



Is Strict Reciprocity Required for Fair Trade?

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ABSTRACT

The administration of Donald J. Trump has repeatedly claimed that reciprocity is required for “fair” trade. While this concept is not new in US political discourse, the Trump administration’s insistence that strict or absolute reciprocity is required goes beyond any claims made by previous US administrations. By strict reciprocity, the United States means that all trade volumes and terms and conditions of trade must be mirror images of each other. As the United States has a trade deficit with all of its largest trading partners, the Trump administration claims that this is evidence of unfairness in trade harming the United States. Since countries like China have tariff rates (25 percent) for a particular import, such as automobiles, that are significantly higher than US tariff rates (2.5 percent) for imported automobiles, this is also evidence of unfair trade that adds to the US trade deficit. Based on this lack of strict reciprocity, the United States claims that trade with many of its partners is unfair and has imposed punitive trade sanctions to correct the imbalance.

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This Article demonstrates that not only is strict reciprocity impossible to achieve in practice, but it is based on a critical misunderstanding of elementary economic concepts. Since the Trump administration has not proven its case that the lack of strict reciprocity is evidence of unfair trade, the United States must either find an alternative justification or withdraw the sanctions.

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I. INTRODUCTION

The election of Donald J. Trump to the US presidency has led to the revival of economic nationalism as the guiding policy of US international trade relations.¹ Economic nationalism posits international trade as a zero-sum game in which a gain in trade by one nation must be accompanied by a corresponding trade loss to another nation.² This modern expression of the political economic philosophy of

1. See generally Daniel C.K. Chow, *United States Unilateralism and the World Trade Organization*, B.U. INT'L L.J. 2 (forthcoming 2019) [hereinafter *Unilateralism*] (on file with the Boston University International Law Journal). A favorite target of the Trump administration trade policy is China, as discussed further in this Article. For a specific examination of the Trump administration's China trade policies, see generally Daniel C.K. Chow, William McGuire & Ian Sheldon, *A Legal and Economic Critique of China's Trade Policies*, 79 U. PITT. L. REV. 39 (2017).

2. See *Unilateralism*, *supra* note 1.

*mercantilism*³ (i.e., that a nation should increase its exports and decrease its imports) was the basis on which the Trump administration was able to win significant political support.⁴ Trump incited dissatisfied voters by claiming that the United States has too often been the loser in a zero-sum game and that it will dictate the terms of all new trade agreements to ensure that the United States is the winner in trade deals at the expense of its trading partners, if necessary.⁵ As for existing trade agreements that compromise US interests, the United States will impose wide-ranging punitive tariffs (i.e., customs duties on imports)⁶ on its trading partners to force them to come to the table and to concede to new terms.⁷ The aggressiveness of the US position has shocked and antagonized other nations that have responded with threats of retaliation.⁸ Friendly trading nations and allies of the United States seem genuinely shaken by US threats, and the entire world economy seems to be bracing for a destructive global trade war.⁹

3. See William R. Allen, *Mercantilism*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS 445 (John Eatwell et al. eds., 1987).

4. The policy idea that the solution to fixing the US economy is to increase exports and decrease imports, a modern version of mercantilism, was set out in a key trade policy paper. See generally PETER NAVARRO & WILBUR ROSS, SCORING THE TRUMP ECONOMIC PLAN: TRADE, ENERGY, AND POLICY IMPACTS (2016), https://assets.donaldjtrump.com/Trump_Economic_Plan.pdf [<https://perma.cc/J2X6-74TX>] (archived Nov. 8, 2018). Imposing higher tariffs was part of this plan's strategy to decrease imports. *Id.* at 2. This appealed to the many constituents in the Midwest who felt that their jobs were threatened by imports from China and other countries. See Ben Popkin, *Betting the farm: Why the heartland still believes in Trump despite plunging prices*, NBC NEWS (July 6, 2018), <https://www.nbcnews.com/business/economy/betting-farm-why-heartland-still-believes-trump-despite-plunging-prices-n886941> [<https://perma.cc/H6CH-UW64>] (archived Nov. 27, 2018). President Trump later rewarded Navarro by appointing him to a key trade advisor role, and appointed Ross Secretary of Commerce. Navarro and Ross continue to lead the Trump administration's trade policies. See Doug Palmer, *Ross confirmed to lead Commerce*, POLITICO (Feb. 28, 2017), <https://www.politico.com/story/2017/02/ross-confirmed-to-lead-commerce-235469> [<https://perma.cc/B77Q-BTT4>] (archived Nov. 27, 2018).

5. See generally *Unilateralism*, *supra* note 1, at 2–3.

6. See *Tariffs*, WORLD TRADE ORG., https://www.wto.org/english/tratop_e/tariffs_e/tariffs_e.htm (last visited Dec. 2, 2018) [<https://perma.cc/FP9R-2WTN>] (archived Nov. 27, 2018).

7. See generally *Unilateralism*, *supra* note 1, at 20–22.

8. See, e.g., Melissa Edy & Chad Bray, *EU Threatens to Retaliate with Tariffs on Bourbon and Bluejeans*, N.Y. TIMES (Mar. 2, 2018), <https://www.nytimes.com/2018/03/02/business/europe-steel-tariffs-trump.html> [<https://perma.cc/4ZES-EJ7E>] (archived Nov. 8, 2018); Fred Imbert, *China says it must retaliate against tariffs 'to defend the nation's dignity'*, CNBC (Aug. 2, 2018), <https://www.cnbc.com/2018/08/02/china-says-it-must-retaliate-to-defend-nations-dignity.html> [<https://perma.cc/47WV-JMHH>] (archived Nov. 8, 2018).

9. See *Everything You Need to Know About the Trade War*, BLOOMBERG (updated June 29, 2018), https://www.bloombergquint.com/markets/shots-fired-everything-you-need-to-know-about-the-trade-war#gs.a_Z4Zxg [<https://perma.cc/66ZT->

US economic nationalism is based on three major assumptions that are examined and analyzed in this Article. In each of these assumptions, the concept of reciprocity plays a key role. The Trump administration often argues that reciprocity in trade flows and in the terms and conditions of trade are conditions of “fair” trade¹⁰ and that the current lack of reciprocity in US trade relations is evidence of how the United States is being harmed by trade. For example, President Trump recently claimed on Twitter that “Fair trade is now to be called Fool trade if it is not reciprocal.”¹¹

The administration’s appeal for “fair” trade is not new to US political discourse. Since the 1980s, “[c]ongressmen, businessmen, editorialists and the media have repeatedly emphasized fairness in trade, ‘level playing fields’ and reciprocity as a pre-condition for a trade regime to be acceptable to the United States.”¹² As an economic concept, reciprocity can be traced back centuries further to the foundational ideas of the economists Adam Smith and David Ricardo, further discussed below,¹³ who espoused that mutual advantage—a type of reciprocity—was inherent in trade.¹⁴ However, the Trump administration goes beyond classic economic theory to espouse a concept of absolute or strict reciprocity in the sense that each side in a trade relationship must derive benefits that are either exactly the same or that are mirror images of each other.¹⁵ The United States’ insistence on mirror-image reciprocity in trade is not only impossible in practice but is based upon a serious misunderstanding of basic economic concepts, as further explained below.¹⁶

The US insistence that strict reciprocity is required in its trade relations is one reason why the United States is not asserting this claim in the World Trade Organization (WTO) dispute settlement system—the WTO does not recognize strict reciprocity as a WTO obligation.¹⁷ Rather, together with the principle of National Treatment

FVN2] (archived Dec. 2, 2018) (noting that a global trade war is increasingly turning from talk to reality).

10. *President Donald J. Trump’s State of the Union Address*, THE WHITE HOUSE (Jan. 30, 2018), <https://www.whitehouse.gov/briefings-statements/president-donald-j-trumps-state-union-address/> [https://perma.cc/PK9A-SV39] (archived Nov. 8, 2018) [hereinafter *State of the Union Address*] (explaining that the new administration expects trade to be “to be fair and to be reciprocal”).

11. Donald Trump (@realDonaldTrump), Twitter (June 10, 2018, 6:05 PM), <https://twitter.com/realDonaldTrump/status/1005979207544000512> [https://perma.cc/8F78-J89D] (archived Nov. 8, 2018).

12. See Jagdish N. Bhagwati & Douglas A. Irwin, *The Return of the Reciprocitarians—US Trade Policy Today*, 10 *WORLD ECON.* 109, 117 (1987).

13. See *infra* Part II.B.

14. See *infra* Part II.B.

15. See *infra* Parts III & IV.

16. See *infra* Parts II.B & III.B.

17. A more nuanced form of reciprocity, marginal or first difference reciprocity is possible within the WTO. See *infra* Part IV.C.

(NT),¹⁸ the WTO is built on the edifice of the Most Favored Nation Principle (MFN),¹⁹ a principle of nondiscrimination,²⁰ which has the effect of multiplying trade benefits to all WTO members under a positive-sum game theory of international trade.²¹ Unable to assert a

18. NT is a principle of nondiscrimination that prohibits GATT/WTO members from treating their own nationals better in trade than foreign nationals. General Agreement on Tariffs and Trade art. III, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT]. It is sometimes said that NT is a principle of internal nondiscrimination while MFN is a principle of external nondiscrimination. Together, NT and MFN are the twin pillars of the WTO. *See* DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, *INTERNATIONAL TRADE LAW: PROBLEMS, CASES, AND MATERIALS* 149 (3d ed. 2017) [hereinafter *INTERNATIONAL TRADE LAW*].

19. *See* GATT, *supra* note 18, art. I(1), which provides in relevant part: “With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation . . . and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation . . . any advantage, favour, privilege or immunity granted by any contracting party to any product originating or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.”

The effect of this language is that a GATT/WTO member is obligated to extend any trade benefit given to any nation, whether or not it is a GATT/WTO member, to all other members of the WTO. *See* *INTERNATIONAL TRADE LAW*, *supra* note 18, at 149. The basic concept was that universalizing trade benefits would help to increase trade not only for individual members but for the system as a whole, a positive-sum game theory. Although MFN was first embodied in the GATT, MFN has also been included in other WTO agreements. *See, e.g.*, GATS: General Agreement on Trade in Services Art. II, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994); TRIPS: Agreement on Trade-Related Aspects of Intellectual Property art. 4, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 299, 33 I.L.M. 1197 (1994). Thus, MFN applies to all WTO trade in goods, services, and technology, including intellectual property.

20. MFN is sometimes considered to be a principle of favoritism, but this is misleading. Rather, MFN is a principle of nondiscrimination that prevents nations from granting special privileges in favor of a single nation or group of nations. Rather than being a principle of favoritism, MFN is the norm in the WTO and in international trade generally. For this reason, the United States eschews the use of MFN and prefers instead to use the term “Normal Trade Relations.” *See* DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS* 138 (3d ed. 2015). At an earlier historical period, a principle of reciprocity did exist in international law, but over time NT and MFN won the allegiance of most nation states. *See* DANIEL C.K. CHOW & EDWARD LEE, *INTERNATIONAL INTELLECTUAL PROPERTY: PROBLEMS, CASES, AND MATERIALS* 33–34, 39–40 (3d ed. 2017).

21. MFN requires a WTO country to immediately and automatically extend trade benefits given to any country to all other WTO countries. *See* GATT, *supra* note 18, art. I. The effect of MFN is to universalize trade benefits to the entire WTO membership. A country is entitled to MFN treatment only if it is a WTO country; thus, MFN serves the dual purpose of universalizing trade benefits and serving as an inducement for countries to join the GATT or the WTO. Holger Hestermeyer, *What is the Most-Favoured-Nation Clause?*, UK TRADE FORUM (Nov. 30, 2017), <https://uktradeforum.net/2017/11/30/what-is-the-most-favoured-nation-clause/> [<https://perma.cc/Z4K2-K9EW>] (archived Nov. 27, 2018).

claim under the WTO, the United States has decided to act unilaterally and outside of the WTO in imposing punitive tariffs, infuriating its trading partners and undermining the continuing viability of the WTO.²²

The validity of the US assumptions about reciprocity is essential because if absolute reciprocity is required for free trade, then its absence in US trading relationships is proof of unfairness and thus provides the justification for the United States to impose punitive tariffs on its trading partners to correct the unfairness. By contrast, if absolute reciprocity is not required for fair trade, then its absence does not provide a justification for the use of trade sanctions. From a normative standpoint, the United States then must provide an alternative justification or withdraw the sanctions.

Turning to the three assumptions of absolute reciprocity, the first assumption is that international trade is a zero-sum game in which there can be only one winner and one loser in every trade deal.²³ This position holds that each gain in trade by one nation must lead to a mirror-image or reciprocal loss in trade by another nation.²⁴ This position ignores a large body of empirical and theoretical work in international economics created in the past five decades or more that supports the view that international trade is a positive-sum game in which cooperative trade arrangements can increase the size of the pie and generate increased trade volumes for the multilateral trading system as a whole and for each nation individually.²⁵ Under a positive-sum game, the concept of strict reciprocity does not play a role.²⁶ Ignoring the voluminous evidence to the contrary,²⁷ the Trump administration insists that the United States has been harmed in a zero-sum game by the trade agreements entered into under the auspices of the General Agreement on Tariffs and Trade (GATT)²⁸ and its successor, the WTO.²⁹

If the Trump administration ignores this existing body of theory and empirical evidence, then on what evidence does it base its position that international trade harms the United States? The current

22. See *Unilateralism*, *supra* note 1, at 3, 24–25.

23. See Veronique de Rugy, *How Trump Misunderstands Trade*, N.Y. TIMES, (Apr. 10, 2018), <https://www.nytimes.com/2018/04/10/opinion/trump-china-trade-deficit.html> [<https://perma.cc/WP2S-5JF2>] (archived Nov. 9, 2018) (“The first mistake [of the Trump administration’s trade policy] is the assumption that trade is a zero-sum game, suggesting that the country selling products abroad is a winner while the one who buys is a loser. That’s simply wrong.”).

