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Trade Wars

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Cornhusker Economics

Trade Wars

Market Report	Year Ago	4 Wks Ago	7-13-18
Livestock and Products.			
Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.	120.00	*	*
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.	182.33	168.80	186.85
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	165.82	*	163.51
Choice Boxed Beef, 600-750 lb. Carcass.	212.93	223.52	206.48
Western Corn Belt Base Hog Price Carcass, Negotiated	86.31	82.22	72.72
Pork Carcass Cutout, 185 lb. Carcass 51-52% Lean.	104.10	81.73	82.47
Slaughter Lambs, woolled and shorn, 135-165 lb. National.	185.51	156.95	167.49
National Carcass Lamb Cutout FOB.	429.14	379.36	384.71
Crops.			
Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu.	4.04	4.43	4.35
Corn, No. 2, Yellow Columbus, bu.	3.38	3.39	3.27
Soybeans, No. 1, Yellow Columbus, bu.	9.07	8.35	7.60
Grain Sorghum, No.2, Yellow Dorchester, cwt.	5.71	5.20	4.96
Oats, No. 2, Heavy Minneapolis, Mn, bu.	3.19	2.81	2.79
Feed			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.	148.00	170.00	*
Alfalfa, Large Rounds, Good Platte Valley, ton.	75.00	100.00	107.50
Grass Hay, Large Rounds, Good Nebraska, ton.	*	102.50	107.50
Dried Distillers Grains, 10% Moisture Nebraska Average.	102.50	130.00	1000.00
Wet Distillers Grains, 65-70% Moisture Nebraska Average.	42.00	39.00	36.95
* No Market			

Current United States trade policies are in line with an old economic doctrine known as mercantilism which calls for protectionist policies to reduce imports and expand exports with the goal of generating large trade surpluses. This doctrine has been discredited for over 200 years following the analyses of Adam Smith, David Ricardo and other late eighteenth- and early nineteenth-century economists. Mercantilist policies by one country not only lower well-being in that country through harm to consumers and industries relying on imported inputs but also almost always lead to trade wars with that country's trading partners. This is precisely what appears to be happening today. Canada, Mexico, China, the European Union (EU), and other targets of recent United States tariffs have all declared their intentions to retaliate with tariffs of their own and most have also filed complaints about the United States policies with the World Trade Organization (WTO).

Historically, trade wars have not been uncommon. In fact, the current world trade system established after World War II is aimed at preventing or reducing the likelihood that countries would enter into such tit-for-tat tariff competitions. In the aftermath of the 1929 stock market crash, the United States government raised already high tariff levels even higher with the Smoot-Hawley tariff of 1930 in a misguided effort to counter the effects of the economic crisis (Krugman et al., 2012). Other countries raised their tariffs in response and this trade war con-

tributed significantly to prolonging the Great Depression and deepening its severity. Between 1929 and 1933, world exports fell by about 56 percent while United States exports and imports both fell by 66 percent (United Nations, 2018; Carter et al., 2006). The value of United States exports did not return to the level reached in 1929 until the end of World War II. The declines in United States and global trade were due in part to the economic contraction occurring at that time, but widespread protectionist policies exacerbated the effects of the crisis. Trade wars are always negative-sum games in which the value of the losses far outweighs the value of actual gains, if any.

After World War II, world leaders, cognizant of this history, met to design a better global system for international economic relations. In 1944, at Bretton Woods, Vermont, they agreed to establish the International Monetary Fund to oversee international financial transactions and the World Bank to help with post-war reconstruction. In 1947, the General Agreement on Tariffs and Trade (GATT) was established to provide mechanisms for agreeing on global trade rules and for resolving trade disputes. The GATT was folded into the newly-created WTO in 1995 along with other agreements on services, agricultural trade, and technical standards. Both the GATT and WTO have held periodic rounds of negotiations during which countries agree to rules on international trade and make commitments concerning how they will comply with these rules. The Uruguay Round (1986-1994) was the eighth round and the last to be successfully completed (the current Doha Development Round launched in 2001 appears to be stalled). The early rounds led to significant reductions in industrial tariffs in high-income countries from around 20-30 percent to averages today of only 2-3 percent (WTO, 2017; World Bank, 2018). As an example of the types of rules negotiated for these agreements, the 1995 Agriculture Agreement included a provision that countries would eliminate non-tariff barriers (e.g., quotas) to agricultural trade translating their levels of protection into equivalent tariffs that were to be reduced by 36 percent over six years.

