

# Econ 340

## Lecture 2

### Current Tensions in the International Economy



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LECTURE 2: TENSIONS

# Announcement

- I will not be holding my usual office hour tomorrow, Sep 12.

# Clicker Question

Are you here?

- ✓ a) Yes
- b) No
- c) I'm not sure

# Outline: Current Tensions in the International Economy

- NAFTA
- Brexit
- Trade War
  - Metals
  - China
  - Other?
- WTO
- Currencies

# NAFTA

- What is it?
  - North American Free Trade Agreement
  - Does many things but most important:
    - Zero tariffs on most trade between US, Canada, and Mexico
    - Rules of Origin (ROOs) to qualify for zero tariffs
  - History
    - Negotiated under George H. W. Bush 1992
    - Enacted under Bill Clinton, took effect 1994
  - We'll study it more later in the course

# NAFTA

- NAFTA's Effects
  - Huge expansion of trade in North America
    - Resulting gains from trade, as we will study
  - Growth of supply chains in manufacturing
  - Some US loss of jobs to Mexico
    - But no fall in overall US employment
  - Bad reputation among
    - US labor unions
    - Some politicians

# NAFTA

- NAFTA and Donald Trump
  - Trump opposed it even in 1993
    - “The Mexicans want it, and that doesn't sound good to me.”
  - As candidate for President, called it “The single worst trade deal ever approved in this country”
  - After he became President
    - Threatened to pull out of NAFTA
    - Initiated “Renegotiation”



# NAFTA

- NAFTA Renegotiation
  - Began negotiating May 18, 2017
  - Made little known progress until August 2018
  - US, Mexico, and Canada signed agreement November 30, 2018
    - Tighten ROOs, especially on autos
    - Require minimum content from high-wage labor
    - Review the agreement every six years and renegotiate if necessary
  - Renamed (by Trump) USMCA





# NAFTA

- Still needs to be ratified by all three
  - Mexico ratified June 19, 2019
  - Canada is waiting for US
  - Ratification by US Congress is uncertain
    - Democrats control House and are skeptical
    - Want strong protection for labor
- Stay tuned

# Clicker Question

Under what US President was NAFTA negotiated?

- a) Ronald Reagan
- ✓ b) George H. W. Bush
- c) Bill Clinton
- d) George W. Bush
- e) Barack Obama

# Clicker Question

What is a Rule of Origin?

- a) A prohibition on employing illegal immigrants
- b) A requirement for registering to vote
- c) A restriction on who can invest in a country
- ✓ d) A specification of what qualifies for zero tariff
- e) A law against exporting imitations

# Outline: Current Tensions in the International Economy

- NAFTA
- **Brexit**
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# Brexit

- What is it?
  - Exit of the United Kingdom from the European Union
  - Voted in referendum June 23, 2016
  - UK-EU negotiations reached a “Deal” in November 2018, covering:
    - Rights of EU/UK citizens in UK/EU
    - Money UK to pay EU for exit
    - The “Irish Backstop” to avoid a hard border
    - Much else



# Brexit

- Fate of the Deal
  - Voted down 3 times in UK Parliament
  - Brexit, scheduled for Mar 29, 2019, now delayed to Oct 31, 2019
  - Prime Minister May, who made the Deal, driven from office
  - New Prime Minister Boris Johnson (as of July 24, 2019) vows to leave EU with “no deal” if EU won’t revise the Deal.

# Brexit

- What if No Deal Brexit?
  - Tariffs go up on UK trade with EU and EU's FTA partners
  - Many EU commercial and other agreements for UK businesses and others cease to hold
  - Many other challenges

# Brexit

- No Deal Brexit (cont.)
  - UK citizens resident in EU, and EU residents in UK, may have to leave
  - Border between Northern Ireland (part of UK) and Ireland (part of EU) re-erected
    - Customs officers to collect tariffs both ways
    - Physical border may undermine the peace agreement (Good Friday Agreement) that ended the “Troubles” in Northern Ireland

# Clicker Question

If the UK and EU do not reach a deal on Brexit, on October 31, 2019

- a) EU will levy tariffs on UK exports
- b) UK citizens resident in EU may have to leave
- c) Canada will levy tariffs on UK exports
- d) Ireland will levy tariffs on Northern Ireland
- ✓ e) All of the above

(Canada has an FTA with EU,  
which will no longer apply to UK.)

