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### **Eliminating the Constraints on Trade Policy – The Strategy that Underpins US Negotiations in the Trump Administration**

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For those steeped in the ruling paradigm of international trade relations based on gradual liberalization and strengthening rules of trade, the trade policy of the administration of President Donald Trump often appears chaotic, contradictory and economically uninformed – and viewed from the paradigm’s perspective it largely is. The ruling paradigm, however, is not the only paradigm regarding international trade relations. The Trump administration is following an alternative narrative whereby trade is viewed as a zero sum game where a country can only win by garnering concessions from trade partners by hard bargaining or guile. When nefarious trade practices are found, or poor negotiation outcomes identified, swift and strong action is required to rectify the disadvantageous outcome. This alternative paradigm has a long history but has, until now, never informed a U.S. administration’s trade policy since the rules-based multilateral trade institutions were established at the end of the Second World War. The rules-based system imposes constraints on the ability to move swiftly and decisively when the need for action is identified. Removing these constraints is a central facet of the Trump administration’s trade strategy. This article explores the alternative paradigm and the steps being taken to remove the constraints on freedom of action in trade policy.

Keywords: alternative paradigm, constraints, freedom to act, ruling paradigm, Trump administration

## Introduction

The United States is now engaging in a divisive debate over international trade. On the one side are disciples of the principles of free trade .... Free traders argue that the interests of the United States, and of the world, continue to lie in reducing barriers, subsidies and other government interventions which distort the natural pattern of specialization and trade among countries. On the other side are those calling for policies to protect American industry from foreign competition. Protectionists argue that imports are causing massive unemployment and eroding the nation's industrial base.

*The two camps have recently found common ground in the view that the United States must 'get tough' with trading partners that protect or subsidize their own industries. By threatening to close American markets or subsidize American traders if other nations fail to abandon their own interventions, free traders and protectionists can both serve their concerns.*

*It is an ideal political solution. By framing the issue as the proper American reaction to foreign transgressions we need not directly face the painful choice between free trade and protection. We can avoid articulating the national goals underlying our trade policy. Protection can be the sword of the free traders in their assault upon foreign trade practices while it simultaneously serves as a shield for those anxious to preserve American jobs. Everyone seems to win. [emphasis added]*

Robert B. Reich (1983)

The musings on trade and the concrete activities in trade policy making and trade negotiations of President Trump and his administration's trade officials are often portrayed as chaotic – and indeed in many cases they may well be. As this quote from 1983 illustrates, however, the vision of the United States being victimized by trading partners using *unfair* trading practices has long had currency with a considerable segment of the American trade policy community. Offsetting and deterring any harm that may arise from untoward activities by foreign firms and governments requires proactive measures by the U.S. government. Until the Trump administration, this perspective on trade relations has been largely overshadowed by what Reich (1983) terms the *free traders'* view, which sees trade liberalization and strong rules of trade as the foundation for trade contributing to economic growth and well-being (Kerr, 2010a). This foundation was the basis for the negotiation of the International Trade Organization (ITO)<sup>1</sup> and the General Agreement on Tariffs and Trade (GATT) at the end of the Second

World War (U.S. Department of State, 1945) and continued through successive administrations until the presidential election in the United States in 2016.

One cannot be sure whether the views on trade matters expressed by Donald Trump are deeply held or simply tactical gestures meant to unsettle trading partners in the run-up to future negotiations or to *wrong foot* those with whom the administration is in negotiation. The apparent obsession with current account deficits may represent a poor understanding of the economics of international trade or a tactic to signal that current trade arrangements will have to change – or both. Trade policy actions against trading partners are threatened, withdrawn, put in place, put on hold, re-imposed, softened – it can appear as if it is *trade policy by whim*. It may also be a tactical exercise to unsettle trading partners and soften them up so that concessions can be secured in future. Of course, if there is a coherent strategy it would not be wise to reveal it. It is important, however, to understand if there has been major change in how trade is perceived since the change in the U.S. administration.

### **A Different Perspective on Trade Relations?**

If one perceives international trade relations as a largely adversarial zero sum game where a country can win only if benefits arise from concessions garnered from trading partners by the exercise of superior economic power or guile, then trade policy making needs to be pro-active and unfettered. Guile can be either nefarious practices (e.g., hidden subsidies to exporters, currency manipulation, industrial policies to foster future industries with considerable potential, wage suppression, underpriced inputs such as timber or electricity) or concessions given in negotiations where there was no intention to honour them. Hence, in this view of the world, the use of trade policy measures needs to be swift, targeted and, if possible, overwhelming to offset any damage suffered and to act as a deterrent against future transgressions – in short their use needs to be unconstrained.

