

# Trade

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*A Pro-Growth Agenda for  
the 116th Congress*



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# 2

## Trade

Protectionism, long a byword in politics for economic folly, has recently regained currency under the Trump administration. To safeguard America's prosperity, one of the new Congress' most urgent priorities should be to rein in the executive branch's protectionist policies. President Trump, without input from Congress, has enacted multibillion-dollar tariffs on steel and aluminum and on more than 6,000 different goods from China, from circuit boards to peanut butter and jelly, covering more than \$200 billion of exports. Other countries, including allies such as Canada, Mexico, and the European Union (EU), have responded with retaliatory tariffs on U.S. goods, including pork, cheese, motorcycles, bourbon, and blue jeans.

U.S. producers such as Harley-Davidson are offshoring some of their production to avoid the tariffs, while downstream domestic industries such as construction, automobiles, and canned goods are facing inescapable cost increases of up to 25 percent. They have little choice but to pass those costs on to consumers. Affected companies are also laying off employees, canceling multimillion-dollar deals, and adapting to reduced demand. Futures markets are more volatile than usual, due both to the tariffs themselves and to the frequent and unpredictable twists and turns in how the administration has gone about imposing them.

In the short term, the Trump tariffs have displaced hundreds of thousands of workers, who must now seek different employment, according to a June 2018 analysis by the Tax Foundation. The tariffs' costs to consumers—some of them freshly out of a job—

may well outweigh any savings from the 2017 income tax cut. In the long term, the tariffs will lead to higher producer costs, higher consumer prices, less competition, less innovation, and slower economic growth. Going forward, our allies may also credibly threaten to withhold their cooperation on other foreign policy issues.

The president's unilateral protectionist behavior cuts against 75 years of ongoing trade liberalization that pushed the United States' tariff rate on dutiable goods from a peak of more than 59 percent in the aftermath of the 1930 Smoot-Hawley tariff bill down to about 5 percent when the Trump administration took office—more than a 90 percent reduction. Given the harm that tariffs cause to the U.S. economy and to American foreign policy, Congress must work to ensure that the Trump administration's protectionist stance turns out to be an aberration, not a full-on reversal of decades of bipartisan policy toward more open international trade.

Some of America's trading partners, such as China, do not always act in good faith. Policies and practices that China and other autocratic countries must change include weak intellectual property protections and theft of trade secrets. Congress should pursue sound policy no matter what other countries do. This means not only refraining from enacting new trade barriers but getting rid of existing barriers. Tariffs not only will fail to change such bad behavior but will hurt the U.S. economy.

A more effective approach would combine bilateral negotiations with multilateral international pressure. In the case of China, this could mean negotiating a binding bilateral agreement with the Chinese government. The Trans-Pacific Partnership (TPP), from which the Trump administration pulled out on its third day in power, would have accomplished many of Trump's policy goals with China. It is not too late to attempt a revival, with Congress' help. Other countries and regions, such as Japan and the European Union, have similar concerns about the Chinese government's trading policies and can be natural allies on that issue. The Trump administration's trade policies to date are preventing such a potentially effective alliance from forming, and other countries are pursuing their own policies without U.S. involvement. It was encouraging, however, that President Trump and EU President Jean-Claude Juncker were able to step back from mutually damaging policies and agree on a common approach to Chinese practices when they met in July 2018. The relative lack of changes in renegotiating the North American Free Trade Agreement (NAFTA) into the new United States–Mexico–Canada Agreement (USMCA) was also welcome.

A word of caution about pursuing trade agreements is in order. Congress has many international policy priorities, but it is important to restrict trade agreements to trade issues only. Separate issues should be treated separately. Trade-unrelated issues, such as labor and environmental regulations and intellectual property standards, should be negotiated in separate agreements. Lumping trade-unrelated issues into trade agreements makes negotiations slower and more contentious and gives protectionists more opportunities to torpedo liberalization efforts. The section of the USMCA that instructs Mexico to raise auto workers' wages is a terrible precedent for infringing on other nations' sovereignty in trade agreements, and we should not be surprised when other nations make such trade-unrelated demands of America. Such demands also increase the possibility of future renegotiations or outright repeal of the agreements over issues that have nothing to with trade.