24. See *infra* Part II.A.

25. See *infra* Part II.B for a discussion of this large body of work.

26. See *infra* Part II.B.

27. See *infra* Part II.B.

28. See generally GATT, *supra* note 18.

29. See generally Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, 1867 U.N.T.S. 154 [hereinafter WTO].

administration seems to rely on the next two assumptions as the evidence of harm to the United States. The Trump administration assumes that, in order for trade to be fair, there must be strict reciprocity in trade volumes or a trade balance between the United States and its trading partners.³⁰ (This assumption is the second of the three basic assumptions underlying the requirement of strict reciprocity in trade.) Currently the United States does not enjoy reciprocity in its trade relations with many of its trade partners but has a trade deficit with many partners, including its closest allies, such as Mexico (\$71.1 billion), Japan (\$68.8 billion), and Germany (\$64.3 billion).³¹ In the view of the administration, a trade deficit indicates an economic loss to the nation that incurs the deficit, while a trade surplus indicates an economic gain to the nation that enjoys the surplus.³² In 2017, the United States had a \$375 billion deficit in trade in goods with China.³³ President Trump views this as evidence that the US economy incurred a net loss of \$375 billion in 2017 as a result of trade with China, which enjoyed a net gain of \$375 billion to its economy.³⁴

The third assumption is that the terms and conditions of trade must be strictly reciprocal in order to be fair.³⁵ Tariff rates must be mirror images of each other; nonreciprocal tariffs indicate a loss to the nation that has the lower tariff.³⁶ For example, the US tariff for imported automobiles from China is 2.5 percent, while China has a tariff of 25 percent for imported automobiles from the United States.³⁷ The Trump administration claims that the difference between these two tariff rates indicates that the United States is suffering a loss in

30. President Trump repeatedly makes these statements. In a series of tweets in June 2018, Trump argued that billion-dollar trade surpluses enjoyed by Canada and EU countries are evidence that they “rip us off in trade” and US farmers are faced with such a “big and unfair price to pay.” See Yan Nee Lee, *Ahead of meeting with North Korea, Trump keeps lashing out at allies Canada and Europe*, CNBC (June 10, 2018), <https://www.cnn.com/2018/06/10/trump-fair-trade-should-be-called-fool-trade-if-its-not-reciprocal.html> [<https://perma.cc/WL5W-E6PG>] (archived Nov. 27, 2018).

31. See *Top Trading Partners—December 2017*, U.S. CENSUS BUREAU, <https://www.census.gov/foreign-trade/statistics/highlights/top/top1712yr.html> (last visited Dec. 2, 2018) [<https://perma.cc/HWX8-CMRF>] (archived Nov. 9, 2018) (trade deficits are in terms of goods and do not include services).

32. See Lee, *supra* note 30.

33. See Keith Bradsher, *China Cuts Car Tariffs, in a Small Offering to the U.S. on Trade*, N.Y. TIMES (May 22, 2018), <https://www.nytimes.com/2018/05/22/business/china-cuts-auto-tariffs.html> [<https://perma.cc/EZ7D-XCQX>] (archived Nov. 9, 2018); *Trade in Goods with China 2017*, U.S. CENSUS BUREAU, <https://www.census.gov/foreign-trade/balance/c5700.html> (last visited Dec. 2, 2018) [<https://perma.cc/4ZSJ-XTHQ>] (archived Nov. 9, 2018).

34. See *infra* Part III.A.

35. See *infra* Part IV.

36. See *infra* Part IV.

37. See Bradsher, *supra* note 33.

automobile trade with China.³⁸ If the entire US tariff schedule has on average lower tariffs than the Chinese tariff schedule, the United States is suffering a loss in its trade with China, and the tariff rate differential is therefore claimed by the United States to be one cause of its massive trade deficit with China.³⁹

These three assumptions, all based on a view that strict reciprocity is a condition of fair trade, have a certain intuitive appeal to a large segment of the US population, which helped to propel Trump to the US presidency. The Trump administration continues to frequently cite the lack of strict reciprocity in the media to incite the public⁴⁰ and to justify tariffs and other extreme measures, such as publicly berating high government officials of close US allies, such as the European Union (EU).⁴¹

This Article will demonstrate that the claim that strict reciprocity is required for fair trade is fallacious by proceeding in four Parts. The first three Parts will examine the three assumptions of US economic nationalism in detail and analyze their validity. Using the existing economic literature, Part II demonstrates that trade is not a zero-sum game, as asserted by the United States, but instead is a positive-sum game that can, under the right conditions, create mutual benefits for numerous trading partners. Part III demonstrates that the US claim that trade with China causes the US trade deficit and creates a direct loss to the US economy is a fallacious argument. The causes of the US trade deficit are tied to macroeconomic policies, such as saving and consumption, not trading with a specific nation. Part IV demonstrates that requiring identical tariff rates and conditions of trade between the United States and China is based on a misunderstanding of how tariff schedules are negotiated under the WTO; it is myopic and misleading to point to isolated tariff rates for one or more particular goods as an example of unfairness instead of examining the overall balance of

38. *See id.* (discussing how the Trump administration's complaints about the auto industry).

39. *See infra* Part IV.

40. President Trump reiterated this point in a Tweet on April 9, 2018 noting that US and Chinese tariffs on automobiles are not reciprocal. Donald Trump (@realDonaldTrump), TWITTER (Apr. 9, 2018), <https://twitter.com/realDonaldTrump/status/983284198046826496> [<https://perma.cc/YFV5-ZDHT>] (archived Nov. 27, 2018) ("When a car is sent to the United States from China, there is a Tariff to be paid of 2 1/2%. When a car is sent to China from the United States, there is a Tariff to be paid of 25%. Does that sound like free or fair trade. No, it sounds like STUPID TRADE - going on for years!").

41. *See* Michael Birnbaum & Seung Min Kim, *Trump berates NATO Allies and then asks them to double their defense spending goals*, WASH. POST (July 11, 2018), https://www.washingtonpost.com/world/europe/trump-says-germanyis-captive-to-russia-in-fiery-opening-salvo-against-nato/2018/07/11/56aa7174-7f0a-11e8-a63f-7b5d2aba7ac5_story.html?utm_term=.885270a138d7 [<https://perma.cc/6Y2N-M9HK>] (archived Nov. 27, 2018).

concessions in the tariff schedules as a whole. Part V then discusses the consequences of this analysis for US economic sanctions.

II. INTERNATIONAL TRADE AS A ZERO-SUM GAME

A. *The Trump Administration's View of International Trade*

In the 2018 State of the Union Address, President Trump stated:

America has also finally turned the page on decades of unfair trade deals that sacrificed our prosperity and shipped away our companies, our jobs, and our Nation's wealth. The era of economic surrender is over. From now on, we expect trading relationships to be fair and to be reciprocal.⁴²

The Trump administration's trade policy is formally set forth and elaborated in the President's National Trade Policy Agenda,⁴³ which is submitted by the United States Trade Representative (USTR), the chief US official responsible for international trade.⁴⁴ The USTR is also charged by US law to "act as the principal spokesman of the President on International Trade."⁴⁵ In the 2017 Trade Policy Agenda, the USTR, Robert Lighthizer, stated:

The overarching purpose of our trade policy—the guiding principle behind all of our actions in this key area—will be to expand trade in a way that is freer and fairer for all Americans. Every action we take with respect to trade will be designed to increase our economic growth, promote job creation in the United States, promote reciprocity with our trading partners, strengthen our manufacturing base and our ability to defend ourselves, and expand our agricultural and services industry exports. As a general matter, we believe that these goals can be best accomplished by focusing on bilateral negotiations rather than multilateral negotiations—and by renegotiating and revising trade agreements when our goals are not being met. Finally, we reject the notion that the United States should, for putative geopolitical advantage, turn a blind eye to unfair trade practices that disadvantage American workers, farmers, ranchers, and businesses in global markets.⁴⁶

President Trump's statement, reiterated by the USTR, is a prime illustration of the Trump administration's main claims that trade has

42. See State of the Union Address, *supra* note 10.

43. See generally U.S. TRADE REP., THE PRESIDENT'S 2017 TRADE POLICY AGENDA (2017), <https://ustr.gov/sites/default/files/files/reports/2017/AnnualReport/Chapter%20I%20-%20The%20President%27s%20Trade%20Policy%20Agenda.pdf> [<https://perma.cc/2F9G-RFZQ>] (archived Nov. 27, 2018) [hereinafter 2017 TRADE POLICY].

44. See *About Us*, OFFICE OF THE U.S. TRADE REP., <https://ustr.gov/about-us> (last visited Dec. 2, 2018) [<https://perma.cc/7B45-Q24P>] (archived Nov. 27, 2018).

45. 19 U.S.C. § 2171(c)(1)(E) (2012).

46. See 2017 TRADE POLICY, *supra* note 43, at 1.

benefited US trading partners but has caused serious economic losses to the United States. The statement is also an example of the Trump administration's reliance on the key concept of reciprocity: trade must be reciprocal in order to be fair. The concept of reciprocity is also emphasized by the USTR who, in addition, reinforces the importance of that concept by viewing it primarily in bilateral, not multilateral, terms.

The concept of reciprocity, as further explained below, means strict equivalence in trade flows and also in the terms and conditions of trade in a bilateral trading relationship. If there is nonreciprocity in a bilateral trade relationship, then the nation suffering the shortage in the trade flows or terms and conditions is being treated unfairly and is the loser in the trade relationship. This view suggests that trade is a simple zero-sum game between two nations locked in a bilateral struggle to determine who will be the winner and the loser in a trade agreement. For the Trump administration, the United States has too often been the loser under the poor guidance of prior administrations. In other words, the United States will henceforth win in its trade relationship with its trading partners. To achieve this goal, the USTR has identified four priorities:

- (1) defend U.S. national sovereignty over trade policy; (2) strictly enforce U.S. trade laws; (3) use all possible sources of leverage to encourage other countries to open their markets to U.S. exports of goods and services, and provide adequate and effective protection and enforcement of U.S. intellectual property rights; and (4) negotiate new and better trade deals with countries in key markets around the world.⁴⁷

The first of these priorities—the elevation of US sovereignty over trade policy—is vital to understanding US economic nationalism. By “trade policy,” the USTR means the WTO and its rules and decisions.⁴⁸ By this priority, the USTR implies that the United States will disregard the rules and decisions of the WTO when they conflict with US sovereign interests.⁴⁹ Under the second and third priorities, the United States will use trade sanctions or the threat of sanctions to enforce its laws and protect its rights and interests;⁵⁰ under the fourth priority, the United States indicates that it will adopt a negotiation strategy that uses the threat of trade sanctions to induce US trading partners to renegotiate unfavorable trade agreements entered into by prior US administrations.⁵¹ The Trump administration has boasted

47. *See id.* at 2.

48. *See Unilateralism, supra* note 1, at Part II.

49. *See id.*

50. *See id.* at Part III.

51. *See id.* at Part III.F.

that this strategy was successful in the case of South Korea.⁵² On March 27, 2018, to avoid newly announced tariffs on steel and aluminum, South Korea agreed to a number of new trade concessions, including a limit of 2.68 tons of steel exports to the United States per year, or roughly 70 percent of the volume of steel exports from Korea to the United States, for the years 2015–17.⁵³

B. *International Trade as a Positive-Sum Game*

The notion that trade is a positive-sum game is a core idea in international economics, with a long pedigree dating back to Adam Smith's *Wealth of Nations*.⁵⁴ Smith essentially debunked mercantilism, the dominant political economic philosophy of the time, which claimed that for a trading country, exports are good and imports bad.⁵⁵ Smith's key contribution was to argue that if a country is more productive at producing, say, cloth compared to another country, while the other country is more productive at producing, say, wine, then each country should reallocate its resources to producing and trading that good in which it has an *absolute* advantage.⁵⁶

Although important in the unilateral push in nineteenth century Britain toward free trade starting with its repeal of the corn laws, it was David Ricardo writing in the early nineteenth century who developed the principle of *comparative* advantage—one that all students of economics are exposed to, and an idea that Paul Samuelson, the Nobel Prize-winning economist, once described as a “non-trivial” theorem.⁵⁷ The gap in Smith's argument was that it ignored the possibility that one country has an absolute advantage in producing both cloth and wine, the logical conclusion of which is that there would be no trade.⁵⁸

Ricardo's contribution was to recognize that it was relative productivity that mattered—what is the *opportunity* cost in each country of shifting resources (labor) from producing cloth to producing

52. See Alan Rappeport & Jim Tankersley, *Trump Gets First Major Trade Deal as South Korea Looks to Avoid Tariffs*, N.Y. TIMES (Mar. 26, 2018), <https://www.nytimes.com/2018/03/26/business/south-korea-us-tariffs.html> [https://perma.cc/PH3U-N7US] (archived Nov. 27, 2018).

53. See *id.*

54. See 1 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 505–06 (1976).

55. See Laura Lahaye, *Mercantilism*, THE LIBRARY OF ECON. & LIBERTY, <https://www.econlib.org/library/Enc/Mercantilism.html> (last visited Dec. 2, 2018) [https://perma.cc/SBK8-E7W3] (archived Nov. 26, 2018).