Trade agreements negotiated under the *free trade* perspective make rules of trade. Rules of trade are constraints on when governments can intervene in international commercial activities. Strong rules of trade are requested by firms wishing to invest in international commerce, because there is transparency to the circumstances when governments can intervene and the degree to which they can intervene. In the WTO, for example, tariff levels are *bound*, meaning in future tariffs can never be raised above the specified level. This provides a degree of surety to firms contemplating investments in trading activities regarding the maximum tariffs they can face in the future (Kerr and Perdakis, 2014). In the WTO's Agreement on Agriculture (AoA) the values of export and domestic subsidies on agricultural products are capped (Gaisford and Kerr, 2001).

Discrimination among trading partners is not allowed, so that strong international competitors cannot be singled out for trade policy measures. Such constraints on government actions are the essence of trade agreements.

From the alternative perspective, what has been agreed in trade negotiations are simply unacceptable constraints on the ability of a country to act and act swiftly to counter detrimental trade policy measures of trade partners. This is particularly galling for a country that has the economic clout to punish or intimidate most other countries. In President Trump there is an individual who likes to think of himself as a bold and decisive leader – a man of action. He does not like to be constrained by rules, whether they be formal domestic laws, informal conventions of behaviour, other constituents of the checks and balances embedded in the U.S. Constitution, etc. He finds trade agreements constraining, as they hamper the ability to take measures, whether those measures are aimed at bringing automobile manufacturing jobs back from Mexico, or reducing the trade deficit with China, or restricting steel and aluminum imports. Non-discrimination means that egregious users of nefarious practices cannot be specifically selected for retribution.

On the campaign trail and since taking office he has railed against the North American Free Trade Agreement (NAFTA) as the *worst deal ever, ever*, yet he has never articulated what is wrong with the agreement. This has frustrated both Mexico and Canada. After forcing the parties into renegotiation on threat of cancellation, the United States and its negotiators have failed to specify how they would like to improve NAFTA. In essence, NAFTA is simply too restrictive on U.S. trade policy and, in particular, too constraining on President Trump's freedom of action.

The trade agreements negotiated by previous administrations, when viewed through this lens, are all *bad deals* simply because what was agreed limits the freedom to act. Of course, that was the intent, and what a *rules-based trading system* means. Mutual agreement to constrain the ability of governments to act is intended to prevent tit-for-tat, *beggar-thy-neighbour* trade wars. The experience with the tariff wars of the 1930s, when there were no multilateral rules for trade, led to the initiatives to put international institutions in place (e.g., the ITO and GATT)<sup>2</sup> to prevent conflicts from entering downward spirals with detrimental economic effects that are hard to undo (Pomfret, 1991). The experience of the 1930s appears to have little influence with members of President Trump's administration – they see only constraints, not benefits.

## **Lifting the Constraints Imposed by Trade Agreements**

If one starts with the perspective that a successful trade policy requires freedom to act, the question becomes: how does one remove the constraints imposed by existing trade

commitments? Further, one may not wish to formally break one's commitments but rather to render the existing agreements impotent without breaking the rules. This means, in part, finding loopholes in the agreements that can be exploited and, in part, using one's economic power effectively to have constraints lifted through renegotiation. This requires a good understanding of existing trade agreements – an in-depth legal understanding of the system rather than an economic one. To follow this approach one either does not care about the economic ramifications or feels that the freedom of action obtained will yield sufficient economic benefits to more than offset any negative economic outcomes following the removal of the constraints. How would one proceed if one wanted to remove the constraints?

The first thing would be to maximize one's leverage in negotiations. This is particularly the case for the United States given the size of its economy and the lure gaining access to the U.S. market has for smaller countries. The United States is likely to benefit from bilateral negotiations rather than multilateral or regional negotiations. Securing an advantageous deal is much more likely in bilateral negotiations than when dealing with the demands of multiple trading partners and the increased economic power that a group of countries can represent. The United States has some evidence to support this perspective from when it abandoned its policy of not engaging in regional or bilateral negotiations in favour of WTO exclusivity near the end of the Clinton administration.<sup>3</sup> In subsequent bilateral and regional negotiations the use of economic clout appears to have allowed the United States to achieve more of its aims (Kerr and Hobbs, 2006; Kerr, 2005).