Finally, greater engagement with the World Trade Organization (WTO) provides another effective avenue for improving other countries' bad behavior. The WTO lacks binding authority, but the norms of international cooperation give its rulings substantial heft, which the United States can use to its advantage. Countries with legitimate grievances, of which the United States has many, have a roughly 90 percent success rate in the WTO's dispute resolution system. The tradeoff is that other countries would bring their own legitimate grievances against the United States, but working within a rule-based system requires such cooperation. By removing protectionist policies, those rulings would actually help the United States in the long run and can hardly be called concessions. Congress should prevent the president from leaving the WTO, as he has occasionally threatened to do.

Trade is an ongoing policy issue but usually a dormant one, far down Congress' priority list. The current administration has changed that, and Congress must act swiftly and decisively to nip in the bud policies that could cause immense economic and political harm—in the short term and the long term, both here and abroad.

## RECLAIM TARIFF AUTHORITY FROM THE EXECUTIVE BRANCH

Article I, section 8 of the United States Constitution gives taxing and spending power to Congress alone. Regarding tariffs, that situation changed in the aftermath of the Smoot-Hawley Act of 1930. The passage process was a mess of special interest favors, vote trading, and mutual back scratching. It caused public outrage that still affects tariff policy today. Congress realized how dysfunctional the situation had become and delegated some of its tariff-making authority to President Franklin Roosevelt in 1934, on the thinking that the president represented the country as a whole, rather than a narrow constituency, and was thus less prone to influence by special interests.

Since then, the United States has slowly but steadily reduced its tariffs and other trade barriers—until the Trump administration took office in 2017. Unlike past presidents from both parties who more or less used their delegated power responsibly (if inconsistently), Trump has repeatedly and haphazardly raised tariffs, thereby harming America's economic and political interests. The time has come for Congress to reclaim the power it delegated to the president. It can accomplish this by repealing three clauses.

### Congress should:

- ◆ Repeal Section 232 of the Trade Expansion Act of 1962.
- ◆ Repeal Sections 201 and 301 of the Trade Act of 1974.

Section 232 of the Trade Expansion Act of 1962 empowers the president to enact tariffs for national security reasons. That makes some intuitive sense; it is important to have viable domestic industries in steel and energy, for example, so that if the United States is cut off from supplies during a war, it will not harm the military's ability to fight. The national security argument does not hold up under scrutiny, however. In a world market, a country simply cannot be cut off from a commodity. If a hostile country refuses to sell steel or oil to the United States, then somebody else will be more than happy to either supply that commodity directly or act as a middleman and sell the blockaded commodity to the United States at a profit.

In fact, protectionist measures often cause more long-term security harm than they help the protected industries. Obsolete technologies, inferior quality control, and higher prices that result from less competition can hurt military capabilities. And to the extent that tariffs slow economic growth, the country will have fewer resources to devote to national security than it would under a policy of free trade.

Finally, domestic industries do not need protection. Manufacturing output in 2018 is near the all-time high set in 2014. Worries about foreign steel, for example, are misplaced. Imports account for roughly 30 percent of U.S. steel consumption; that means 70 percent is made domestically. The U.S. military, the world's largest by a wide margin, uses roughly 3 percent of total steel production, or less than 1/20<sup>th</sup> of domestic output alone. So even if a complete blockade were enacted tomorrow and succeeded, it would have no impact on military capabilities.

When President Trump used Section 232 authority to enact steel and aluminum tariffs and Canadian Prime Minister Justin Trudeau asked him what the national security justification was for those tariffs, Trump's response involved the War of 1812. Congress should protect the president from such embarrassments by repealing Section 232, thus taking away the flawed national security justification for security-unrelated tariffs.

Section 201 of the Trade Act of 1974 gives the president the power to offer relief to businesses affected by increased competition from imports. That policy is practically an open invitation to abuse. An increased flow of imports can enter a market that is growing at a faster rate than domestic producers can keep up with. Trade-unrelated factors such as changing consumer tastes and technological change also negatively affect many businesses. How does one determine whether international competition or new technology are what harmed a company? If both factors are in play, how much blame does each deserve?

