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Learning to Love Trade Again

Time to Think Small

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EXECUTIVE SUMMARY

We are at the moment, the first in seventy-five years, where there is no international consensus in support of trade. Indeed, trade is unloved, unsupported, and even unwanted. There is no shortage of topics in the rhetoric of trade complaints: from the rapid rise of China to Coronavirus as a metaphor for the evils of greater connectivity. Regardless of the validity of these complaints, none of them negate the central truth of trade: countries that engage in trade move ahead, and those that do not, stagnate.

Our political leaders disagree. Anti-trade positions are held by leaders across the political spectrum, from Donald Trump to Bernie Sanders. And yet, the public is increasingly warm to the idea of trade. When Gallup asks Americans, "Do you see foreign trade more as an opportunity for economic growth through increased U.S. exports or a threat to the economy from foreign imports?" a record high of 79% see trade as an opportunity, with 18% viewing it as a threat.

How did the world arrive at this moment where the benefits of trade are clearly evidenced while trade has become politically toxic? We identify four main factors: (i) U.S. absenteeism from the leadership role; (ii) detachment between trade and security architecture; (iii) no alternative leadership in Europe or elsewhere; and (iv) the cumbersome WTO process.

Against this background we put forward five initiatives that will be big enough to count but unobjectionable enough to be adopted.

1. **The Big Three.** The U.S., EU, and Japan, should establish a consultative body on trade to forge a new approach that allows trade to move ahead in the absence of universal consensus.

2. **No harm, no foul.** Each of the Big Three should commit to zero tariffs on any item not produced in each particular market.

3. **A de minimis strategy.** Tariffs should be eliminated on all products where the current tariff is less than 2%. At that level tariffs are simply a nuisance fee.

4. **Mind the social costs.** Expand the Nairobi Protocols to include health products and green tech. Scrapping import tariffs on medical and green goods would not only encourage additional trade but will also provide health and environmental benefits.

5. **Harmonize down.** The Big Three should commit that on every tariff line each of the three will be no worse than the next worse. In other words, each of the Big Three will agree to reduce its tariff on every product where it has the highest tariff of the three.

These actions will spur the WTO, not undermine it. The measures we propose can be set up on a plurilateral basis that would allow other trading powers to participate. By breaking away from the tyranny of universal consensus, these actions will encourage the trading community – including the WTO – to get back in forward motion.

In some respect, convergence between the Big Three is already happening. The EU and Japan signed an FTA that lowers import tariffs between these two economies, while the U.S. and Japan agreed to negotiate a comprehensive FTA.

And if China is willing to step up? China should be welcomed into this group if it supports the four initiatives, changing the Big Three to the Big Four.

1. THE NON-TRADE MOMENT

Is the upcoming selection of the new Director General of the World Trade Organization somewhat of a hollow decision? We are at the moment, the first in seventy-five years, where there is no international consensus in support of trade, and the WTO seems to be in disrepute as well. Indeed, it sometimes seems that the leading trading nations all have the same main export: sanctimony. Trade policy is used to assert moral superiority, claim victimhood, advocate social policy, define a nation's international role, or to pose as strong or defiant – anything but to support trade.

There is no shortage of topics in this rhetoric of trade complaints, be it China's record in adherence to trade norms or simply the rapid rise of China itself; the role of technology and automation and the erosion of job security; the shift from a manufacturing to a service economy; the fear of diminished sovereignty in a global setting; the distribution effects of trade; and now some might add Coronavirus as a metaphor for the evils of greater connectivity. For its part, the WTO is faulted for its inability to complete a trade round, and faulted by the U.S. in particular for alleged bias. It is easier to promote doubts about trade than it is to promote trade.

And even when the rhetoric is substantive, it is frequently about trade rules, dumping, countervailing duties, and tariffs. A lot of stick and little carrot. Trade policy is seen as a mechanism to pursue grievances, not to advance trade or help economies move ahead. Using tariffs to promote a trade vision is like using speeding tickets to advance transportation policy. We aren't sure what we like, but we are pretty sure what we don't like.

None of this is surprising. All of these complaints have some validity to them, but none of them negate the central truth of trade: countries that engage in trade move ahead, and those that do not, stagnate. Trade rhetoric is easy but trade policy is hard. What would it take for political leaders to move away from using trade policy to posture and instead use trade policy to advance trade?