In addition to organizing rounds of multilateral trade negotiations, the WTO oversees procedures for settling disputes. If a country believes that another country has violated its obligations, it can request consultations and if the dispute is still not settled, petition the WTO to establish a dispute- settlement panel to

rule on the merits of the complaint. If the judgment of the panel is that a country has violated its commitments, it is expected to change its policies or offer compensatory payments to the complainant. In 2002, Brazil filed a complaint against United States cotton subsidies and the dispute-settlement panel ruled in its favor. Rather than change its policy, the United States government agreed to pay Brazil compensation for a certain number of years. Another dispute was resolved in favor of the United States and Canada which had challenged the EU's ban on imported beef raised with hormones. The EU refused to change its policy and no compensation could be negotiated so the WTO allowed the United States and Canada to levy retaliatory tariffs without penalty. The hormone dispute was eventually closed with agreement by the EU to purchase certain quantities of North American beef that is hormone-free (e.g., organic) while maintaining its ban on beef raised with hormone treatments (Peterson, 2016).

The WTO dispute settlement procedures can be slow and occasionally ineffective as in the US/Canada-EU hormone case but they do provide a way for countries to resolve disputes without getting into full-blown trade wars. There have been about 500 disputes that have been submitted to the WTO since 1995, most of which have been resolved without invoking the formal procedures and only a handful of which have wound up with trade retaliation as in the hormone case. Farley (2017) reports that the United States has won 91 percent of the complaints it has filed and lost 89 percent of the cases brought against it. The won-lost statistics for other countries are essentially identical to those for the United States. Those who claim that dispute settlement at the WTO is unfair to the United States are simply mistaken (Farley, 2017).

The nominal value of total world trade in 1948 was about \$60 billion compared with values on the order \$15,500 billion in 2016 (WTO, 2017). In 1950, about 5.5 percent of world output was exported compared with 28.5 percent in 2016 (United Nations, 2018; World Bank, 2018). Inflation, lower transportation costs, and economic growth explain much of this dramatic change but reduced tariff levels have also contributed significantly to the growth of trade and global output. Protectionism,

on the other hand, slows growth and can give rise to serious detrimental effects in particular industries. This is particularly true of United States and Nebraska agriculture both of which are highly dependent on the revenue from exports for economic well-being. In 2017, Chinese imports of United States soybeans accounted for 57 percent of the total value of United States soybean exports. In the first half of 2018, Chinese soybean imports from the United States were 26 percent below the level reached during the same period in 2017 because of the anticipated trade war (FAS, 2018). Good (2018) points to falling commodity prices and highlights the particular difficulties for soybean and pork producers as a result of the trade wars. Brazilian soybean exports to China already surpass those of the United States and are likely to increase further as Chinese imports shift away from the United States.

The history of WTO dispute settlement suggests that the United States will lose the cases being brought against it in the aftermath of the various tariff increases. The national-security justification for United States tariffs on steel and aluminum is unlikely to prevail and the unilateral tariff increases for goods from China on the grounds of past Chinese currency manipulations are also unlikely to pass muster. To the extent that the United States has legitimate complaints against the policies of China and other countries, it would be better to rely on the WTO dispute-settlement mechanisms instead of deploying unilateral tariff increases. The United States is more likely to attain its objectives on international trade by following normal WTO procedures than by declaring trade wars. In addition, unilateral protectionist policies lead to retaliation and undermine the effectiveness of the global trading system that has been painstakingly developed over the past 70 years and that has contributed importantly to United States and global economic growth and improved international relations.

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