

## Interview in “Drive Time,” Voice of Islam Radio, London, UK, 07/19/19

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I was interviewed in an episode of the Voice of Islam’s “Drive Time” show discussing economic and trade wars. You can listen to the podcast episode [here](#). My interview begins at minute 46’30”.

Producer Sana Nadeem had sent me a set of questions in advance of the conversation. Only a few of them were asked, but the notes I had prepared on all of them are below. The questions that Sana sent are in bold fonts, followed by my answers.

### **1. Could you tell our listeners more about trade wars and why would any nation want to be involved in it?**

Globalization and the exposure of advanced economies to competition from emerging and developing ones—China being the most notable—have been associated with shrinking manufacturing sectors and loss of jobs in advanced countries. Much of this job loss was actually due to technological change in the U.S. itself, but the dynamics of U.S. manufacturing and jobs coincided with large and persistent U.S. external deficits (aggregate and bilaterally with some key trade partners—like China). The Trump Presidential campaign in 2016 succeeded also thanks to the support from the parts of the country that were most affected by Chinese competition. The Trump administration erroneously thinks of international trade as a zero-sum game—“you win, I lose”—and it interprets trade balances (aggregate and bilateral) essentially as score cards. Therein lie the roots of the trade war that the U.S. initiated. Note that poor understanding of trade balance dynamics is key: the aggregate trade balance is determined by macroeconomic phenomena (the dynamics of the country’s savings and investment). Thinking of affecting it by acting on bilateral balances toward individual countries through protectionism without taking actions that actually affect the overall balance of savings and investment has no effect on the aggregate trade balance; it only diverts trade to other countries, which is precisely what we are seeing.

### **2. What is the cost of trade wars? Do you think it can lead to a recession?**

Protectionism results in inefficient allocation of production within and across countries. Currently, production and supply chains for many U.S. companies are being hurt by higher input prices and by retaliatory tariffs from the counterparts in the trade war (China is not the only one). Uncertainty about future trade arrangements has been having a negative impact on investment decisions of U.S. firms, which are wary of committing to sunk investments when they worry

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about possible future trade barriers. When you take into account that the U.S. has initiated trade conflict or tension not just with China but also with other important trade partners (the EU, Canada, Mexico, to name a few), all this feeds into significant distortion of the global economy and a climate of uncertainty that, if trade war escalates further, could indeed feed into recession. Now, there are other problems the global economy is facing regardless of trade war, and it is always difficult to isolate causal mechanisms, but it is pretty safe to say that the trade war is not helping.

### **3. We have been discussing how harmful trade wars are. How does it or can it trigger political or social crises?**

One could say that the actions of the Trump administration were partly triggered by political and social concerns (the concern for the Midwest segments of the U.S. population that were most exposed to foreign competition). But remember that most of the shrinking of U.S. manufacturing was due to structural change of the U.S. economy that was happening (and will continue to happen) regardless of trade: protectionism won't bring jobs back, as they are replaced by automation anyway. This can cause its own backlash. Moreover, retaliation from foreign countries can contribute: For instance, China has been very strategic in its retaliation, applying large tariffs against U.S. agricultural products (for example, soybeans). This has been hurting disproportionately states where Trump received much support—to the point that the administration is having to spend more in subsidies to hurting farmers than the revenue generated by its own tariffs! In turn, this means that resources are not destined to other, potentially socially desirable uses. One can imagine these dynamics feeding into political issues going forward.

### **4. How much damage do you think the US has seen because of the trade war? And who do you think suffers most from it?**

Estimates are appearing in the academic literature and in work at policy institutions, but again, it is hard to quantify aggregate effects precisely because there is so much more going on than just the trade war. Moreover, more data over time will be needed to evaluate short-run versus long-run effects. For instance, a study by Penny Goldberg (the Chief Economist at the World Bank) and coauthors finds a small short-run impact on U.S. overall GDP (0.04%), but the study abstracts from dynamics that macroeconomists think would be important for this evaluation. Across different parts of the U.S., the impact of the trade war is different based on who is being protected and on foreign retaliation (evidence that is documented in the same study by Goldberg et al.), but also based on income: Lower income households are most negatively affected because the composition of their consumption depends more heavily on traded, imported goods, for which prices are rising. So, it is clear that there are negative consequences especially for some states and segments of the population, but our evaluation of the overall GDP effect is still work in progress. Note, however, though studies based on past experiences of many countries (for instance, work I did with Alessandro Barattieri and Matteo Cacciatore, and work by Andy Rose and coauthors) show that protectionist actions do find evidence of non-negligible loss of aggregate GDP (even in the short run) and rising inflation.

**5. Do you think China's GDP has dropped because of the trade war or are there other factors involved?**

There are certainly other factors involved in the slowdown of Chinese growth, including the natural slowdown that happens when economies transition from emerging to advanced, industrial status and growth in which domestic consumption is a relatively more important driver. For a long time, China's growth model was largely based on export expansion. Now the Chinese overall current account (the trade balance plus net income from foreign assets) is roughly balanced, but growth is still mostly driven by state-directed allocation of resources to state-owned enterprises (a legitimate issue from foreign perspective) and there is a problem of large accumulated debt. Add to this that China is indeed suffering from the trade war itself (as, for instance, many U.S. firms are now importing from countries other than China in order to avoid tariffs), and it all feeds into the determinants of the observed Chinese slowdown.

**6. We know China and USA are really trying to have it their way. Who do you think will win? Are there any winners in a trade war?**

Both parties stand to lose. A lesson from the past is that trade war is a lose-lose proposition. Doug Irwin's work on the experiences of the past teaches us much about that. Distortion in resource allocation, with negative effects on efficiency, rising prices, and reduced growth are likely effects for all parties involved. This is not to say that there is no role for trade policy in the economy, and—most importantly—for policies designed to facilitate the reallocation of resources in shrinking parts of the economy to expanding ones when shocks happen, but what we are seeing now is very counterproductive for everyone involved. And a key concern has to do with the longer-term impact of the trade war on the multilateral, rules-based trade system that had been put in place after World War II building precisely on the experience of the pernicious effects of the trade war of the 1930s.

**7. What is the solution to this war? How can we make peace?**

Multilateral institutions and multilaterally accepted rules remain the best solution. And multilateral agreements: For instance, in order to address legitimate issues with China on intellectual property rights and subsidization of state-owned enterprises, the U.S. should have continued on the path the Obama administration had embarked on with the Trans-Pacific Partnership (TPP) treaty, with a coalition of like-minded partners setting the rules for trade in the Asia-Pacific. The combination of action within the World Trade Organization and large arrangements like TPP would have been a much better way to proceed than Trump's idea of bilateral deals into which the U.S. can bully individual partners (if the bullying succeeds). The whole institutional setup created after World War II was a response also to the negative effects of trade war and bilateralism during the 1930s. The U.S. itself invested 70 years of effort into bolstering the post-World War II multilateral system. Will the U.S. return to this path? Or will the rules-based, multilateral system be eroded and collapse? The EU, Japan, others are acting to take leadership in preserving rules-based multilateralism, but there is so much uncertainty that it is hard to predict what will eventually happen. There is really much at stake in the 2020 U.S. presidential election.