2. THE U.S., THE WTO, AND THE END OF TRADE POLICY

The world has never been more prosperous. Never have so many people been able to participate in the economy, and never have so many people escaped poverty. Between 1981 and 2015, the world has seen life expectancy increase from 62 to 72[1] and the number of people living below the International Poverty Line fell by 83%[2].

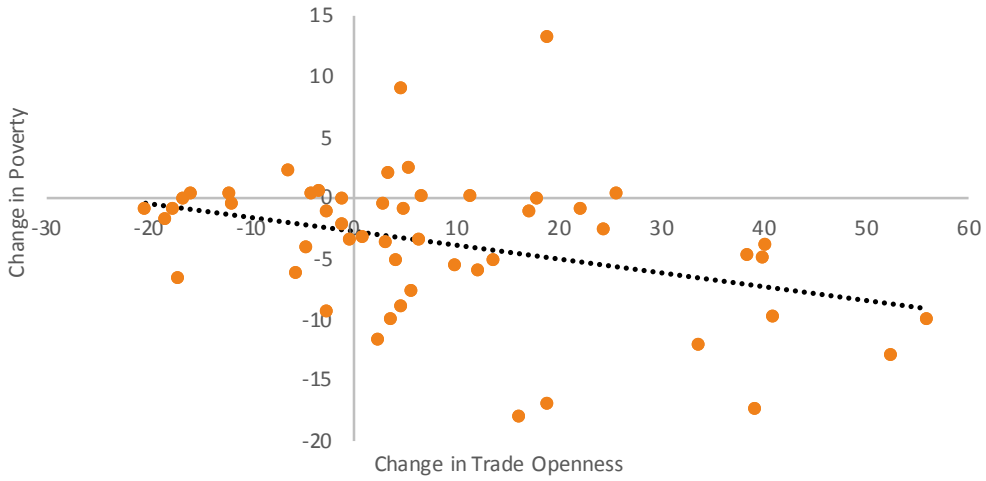
Trade has been a fabulous boon to the world economy, benefiting every country that participates and benefiting people from all socio-economic backgrounds. In 1950, the average ratio of trade to Gross Domestic Product (GDP) was 48%, while in 2017, this number reached 91%[3]. As the chart below indicates, those countries that became more open to trade tended to achieve larger falls in poverty. For example, the number of people living in poverty in Bolivia fell from 15% to 3% while Bolivian trade to GDP ratio went from 46% to 80%. The same pattern unfolded in countries like Ethiopia, Georgia, Pakistan, or Vietnam.

[1] Life Expectancy is defined as the average number of years that a newborn could expect to live. Source: James C. Riley (2005).

[2] Poverty is defined as the number of households living with less than $1.90 a day in 2011 international dollars. Source: World Bank, World Development Indicators.

[3] Trade openness is the sum of a country's exports and imports as a percentage of that country's GDP. Source: Feenstra, Robert C., Robert Inklaar and Marcel P. Timmer (2015).

FIGURE 1: TRADE OPENNESS AND ABSOLUTE POVERTY



Note: Authors' calculations. Source: World Bank, World Development Indicators; Feenstra, Robert C., Robert Inklaar and Marcel P. Timmer (2015). The change in the two variables refers to two periods, 1999-2002 and 2012-2015. To calculate the change in absolute poverty and trade openness we subtract the average absolute poverty and the average trade openness in 2012-2015 from the average absolute poverty and the average trade openness in 1999-2002.

Yet we are at a moment when active support for increased trade is at a standstill. Trade is unloved, unsupported, and even unwanted.

The U.S. helped shape this global pattern. In the modern era, U.S. political leadership had been generally in support of trade initiatives and the general public more mixed in their assessment. Now, however, this situation seems reversed, with a leadership consensus skeptical of trade. The anti-trade position that used to be held by more marginal candidates such as Jesse Jackson and Pat Buchanan is now held by leading candidates across the political spectrum, from Donald Trump to Bernie Sanders. Hilary Clinton found it expedient during her presidential campaign to publicly renounce the Obama Administration's signature trade accomplishment, the Trans-Pacific Partnership (TPP). At the same time, polls show the American public increasingly warm to the idea of trade. When Gallup[4] asks Americans, "Do you see foreign trade more as an opportunity for economic growth through increased U.S. exports or a threat to the economy from foreign imports?" a record high of 79% see trade as an opportunity, with 18% viewing it as a threat.[5] This ambivalence toward trade was neatly captured by Obama himself, who was the first candidate to win in the modern era while running against trade, yet who supported the TPP once in office. Donald Trump built on Obama's opposition to NAFTA and made hostility to trade a touch-point of his campaign and his administration.