56. See THOMAS A. PUGEL, INTERNATIONAL ECONOMICS 32–34 (2007).

57. See PAUL A. SAMUELSON, *The Way of An Economist*, in INTERNATIONAL ECONOMIC RELATIONS 1–11 (1969).

58. See PUGEL, *supra* note 56, at 34–35.

wine, where opportunity cost is defined as the units of cloth given up to produce an extra unit of wine.⁵⁹ In his famous example of trade between Britain and Portugal, Ricardo observed that Portugal was absolutely more productive at producing both cloth and wine, yet Britain exported cloth to Portugal in exchange for imports of wine.⁶⁰ As described in every undergraduate textbook in international economics, the opportunity cost of Britain reallocating labor to producing cloth was lower than for Portugal, and vice-versa for wine.⁶¹ Therefore, if Britain and Portugal specialized in producing the goods in which they had a comparative advantage, the volume of cloth and wine produced globally would be greater as a result of efficient resource allocation.⁶² Of course this result gets at the idea of specialization, but in order to understand why trade is not a zero-sum game, the idea that there are gains from international exchange has to be introduced along with sources of those gains from trade.⁶³

An important corollary to Ricardo's result is that prior to trade, a country's relative prices—here the price of cloth relative to the price of wine—will depend on the opportunity cost of producing cloth.⁶⁴ So in the simple example, with no trade, Britain's relative price of cloth will be lower than that for Portugal, and the reverse is true for wine. This difference in relative prices is enough to generate trade between the two countries once they move away from autarky (no trade); in other words, agents who trade cloth and wine will reduce the difference in relative prices through the process of "arbitrage," at least up to the point where they can just cover transport costs.⁶⁵

Arbitrage means that Portugal will seek to import cloth from Britain, which necessarily bids up the relative price of cloth in Britain, while lowering the relative price of cloth in Portugal. At the same time, Britain will seek to import wine from Portugal, which increases the relative price of wine in Portugal, and lowers the relative price of wine in Britain. This process continues until there are no longer any reasons to trade, or both Britain and Portugal face the same set of (world) relative prices for cloth and wine, with Britain specializing in producing cloth and Portugal specializing in producing wine.

The idea that relative prices have to differ between countries for trade to occur is really quite fundamental to international economic theory. In the Ricardian world, and its modern versions, it is

59. See Robert W. Dimand, *Ricardo and International Trade Theory*, 8 HIST. ECON. IDEAS 7, 7–24 (2000).

60. See *id.* at 8–9.

61. See PUGEL, *supra* note 56, at 35–38.

62. See *id.* at 35–38.

63. See JAMES R. MARKUSEN ET AL., INTERNATIONAL TRADE; THEORY AND EVIDENCE 61–68 (1995).

64. See *id.* at 87–89.

65. See PUGEL, *supra* note 56, at 36–37.

differences in labor productivity across countries that matter.⁶⁶ By contrast, in the Heckscher-Ohlin-Samuelson (HOS)⁶⁷ world, it is relative endowments of inputs such as labor and capital that matter; Britain has a lower relative price of cloth compared to Portugal because it is relatively well endowed in capital compared to labor, with production of cloth being capital intensive.⁶⁸ In contrast, Portugal has a lower relative price of wine compared to Britain because it is relatively well endowed in labor, with production of wine being labor intensive. Relative specialization occurs where Britain and Portugal export the good that intensively uses the input in which they are relatively well endowed.

Whether trade results from differences in productivity or relative factor endowments, the economic benefits from specialization along with the benefits from exchange are fundamental to the so-called gains from trade theorem, which underlies the argument that trade is a positive-sum game.⁶⁹ The intuition for this theorem is as follows: under autarky, relative prices in an economy ensure that the supply of goods equals demand, such that inputs such as labor and capital are fully employed, and the value of a country's national income (GDP) is maximized.⁷⁰ With trade, relative prices adjust to reflect a country's comparative advantage, and even if its pattern of production does not change immediately, a country benefits from being able to exchange goods at world relative prices.⁷¹ Specifically, based on their preferences, consumers are able to substitute toward importing the good whose relative price has fallen with trade, thereby increasing their utility—the gains from exchange.⁷² Once production adjusts to world relative prices, there is an additional gain in utility to consumers—the gains from specialization.⁷³ A way to think of this is that by continuing to produce at the autarky position at world relative prices, a country is not maximizing its national income, even though consumers are able to benefit from the lower-priced import(s) (a substitution effect), but once production does adjust, national income increases and consumers are even better off as their purchasing power has risen (an income effect).⁷⁴

66. See Jonathan Eaton & Samuel Kortum, *Putting Ricardo to Work*, 26 J. ECON. PERSP. 65, 65–79 (2012).

67. See Ronald W. Jones & J. Peter Neary, *Positive Theory of International Trade*, in 1 HANDBOOK OF INTERNATIONAL ECONOMICS 14 (Ronald W. Jones & Peter B. Kenen eds., 1984).

68. See MARKUSEN ET AL., *supra* note 63, at 104–08.

69. See *id.* at 63–66.

70. See *id.* at 64.

71. See *id.* at 70.

72. See *id.*

73. See *id.* at 68–70.

74. See *id.*

By the preceding logic, trade must be a positive-sum game. For example, lowering tariffs will increase the global volume of trade, raising trading countries' GDPs and thereby consumer purchasing power. Of course, the gains from trade may not be evenly distributed between countries, and in the limit it is possible that relative prices only move in favor of one country, the other facing no change in relative prices. Necessarily though, countries will trade as long as they either benefit or they are at least no worse off than under autarky.

There is an important caveat to the previous result: within a country there can be both winners and losers from trade. "The corollary of the HOS model is that resources used intensively in export-competing sectors benefit from trade,"⁷⁵ while resources used intensively in import-competing sectors are made worse off.⁷⁶ In the United States, it might be expected that trade will benefit a skilled worker such as a researcher at a pharmaceutical firm, while unskilled US manufacturing workers would be worse off.⁷⁷ This result, originally proposed by Wolfgang Stolper and Paul Samuelson,⁷⁸ implies that international trade can have a significant impact on the distribution of income. However, the orthodox view as outlined "is that benefits to winners (skilled workers and consumers) will outweigh costs to losers (unskilled workers)."⁷⁹ Openness to trade therefore passes the benefit-cost test: the winners can in principle compensate the losers and still be better off.

Until the 1980s, the workhorse of international economic analysis was the HOS model.⁸⁰ However, it did not do a particularly good job of explaining observed trade patterns in the post-war period.⁸¹ Prior to the 1990s, the flow of trade in goods was mostly between developed countries.⁸² For example, high-income countries accounted for 80 percent of world trade in 1985.⁸³ Specifically, countries with similar GDP per capita produced goods "such as automobiles, constrained by economies of scale and the size of their own market, and then traded

75. Ian M. Sheldon, *The Economic Impact of Tariffs on Chinese Imports: A Potentially Costly Mistake?*, ANDERSONS POLICY BULLETIN (Dec. 2016), https://aede.osu.edu/sites/aede/files/publication_files/Andersons%20Policy%20Bulletin%2012%20%281%29.pdf [<https://perma.cc/3G8N-RRBK>] (archived Nov. 26, 2018).

76. *See An inconvenient iota of truth*, THE ECONOMIST (Aug. 6, 2016), <http://www.economist.com/news/economics-brief/21703350-third-our-series-looks-stolper-samuelson-theorem-inconvenient-iota> [<https://perma.cc/74RV-QVSU>] (archived Nov. 26, 2018).

77. *See* Jonathan Haskel et al., *Globalization and US Wages: Modifying Classic Theory to Explain Recent Facts*, 26 J. ECON. PERSP. 127, 119–40 (2012).

78. *See id.*

79. Sheldon, *supra* note 75, at 1; *see* Haskel, *supra* note 77, at 128–31.

80. *See* Gordon H. Hanson, *The Rise of Middle Kingdoms: Emerging Economies in Global Trade*, 26 J. ECON. PERSP. 41, 42–48 (2012).

81. *See id.*

82. *See id.*

83. *See id.* at 42; *see also* Sheldon, *supra* note 75, at 1.

those goods with other high-income countries in a larger integrated market for similar but differentiated goods” (i.e., *intra-industry* trade).⁸⁴ This contrasted with the key prediction of the HOS model that countries would trade different products (i.e., *inter-industry* trade).⁸⁵

Paul Krugman and others introduced a number of innovations in trade theory that helped explain the empirical observation that intra- and inter-industry trade could exist simultaneously.⁸⁶ Compared to the HOS model, Krugman allowed for the possibility that in industries such as automobiles, goods are differentiated as well as being produced by a few firms constrained by economies of scale—a market structure termed *monopolistic competition*.⁸⁷ Each firm in the industry produces a good that is different from the competition (brand monopoly), but given a distribution of consumer preferences, firms will enter the industry with new brands (competition) until it is no longer profitable to do so. In equilibrium, the number of entrants into an industry is determined by the extent of economies of scale and the size of the market.⁸⁸

This type of structure was then married to the HOS model, whereby a differentiated goods industry was assumed to be capital intensive, while a second industry was assumed to be labor intensive producing a homogeneous good under constant returns to scale.⁸⁹ Assuming a country is relatively well endowed in capital allows for both inter- and intra-industry trade.⁹⁰ Specifically, under reasonable assumptions, the country that is relatively well endowed in capital (labor) will be a net exporter (importer) of differentiated goods and an importer (exporter) of the homogenous good.⁹¹ Consequently, in moving from autarky to trade, there are now additional gains to trade, beyond what the HOS model predicts: specifically, in the integrated world market, consumers benefit from a greater variety of goods sold at lower prices, and there may also be additional realization of scale economies.⁹²

While highly influential, Krugman’s model assumed that firms were homogenous in the sense that they were all equally productive;

84. Sheldon, *supra* note 75, at 1.

85. See Paul R. Krugman, *Intraindustry Specialization and the Gains from Trade*, 89 J. POL. ECON., 959, 961–70 (1981).

86. See Paul R. Krugman, *Increasing Returns, Imperfect Competition and the Positive Theory of International Trade*, in 3 HANDBOOK OF INTERNATIONAL ECONOMICS 1252–54 (Gene M. Grossman & Kenneth Rogoff eds., 1995).

87. See *id.* at 1248–51.

88. See *id.*

89. See *id.* at 1245–48.

90. See *id.* at 1252–54.

91. See *id.*

92. See Paul R. Krugman, *Increasing Returns, Monopolistic Competition, and International Trade*, 9 J. INT’L ECON. 469, 476–79 (1979).

there was nothing in his model that would predict which firms would produce which goods in which country in the trading equilibrium.⁹³ Krugman's model could not explain some important stylized facts that were discovered when firm-level trade data became more accessible: specifically, only a relatively small number of firms actually export, and those that do export tend to be larger, more skilled, and capital intensive, and also exhibit higher levels of labor productivity.⁹⁴ Essentially, a systematic relationship appears to exist between the characteristics of firms and their participation in export markets.⁹⁵

Seminal research by Marc Melitz and others has focused on the idea that firms will incur additional fixed costs when entering export markets, and that only the most productive firms will be able to bear such costs while remaining profitable.⁹⁶ Melitz showed that in the context of barriers to trade, there would be two key productivity cutoff points in the domestic market.⁹⁷ Below a lower productivity level, domestic firms would be unable to bear the fixed costs of supplying even the domestic market.⁹⁸ Above that lower productivity level and up to a higher productivity level, domestic firms would be able to bear the fixed costs of supplying the domestic market alone.⁹⁹ Above the higher productivity level, domestic firms would be able to bear the fixed costs of supplying both the domestic and export markets.¹⁰⁰ With increased market access due to bilateral trade liberalization, the productivity level necessary to survive in the domestic market would increase, while the productivity level necessary to enter the export market would decrease.¹⁰¹ As a consequence, some low-productivity domestic firms will exit the domestic market and be replaced by new foreign exporting firms, some domestic firms that are already productive enough to export will export more, and new domestic firms will also enter the export market.¹⁰² In other words, with reduction in barriers to trade, there will be resource allocation within industries.¹⁰³ This means that consumers will not only benefit from lower prices of imports at the so-called intensive margin due to higher average firm

93. See Andrew B. Bernard et al., *The Empirics of Firm Heterogeneity and International Trade*, 4 ANN. REV. ECON. 283, 284–90 (2012).

94. See *id.* at 284.

95. See *id.*

96. See *id.* at 286–88.

97. See Elhanan Helpman et al., *Export Versus FDI with Heterogeneous Firms*, 95 AM. ECON. REV. 300, 301–09 (2004).

98. See *id.*

99. See *id.*

100. See Marc J. Melitz & Stephen J. Redding, *Heterogeneous Firms and Trade*, in 4 HANDBOOK OF INTERNATIONAL ECONOMICS 8–21 (Gita Gopinath, Elhanan Helpman & Kenneth Rogoff eds., 2014).