As far as job churn goes, a 2015 Ball State University study estimates that innovation and changing tastes have more influence than does foreign competition by about a factor of six. Why do companies adversely affected by imports get special treatment, when other causes are far more impactful? The best policy would be an open competitive market with no special treatment for anyone. Section 201 allows the president to subvert that policy goal on a whim, and therefore should be repealed.

Section 301 of the Trade Act of 1974 gives the president the authority to retaliate against countries that violate treaties they have signed with the United States. Because the president seems to think that a large percentage of international trade rules are unfairly stacked against the United States, he has abused this grant of power beyond recognition. There are many valid grievances against other countries' trade practices, from arbitrary antidumping duties to import quotas. The proper forum for resolving such disputes is the WTO's dispute resolution process, as well as similar mechanisms under bilateral and multilateral agreements to which the United States is a party. Congress should repeal Section 301 and work with the president on more appropriate and effective policies in the proper venues.

Experts: Iain Murray, Ryan Young, Marc Scribner

### **For Further Reading**

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## REJECT RETALIATORY TARIFFS

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Countries with high trade barriers have economies that are essentially running with a flat tire. As previously stated, trade barriers mean less competition, higher producer costs, higher consumer prices, less choice, and slower innovation. Trying to get other countries to reduce their trade barriers by raising our own is essentially reacting to their flat-tire economies by flattening our own economic tires. Nobody wins, and everyone loses.

In some cases, Congress can prevent such harm by essentially doing nothing. In others, there are positive measures it can and should take. Closing the Section 232 and Section 201 and 301 presidential loopholes is wise policy. So is enacting a blanket ban on giving the president unilateral taxing authority or raising trade barriers without congressional approval. But the most important policy here is self-discipline.

### **Congress should:**

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- ◆ Refuse to pass legislation enacting retaliatory trade barriers.
- ◆ Institute a rule explicitly forbidding the president from enacting retaliatory trade barriers.

If another country raises trade barriers against the United States, whether for economic or diplomatic reasons, it is hurting its own economy. We should not compound other countries' mistakes with our own by responding in kind. To paraphrase the renowned Cambridge economist Joan Robinson, when other countries dump rocks into their own harbors, the solution is not to dump rocks into our own harbors. This is a case in which discretion is the better part of valor. Doing nothing might be hard, but given the emotions and the heated rhetoric involved, doing something often means enacting policies that make matters worse. If such proposals are the only politically viable ones, the best response is no response.

Experts: Iain Murray, Ryan Young, Marc Scribner

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## PURSUE NEW TRADE AGREEMENTS WITH THE UNITED KINGDOM, THE EUROPEAN UNION, AND CHINA

### Congress should:

- ◆ Pursue a bilateral trade agreement with the United Kingdom.
- ◆ Pursue a bilateral trade agreement with the European Union.
- ◆ Pursue either a bilateral or a multilateral trade agreement with China.

### U.S.–U.K. Agreement

With the United Kingdom leaving the European Union in 2019, America's closest ally should regain control over its trade policy. That would enable the United States to negotiate a free-trade agreement with the U.K. that reflects the affinity of the two countries' legal systems and shared cultural understandings of the value of commerce. Such an agreement should reduce tariffs on both goods and services to virtual nonexistence.

Furthermore, this presents an opportunity to develop a new form of trade agreement based on mutual recognition of regulatory systems. By acknowledging that each party's regulatory system has broadly similar goals and effects, such an agreement would sweep away many regulatory nontariff barriers. That would spur regulatory competition, as problems with one party's system that stood in the way of trade would be laid bare.

Further enhancements could be made by enacting provisions that guarantee regulatory review of new regulations for their trade effects, and mutually agreed standards for cost–benefit analysis. Those provisions would have the effect of reforming regulatory practices that have resisted reform efforts. Sector-specific agreements on topics such as financial services could help prompt competitive solutions to problems that have so far been tackled mainly by restrictive regulation, such as the problem of too-big-to-fail financial institutions.