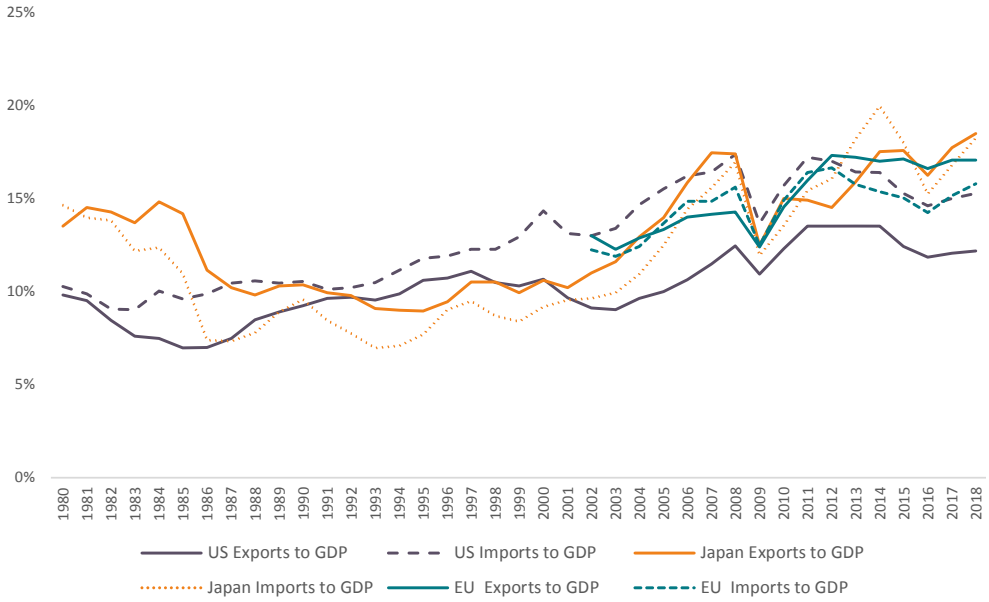
U.S. political parties have also reversed roles, and perhaps reversed again. Initially the Democrats were more supportive of trade initiatives, with Harry Truman helping to establish the GATT and John F. Kennedy's leadership resulting in an eponymous trade round. Over time, it seemed Republicans became more supportive of trade, with Reagan leading the fight for NAFTA and

[4] Saad, L. (2020, February 26). Americans' Vanishing Fear of Foreign Trade. Gallup. Retrieved from https://news.gallup.com/poll/286730/americans-vanishing-fear-foreign-trade.aspx

[5] A 2010 Eurobarometer found that 44% of Europeans think they have benefitted from trade, while almost 20% of them do not know if they were positively or negatively affected. higher educated people and consumers who knew more about the origin of the goods were more likely to feel positive (European Commission, 2010).

George W Bush pushing DR/CAFTA. Nonetheless, from 1949 to 2009, the United States supported nine GATT/WTO rounds and joined into Free Trade Agreements with twenty countries, along with various unilateral initiatives such as the Generalized System of Preferences[6], the Caribbean Basin Initiative[7], and the African Growth and Opportunity Act[8]. The result of all this is that the U.S. became the world's export powerhouse, with exports growing from 7% to 12% of GDP between 1985 and 2018[9]. As can be seen in the figure below, the same can be said for the EU and for Japan. Exports to GDP in Japan increased from 14% in 1985 to 19% in 2018[10] while EU also shows an upward trend from 13% in 2002 to 17% in 2018[11].

FIGURE 2: U.S., JAPAN, EU IMPORTS AND EXPORTS AS A SHARE OF GDP



Source: International Monetary Fund (2020). International Financial Statistics. Gross Domestic Product and Components for Japan and the U.S. Eurostat (2020) for the EU.

Opponents of trade note that the U.S. also became the world's import powerhouse, with imports growing from 10% to 15% of GDP over the same period[12]. Likewise, in Japan imports went from 11% in 1985 to 18% in 2018 and the EU also presents a similar trend with imports as a share of GDP rising from 12% in 2002 to 16% in 2018. Some even see something intrinsically wrong, even sinister, in the fact that U.S. imports typically exceed exports, this despite the con-

[6] The Generalized System of Preferences is a U.S. program that provides benefits for products from least developed countries. Retrieved from https://ustr.gov/issue-areas/trade-development/preference-programs/generalized-system-preference-gsp

[7] The Caribbean Basin Initiative was a U.S. program that provided tariff and trade benefits to Central American and Caribbean countries. Retrieved from https://ustr.gov/issue-areas/trade-development/preference-programs/caribbean-basin-initiative-cbi

[8] The African Growth and Opportunity Act is a U.S legislation to assist the economies of Sub-Saharan Africa. Retrieved from https://legacy.trade.gov/agoa/

[9] International Monetary Fund (2020). International Financial Statistics. Gross Domestic Product and Components.