Almost the first act of the Trump administration was the U.S. withdrawal from the Trans-Pacific Partnership (TPP), which had been negotiated with 11 countries by the previous administration of President Obama. At the time of the announcement, President Trump said that his administration would seek to negotiate bilateral agreements with a number of the countries in the TPP. He has said he will be pleased to negotiate one-on-one with the United Kingdom once Brexit is completed. He has even mused about negotiating with individual EU countries.<sup>4</sup> In the NAFTA negotiations he has mused about undertaking separate negotiations with Canada and Mexico as an alternative to trilateral negotiations. He has shown no enthusiasm for the Trans-Atlantic Trade and Investment Partnership (T-TIP) with the 28-country EU. All of this is consistent with having the United States enjoy the maximum possible economic leverage during any negotiations.

In a similar vein is the Trump administration's demand that any new NAFTA deal have a sunset clause<sup>5</sup> whereby the agreement would be automatically reviewed and cancelled unilaterally by any of the NAFTA countries. This gives the United States, as

the much larger economy, leverage to ask for concessions on threat of cancellation. Further, it would likely mean that more investment and, hence, North American jobs would be located in the United States rather than Mexico and Canada. This would be the case because firms wishing to invest in North America would choose to locate in the United States with its large market rather than in the other countries, because their market access to that large market could be cut off after five years. That would significantly increase the risk associated with investing in Mexico or Canada to serve the North American market.

One of the major constraints on unilateral action in trade agreements is dispute settlement. Domestic trade policy actions are scrutinized by super-national panels, often without U.S. representatives on the panels. If domestic trade policy activities are judged by panels to be inconsistent with the obligations of an agreement, then those activities must cease or, if not, retaliation may be authorized. Further, dispute proceedings take time, often with relatively specific schedules set out, meaning that no quick action can be taken to solve a problem.

The WTO had already ceased to be an effective venue for new constraints to be negotiated before the advent of the Trump administration. Its consensus-based decision making model means that it is almost impossible to arrive at a new agreement (Kerr, 2014). No substantive progress has been made in the Doha Round negotiations that commenced in 2001. One of the reasons there has been an absence of progress is that the United States has shown little interest in taking a leadership role in the organization – but this pre-dates the Trump administration. As a result, the Trump administration has largely ignored the WTO negotiations.

Where the WTO is effective, however, is through its dispute settlement mechanism. The Trump administration has been actively working to remove this constraint. It is using a good understanding of the rules and procedures to accomplish this. The WTO makes decisions based on consensus. The WTO appellate system has term-limited members. Three appellate judges must hear each case. While the Appellate Body normally has a roster of seven members, the United States has not been cooperating to fill positions as existing members' terms expire. If nothing is agreed, eventually fewer than three judges will remain. At that point, arguably, appeals cannot be heard. Without the ability to appeal, it can be further argued that the judgements of dispute settlement panels will not be valid and there will be no requirement to comply with adverse judgements.

From the administration's perspective the major benefit of removing the constraint provided by the WTO dispute settlement mechanism is that U.S. domestic contingency protection institutions will be able to be used to punish those considered to be trading

*unfairly*. Dumping and unfair subsidy cases will be able to be undertaken without an international avenue of appeal. The current U.S. antidumping and countervail procedures are already controversial at the WTO (Kerr and Loppacher, 2004). Without international oversight, these U.S. domestic institutions can become the front line means to deliver a quick and decisive trade policy.

When asked by other WTO members what changes would need to be made to the disputes system to secure cooperation in the appointment of appellate judges, U.S. diplomats have not put forward specific suggestions, only suggesting they are not content. According to *Bridges News* (2018),

The US has criticised a series of aspects of how the Appellate Body functions, such as how some judges whose terms have expired are continuing to serve on cases that they had been working on while in office. That practice is a long-standing one, outlined in the Appellate Body's Working Procedures. However, various members have argued that the US has not engaged sufficiently in discussions to resolve the problem, nor made clear what changes it would like to see to lift its hold on new appointments.

As further evidence that the Trump administration is wanting to lift constraints imposed by the disputes systems in trade agreements, one of the demands in the NAFTA trade negotiations is that any future agreement would no longer include a dispute resolution mechanism.<sup>6</sup> As of June 2018 neither Canada nor Mexico has agreed to this demand.

In May and June of 2018 the Trump administration imposed 25 percent tariffs on steel imports and a 10 percent tariff on imports of aluminum. The justification for these tariffs was national security concerns. A number of the countries against whose steel and aluminum the tariffs were imposed consider themselves longstanding allies of the United States and were incensed that they were considered threats to national security. Of course, they were not. This was just a well designed ploy to take advantage of the existing rules of trade to allow the imposition of tariffs as part of an activist trade policy.

Article XXI of the WTO allows a country to ignore GATT obligations on national security grounds. According to John Jackson (1989, 18),

A problem inherent in the national security argument is that of determining limits. Which industries (if any) are needed for security in a world of potentially instantaneous wars? It is all too easy for any economic group to argue its importance to national security as an excuse for import protection. One variation on this argument proposes that a nation must always have certain industries as part of its industrial "infrastructure". Thus, it says, a certain minimum steel-making capacity must be maintained regardless of its efficiency or competitiveness in the world economy.