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# Trade War

- What is it?
  - Tariffs and retaliation
    - US tariffs increased on imports from others, and
    - Increased tariffs by others on US exports
  - Two main parts (so far)
    - Tariffs on metals
    - Tariffs on China
  - Other
    - Threat of tariffs on cars
    - Threat of more tariffs on Mexico

# Trade War

- Metals: Events
  - Apr 20, 2017: Trump initiates “national security” investigation of metals imports
  - Mar 1, 2018: Announces tariff on all countries
    - 25% on steel
    - 10% on aluminum
  - Mar 8-22: Announces exemptions for some countries
  - Mar 23: Tariffs go into effect

# Trade War

- Metals (events continued, 2018)
  - Mar 28: S. Korea agrees to reduce steel exports to US in return for being exempt from the tariffs
  - Apr 2: China puts tariffs on \$2.4 billion of US exports
  - Jun 1: US extends tariffs to EU, Canada, & Mexico



# Trade War

- Metals (events continued, 2018)
  - Jun 1: EU files WTO complaint against US metals tariffs (as do others around this date)
  - Jun 22: EU retaliates on \$3.2 billion of US exports
  - Jul 1: Canada retaliates on \$12.8 billion of US exports

# Trade War

- Metals (events continued, 2018, 2019)
  - Jul 16: US files complaint in WTO against retaliation by Canada, China, EU, Mexico, and Turkey
  - Aug 10: Trump doubles tariffs on Turkey due to Turkey's currency depreciation
  - May 17, 2019: US removes tariffs on Canada and Mexico

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# Trade War

- China
  - The issue
    - Chinese theft of technology
    - China's requirement that investors enter joint ventures, giving technology ownership to Chinese partners
  - US, EU, and others had complained of this for some time, but had done nothing
    - Both filed complaints in WTO
      - US Mar 23, 2018
      - EU Jun 1, 2018

# Trade War

- China: Events
  - Aug 18, 2017: US initiates Section 301 investigation of “China’s laws, policies, practices, or actions”
  - Mar 22, 2018: Report finds unfair trade practices; Trump plans:
    - Tariffs on \$60 billion of China exports
    - Initiation of WTO dispute
    - New rules on Chinese investment in US

# Trade War

- China: (events continued, 2018)
  - Apr 3-Jun 18: Trump and China threaten tariffs on increasing amounts of trade
  - Jul 6: US places tariffs on \$34 billion of China exports; China does the same on \$34 billion
  - Aug 23: US and China both place tariffs on \$16 billion more
    - China adds to its earlier complaint to WTO

# Trade War

- China: (events continued , 2018)
  - Aug 23: US and China impose 2<sup>nd</sup> round of tariffs
  - Sep 24: US and China impose 3<sup>rd</sup> round of tariffs
  - Dec 1: Trump & Xi meet at G20 and agree on talks and truce
    - (to stop raising tariffs, not to remove them)

# Trade War

- China: (events continued, 2019)
  - May 10, 2019: Trump raises 10% tariffs on \$200 billion to 25%
  - Aug 13: Trump plans tariffs on \$300 billion more (thus covering almost all) in two rollouts
  - Sep 1: Tariffs on first rollout
  - Talks planned for some time in September
  - Dec 15: Tariffs (planned) on second rollout



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# Trade War

- Cars?
  - May 23, 2018: Trump initiates “national security” investigation of auto imports
    - Trump considering tariffs of 25%
  - Jul 25: Trump agrees a “truce” with Jean-Claude Juncker, head of the European Commission and
    - US & EU will work toward lower tariffs
    - EU to buy more soybeans and gas from US
    - Hold off on further tariff increases

# Trade War

- Cars?: (events continued, 2018)
  - Aug 30: EU offered to cut auto tariffs to zero if US would do the same.
  - Trump's response:
    - “It's not good enough.”
    - “Their consumer habits are to buy their cars, not to buy our cars.”

# Trade War

- Cars?: (events continued, 2019)
  - Feb 17, 2019: Commerce report recommends tariffs
  - May 17: Trump delays decision until Nov 13

# Trade War

- Mexico?
  - May 30, 2019: Trump announces tariffs of 5% on all Mexican exports
    - To rise each month by 5% more
    - Unless Mexico acts to stop migration to US
  - Jun 7: Trump calls off the threatened tariffs, after signed agreement with Mexico

# Trade War – Who Wins?

- Who will “win” the trade war?
  - Nobody! Everybody loses from tariffs
  - Trump sees it “easy to win” because he measures success from trade deficit: If that falls, we win.

