THE AUSTRALIAN

Some trade wars have been a win for the world

HENRY ERGAS
Follow @HenryErgas

By **HENRY ERGAS**, COLUMNIST
12:00AM AUGUST 30, 2019

The platitude du jour, repeated at every turn by the Treasurer and the governor of the Reserve Bank, is that no one wins a trade war. Pleasing as that homily may be, it reflects neither theory nor experience.

It was, after all, Adam Smith who argued in *The Wealth of Nations* that while free trade was eminently desirable, it was questionable whether "the free importation of certain foreign goods" should be permitted "when some foreign nation restrains the importation of our manufactures into their country". In those cases, retaliating could force the protectionist country to reduce its trade barriers, yielding benefits for the world as a whole.

And while it would have been preferable had negotiations sufficed to achieve that outcome, it was certain that there were many instances in which they would not.

Yes, a trade war would impose short-term costs; but those costs always needed to be weighed against the permanent gains from freer trade.

However, it is not the authority of Smith that drives policymakers in Washington, DC: it is experience. And no experience weighs more heavily than that of the trade war Ronald Reagan unleashed against Japan.

The US had, over a period of many years, sought to secure from Japan a comprehensive agreement to a phased opening of its domestic market, with those efforts culminating in the Market Oriented, Sector Selective negotiations of 1985.

But after those negotiations failed to achieve meaningful outcomes, Reagan announced that his administration would no longer "stand by and watch American businesses fail because of unfair trading practices abroad".

Rather, it would "take all the action that is necessary to pursue our rights and interests in international commerce", ensuring that "other nations live up to their obligations".

Nor was the administration slow to prove its determination. On the contrary, after pressure from industry led the Japanese government to continue dragging its feet, the US — in what was certainly one of the largest, if not the largest, retaliatory trade measures of the postwar era — stunned Japan by imposing 100 per cent tariffs on imports of Japanese computers, consumer electronics and home appliances.

That move, which dramatically highlighted the seriousness of the situation, finally prompted Japan to comply with its commitments, allowing the tariffs to be partially lifted some months later.

But the Reagan administration's assertiveness did not end there. It also adopted a much harder line against the European Economic Community, slapping tariffs of 200 per cent on a broad range of European exports in retaliation for EEC restrictions affecting imports of citrus products. And in that case, too, the scale of the administration's response, and the credibility of its threat to go even further, allowed the US to largely secure the concessions it was seeking.

Moreover, the gains the US made stretched well beyond the individual disputes. Rather, demonstrated toughness helped the US achieve its key objectives in the Uruguay Round of multilateral trade negotiations, including through landmark agreements on intellectual property rights, foreign investment and trade in services.

There is, in short, a pattern that has become increasingly clear since the so-called "chicken war" between the Kennedy administration and the EEC: when it resorts to the commercial battering ram, the US may not get what it wants but it gets what it needs.

Of course, that hasn't stopped the howls of protests from the pundits each time a dispute flares. But while literally every instance of US retaliation has led to claims that the international trading system is on the verge of collapse, the longer-term outcome has more often been to reduce trade barriers than to increase them.

Given just how great the benefits of trade are, not least to the US, that ought to be unsurprising. But it would be foolish to assume that China will prove an easy nut to crack.

The difficulties are not primarily economic. Rather, the opposite is true: there is a compelling case, put by many reform-oriented economists in China itself, that China would gain were its government to stop subsidising inefficient state-owned enterprises, eliminate its arbitrary interference in the affairs of foreign companies, properly enforce intellectual property rights and place the administration of commercial law on an honest, transparent and predictable basis.

And it is also clear that the costs to China, which is still a relatively poor country, of being durably shut out of the American market substantially exceed those a prolonged dispute would impose on the US, all the more so as American importers would soon develop alternative sources of supply.

Rather, the problem is that the trade distortions the US is targeting are at the heart of Xi Jinping's regime, whose power rests on a coalition between the groups — in the Chinese Communist Party, the business community and the military — which benefit directly from their perpetuation. And far from phasing out those distortions, the regime has raised them to new heights as it expands China's military-industrial complex and seeks to extend its global reach.

There is, in that respect, an obvious parallel between the policies Xi has adopted and the infamous German tariff of 1879, which cemented the "marriage of iron and rye" between the Prussian Junkers and the emerging steel industry in the Ruhr.

As Harvard's Alexander Gerschenkron argued in his classic study of Germany's authoritarian turn, that tariff set in motion forces that could sustain themselves only by an increasingly belligerent form of nationalism.

Had Britain, instead of muted diplomatic protests, attacked that coalition at its economic core when it was still clearly powerful enough to do so, it would not only have secured economic benefits but improved the prospects for global stability.

To say that is not to downplay the risks the present conflict creates. It may entrench the Chinese regime rather than weaken it, especially if Xi believes the Trump administration's days are numbered and that the Democrats — despite their strident rhetoric — will ultimately focus on domestic income redistribution, shunning issues such as trade.

And even if Xi does make concessions, Trump may, with 2020 looming, opt for massive and immediate Chinese purchases of American goods, instead of the profound structural reforms China needs and that its trading partners can legitimately demand.

Australia, whose economic and political interests lie unambiguously with ensuring China returns to the reform trajectory that underpinned its emergence from poverty, should do whatever it can to avert those risks.

That requires realism, not homilies: for as Clausewitz said, in war everything is simple but nothing is easy.

With the US, whose enduring interests align with our own, engaged in the trade battle of the century, the homilies are best left for the children.