Jackson (1989, 204-205) goes on to say with regard to Article XXI,

This language is so broad, self-judging, and ambiguous that it obviously can be abused. ... Because of this danger of abuse, contracting parties have been reluctant to formally invoke Article XXI, even in circumstances where it seems applicable. Thus there have only been a few reported cases regarding Article XXI in the GATT's history. In general, *the GATT approach to Article XXI is to defer almost completely to the judgement of an invoking contracting party* [emphasis added].

Thus, if one wanted to have the use of tariffs unfettered in the sense of the inability of trading partners to formally complain, one obvious way is to claim they are being imposed for reasons of national security. Again, one sees a good understanding of the WTO rules and how they can be used to advantage. While other governments and previous U.S. administrations have seen value in the multilateral constraints and, hence, were reluctant to invoke Article XXI, the Trump administration, chafing under the constraints, is willing to use the national security justification for its actions. It is simply convenient. Further investigations on whether imports of automobiles and trucks also threaten U.S. national security are underway.

## Conclusions

The trade policy of President Trump's administration is often perceived as chaotic or *rule by whim* by those who accept gradual liberalization and the *rules based* trading system as the foundation of trade policy. This perspective has been the *ruling paradigm* in trade policy since the end of the Second World War. Alternative trade policy paradigms do exist, however, and rather than being chaotic the Trump administration appears to have accepted a different paradigm and to be systematically attempting to implement it. Assuming the Trump administration's trade policy is based solely on presidential whims can, however, lead to underestimations of the potential threat to the institutions of the *rules based* system by those that accept the ruling paradigm as the foundation of trade policy.

Without understanding the alternative paradigm underlying the Trump administration's trade policy, it is easy to simply characterize it as *protectionist*. This is naïve. While it certainly has elements of protectionism, it is not the protectionism expected in the *ruling paradigm* – the protectionism of *vested interests*. In the alternative paradigm protection is a strategic and tactical weapon used to inflict costs on trading partners perceived to be engaging in nefarious practices to induce them to cease those practices. Imposing costs on trading partners is a means to gain negotiating advantage and garner concessions, not to provide economic protection to domestic industries whose relative international efficiency is in decline.



This does not mean that traditional *vested interests* will not try to convince the Trump administration to impose trade barriers that will provide them with economic protection. Just as administrations that accepted the *ruling paradigm* had to deal with *vested interests* asking for protection, so too does the Trump administration. While the way in which industries are chosen to receive protection may reflect typical *vested interests*, the underlying motive is strategic.

There is a fundamental conflict between success in trade policy being seen as strong rules constraining the freedom of governments to intervene in international commercial transactions and success being seen as the freedom to act decisively to punish *unfair* trade practices and obtain concessions. The last time trade policy making was unconstrained – between the two world wars of the 20<sup>th</sup> century – the result was beggar-thy-neighbour trade wars that nobody won.

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## Endnotes

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<sup>1</sup> While the U.S. administration negotiated the ITO, the U.S. Congress thought what had been negotiated to be too constraining on U.S. trade policy, and in the end the ITO was never presented to the Congress for ratification (Kerr, 2010b).

<sup>2</sup> Putting in place multilateral institutions to deal with conflicts was not confined to trade. The United Nations was established to deal with state-to-state political conflict. The International Monetary Fund was established to deal with the conflicts arising from strategic devaluations when exchange rates tended to be fixed. The World Bank was put in place to deal with conflicts that arise when countries have different levels of development (e.g., Italy's invasion of Ethiopia, Japan's invasion of China). These three organizations, along with the ITO, are sometimes known as the four pillars of the New World Order (Kerr, 2010a).

<sup>3</sup> The United States did have a free trade agreement with Israel, and the NAFTA. These were exceptions to WTO exclusivity. The Israel agreement was largely political symbolism given the small size of its economy. NAFTA had elements that the United States wanted to use as models for GATT reforms during the Uruguay Round of negotiations (Apuzzo and Kerr, 1988).

<sup>4</sup> Suggesting he may not have understood that trade negotiations for all EU members are handled by the EU Commission.

<sup>5</sup> The United States has proposed this take place every five years.

<sup>6</sup> Although the NAFTA dispute system is not as robust as that of the WTO, it can still act as a constraint. The NAFTA countries have always had the option of choosing the WTO disputes system (Kerr, 2001), but if the United States is successful in disabling the multilateral system then that avenue would no longer be available to Mexico and Canada.