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Speaker: Robert Koopman, World Trade Organization, Switzerland
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Trade Wars: The Global Menace

International Economics Series

In his lecture at SAIS, Dr. Robert Koopman discussed the direct and indirect effects of trade war and trade diversion, the response of policy makers, the origins of global trade conflict, and the current state of global trade policy. Dr. Koopman is Chief Economist at the World Trade Organization and provides analysis and advice to policy makers to improve economic efficiency, growth and development, as well as promote a smoothly-functioning global trading system. While the direct, day to day effects of trade war can be small, the biggest impacts are often indirect and long-term. The reason for the longer term effects is the surge in uncertainty caused by trade wars.

This increased uncertainty affects consumption and investment which are two components of aggregate demand. For instance, businesses will delay building plants or creating new products which in turn affects consumer confidence. Moreover, a negative investment shock lowers long term growth. While tariffs and rising trade costs cause a lot of trade diversion and some fragmentation of a fairly globalized economy, a negative investment shock lowers long term growth and a technology war could fragment the world digital economy into two or three spheres--China, the United States, and Europe. The major impacts of rising tariffs are the inefficiencies and deadweight losses that accumulate over time. With rising tariffs and trading costs, trade is diverted to other, less efficient countries.

The impact of the trade war between China and the United States affects world trade in general. But it is not the only spat; trade between Korea and Japan has been significantly disrupted in their trade dispute, particularly since Korea sources many of its imports from Japan. They are also caught in the middle between the US and China trade conflict. Additionally, members of the WTO might complain that the agreement signed between the U.S. and Japan does not comply with the WTO free trade agreement disciplines (Article XXIV). Long term risks of these growing tensions include a decline in trust in established institutions; in many ways, uncertainty has reached unprecedented levels in the post-war period and is creating global economic discomfort.

According to Dr. Koopman, this leads to a series of problems. The negative impacts of the trade war include an accumulation of foregone income, a decrease in consumption, and a lowering of GDP. Dr. Koopman made a distinction between GDP and potential GDP. While GDP can still continue to rise, potential GDP will start to decline with uncertainty and it will become harder to recover to the higher growth scenarios. In any event, potential GDP is a somewhat elusive factor as most policy-makers do not consider it to be a major factor in their political calculus.

The OECD recently reported expected growth rates at 2.9%, recently adjusted downwards mostly due to the uncertainty rising because of the trade conflict affecting investment and consumption behavior. Following uncertainty, growth rates of trade and industrial production have fallen, marking slowdowns for advanced economies.

Trade conflict began after the 2008 financial crisis that led to unbalanced growth, including by sector, demographics, regions, and households. Furthermore, the effects of trade policy depend on a variety of factors including job and skill level of workers and concentrations of competitive import sectors. There are other drivers of adjustments including technological shifts, change in consumer preferences, efficiency of labor and property markets, market power, changing institutional relationships and economic geography. For instance, trade is not responsible for the decline of the newspaper industry. Instead, this was an effect of technology advancement.

Mr. Koopman attributes most of this global slowdown to a lack of investment not the tariffs themselves. The global average tariff is 8.5%, but trade costs for manufacturing goods and services can be much higher. Moreover, while manufacturing, agricultural, and service trade costs have all declined, uncertainty has skyrocketed after a period of stability that has sustained trade growth over the past two decades. While the Trump Administration accuses China of unfair trade policies, the IMF suggests that this global imbalance is not driven mostly by trade policies. Many other macroeconomic and microeconomic variables are at play.

Mr. Koopman concluded the lecture on a positive note by stating that governments can offset some of the negative indirect impacts on at-risk investment from trade wars through monetary and fiscal policy. For example, Germany is potentially thinking about changing its hard zero policy which would have a positive impact on European economy and would offset some of the potentially harmful effects of the trade war. And the negative impacts of the trade war are still reversible.