101. See *id.* at 18–21.

102. See *id.*

103. See *id.*

productivity, but also at the so-called extensive margin because of entry of new, more productive firms in the domestic market.¹⁰⁴

In the post-war period, global trade has grown: the value of world merchandise trade as a share of world GDP has increased from 17.5 percent in 1960 to 42.3 percent by 2016.¹⁰⁵ Also over this period there have been multiple rounds of tariff cutting under the auspices of the GATT,¹⁰⁶ so it might be expected that growth in the volume of trade would be correlated with multilateral trade liberalization.¹⁰⁷ Not surprisingly, there have been several empirical studies that have explored the relationship between membership of the GATT/WTO and countries' trade flows.¹⁰⁸ A widely accepted study by Arvind Subramanian and Shang-Jin Wei argues that the impact of a country's membership of GATT/WTO will depend on three dimensions: first, what a country does with its membership; second, with which other countries a country negotiates; and, third, which products are covered in trade negotiations.¹⁰⁹ The study's econometric results are consistent with these predictions: industrial countries that have participated in multilateral trade negotiations have enjoyed a significant increase in trade, bilateral trade is greater when many countries engage in tariff reduction as compared to when only a subset of countries do, and sectors such as agriculture that were not covered by trade negotiations exhibit little or no increases in trade.¹¹⁰ However, subsequent empirical work has established that countries' agricultural trade has

104. See Arnaud Costinot & Andrés Rodríguez-Clare, *Trade Theory with Numbers: Quantifying the Consequences of Globalization*, in 4 HANDBOOK OF INTERNATIONAL ECONOMICS, *supra* note 100, at 208–10.

105. See *Merchandise trade (% of GDP)*, THE WORLD BANK, <https://data.worldbank.org/indicator/TG.VAL.TOTL.GD.ZS> (last visited Dec. 2, 2018) [<https://perma.cc/5TJ2-EPVD>] (archived Nov. 8, 2018).

106. See Jagdish Bhagwati, *Seventh Harry G. Johnson Memorial Lecture: Multilateralism at Risk. The GATT is Dead. Long Live the GATT*, 13 *WORLD ECON.* 149, 150 (1990); see also Douglas A. Irwin, *The GATT in Historical Perspective*, 85 *AM. ECON. REV.* 323, 326 (1995); Andrew K. Rose, *Do We Really Know That the WTO Increases Trade?*, 94 *AM. ECON. REV.* 98, 99 (2004).

107. For a discussion about the effects on trade volume that trade liberalization has had, see Pushan Dutt et al., *The Effect of WTO on the Extensive and the Intensive Margins of Trade* 25–26 (INSEAD, The Bus. Sch. of the World, Working Paper No. 2013/38/EPS 2013), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1800563 [<https://perma.cc/3XAV-6LH4>] (archived Nov. 28, 2018) (finding multi-lateral trade liberalization to have the most effect in increasing trade in goods previously not traded).

108. See, e.g., Rose, *supra* note 106, at 98.

109. See Arvind Subramanian & Shang-Jin Wei, *The WTO Promotes Trade, Strongly but Unevenly*, 72 *J. INT'L ECON.* 151, 151–53 (2007).

110. See *id.* at 152.

also been significantly increased by their memberships in GATT/WTO.¹¹¹

In terms of the gains from trade, over the past twenty years, considerable advances have been made evaluating trade theory, especially through application of the so-called gravity model.¹¹² As a consequence, best practice in the applied international economics literature has evolved to the point where it is possible to measure the benefits of trade predicted by both the traditional models as well as those of a more recent vintage.¹¹³ This methodology has been extensively reviewed by leading trade economists Arnaud Costinot and Andrés Rodríguez-Clare in the latest volume of *The Handbook of International Economics*,¹¹⁴ and while the details are highly technical, their bottom line is very revealing and clearly undermines the notion that trade is a zero-sum game. In their main empirical exercise, Costinot and Rodríguez-Clare use 2008 World Bank data for a sample of forty major countries to simulate what would happen to each country's real income if they returned to autarky.¹¹⁵ On average across the sample, the empirical results predict that, without including intermediate goods, the real income gains from trade range from 14 percent to 15 percent depending on whether markets are competitive or monopolistically competitive, and if intermediate goods are factored in, the real income gains from trade range from 27 percent to 40 percent.¹¹⁶ Including trade in intermediate goods captures another channel for gains from trade: domestically produced goods' prices fall, and if those goods are also inputs into producing final goods, there are additional productivity gains leading to larger real income gains (i.e., there is an input-output loop).¹¹⁷

While great progress has been made in international economics in measuring the gains from trade, the results outlined are essentially static (i.e., there is a shock to trade and the gains (losses) are one-off).¹¹⁸ As described above, it is well understood that trade has a *pro-competitive* effect, with import competition driving down firms' profit margins, followed by a *selection* effect where less-profitable/less-productive firms exit markets.¹¹⁹ What is not captured though is the impact that these effects have on investment in innovation as firms try

111. See also Jason H. Grant & Kathryn A. Boys, *Agricultural Trade and the GATT/WTO: Does Membership Make a Difference?*, 94 AM. J. AGRIC. ECON. 1, 2 (2012).

112. See Costinot & Rodríguez-Clare, *supra* note 104, at 198.

113. See *id.* at 198.

114. See *id.*

115. See *id.* at 206.

116. See *id.* at 215.

117. See *id.* at 219.

118. See Giammario Impullitti & Omar Licandro, *Quantifying the gains from trade*, VOX: CEPR POLICY PORTAL (Apr. 29, 2018), <https://voxeu.org/article/quantifying-gains-trade> [<https://perma.cc/5T4Q-ZG2>] (archived Nov. 8, 2018).

119. See *id.*

to raise their productivity and seek advantage over foreign competitors.¹²⁰ In other words, there may be a sequence of gains in productivity and associated price reductions over time that benefit both current and future consumers. A recent body of literature has begun to address this with interesting results. For example, Giammario Impullitti and Omar Licandro conduct an experiment where they push the US economy to shutting down trade, their results indicating that the gains from trade are 50 percent higher than under autarky, half of this gain coming from the effect that trade has on firms' incentives to innovate.¹²¹ In other words, even best-practice applied methodology is likely underestimating the gains from trade. This possibility was confirmed in recent research by Swati Dhingra and others.¹²² The research evaluated the potential economic impact on the UK of its decision to exit the EU, known as "Brexit."¹²³ Their static results suggest that on average, households in the UK will suffer income losses ranging from 1.34 percent to 2.66 percent depending on whether the UK chooses to remain relatively close to the EU by becoming a member of the European Economic Association (EEA), or whether it chooses to leave the EU altogether and trade under WTO rules.¹²⁴ By contrast, their dynamic results indicate that per capita income losses could range from 6.3 percent to 9.4 percent.¹²⁵ Even though the "hardest" Brexit is not a move to autarky, the income losses are expected to be significant. In other words, for the UK, being part of the EU with its highly integrated "internal" market has been a positive-sum game.

III. TRADE DEFICITS ARE CAUSED BY TRADE AND ARE A DIRECT LOSS TO THE US ECONOMY

The previous Part shows that over the decades since the establishment of the GATT/WTO, trade volumes and real GDP have grown for the world and for nations, including the United States. Without explanation, the Trump administration seems to just flatly ignore the large body of theoretical and empirical work that supports the view of trade as a positive-sum game. If so, then on what evidence is the current administration basing its argument that trade has

120. *See id.*

121. *See id.*

122. *See generally* Swati Dhingra et al., *The Costs and Benefits of Leaving the EU: Trade Effects*, 92 *ECON. POL'Y*, 651 (2017) (examining the economic consequences of leaving the European Union on living standards for the United Kingdom).

123. *See id.* at 654.

124. *See id.* at 671.

125. *See id.* at 681.

harmed the United States? To understand its position, we now turn to two other economic assumptions that the United States uses to support its case that it is being harmed by trade: trade deficits and nonreciprocal tariffs.

A. *Bilateral Trade Deficits as a Direct Loss to US GDP*

A basic assumption of the Trump administration is that trade flows between trading partners must be reciprocal to be fair.¹²⁶ In this view, a trade deficit occurs when there is nonreciprocity in the trade flows between two nations.¹²⁷

Although a trade deficit can apply to other categories such as services and technology, most of the time that the US media or experts discuss trade deficits, they are referring to trade in goods.¹²⁸ A trade deficit in goods exists when a nation, such as the United States, purchases more goods from its trading partner than it sells to the same partner.¹²⁹ In the example of China, the United States had a trade deficit in 2017 of \$375 billion, indicating that the United States purchased \$375 billion more in goods from China than China purchased from the United States.¹³⁰ Specifically, in 2017, the United States imported \$130 billion worth of goods from China while exporting \$505 billion worth of goods to China.¹³¹ When the United States sells goods to China, it is earning revenue;¹³² when the United States buys goods from China, the United States is spending its funds and China earns revenue.¹³³ In its trade with China, the United States spends more than it earns, while China earns more than it spends.¹³⁴ The Trump administration sees the gap between what the United States earns in its trade in goods with China and what it spends as a direct loss to the US economy.¹³⁵ Although the Trump administration often focuses on China for unfair trade practices and the trade deficit with China is by far the largest, the United States also has large trade deficits with numerous other trade partners, including Mexico, Canada, Japan, and Germany.¹³⁶ The Trump administration also sees these deficits as evidence that the United States is suffering many

126. See sources cited *supra* note 28.

127. See *id.*

128. See INTERNATIONAL TRADE LAW, *supra* note 18, at 30.

129. See *id.*

130. See Ana Swanson, *U.S.-China Trade Deficit, Fueling Trade Fight*, N.Y. TIMES (Feb. 6, 2018), <https://www.nytimes.com/2018/02/06/us/politics/us-china-trade-deficit.html> [https://perma.cc/42CS-A4HC] (archived Nov. 8, 2018).

131. See *Trade in Goods with China*, *supra* note 33.

132. See INTERNATIONAL TRADE LAW, *supra* note 18, at 30.

133. See *id.*

134. See *id.*

135. See Lee, *supra* note 30.

136. See *Trade in Goods with China*, *supra* note 33.

losses from trade. As US trade in goods with all of these nations is governed by the GATT/WTO, the president therefore views the GATT/WTO as unfair to the United States.¹³⁷

In addition, the administration believes that the trade deficit with China is exacerbated by various illegal and unfair practices, including the use of government subsidies and the theft of intellectual property.¹³⁸ Moreover, in the administration's view, the trade deficit in goods also has many harmful indirect impacts, such as causing the relocation of companies to China and other foreign locations and the loss of jobs in the United States that have been moved abroad.¹³⁹ Although China is often the target of the Trump administration's ire and criticism, similar issues arise in connection with trade with many other nations.

B. A Closer Look at Trade Deficits

As just noted, a key characteristic of the Trump administration's approach to "fair" trade is its focus on the US trade deficit, and in particular, the significant bilateral trade deficits it has with countries such as China and Germany. This focus is driven by the notion that reciprocity requires bilateral trade to be balanced, and if a trading partner does run a trade surplus with the United States, it must be because it is not granting equal reciprocal access. This is another dimension of seeing trade as a zero-sum game; countries running a trade surplus with the United States must be "winners" while the United States must be a "loser." President Trump has frequently expressed this view, tweeting on April 4, 2018:

We are not in trade war with China, that war was lost many years ago by the foolish, or incompetent people who represented the U.S. Now we have a Trade

137. See Renae Reints, *Trump Said to Seek U.S. Withdrawal from the World Trade Organization*, FORTUNE (June 29, 2018), <http://fortune.com/2018/06/29/trump-wto-withdrawal/> [<https://perma.cc/89BS-KV32>] (archived Nov. 8, 2018) (noting that President Trump believes that "WTO was designed by the rest of the world to screw the United States").

138. See Daniel C.K. Chow, *How the United States Uses the Trans-Pacific Partnership to Contain China in International Trade*, 17 CHI. J. INT'L L. 370, 395–99 (2017) (discussing government subsidies paid to state owned-enterprises); *Unilateralism*, *supra* note 1, at Part III.A (discussing China's alleged thefts of US intellectual property).

139. See *Full transcript: Donald Trump's jobs plan speech*, POLITICO (June 6, 2018), <https://www.politico.com/story/2016/06/full-transcript-trump-job-plan-speech-224891> [<https://perma.cc/5TER-D3PG>] (archived Nov. 8, 2018) ("Our politicians have aggressively pursued a policy of globalization - moving our jobs, our wealth and our factories to Mexico and overseas."); Swanson, *supra* note 130 (discussing the Trump administration's citation of the trade gap as a reason for manufacturing decline).

Deficit of \$500 Billion a year, with Intellectual Property Theft of another \$300 Billion. We cannot let this continue!¹⁴⁰

If this were simply the argument of an ill-informed politician, that would be one thing, but the president is receiving advice on how to deal with the US trade deficit from both economist Peter Navarro, head of the White House National Trade Council, and Wilbur Ross, the Commerce Secretary, that is fundamentally flawed.¹⁴¹ During the presidential election, Navarro and Ross wrote a position paper on trade¹⁴² that, to quote one observer, “shows a mind-boggling misunderstanding of the effect of trade on GDP.”¹⁴³ In addition, once in office, the president signed an executive order directing the Commerce Department and the USTR to assess what is driving the US trade deficit, with a focus on the extent to which countries with a bilateral surplus with the United States are acting unfairly.¹⁴⁴ The corollary of this is that a US trade policy pushing trade partners, in bilateral negotiations, to reduce their trade surpluses with the United States will reduce the US trade deficit, and, at the same time, increase its GDP growth rate.¹⁴⁵

In order to illustrate why this policy conclusion is a fallacy, and why virtually all economists would disagree with it,¹⁴⁶ it is necessary to outline some basic national income accounting relationships that can be used to show that the US trade deficit is a structural macroeconomic problem that will not be resolved through bilateral trade negotiations. Starting with the national income accounting identity for an open economy, this can be stated as $Y=C+I+G+(X-M)$ where Y is a country’s GDP (aggregate supply of goods and services); C+I+G (aggregate demand for goods and services) is made up of total

140. Donald Trump (@realDonaldTrump), TWITTER (Apr. 4, 2018 2:22 PM), <https://twitter.com/realdonaldtrump/status/981492087328792577?lang=en> [<https://perma.cc/Z8T6-F4X9>] (archived Nov. 8, 2018).

