaries of trade, to give voice to those whose voices are often not heard in public discussions about trade and to make the system more free, fair and open. Much of this can be achieved by better implementing WTO rules and applying free trade principles in areas, such as agriculture, which have long escaped the logic of liberalisation. International cooperation on matters pertaining to competition policy could also help. Cooperation is also needed to govern the global digital economy which has often avoided the agreed-on rules of the game. Likewise, a consolidated international effort is needed to resolve the problem of base erosion and profit shifting (BEPS) which has allowed multinational firms to avoid paying taxes in local markets from which they derive profits. Labour standards and working conditions have long been excluded from trade discussions. But there is room to do more here as well, and much can be done outside of formal trade talks. This effort is essential to lower public anxiety about trade. Finally, there is ample room to make trade negotiations more transparent and open. Public suspicions about trade are often fueled by secret negotiations where many imagine their own interests are being sold out. Transparency can help alleviate those kinds of concerns (OECD, 2017).

80. The United States and Europe have traditionally shared many fundamental assumptions about trade and its benefits. The TTIP framework was supposed to take the trade relationship to a new level of integration and should be revived. Allied countries should reinforce the commercial partnership. The collective weight of a shared Euro-Atlantic vision for trade is all the more important as the Chinese are advancing a very different view of the global trading system. There is ample room for North America and Europe to advance a shared vision for trade well beyond the Euro-Atlantic area.

81. In this regard, it makes sense to create an informal transnational parliamentary caucus of democratic societies dedicated to defending and improving the liberal trading order. Parliamentarians have a critical role to play in developing trade policy and building public consensus to support it. Their efforts could be strengthened by reaching out to elected leaders who share those goals.

82. Finally trade protectionism never occurs in a vacuum. Unilaterally imposing tariffs or quotas is a shortcut to triggering a trade war. Economic history points to the destructive nature of “beggar thy neighbour” trade wars. No country wins and both international and domestic markets can be severely constricted when this dynamic is unleashed. The experience of the 1930s remains instructive. A dangerous process of deglobalisation was unleashed at a time when a financial crisis made it impossible for the long-reigning hegemonic power, Great Britain, to reassume responsibility for the broader trading order. The rising power, the United States, was not yet politically prepared to take on that burden. A period of competitive devaluations and rising tariffs and quotas followed which essentially amounted to a chain of ‘beggar thy neighbour’ policies that choked off growth in the global economy and led to a degradation in state relations. Some analysts have discerned parallels with the current situation and there are worries that mounting trade strife today could translate into more serious security risks in the future (Barbieri, 2016). In short, unilaterally prioritising national economic growth with no consideration for broader systemic obligations will poison the well for all countries including the most powerful, and it will paradoxically undermine growth for all. At the end of the day, it remains the essential task of leaders to mind the lessons of history.

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