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Rethinking trade

The global trading system needs new rules, not tariffs, say Wally Adeyemo and Joshua Zoffer

A former deputy treasury secretary and a presidential economic adviser on the need to draw a sharper line between open economies and the rest

Illustration: Dan Williams

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IF PRESIDENT DONALD TRUMP is true to his word, reciprocal tariffs on the world will come as soon as next week. This follows tariffs on America's allies in Mexico, Canada and the EU, as well as China, who have all responded with tariffs of their own. Mr Trump is pulling the world back towards the kind of protectionism not seen in a century. But the return of tit-for-tat tariffs is just the latest symptom of a dysfunction that has been growing for more than two decades.

It is clear the global trading system is broken. But the use of tariffs as a first, second and last resort won't fix it. What would is a new set of trade rules that fit the realities of the global economy.

Today's governance of global trade, including the World Trade Organisation (WTO), grew out of the Bretton Woods agreement of 1944, a rules-based system designed to promote international financial stability and market-based economic governance. That system was premised on shared commitments to multilateralism, open markets and good-faith economic dealing that emerged in response to the Depression and the second world war.

China's accession to the WTO in 2001 was premised on the belief that it would behave similarly. That turned out to be spectacularly wrong. President Xi Jinping's policies have shown China's unwillingness to live within the constraints of this rules-based order and lack of interest in becoming a market economy. While developed countries opened their markets and cut their subsidies for domestic industries, China spent the past several decades doing exactly the opposite: undercutting intellectual-property protections and spending hundreds of billions of dollars on subsidies in an effort to dominate global manufacturing and supply chains. This is why the Obama administration, in which one of us served, refused to grant China market-economy status and the full privileges of WTO membership.

As China took these actions, advances in internet communications, robotics and other technologies led to increased automation. This created pressures that hit advanced, industrialised economies hard—resulting in the loss of millions of jobs, the hollowing-out of industrial bases and a backlash against globalisation.

In response, many countries have adopted self-help measures like tariffs and industrial subsidies, and beggar-thy-neighbour policies such as digital-services taxes. The WTO has proven incapable of enforcing its rules that supposedly bar many of these practices. Ironically, China has even sought to use the WTO to challenge the legality of America's Inflation Reduction Act and Europe's efforts to protect itself from China's own battery subsidies.

We should be clear-eyed about where all of this is heading if we don't change course. The global economy is starting to look a lot like the Siege of Melos, according to Thucydides: "The strong do what they can and the weak suffer what they must." America is using its economic heft to bully other countries with tariffs, using them to demand everything from more inward investment to actions to curb the flow of fentanyl into the country. Meanwhile, China is using its industrial overcapacity to flood the world with cheap goods and make it harder for other countries to develop their own manufacturing sectors.

A global economy where might makes right will hurt everyone, but it will be particularly hard on emerging and developing economies. It will slow growth, lower incomes and encourage economic migration—further fuelling the discontent seen recently in rich countries.

Trade has lifted untold millions around the world out of poverty, and consumers have benefited from reduced goods prices. But it is also true that in many cases those lower costs were the result of labour or environmental arbitrage and distortive industrial policies, not true competitive advantages. China and many of the largest multinational companies have been the winners of this arrangement. Others, especially developed economies and their workers, have suffered. And going forward, China's overcapacity will make it harder for developing countries to move up the global value chain through manufacturing. They, too, will lose out.

It is time to admit that the WTO is not fit for purpose. We need a new set of rules and institutions that are up to the task of governing today's global economy. This system will have to be able to distinguish between market-oriented, open economies that respect labour and environmental protections, and everyone else. And it will need a different set of rules, including tariffs and other barriers, for countries in the second camp.

The success of the system should not be judged by trade balances alone, as some in Mr Trump's orbit advocate. The underlying substance of labour and environmental rules driving those balances, as well as investment and capital flows, must be taken into account.

The system should promote competition and prosperity by strengthening these safeguards and creating the conditions needed for fair trade. The goal should be for developing countries to grow, adopt higher standards and move into the trading bloc of open economies. They cannot be allowed to operate outside the global trading rules indefinitely. If they are, workers and companies operating in more advanced economies will continue to be punished for holding themselves to the high standards their own laws require.

The system will also need a wider mandate, recognising that trade is just one part of the global economy. Today, for example, capital and trade flows are being distorted by incentives in the international tax system for multinationals to shift jobs and assets to low-tax jurisdictions—rendering smaller businesses uncompetitive and short-changing governments on tax revenues. A new system must address these challenges together, starting with implementing the 15% global minimum tax agreed by most OECD countries.

The rules governing global commerce must change to address these challenges. And that starts with reimagining the global trading system. The world does not need to wait for America to catalyse this effort. Other market-oriented economies, including the EU and the 12 members of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, represent roughly one-third of global GDP. If these countries are willing to forge a new way forward on trade, rooted in fair, market-based competition and protection for labour and environmental standards, the rest of the world should welcome it. ■

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