Finally, such an agreement could be drawn up to allow accession by other parties. It is likely that the agreement would be attractive to common-law nations such as Canada, Australia, and New Zealand, as well as to other Trans-Pacific Partnership parties such

as Singapore, Malaysia, and Chile. This could form the basis of a new trading alliance based on shared principles of economic freedom.

## **U.S.–EU Agreement**

The arguments are similar for a trade agreement between the United States and the European Union. In addition to imparting mutual recognition and lower tariffs, a trade agreement gives both parties an opportunity to reform their illiberal agricultural policies. The EU’s Common Agricultural Policy (CAP), which consumes roughly 40 percent of the EU’s budget, provides an array of subsidies, trade barriers, and regulatory obstacles that make life difficult—and expensive—for farmers, importers, exporters, and consumers. Anti-GMO (genetically modified organism) activists and other anti-technology ideologues have also used CAP to pursue their anti-science policy agendas, whereas producers who compete with such products have happily played along. Development economists have noted that heavily subsidized EU agricultural exports price many farmers in developing countries out of the world market and thus make it harder for many of the world’s poor to rise out of poverty. A more compassionate approach would liberalize or eliminate CAP.

American farm policy is also a mess. Subsidies, production quotas, price supports, and government-subsidized marketing raise prices for families and have similar effects on farmers in developing countries. Congress makes the problem worse with a fresh farm bill every few years. President Trump even gave farmers a \$12 billion aid package to counteract the harms his tariffs have caused them. America’s agricultural protectionism has caused international friction with the EU and other allies, such as Canada, and should be repealed. A U.S.–EU trade agreement to lessen or eliminate agricultural trade barriers would benefit both economies and improve international relations. A trade agreement could also defuse tensions over other products, such as cars, aircraft, and designer clothing.

## **What about China?**

China is the elephant in the room. Although a much freer place than it was under Mao Zedong, China still suffers from living under a thoroughly authoritarian government. The Chinese government often engages in actions that are anathema to free markets and democratic governance. It steals intellectual property and technology, expropriates assets, insists on state ownership—or at least state control—of many

industries, and often changes policies or reneges on deals at the last minute, after investors have already committed millions or even billions of dollars.

And of course, there is the Chinese government's appalling human rights record, which Congress should always keep in mind. Even though China poses no immediate military threat to the United States, a free and open China is an important foreign policy objective. Not only would the United States economy benefit from lower trade barriers and easier access to a thriving 1.3 billion-person market, but freedom is its own goal. The Chinese people deserve the right to free speech, economic opportunity, freedom of religion, and other basic freedoms that much of the rest of the world takes for granted. A free China would also be an ally, giving the United States another partner with whom to face potential global threats.

Increasing tariffs will not achieve any of those policy goals. The tariffs that President Trump has enacted, without congressional input, on more than 6,000 Chinese goods that are worth more than \$200 billion, will prompt China to close its economy, not open it further. China's swift retaliatory tariffs will also make that country less open and less free and its people less prosperous. Ultimately, China's liberalization must come from within. But there is a role for Congress to play. Pursuing a bilateral agreement with the Chinese government would put pressure on it to liberalize, with the knowledge that the United States will respond positively. A multilateral agreement that includes China's neighbors and biggest trading partners would put further international pressure on the Chinese government to improve its behavior.

In fact, just such an agreement, the Trans-Pacific Partnership, was on the cusp of being implemented until the Trump administration withdrew from it on Trump's third day in office. Other countries are pursuing a TPP-style agreement but without the United States or its input. It is not too late to rejoin this liberalization effort or for the United States to pursue its own.

Experts: Iain Murray, Ryan Young, Marc Scribner

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## RENEGOTIATE EXISTING TRADE AGREEMENTS TO REMOVE TRADE-UNRELATED PROVISIONS

The Trump administration has long expressed a desire to renegotiate the North American Free Trade Agreement and other existing trade agreements. Other countries have expressed a willingness to listen. Congress should take a seat at the discussion. President Trump seems less interested in the *absolute* level of trade barriers than their *relative* level; he might see a victory as the United States “conceding” less than its trading partners. Congress should use this to America’s advantage.