141. See David R. Henderson, *Trump’s trade trifecta will likely target China, Canada and beyond*, FRASER INST. (Jan. 9, 2017), <https://www.fraserinstitute.org/blogs/trump-s-trade-trifecta-will-likely-target-china-canada-and-beyond> [<https://perma.cc/L42R-KD66>] (archived Nov. 8, 2018).

142. See NAVARRO & ROSS, *supra* note 4.

143. See Henderson, *supra* note 141.

144. See Caroline Freund, *Public Comment on Trump Administration Report on Significant Trade Deficits*, PETERSON INST. INT’L ECON. (May 8, 2017), <https://piie.com/blogs/trade-investment-policy-watch/public-comment-trump-administration-report-significant-trade> [<https://perma.cc/KZH9-LSLC>] (archived Nov. 8, 2018).

145. See ROBERT Z. LAWRENCE, PETERSON INST. INT’L ECON., POLICY BRIEF 18-6: FIVE REASONS WHY THE FOCUS ON TRADE DEFICITS IS MISLEADING 5 (Mar. 2018), <https://piie.com/system/files/documents/pb18-6.pdf> [<https://perma.cc/6K55-BLHG>] (archived Nov. 6, 2018).

146. See C. FRED BERGSTEN, PETERSON INST. INT’L ECON., POLCY BRIEF 17-23: TRADE BALANCES AND THE NAFTA RENEGOTIATION 2 (June 2017), <https://piie.com/system/files/documents/pb17-23.pdf> [<https://perma.cc/YJ57-P2XL>] (archived Dec. 2, 2018).

household consumption of goods and services (C), investment purchases by firms of goods and services (I), and government purchases of goods (G); and X and M are the total exports and imports of goods and services, (X–M) being a country's current account (CA).¹⁴⁷

The national income accounting identity is an equality, that is, it is true regardless of the value of its variables. Therefore, it is very straightforward to dismiss the argument that reducing imports will increase a country's GDP. More importantly though, this identity can be rearranged to show that the current account (X–M) is in surplus or deficit depending on the difference between the aggregate supply (Y) and demand (C+I+G) of goods and services (i.e., $CA=Y-(C+I+G)$). Essentially, if aggregate supply (demand) exceeds aggregate demand (supply), a country will run a trade surplus (deficit). Therefore, in the case of the United States which runs a current account deficit, imports of goods and services make up the difference between what US residents supply and demand.¹⁴⁸

This leads to a key question: what is the root cause of the US trade deficit? To answer this requires rewriting the national income accounting identity to highlight the connection between the flow of goods and services (C, I, G, X, and M) and financial flows. Specifically, a country's national savings (S) are made up of private and public savings. Private savings are defined as GDP net of taxes minus consumption ($Y-T-C$), while public savings are defined as the difference between government revenue generated through taxation and government spending ($T-G$) (i.e., national savings can be denoted as $S=(Y-T)-C+(T-G)$).¹⁴⁹ Assuming that the taxes deducted from income are the same as the taxes levied by the government, then national savings can be defined as $S=Y-C-G$. The expression for national savings can then be used to rewrite the national income accounting identity as $CA=S-I$ (i.e., the current account is the difference between a country's savings and investment). Therefore, the underlying macroeconomic reason for the US trade deficit is due to the fact that the US supply of savings (S) is less than its demand for investment (I).¹⁵⁰ In other words, as a nation, the United States does not save enough, a conclusion with which virtually all economists agree.¹⁵¹ Figure 1 clearly illustrates that since the 1980s, as a percentage of GDP, US investment has exceeded national savings, and at the same time the United States has consistently run a trade deficit.

147. See PAUL R. KRUGMAN ET AL., INTERNATIONAL ECONOMICS: THEORY AND POLICY 300 (2012) [hereinafter KRUGMAN THEORY].

148. See *id.* at 300–01.

149. See *id.* at 303–04.

150. See *id.* at 302–04.

151. See Freund, *supra* note 144.

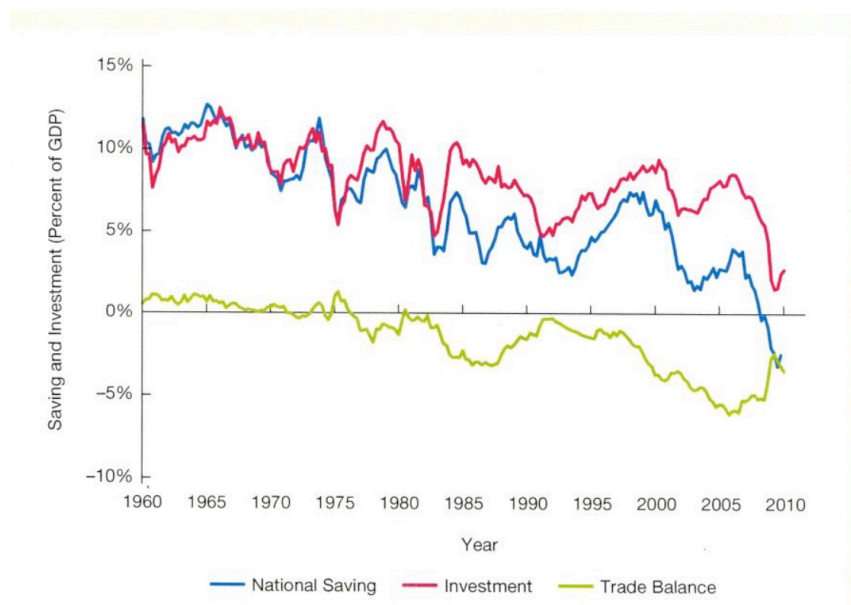


Figure 1: US National Savings, Investment and Trade Balance, 1960–2010¹⁵²

The difference between national savings and investment is made up by net foreign investment, which is defined as the difference between capital outflows from and capital inflows to a country.¹⁵³ If a country's financial claims on foreign residents and institutions exceed the foreign financial claims on that country's residents and institutions, its net foreign investment is positive; in the case of the United States, its net foreign investment is negative. This means that the United States is a net exporter of claims on financial assets at the same time as it is a net importer of goods and services.¹⁵⁴ The international flow of assets is measured through an economy's capital account, which in combination with its current account, forms the balance of payments—in other words, a negative current account will

152. See *BEA's Support of Open Data*, BUREAU ECON. ANALYSIS, <https://www.bea.gov/open-data> (last visited Dec. 2, 2018) [<https://perma.cc/K5L6-AUFS>] (archived Nov. 8, 2018).

153. See BERGSTEN, *supra* note 146, at 2.

154. This flow of assets can be seen in the case of China, which uses its earnings from imports sold to the United States to buy US treasury bonds. See Panos Mourdoukoutas, *Trade War or Not, Beijing Will Continue Buying U.S. Treasuries—It Has No Choice*, FORBES (Mar. 25, 2018), <https://www.forbes.com/sites/panosmourdoukoutas/2018/03/25/trade-war-or-not-beijing-will-continue-buying-us-treasuries-it-has-no-choice/#c6bbe055d68e> [<https://perma.cc/3WRS-UP5A>] (archived Nov. 8, 2018) (explaining why China will continue to keep buying US treasury bonds and why selling off US treasury bonds would probably backfire).

be balanced by a positive capital account, that is, the balance of payments as an accounting convention should equal zero.¹⁵⁵

Given that the United States' trade deficit is a macroeconomic phenomenon, there are three interconnected questions relating to the deficit. First, if the US trade deficit is not a function of trade policy, what is its underlying cause? Second, should policymakers be concerned about the United States persistently running a trade deficit? Third, what are the appropriate policy instruments that could be targeted at reducing the US trade deficit?

In answer to the first question, most economists agree that the US trade deficit has grown over time due to a decline in the national savings rate, driven by declines in both private and public savings rates.¹⁵⁶ In other words, US households have a high marginal propensity to consume and the US government has had a propensity to run fiscal deficits, as shown in Figure 2.

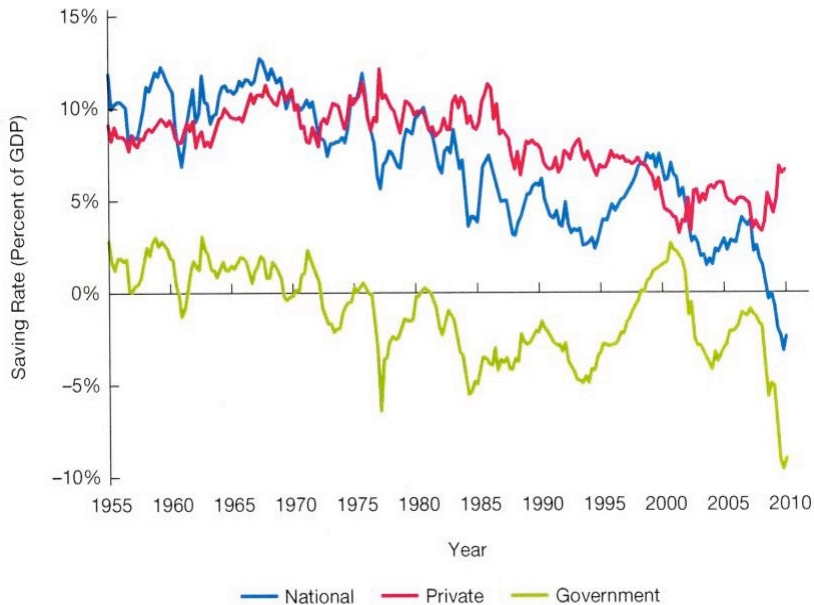


Figure 2: US Savings Rates, 1960–2010¹⁵⁷

Consequently, unless savings increase and/or investment falls, the US trade deficit will continue to grow. In particular, economists such as Jeffrey Frankel at Harvard have pointed out that the tax cuts

155. See KRUGMAN THEORY, *supra* note 147, at 306–09.

156. See Freund, *supra* note 144.

157. See BEA's Support of Open Data, *supra* note 152.

and budget legislation passed in Congress in 2017¹⁵⁸ and trade policy supported by the Trump administration will increase the US fiscal deficit, which will feed into an increase in the current account deficit.¹⁵⁹ This outcome will be exacerbated by the fact that the US economy is currently running at full employment, output being constrained by capacity.¹⁶⁰ Therefore, increased spending due to tax cuts will almost entirely go into imported goods and services thereby increasing the trade deficit.¹⁶¹

In thinking about the second question, while the administration focuses its concern on the fact that the United States currently runs bilateral trade deficits with countries such as China and Germany, economists argue that these are of little or no concern.¹⁶² What matters is that in order to facilitate its aggregate trade deficit, the United States continues to run a negative and growing net international investment position (NIIP), as shown in Figure 3.¹⁶³

158. Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

159. See Jeffrey Frankel, *Donald Trump is making America's deficits great again*, THE GUARDIAN (Jan. 15, 2018), <https://www.theguardian.com/business/2018/jan/15/donald-trump-is-making-americas-deficits-great-again> [<https://perma.cc/86SD-N6PE>] (archived Nov. 8, 2018).

160. See *id.*

161. See *id.*

162. See Freund, *supra* note 144.

163. See Joseph E. Gagnon, *The Unsustainable Trajectory of US International Debt*, PETERSON INST. INT'L ECON. (Mar. 29, 2017), <https://piie.com/blogs/realtime-economic-issues-watch/unsustainable-trajectory-us-international-debt> [<https://perma.cc/S54H-QUY2>] (archived Nov. 8, 2018) [hereinafter Gagnon *Unsustainable*].

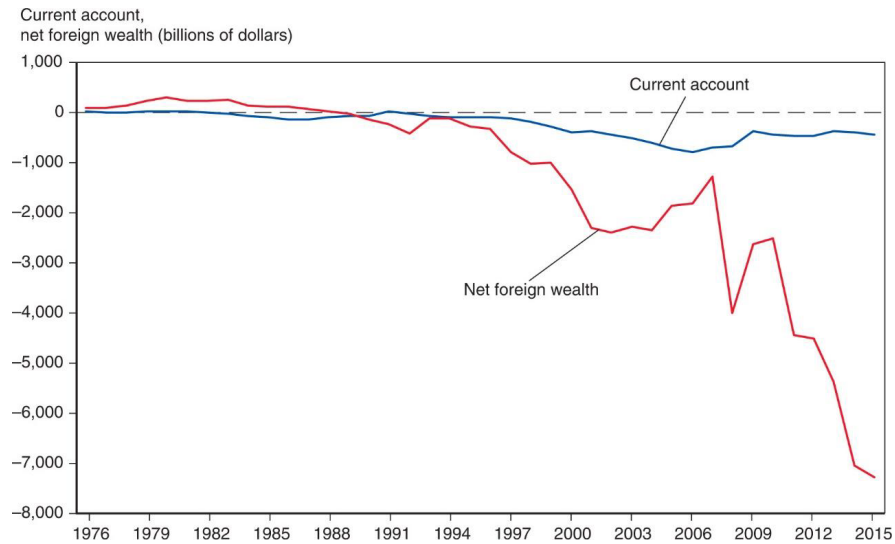


Figure 3: US Current Account and Net International Investment Position, 1976–2015¹⁶⁴

At the end of 2016, foreign financial claims on the United States exceeded US financial claims on other countries by \$8.4 trillion, NNIP being -45 percent of GDP, and forecast to increase to -53 percent of GDP by 2021.¹⁶⁵ Economists such as Maurice Obstfeld and Kenneth Rogoff, current and former chief economists at the International Monetary Fund (IMF), have argued that this is not sustainable and would require a significant real depreciation of the US dollar with associated adjustment costs, and the longer the trade deficit continues, the more extreme relative price adjustments will have to be.¹⁶⁶

Economists, with almost no exceptions, are in agreement that trade policy will not solve the US trade deficit/international debt problem.¹⁶⁷ The empirical evidence suggests that trade policy has little effect on a country's trade balance—average tariffs are negatively correlated with trade balances, and liberalizing trade has little impact on those balances.¹⁶⁸ More restrictive trade policy, such as higher tariffs, will therefore have only a marginal effect, if any, on the US

164. See BEA's *Support of Open Data*, *supra* note 152.

165. See Gagnon *Unsustainable*, *supra* note 163.

166. Maurice Obstfeld & Kenneth Rogoff, *Global Current Account Imbalances and Exchange Rate Adjustments*, 1 BROOKINGS: PAPERS ON ECON. ACTIVITY No. 67, at 74 (2005).