# Trade War – Who Wins?

- Reading by Legrain (Apr 2018) points out that US has much more to lose than Trump realizes
  - Much that we import from China
    - Is made from US inputs
    - Are inputs we need to be competitive
  - Tariff would cut China's exports by 0.05% of GDP, a “pin prick”
  - China has options beyond tariffs: regulations on US firms
  - China can target US vulnerabilities: aircraft and soybeans
  - By bypassing the WTO, Trump has yielded the “high ground” to China

# Trade War – How to Stop It

- Reading by Hillman (Aug 2019) argues that US Congress has power to stop this
  - Constitution gives power over tariffs to Congress, not President
  - Congress passes laws years ago (Section 301 and 232) delegating some power to President
  - Congress could amend these laws to limit Presidential power.



# Clicker Question

How big are Trump's tariff on metals?

- a) 10% on both steel and aluminum
- b) 10% on steel; 25% on aluminum
- ✓ c) 25% on steel; 10% on aluminum
- d) 25% on both steel and aluminum

# Clicker Question

What reason is given for Trump's tariffs on China?

- a) That imports are hurting US producers
- b) National security
- ✓ c) Unfair acquisition of intellectual property
- d) Dumping
- e) China's trade surplus

# Clicker Question

What reason is given for Trump's threatened tariffs on cars?

- a) That imports are hurting US producers
- ✓ b) National security
- c) Unfair acquisition of intellectual property
- d) Dumping
- e) China's trade surplus

# Clicker Question

Which is a reason why Legrain thinks China will win the trade war?

- a) Exports that would fall due to US tariff would be a “pin prick”
- b) US tariffs on imports are also on US exported inputs
- c) US tariffs will make some US industries less competitive
- d) China’s government has options other than tariffs
- ✓ e) All of the above

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# World Trade Organization

- Trump's actions threaten the WTO
- According to Barfield Trump has said
  - “The WTO is designed by the rest of the world to screw the United States”
  - “We are going to renegotiate (the WTO agreement) or we are going to pull out”

# World Trade Organization

- Can Trump pull out of WTO?
  - Probably not. Congress would have to change legislation
- How Trump can undermine the WTO
  - By refusing to allow the appointment of new judges on Appellate Body
  - By claiming decisions are invalid
  - By not engaging in WTO negotiations
  - By ignoring its rules

# World Trade Organization

- Trump's latest complaint about WTO (see Swanson, Jul 2019)
  - WTO grants privileges to “developing countries”
  - It lets countries decide for themselves whether they are developing: nearly 2/3 say they are, including
    - China (world's largest exporter)
    - Several countries that have become rich, such as Singapore