The larger policy goal here is to treat separate issues separately. Environmental, labor, intellectual property, and regulatory policies have no place in trade agreements; they are separate issues that should be treated separately. If the United States and its trading partners decide to renegotiate any trade agreements, getting other countries to “concede” on weakening or removing trade-unrelated provisions might well justify lower U.S. tariffs in the president’s mind. Congress should work to remove from existing trade agreements—and negotiate them separately, if it wishes—provisions that address certain issues.

### Congress should oppose industries in future trade agreements with provisions on:

- ◆ Environmental policy.
- ◆ Labor policy.
- ◆ Intellectual property protection.
- ◆ Provisions for harmonized regulation.

The United States has one of the world’s most expensive regulatory compliance systems; many countries would be happy to follow their own, less expensive domestic policies instead. As long as President Trump is in office, it is in their interest—and Congress’s and America’s—to give the president a victory in this regard. All sides would benefit from removing trade-unrelated provisions from trade agreements and treating separate issues separately. The president has opened the possibility of renegotiating agreements. If such negotiations happen, Congress should ensure that the right things get negotiated, which will require appealing to the president’s view of his relationship with his voters.

### ***For Further Reading***

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## ENGAGE WITH THE WORLD TRADE ORGANIZATION TO REMOVE UNFAIR TRADE BARRIERS

President Trump has repeatedly expressed a desire to leave the World Trade Organization. Although the WTO and its dispute resolution are imperfect mechanisms, on balance they are a force for good. And because its verdicts are nonbinding, complaints that the WTO impinges on national sovereignty do not hold water. Instead, the WTO relies on diplomatic norms, commitments to good behavior, and countries' credible threats to punish bad behavior. That means that when a country files a grievance with the WTO, it only does so if it has a good case.

### Congress should:

- ◆ Oppose President Trump's threat to leave the World Trade Organization.
- ◆ Use the WTO's dispute resolution mechanism to prompt other countries to remove their trade barriers.
- ◆ Cooperate with other countries' efforts to remove our own unfair trade barriers.

Because the majority of complaints brought before the WTO are valid, it rules in the complainer's favor roughly 90 percent of the time. Countries who lose the case usually respect the verdict because doing so improves the chance that their own grievances will succeed and the resulting admonitions will be obeyed. Frivolous filings happen, but they are rare.

To some extent, personnel is policy. Here, Congress can play a role. The Senate must confirm nominees for the United States Trade Representative, Secretary of Commerce, and dozens of other trade-related officials at a variety of agencies. The Senate should confirm only nominees who demonstrate a knowledge of and commitment to sound economic policy. Many current Senate-confirmed presidential economic advisers, including United States Trade Representative Robert Lighthizer and Secretary of Commerce Wilbur Ross, have failed to meet this test and for that reason should not have been confirmed.

Congress must work to ensure that the United States remains in the World Trade Organization. It should encourage the president to file valid complaints to get trading partners to lower their trade barriers—anti-dumping duties are fertile ground here—

and see to it that the United States respects adverse verdicts. Likewise, Congress should discourage the administration from pursuing frivolous or politically motivated trade disputes. Other players will usually repay cooperative gestures in kind and punish dishonest behavior. Congress and the WTO can improve trade policy in the United States and abroad if they can keep the executive branch in check.

Experts: Iain Murray, Ryan Young, Marc Scribner

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- Iain Murray and Ryan Young, with contributions from Fred L. Smith Jr., Daniel Press, Marc Scribner, and Ryan Khurana, “Traders of the Lost Ark: Rediscovering a Moral and Economic Case for Free Trade,” *Profiles in Capitalism* No. 4, Competitive Enterprise Institute, August 2018, <https://cei.org/content/traders-lost-ark>.
- Pierre Lemieux, *What’s Wrong with Protectionism: Answering Common Objections to Free Trade* (Lanham, MD: Rowman & Littlefield, 2018).
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