167. See Freund, *supra* note 144.

168. See *id.*

trade deficit.¹⁶⁹ While tariffs do reduce imports, they will also reduce exports, which follows from the fact that import tariffs reduce the demand for foreign currency, thereby strengthening the US dollar, which then feeds into lower exports.¹⁷⁰

Many economists believe two interdependent policy choices need to be made in order to target the underlying macroeconomic cause of the US trade deficit: a managed real depreciation of the US dollar in combination with policies designed to increase national savings.¹⁷¹ Joseph Gagnon and Fred Bergsten of the Peterson Institute for International Economics have argued that the United States should announce a policy of “countervailing currency intervention” to offset any currency intervention by G20 countries that are running trade surpluses.¹⁷² At the same time, the gap between US savings and investment should be reduced by cutting the fiscal deficit.¹⁷³ Without the latter, there is a potential for overheating in the US economy as inflation increases with dollar depreciation, resulting in the Federal Reserve raising interest rates.¹⁷⁴ The latter would encourage more savings and less investment but, at the same time, put upward pressure on the dollar as US financial assets become more attractive to overseas lenders.¹⁷⁵ Therefore, reducing the fiscal deficit will result in lower interest rates, which will in turn help with currency depreciation.

As outlined here, these policy choices are matters of macroeconomic policy, and not trade policy, such as higher tariffs. Indeed, there is little debate among economists on this point.¹⁷⁶ The hurdle to implementing such changes has been a political one because a number of these specific policy choices, such as taxing consumption and increasing public saving through higher taxes and/or lower government spending, are highly unpopular with the American electorate.¹⁷⁷ Thus, a significant practical issue has been the lack of

169. *See id.*

170. *See id.*

171. *See* Joseph E. Gagnon, *Curbing the Growth of US International Debt*, PETERSON INST. INT’L ECON. (Mar. 29, 2017), <https://piie.com/blogs/realtime-economic-issues-watch/curbing-growth-us-international-debt> [<https://perma.cc/95QF-YUEV>] (archived Nov. 5, 2018).

172. *See id.*

173. *See id.*

174. *See id.*

175. *See id.*

176. *See* Freund, *supra* note 144.

177. *See* *Fewer Want Spending to Grow, But Most Cuts Remain Unpopular*, PEW RESEARCH CENTER (Feb. 10, 2011), <http://www.people-press.org/2011/02/10/fewer-want-spending-to-grow-but-most-cuts-remain-unpopular/> [<https://perma.cc/9QDE-P38C>] (archived Nov. 5, 2018) (data showing the difficulty of raising taxes or decreasing spending); John Gramlich, *Few Americans Support Cuts to Most Government Programs, Including Medicaid*, PEW RESEARCH CENTER (May 26, 2017), <http://www.pewresearch.org/fact-tank/2017/05/26/few-americans-support-cuts-to-most->

political will on the part of elected US government officials who are reluctant to propose and implement unpopular policy changes for fear of stoking the ire of their constituencies.¹⁷⁸

IV. NONRECIPROCAL TARIFFS AS CAUSING A LOSS TO THE US ECONOMY

An additional argument made by the Trump administration to support its view that trade harms the United States is based on the unfairness of nonreciprocal tariffs.¹⁷⁹ The concept of reciprocity requires that the terms and conditions of trade between nations must be strictly reciprocal, or equivalent. At the level of tariffs, the tariff rate between two trading partners must be reciprocal, or the same, for any particular imported good. According to President Trump, nonreciprocal tariffs are evidence of unfairness to the nation with lower tariffs:

When a car is sent to the United States from China, there is a Tariff to be paid of 2 1/2%. When a car is sent to China from the United States, there is a Tariff to be paid of 25%. Does that sound like free or fair trade? No, it sounds like STUPID TRADE - going on for years!¹⁸⁰

In the case of China and other trading partners, the Trump administration claims that the United States has many nonreciprocal tariffs (i.e., the US tariff for goods imported from China is lower than the corresponding Chinese tariff for the same goods imported from the United States).¹⁸¹ The administration often points to automobiles as a particularly egregious example of this unfairness and evidence of China profiting from an unfair trade deal at the expense of the United States.¹⁸²

government-programs-including-medicaid/ [https://perma.cc/RVY6-H4GT] (archived Nov. 5, 2018).

178. See Eduardo Porter, *America's Aversion to Taxes*, N.Y. TIMES (Aug. 14, 2012), <https://www.nytimes.com/2012/08/15/business/economy/slipping-behind-because-of-an-aversion-to-taxes.html> [https://perma.cc/W6BS-5NLJ] (archived Nov. 5, 2018).

179. See Colin Grabow, *The Trouble with Trump's Tariff Reciprocity*, CATO INST. (Nov. 10, 2017), <https://www.cato.org/blog/against-reciprocal-tariffs> [https://perma.cc/242E-EXBK] (archived Nov. 6, 2018) (criticizing Trump's view that tariffs must be reciprocal to be fair).

180. Donald Trump (@realDonaldTrump), TWITTER (Apr. 10, 2018, 3:03 AM), <https://twitter.com/realDonaldTrump/status/983284198046826496> [https://perma.cc/K8QP-BF3S] (archived Nov. 6, 2018) [hereinafter Apr. 2018 Tweet].

181. See Paul Bedard, *China trade tariffs more than 2X higher than US*, WASH. EXAMINER (Mar. 23, 2018), <https://www.washingtonexaminer.com/washington-secrets/china-trade-tariffs-more-than-2x-higher-than-us> [https://perma.cc/AS72-7GHN] (archived Nov. 8, 2018) [https://perma.cc/JA9E-9BHB] (archived Nov. 6, 2018) (China "imposes tariffs more than twice as high as the United States").

182. See *id.*

A. Tariffs under the WTO

Under the modern global trading system established by the WTO, most nations continue to use tariffs as part of trade policy.¹⁸³ Tariffs are customs duties or taxes imposed by customs authorities on imports at a port of entry and must be paid before the goods can enter the internal market.¹⁸⁴ Most tariffs today are *ad valorem* tariffs (i.e., expressed as a percentage of the value of the import),¹⁸⁵ although other types of tariffs are also sometimes used alone or in combination with *ad valorem* tariffs.¹⁸⁶ The United States and all other members of the WTO have voluntarily adopted a system of classification of imports for tariff purposes that conform to the International Convention on the Harmonized Commodity Description and Coding System of 1988 (Harmonized Convention) drafted by the World Customs Council, which works closely with the WTO.¹⁸⁷ The Harmonized Convention is a classification system based on ninety-seven chapters covering all goods.¹⁸⁸ Chapters are designated by a two-digit number appearing at the beginning of the classification.¹⁸⁹ The higher the chapter number, the more complex and industrialized the import, and the lower the number, the simpler and closer to nature will be the product.¹⁹⁰ The two-digit chapter number is followed by a four-digit number indicating subheadings for goods within the chapter.¹⁹¹ All WTO members have agreed to adopt the Harmonized Convention up to the six-digit level, with many countries assessing the tariff at the six-digit level.¹⁹² The

183. All WTO members maintain tariff schedules filed with the WTO. See *Current Situation of Schedules of WTO Members*, WORLD TRADE ORG., https://www.wto.org/english/tratop_e/schedules_e/goods_schedules_table_e.htm [<https://perma.cc/G5U8-PNC6>] (archived Nov. 9, 2018).

184. See INTERNATIONAL TRADE LAW, *supra* note 18, at 199.

185. See *id.* at 200.

186. See *id.* Another common type of tariff is a tariff rate quote (TRQ) in which a lower tariff is charged for imports up to a certain limit (the “in quota” amount) and a higher tariff for imports above the limit (the “out of quota” amount). See *id.* TRQs are commonly used in US trade policy. *Are My Goods Subject to Quota?*, U.S. CUSTOMS & BORDER PROT. (July 19, 2018), <https://www.cbp.gov/trade/quota/quota-restrict> [<https://perma.cc/9A24-UDKX>] (archived Nov. 7, 2018) (indicating that many US free trade agreements establish TRQs).

187. See CHOW & SCHOENBAUM, *supra* note 20, at 137.

188. See *id.*

189. See *id.*

190. See *id.*

191. See *id.* at 137.

192. See *id.* at 138. The United States uses a ten-digit system. The tariff is assessed at the eight-digit level, called the tariff line. The ten-digit number is used for information gathering purposes only. The US six-digit number is the same as that used by all other WTO members. See *id.* at 128. In order to make a final assessment of the tariff, the United States will determine the country of origin of the product. Different rates for the same good apply depending upon whether the country of origin is a

United States has implemented the Harmonized Convention as the Harmonized Tariff Schedule of the United States (HTSUS).¹⁹³

This remarkable level of harmonization of tariff codes means that it has now become a straightforward matter to compare tariff rates for all imports across all WTO countries. To determine whether tariffs are reciprocal, it is a simple matter of finding a tariff classification at the six-digit level within the tariff schedule of each nation and then examining the tariff rate associated with the six-digit classification. The harmonization of national tariff schedules for all WTO countries makes it easy for the Trump administration to argue that tariffs must be reciprocal because it is relatively easy and straightforward to compare tariffs for the same product across all countries.

The position of the Trump administration appears to be that previously, US administrations have entered into unfair agreements with their trading partners by agreeing to tariff schedules with new members, such as China, that are nonreciprocal.¹⁹⁴ Moreover, according to the Trump administration, the United States is the losing party in the nonreciprocal tariff agreements and, as a result, is suffering trade losses that contribute to the US trade deficit with China and other trading partners.¹⁹⁵ To correct this problem, the United States must renegotiate tariff schedules with its trading partners and implement strictly reciprocal tariff schedules.

B. *Nonreciprocal Tariffs and Trade Losses*

The argument by the Trump administration on reciprocal tariffs seems to imply that the United States and China engaged in a bilateral negotiation over tariffs and that the United States unwisely accepted an unfair agreement concerning tariffs with China. In practice, however, the process of tariff negotiations under the GATT/WTO is more complex.

Since both the United States and China are members of the WTO, their tariff schedules were negotiated under the auspices of the GATT/WTO. The United States was a founding member of the GATT and its tariff schedule was established in 1947 with the inception of the

member of the WTO, has a trade treaty with the United States, or is neither a WTO member nor a US treaty partner. *See id.*

193. *See id.* at 137.

194. *See* Apr. 2018 Tweet, *supra* note 180.

195. *See id.* Trump also claimed that Japan having tariff rates that are higher than US rates as evidence of the United States being harmed by Japan. *See* Grabow, *supra* note 179.

GATT.¹⁹⁶ China did not become a member of the GATT/WTO until 2001.¹⁹⁷ Under WTO procedures, when a new member seeks to join the GATT/WTO, it must submit a formal written request for accession.¹⁹⁸ The process of access is essentially a back-and-forth negotiation process between the applicant and existing WTO members.¹⁹⁹ As part of this process, the applicant engages in bilateral negotiations (i.e., bargaining on a one-to-one basis) with any WTO member interested in such bilateral talks.²⁰⁰ In the bilateral negotiation, the applicant and existing WTO members must reach agreement on market access commitments²⁰¹ (i.e., tariff schedules).²⁰² Under this process, China's proposed tariff schedule was made available for all interested WTO members who had the opportunity to raise objections; similarly, China had the opportunity to ask for tariff concessions from existing WTO members as the process of accession was essentially a negotiation process concerning a number of issues, including tariffs.²⁰³ This back-and-forth process is a lengthy negotiation that continues until the new member and all existing members are in agreement. The tariff schedule of the new member and any revisions in the schedules of all existing members then become effective legal WTO obligations of all members.²⁰⁴ All members are required by the GATT/WTO to impose tariffs that do not exceed the rates set forth in the agreed-upon tariff schedules.²⁰⁵

196. GATT, *supra* note 18, art. XXXIII (addressing the accession process). For a general overview of how the GATT came to be, see generally DOUGLAS IRWIN ET AL., *THE GENESIS OF THE GATT* (2008).

197. Press Release, World Trade Org., WTO Successfully Concludes Negotiations on China's Entry (Sept. 17, 2001), https://www.wto.org/english/news_e/pres01_e/pr243_e.htm [<https://perma.cc/5DSG-H5JW>] (archived Nov. 6, 2018).