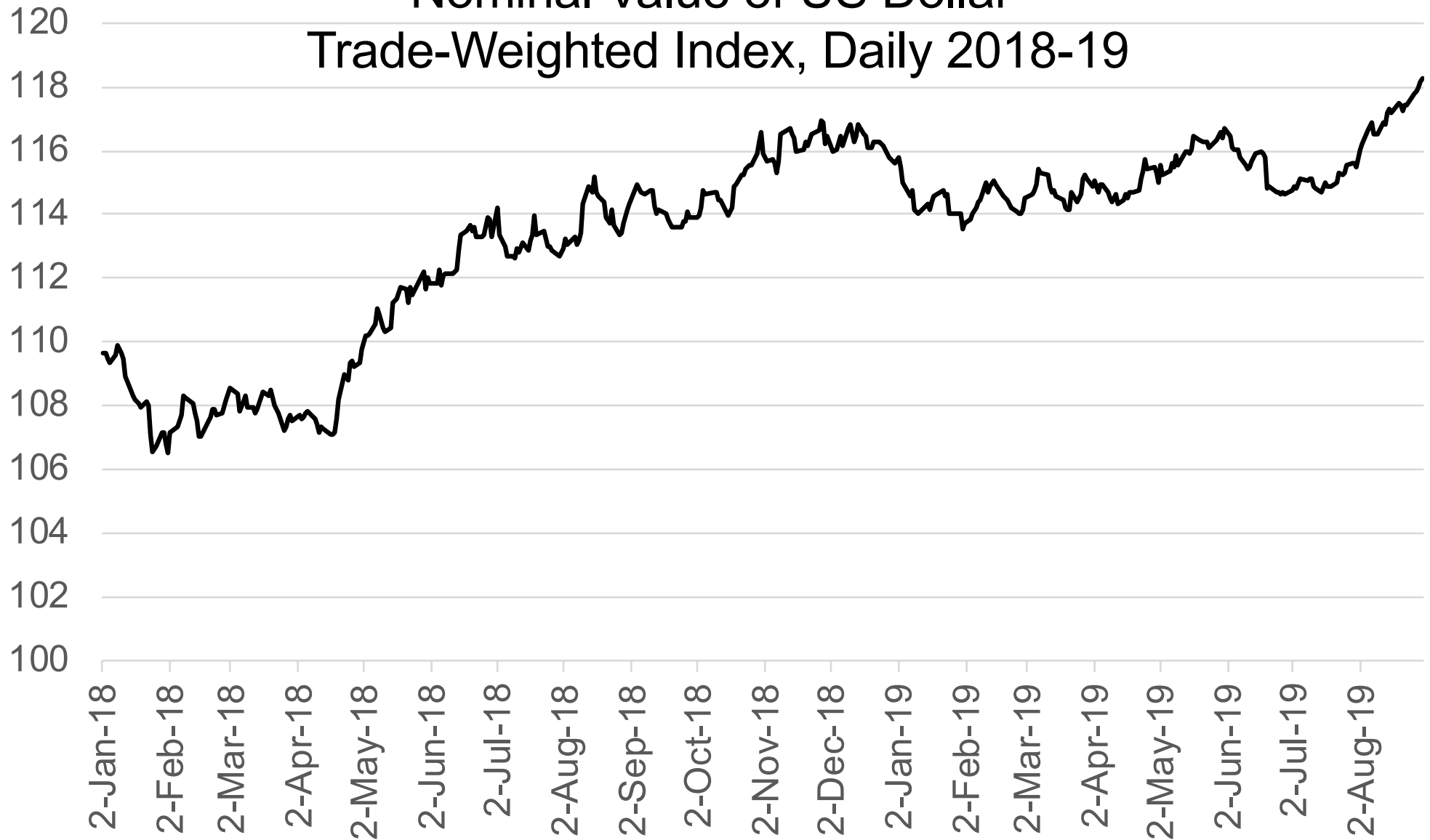
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# Currencies

- US dollar has risen about 7% since April 2018 against an average of other currencies
- Trump's response (*FT* 7/20/18):
  - “China, the European Union and others have been manipulating their currencies and interest rates lower, while the U.S. is raising rates while the dollars gets stronger and stronger with each passing day — taking away our big competitive edge. As usual, not a level playing field,” he said in a tweet.

## Nominal Value of US Dollar Trade-Weighted Index, Daily 2018-19



# Currencies

- Is Trump right that other currencies have been falling?
- Yes, since US started raising tariffs in Apr 2018:
  - Euro fell from \$1.23 to \$1.10, or 10%
  - Renminbi fell from \$0.157 to 0.139, or 11%

# Currencies

- Are these changes deliberate?
  - I.e., are these “currency manipulation”?
  - Do they intervene in exchange markets to manage their currencies?
    - Euro: No
    - Yuan: Yes, but to reduce fluctuations, not to push the currency down.
    - Do they use interest rates for that?
      - Only by not raising rates when US does

# Currencies

- Chinese currency manipulation
  - We'll study this more later in the course
  - China certainly has manipulated its currency in the past, to keep its value from rising
  - They are not doing that now
  - But some say they could be acting to push their currency up if they wanted to. (See Newmyer)
  - Most recently (Aug 5, 2019, see Irwin) Trump
    - Declared China a "currency manipulator"
    - Hinted that the US might intervene in the market itself
    - His threats have actually caused the dollar to rise

# Clicker Question

What has Trump done that undermines the WTO?

- ✓ a) Block appointment of new judges
- b) Prevent China from becoming a member
- c) Persuade allies to vote in favor of US in disputes
- d) Pull the US out of the organization
- e) Refuse to participate in biannual WTO ministerial meetings

# Clicker Question

How has the value of currencies changed since Trump started increasing tariffs?

- a) The dollar, euro and yuan have all fallen
- ✓ b) The dollar has risen while the euro and yuan have fallen
- c) The dollar and euro have risen while the yuan has fallen
- d) The dollar has fallen while the euro and yuan have risen
- e) The dollar and yuan have fallen while the euro has risen



# Clicker Question

How often, prior to Aug 2019, has the US declared China a "currency manipulator"?

- ✓ a) Never
- b) Once
- c) Twice
- d) More than twice

# Next Time

- Sep 16: Comparative Advantage and the Gains from Trade
  - What causes countries to export and import?
  - Why do they gain from trading?
  - The “Ricardian Model” of International Trade