198. *See How to become a member of the WTO*, WORLD TRADE ORG., https://www.wto.org/english/thewto_e/acc_e/acces_e.htm [<https://perma.cc/C2XH-WR3Q>] (archived Nov. 6, 2018) [hereinafter *WTO Member*].

199. *See id.*

200. *See id.* ("At the same time, the applicant government engages in bilateral negotiations with interested Working Party members.")

201. *See id.*

202. *See Market access for goods*, WORLD TRADE ORG., https://www.wto.org/english/tratop_e/markacc_e/markacc_e.htm [<https://perma.cc/54G6-Q7U5>] (archived Nov. 6, 2018) (noting that market access for goods in the WTO includes "tariff commitments . . . set out in each member's schedules of concessions on goods").

203. *See WTO Member, supra* note 198.

204. *See GATT, supra* note 18, arts. II:1(a) & (b).

205. *Id.* Tariffs are "bound" under the GATT, meaning that WTO members have agreed on ceilings on tariffs and WTO members cannot impose tariffs above the ceilings. GATT states in relevant part: "The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided therein." (emphasis added). *Id.* art. II:1(b).

C. Reciprocity and the GATT/WTO

The administration's focus on reciprocity is based on its misunderstanding of exactly how the GATT/WTO has functioned historically and of the economic logic employed by the bodies. "GATT/WTO has established a rules-based system for world trade based on a set of principles enshrined in the GATT Articles, along with a dispute settlement system, that have been universally accepted and respected by its members."²⁰⁶ Membership has grown from the twenty-three countries that signed the GATT in 1947 to 164 countries today.²⁰⁷ Currently, WTO members account for more than 95 percent of both global trade and GDP.²⁰⁸ Over the seventy years of its existence, the GATT/WTO has witnessed eight rounds of trade negotiations, resulting in average industrial tariffs being reduced to less than 4 percent,²⁰⁹ although it should be noted that there is quite a bit of variation in the average level of MFN-applied tariffs across both countries and sectors.²¹⁰

GATT/WTO has worked due to the application of two key principles by member countries: reciprocity²¹¹ and nondiscrimination.²¹² Importantly, though, the approach to reciprocity applied by the GATT/WTO in successive rounds of trade negotiation is not the same as that touted by the Trump administration. The GATT/WTO allows for what is termed *first-difference* (marginal) reciprocity, where trade negotiations focus on balancing concessions on tariffs given an initial set of conditions.²¹³ By contrast, the administration seeks *full* (level/mirror image) reciprocity in trade

206. Ian M. Sheldon, Daniel C.K. Chow & William McGuire, Trade Liberalization and Institutional Constraints on Moves to Protectionism: Multilateralism vs. Regionalism (Dec. 2017) (unpublished paper presented at 2018 Allied Social Sciences Association Annual Meeting) [hereinafter Sheldon Trade] (citing Richard Baldwin, *The World Trade Organization and the Future of Multilateralism*, 30 J. ECON. PERSP. 95, 95–116 (2016)).

207. See ANGELO PRESENZA & LORI R. SHEEHAN, GEOPOLITICS AND STRATEGIC MANAGEMENT IN THE GLOBAL ECONOMY 3 (2018).

208. See PETER J. WILLIAMS, WORLD TRADE ORG., A HANDBOOK ON ACCESSION TO THE WTO 2 (2008), <http://bkp-development.com/et-tcbu-docs/7/Williams%20-%20Handbook%20on%20Accession%20to%20the%20WTO%20%5B2008%5D.pdf> [https://perma.cc/95EP-ZNET] (archived Dec. 2, 2018).

209. See ANWARUL HODA, TARIFF NEGOTIATIONS AND RENEGOTIATIONS UNDER THE GATT AND THE WTO: PROCEDURES AND PRACTICES 53, 70–71 (2001).

210. See Kyle Bagwell et al., *Is the WTO Passé?*, 54 J. ECON. LIT. 1125, 1131 (2016).

211. GATT, *supra* note 18, art. IV (c). This type of reciprocity is made possible by the negotiation process described *infra* in Part IV.C.

212. For a discussion of WTO nondiscrimination principles, see sources cited *supra* notes 17–19 and accompanying text.

213. See BERGSTEN, *supra* note 146.

negotiations.²¹⁴ The latter approach is very straightforward—the United States currently applies a 2.5 percent tariff on imported automobiles, while the EU and China apply 10 percent and 25 percent tariffs, respectively.²¹⁵ This is considered discriminatory, and, therefore, both the EU and China should reduce their automobile tariffs to the same level as that in the United States. This approach to reciprocity is highly sectoral, but it ignores the dynamics of trade liberalization. Specifically, why would policymakers in one country agree to cut tariffs in a specific sector by more than what is politically feasible?

Richard Baldwin describes a dynamic process where policymakers trade off increased access to their own markets through tariff cuts in exchange for access to export markets (i.e., the concerns of those lobbying for the import-competing sectors are balanced by those lobbying for the export-competing sectors).²¹⁶ In other words, negotiations in the GATT/WTO have proceeded on the basis that there will be a balance of trade concessions between member countries, measured in terms of increased market access, but in the final deal, each member country continues to protect a set of politically sensitive sectors that will likely differ across countries.²¹⁷ Therefore, seeking full reciprocity ignores the political reality of trade negotiations. By contrast, first-difference reciprocity recognizes that if the United States seeks a lower tariff on its exports of automobiles to China it can offer to lower the US tariff on imports of footwear, a deal that works if there is a commensurate increase in each country's export market share.²¹⁸ Economic losses in the US footwear sector are balanced by economic gains in the automobile sector, or, quoting from *The Economist*, "Trade liberalization is a sort of jujitsu that uses exporter's determination to get into foreign markets to overwhelm domestic lobbies that would sooner keep home markets closed."²¹⁹

So why has first-difference reciprocity worked in the GATT/WTO? "Orthodox trade theory suggests that a small country will unilaterally cut its tariffs, the gains from trade through specialization and exchange subsequently maximizing national income."²²⁰ This is not

214. Sheldon Trade, *supra* note 206, at 11.

215. *Donald Trump insists on trade reciprocity. But what kind?*, THE ECONOMIST (July 12, 2018), <https://www.economist.com/finance-and-economics/2018/07/12/donald-trump-insists-on-trade-reciprocity.-but-what-kind> [https://perma.cc/45ZX-G7PD] (archived Nov. 7, 2018) [hereinafter *Trump trade reciprocity*].

216. See Richard E. Baldwin, *Multilateralizing Regionalism: Spaghetti Bowls as Building Blocs on the Path to Free Trade*, 29 WORLD ECON. 1451, 1459–71 (2006).

217. See *Trump trade reciprocity*, *supra* note 215.

218. See *id.*

219. See *The future of globalisation*, THE ECONOMIST (July 27, 2006), <https://www.economist.com/leaders/2006/07/27/the-future-of-globalisation> [https://perma.cc/ETD3-3AUY] (archived Nov. 7, 2018).

220. Sheldon Trade, *supra* note 206, at 4.

necessarily the case if a country, such as the United States, is large enough to influence the price of its imports relative to the price of its exports (i.e., its international terms of trade), or if public policy is influenced by government preferences other than maximization of national income. In other words, economic analysis of GATT/WTO is about seeking a logical explanation for why a powerful country, such as the United States, would seek to be part of such a trade agreement, despite these unilateral incentives to raise tariffs.²²¹

In order to answer the first question, the seminal economic approach of Kyle Bagwell and Robert Staiger to modeling GATT/WTO is outlined.²²² The workhorse model for their approach is a simple two-good, two-country model, where one country (home) has a comparative advantage in producing one good, and a second country (foreign) has a comparative advantage in producing a second good.²²³ There are two important price relationships in this setting: local relative prices of goods in the home and foreign countries, respectively, and world relative prices of goods. In the absence of home and foreign tariffs, local and world relative prices are exactly the same (i.e., markets are fully integrated).²²⁴ If each country sets a tariff on the good it imports from the other country, it drives a wedge between its local and world relative prices, giving protection to its import-competing sector by raising the price of imports compared to local products; at the same time, each country is large enough to be able to improve its terms of trade through a tariff (i.e., it is large enough to be able to drive down the world relative price of its imported good).²²⁵ Given that local prices determine the level and distribution of incomes earned by factors of production (labor and capital) in each country, various government preferences discussed in the political economy literature can be implemented, including national income maximization and political lobbying

221. See Kyle Bagwell & Robert W. Staiger, *An Economic Theory of GATT*, 89 AM. ECON. REV. 215, 215–216 (1999).

222. See *id.* at 226–27.

223. See *id.* at 219; Sheldon Trade, *supra* note 206, at 4. In this simple model, there are only two goods, x and y , in the world economy, where the home country is relatively efficient at producing good y , which it exports in exchange for good x , which the foreign country is relatively efficient at producing and exporting. See Bagwell & Staiger, *supra* note 221, at 219.

224. See Bagwell & Staiger, *supra* note 221, at 219; Sheldon Trade, *supra* note 206, at 4. Relative prices are given by the ratio of the price of good x to the price of good y . This ratio exists in each country's local market as well as on the world market. If there are no barriers to trade between the two countries, local and world price ratios are equal to each other. If a country implements a tariff, the local price ratio will then be different to the world price ratio. See Bagwell & Staiger, *supra* note 221, at 219.

225. See Bagwell & Staiger, *supra* note 221, at 220; Sheldon Trade, *supra* note 206, at 4. A country's terms of trade are given by the world price ratio, an improvement in its terms of trade being measured as a fall in the price of the good that it imports. See Bagwell & Staiger, *supra* note 221, at 220.

models.²²⁶ It is also assumed that holding its local relative price fixed, both home and foreign governments value an improvement in their terms of trade.²²⁷ Specifically, the fall in the world relative price of their imported good results in a transfer of income from the foreign to the home country.²²⁸

If there is no trade agreement, the home and foreign countries play out a noncooperative game in tariffs where each government strikes a balance with respect to the local and world relative price effects of its tariff choices.

In terms of local relative price changes, there is a trade-off between the political benefits of redistribution to factors [of production] employed in the import-competing sector and any deadweight losses to domestic consumers. With respect to world relative price changes, the improvement in one country's terms-of-trade necessarily results in a worsening of the other country's terms-of-trade, i.e., each country shifts some of the costs of [its] protection onto the other country.²²⁹

For example, the home country, in using a tariff to drive down the relative price of its imported good, necessarily worsens the terms of trade of the foreign country who exports that same good.

Essentially, it is the cost-shifting externality that results in the noncooperative equilibrium tariffs being inefficient. “[E]ach government would like to lower [its] respective tariffs in order to reduce the domestic distortion and generate more trade, but if done unilaterally [each nation suffers] a worsening of its terms of trade.”²³⁰ The key insight by Professors Kyle Bagwell and Robert Staiger is that if the terms-of-trade externality can be neutralized, it will be beneficial for both countries to lower their tariffs.²³¹ In other words, suppose that neither country's government cared about terms-of-trade effects; tariffs will be set to satisfy domestic political objectives alone.²³² “These tariffs are termed ‘politically-optimal tariffs,’ which would either be zero if each government seeks to maximize national income through free trade, or they would be positive in order to satisfy domestic

226. See Harry G. Johnson, *Optimum Tariffs and Retaliation*, 21 REV. ECON. STUD. 142, 142–53 (1953); see also Gene M. Grossman & Elhanan Helpman, *Protection for Sale*, 84 AM. ECON. REV. 833, 833–50 (1994); Wolfgang Mayer, *Theoretical Considerations on Negotiated Tariff Adjustments*, 33 OXFORD ECON. PAPERS 135, 136 (1981).

227. See Bagwell & Staiger, *supra* note 221, at 221.

228. See *id.* at 221; Sheldon Trade, *supra* note 206, at 4. The transfer of income comes about due to an increase in tariff revenue, i.e., the importer pays a lower price for the imported good on the world market, but the local price of that good increases as a result of the tariff. See Bagwell & Staiger, *supra* note 221, at 221.

229. Sheldon Trade, *supra* note 206, at 6.

230. *Id.* at 6.

231. See Bagwell & Staiger, *supra* note 221, at 226–27.

232. See *id.* at 222–23.

political-lobbying constraints,”²³³ such as the protection of domestic sectors, but importantly, they are lower than those in a noncooperative game.²³⁴ Therefore, if countries enter into a trade agreement, they will seek mutual reductions in tariffs generating an increase in national economic welfare.

Given this model structure, the application of the principle of reciprocity in GATT/WTO does result in tariff reductions that raise economic welfare. Specifically, first-difference reciprocity means that for either country to offer a tariff concession, it requires a tariff concession from the other country such that the world relative prices remain unchanged (i.e., terms-of-trade effects are ruled out). Tariff-cutting continues until one of two conditions is satisfied: either one country’s government achieves its preferred local relative price before the other country, or “politically-optimal tariffs” are achieved. Of course, the idea that trade negotiators are concerned with the technicality of terms-of-trade effects is likely unrealistic, but this concept can be expressed in terms of market access. A tariff, while creating a terms-of-trade benefit for the importing country, also results in a loss of market share for the exporting country. In other words, from a practical standpoint, trade negotiations are about mutual concessions on market access, taking account of domestic political constraints.²³⁵

As well as first-difference reciprocity, the principle of nondiscrimination in GATT/WTO also requires that tariffs be applied on a nondiscriminatory MFN basis;²³⁶ in other words, in the simple model, if the home and foreign country agree to lower their tariffs, those tariff cuts should be extended by each of those countries to any other country that is a member of GATT/WTO.²³⁷ Importantly, MFN in combination with reciprocity can minimize the risk of third-country spillovers.²³⁸ Suppose the home country exports its good to two foreign countries, and imports the other good from both countries, and it chooses to enter into reciprocal tariff reduction with foreign country 1, but both the home and foreign country 1 offer their respective tariff

233. See *id.* at 221; Sheldon Trade, *supra* note 206, at 6. This is getting at the idea that even if there is no benefit from manipulating its terms of trade, a country’s government may still set tariff(s) to achieve its domestic political objectives.

234. See Bagwell & Staiger, *supra* note 221, at 222–24.

235. See *id.* at 216.

236. See GATT, *supra* note 18, art. I (establishing the MFN principle). See also sources cited *supra* notes 17–20.

237. See GATT, *supra* note 18, art. I. This result is required by MFN, which provides that WTO members must extend trade benefits given to any country to all other WTO members. The effect of MFN is to multiply and universalize trade benefits for all WTO members.

238. See Kyle Bagwell & Robert W. Staiger, *The World Trade Organization: Theory and Practice*, 2 ANN. REV. ECON. 223, 245 (2010) [hereinafter Bagwell & Staiger *WTO*].

cuts to foreign country 2 under MFN. The end result is that if foreign country 2 keeps its tariff fixed, negotiations between the home and foreign country 1 under MFN ensure that there is a single world relative price that remains unchanged (i.e., foreign country 2 experiences no change in its export volume). It should be noted though, that without reciprocal tariff cuts by the home and foreign country 1, the world relative price will change, thereby affecting foreign country 2's export trade volume—in other words, MFN on its own is not sufficient to prevent concession erosion.²³⁹ Both MFN and first-difference reciprocity are required to maintain stable world relative prices. This entirely contradicts the claim of Commerce Secretary Wilbur Ross who has argued that MFN is a “significant impediment toward getting to anything like a reciprocal agreement.”²⁴⁰

V. JUSTIFICATION FOR US TRADE SANCTIONS

The analysis set forth above challenges the three basic assumptions of US economic nationalism in its current incarnation as espoused by the Trump administration. Underlying US economic nationalism is a concept of strict reciprocity in both the trade flows and in tariff schedules as part of a zero-sum game. Although the concept of reciprocity has the virtue of simplicity, it is in fact an oversimplification and is grounded on a basic misunderstanding of international economics and trade policy. An examination of these concepts indicates that trade is far more nuanced and sophisticated than the view espoused by US economic nationalism. Reciprocity is an element of free trade, but it is marginal or first-difference reciprocity, not absolute reciprocity. If these assumptions are fallacious, what then are the consequences for US economic nationalism and the Trump administration?

The first consequence is that the United States is no longer justified in maintaining its current trade sanctions. The Trump administration relies on these assumptions and the unfairness in trade that they demonstrate to justify trade sanctions. The reasoning is that if strict reciprocity is required for fair trade and there is a lack of reciprocity in current US trade agreements, then these agreements are unfair, and the United States is justified in imposing tariffs on its trading partners to remedy the unfairness. If strict reciprocity is not a condition of fair trade, then the Trump administration has not proven

239. See *id.* at 246.

240. See Chad. P. Bown & Alan O. Sykes, *The Trump Trade Team's Vocabulary Problem*, WALL ST. J. (May 14, 2017), <https://www.wsj.com/articles/the-trump-trade-teams-vocabulary-problem-1494795625> [<https://perma.cc/PPQ3-6MYC>] (archived Dec. 2, 2018).

that trade is unfair, and the United States loses its justification for the tariffs. From a normative standpoint, the United States must supply an alternative, valid justification or withdraw the tariffs.

The Trump administration's reliance on strict reciprocity in trade is one explanation why the United States is not pursuing a remedy through the WTO.²⁴¹ The GATT/WTO does not recognize strict reciprocity as a fundamental condition of free trade.²⁴² The GATT/WTO does allow for marginal or first-difference reciprocity, but this is a nuanced version of reciprocity, not the absolute reciprocity espoused by the Trump administration.²⁴³ As foundational principles, the GATT/WTO relies on National Treatment²⁴⁴ and MFN, a principle of nondiscrimination that is designed to multiply trade benefits to the entire WTO membership.²⁴⁵ MFN is based on a positive-sum game view of trade.²⁴⁶ The US position of strict reciprocity, based on a zero-sum view of trade, is not a rule or norm recognized in the WTO and does not provide a basis for the United States to challenge trade agreements entered into under WTO auspices.²⁴⁷ If the United States were able to assert that existing trade agreements violated MFN, then the United States would have a cognizable claim under the WTO and the United States might bring actions within the WTO to challenge existing trade arrangements.²⁴⁸ Without this option, the United States has decided to act outside of the WTO on a unilateral basis, which has the additional harmful effect of undermining the authority and relevance of the WTO.²⁴⁹

241. See INTERNATIONAL TRADE LAW, *supra* note 18, at 83–86. The WTO has a dispute settlement system under which WTO members can file a complaint against other members who have breached their WTO obligations. See *id.* The key is that the obligation must be one that is recognized by the WTO. See *id.* at 91–105. As strict reciprocity is not a WTO obligation, it does not provide the basis for a case in the WTO. In order to bring a case in the WTO, a complainant must allege the “nullification or impairment” of a benefit under the WTO agreements. See GATT, *supra* note 18, art. XXIII. As there is no provision in any of the WTO agreements creating a strict reciprocity obligation, there is no basis for arguing that denying strict reciprocity nullifies or impairs a benefit under the WTO. See INTERNATIONAL TRADE LAW, *supra* note 18, at 91–105.

242. See *id.* at 149. The foundational principles of the WTO are MFN and National Treatment, contained in GATT Article I and Article III respectively. *Id.* Nothing in the GATT mentions reciprocity in trade at all. See *generally* GATT, *supra* note 18.

243. See *supra* Part IV.C.

244. See *id.*

245. See INTERNATIONAL TRADE LAW, *supra* note 18.

246. See *id.*

247. See *id.*

248. See *id.* at 91 (noting that a violation of a WTO trade agreement would be a “violation” case that involves the “nullification and impairment” of a WTO obligation and cognizable in the WTO).

249. See *Unilateralism*, *supra* note 1, at Part IV.

A second consequence of the analysis in this Article is that US economic nationalism could actually have the unintended long-term effect of harming US interests. If the large body of empirical and theoretical work is correct that the GATT/WTO has led to trade liberalization, increased trade volumes, and higher incomes on a global basis and for nations individually, then a rejection of this approach in favor of economic nationalism might be harmful to global trade and economic welfare.²⁵⁰ The economic logic of the GATT/WTO should continue to further expand international trade; US economic nationalism could derail this progress or result in complete collapse of the system if US tactics lead to retaliation and a trade war.

A third consequence is that the current approach distracts the United States from addressing serious problems in international trade. For example, while Trump's criticism of China seems to be based on false assumptions, there can be little doubt that China has caused serious problems in international trade. There is widespread agreement among virtually all different constituencies and political affiliations in the United States that China is a serious disrupter of trade.²⁵¹ Moreover, there is nearly unanimous agreement among many nations in addition to the United States that China engages in theft of intellectual property and that China provides illegal government subsidies that supply a financial advantage to its state-owned companies.²⁵² Not only is China causing serious distortions in international trade, China is also boldly challenging the United States for economic supremacy in all areas in the twenty-first century.²⁵³ These are serious challenges that require a thoughtful, sophisticated, and measured response.²⁵⁴ Instead, the Trump administration's current response, based on dubious economic assumptions, is a blunt, "get tough" approach that unilaterally imposes punitive tariffs in an

250. See Daniel C.K. Chow, Ian Sheldon & William McGuire, *The Revival of Economic Nationalism and the Global Trading System*, 441 CARDOZO L. REV. (forthcoming 2019).

251. See Greg Ip, *China Started the Trump War, Not Trump*, WALL. ST. J. (Mar. 23, 2018), <https://www.wsj.com/articles/china-started-the-trade-war-not-trump-1521797401> [<https://perma.cc/9JAC-KDP6>] (archived Nov. 7, 2018).

252. See, e.g., Requests for Consultations by the European Union, *China—Certain Measures on the Transfer of Technology*, WTO Doc. WT/DS549/1 (June 6, 2018); Requests for Consultations by the European Union, *China—Measures Affecting Financial Information Services and Foreign Financial Information Suppliers*, WTO Doc. WT/DS372/1 (Mar. 3, 2018); Requests for Consultations by the Republic of Mexico, *China—Grants, Loans and Other Incentives*, WTO Doc. WT/DS388/1 (Dec. 19, 2008).

253. See generally Daniel C.K. Chow, *Why China Established the Asia Infrastructure Investment Bank*, 49 VAND. J. TRANSNAT'L L. 1255 (2017) (discussing how China is challenging the United States' dominance of international lending through the World Bank).

254. See Thomas J. Schoenbaum & Daniel C.K. Chow, *The Perils of Economic Nationalism and a Proposed Path to Trade Harmony*, STAN. L. & POL'Y REV. (forthcoming 2019) (proposing a general strategy directed at containing China).

attempt to intimidate China.²⁵⁵ But while these bullying tactics might have been effective in the past,²⁵⁶ it is unclear that they can contain an increasingly confident and economically powerful China, which has responded to US attempts at intimidation with anger, ridicule, and contempt.²⁵⁷ Instead, these tactics might backfire and lead to a destructive trade war.

VI. CONCLUSION

The arguments by the Trump administration that strict reciprocity is required for fair trade have a superficial and intuitive appeal that struck a nerve among important groups of US voters and helped to propel Donald J. Trump to the US presidency. Yet these arguments, based upon three assumptions analyzed in this Article, only have a thin veneer of logic that quickly dissipates under scrutiny.

First, unlike the Trump administration, the majority of economists do not view trade as a zero-sum game with one winner and one loser in every bilateral trade relationship; rather, a large body of literature supports the opposite view that both sides in a bilateral trade relationship can benefit and that on a multilateral level, under the right conditions, trade can be beneficial to many nations without harming others.

255. See *Chinese state media slams latest US tariff call as “ridiculous” attempt at intimidation*, REUTERS (Apr. 5 2018), <https://www.reuters.com/article/usa-trade-china-state-media/chinese-state-media-slams-latest-us-tariff-call-as-ridiculous-attempt-at-intimidation-idUSL4N1RJ002> [<https://perma.cc/CJ4D-CPCU>] (archived Nov. 7, 2018) (“This latest intimidation reflects the deep arrogance of some American elites in their attitude towards China”). Of course, making bold statements in the press is not the same as being willing to endure a trade war with the United States. Nonetheless, the authors believe that in the past, a less confident China would not have publicly made such aggressive assertions.

256. See *id.* Before China joined the WTO, China had to undergo an annual review by the U.S. Congress of its record on human rights in order to receive the MFN tariff rates that the United States extended to all WTO members. See Daniel C.K. Chow, *Why China Opposes Human Rights in the World Trade Organization*, 35 U. PENN. J. INT’L L. 61, 79–80 (2014). China had to suffer the humiliation of US lectures on its poor human rights records in stoic silence, but ultimately China would receive congressional approval every year. See *id.* With the accession of China to the WTO, China obtained MFN tariffs as a matter of right and so no longer needed annual congressional approval. See Daniel C.K. Chow, *Why China Opposes Human Rights in the World Trade Organization*, 35 U. PA. J. INT’L L. 61, 80 (2014). However, China has never forgotten this annual rite of humiliation and has viewed it as a matter of national dignity to stand up to US bullying. See Fred Imbert, *China Says it Must Retaliate Against Tariffs “To Defend the Nation’s Dignity,”* CNBC (Aug. 2, 2018), <https://www.cnbc.com/2018/08/02/china-says-it-must-retaliate-to-defend-nations-dignity.html> [<https://perma.cc/ZT6H-3W86>] (archived Nov. 8, 2018).

257. See *id.*

Second, the US position that a trade deficit is a direct economic loss to the nation incurring the deficit and a direct gain to the nation enjoying the surplus is also subject to the same criticism. This argument also falls into the trap of specious arguments with a surface appeal. Trade deficits are the result of complex macroeconomic policies that cannot be corrected by the simple application of tariffs on imports from China and other countries such as those currently being used by the United States.

Third, the argument that US and foreign nation tariffs on the same good must be identical, mirror images of each other is based on a misunderstanding of the lengthy negotiation process that nations undergo in the WTO to reach mutually acceptable tariff schedules. Tariff schedules are complex instruments and reflect an agreement on an overall package of concessions in which higher tariff rates on some goods may be offset by lower tariff rates on others.

What appears to be common in all of the arguments by the Trump administration is that they have the most appeal to a less sophisticated audience that is eager, and perhaps predisposed, to embrace them. While the use of these arguments may display the considerable political acumen needed to win popular elections and attain power, these same arguments must still withstand critical examination if they are to serve as the basis for the exercise of that power, once obtained, in the form of an aggressive US trade policy used against US trading partners, both friendly and less so. The results of this scrutiny, as set forth in this Article, is that these arguments quickly implode once we look beneath the surface.

Not only is strict reciprocity not necessary for fair trade, but insisting on it is harmful to achieving harmony in trade. As the Trump administration's current trade policy of imposing punitive tariffs is based upon these erroneous concepts, its current trade policy is also flawed and must be corrected.