[10] International Monetary Fund (2020). International Financial Statistics. Gross Domestic Product and Components.

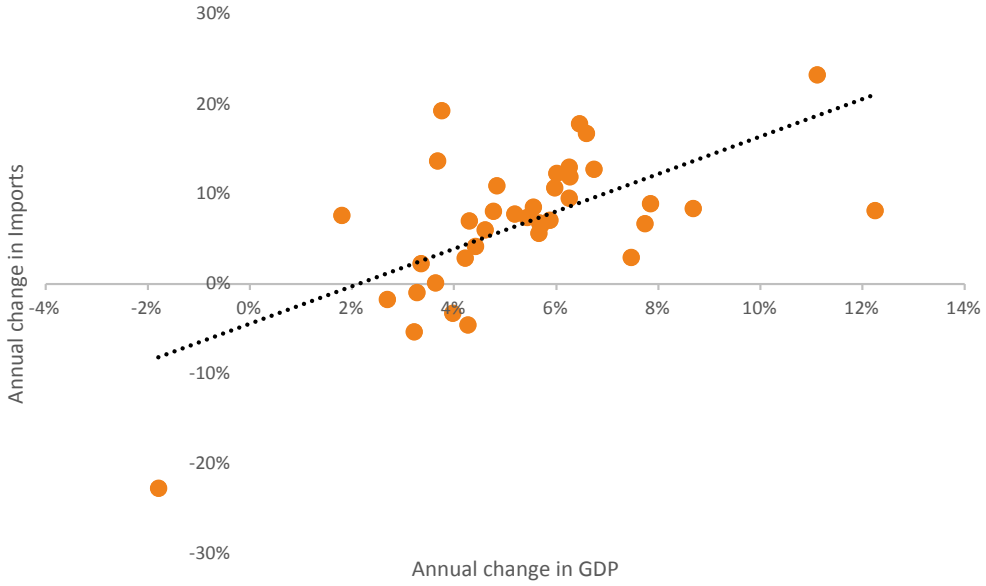
[11] Eurostat (2020).

[12] International Monetary Fund (2020). International Financial Statistics. Gross Domestic Product and Components.

siderable economic value of imports[13]. Indeed, import competition forced U.S. companies to improve and contributed to a decline in inflation from 7% in the 1970s to just above 2% in the period between 2000 and 2018[14].

In general, economic growth in the U.S. is associated with growth in imports, as the graph below indicates and we see similar patterns in the EU and Japan. With the onset of a Coronavirus-related economic shock, the U.S. economy is approaching a core goal of some protectionists shrinking the trade deficit as the economy itself shrinks.

FIGURE 3: ANNUAL CHANGE IN U.S GDP AND U.S. IMPORTS



Source: International Monetary Fund (2020). International Financial Statistics. Gross Domestic Product and Components

How did the world arrive at this moment at which there is considerable evidence regarding the benefit of trade, but little political appetite for movement on this issue? There are four factors contributing to this paralysis.

1. **The U.S. is absent from the leadership role.** Historically, the United States led in the GATT/WTO system and also led from outside this system by promoting bilateral and regional agreements.

2. **No Cold War requirement.** The idea that trade architecture would buttress the security architecture of a U.S.-led international system has declined in appeal, if not completely disappeared. Concern over China's international role might prompt the U.S. to engage again on trade, but that is unlikely to happen in a presidential election year. Put down the TPP as the first test for this theory in 2021.

[13] There is a common misconception which associates imports with a drag on the economy. In reality, statisticians subtract imports from GDP because imports are already computed as part of consumption. In other words, there is a negative next to imports in the formula that calculates GDP to avoid double counting.

[14] Federal Reserve Bank of St. Louis (2020).

3. **No alternative leadership in Europe or elsewhere.** We are at a rare moment where there appears to be no leadership for international architecture. There is no spokesman for international cooperation, à la Tony Blair. Nor is there any national leader who has attained stature outside of his home country, such as a de Gaulle or an Adenauer.

4. **The cumbersome WTO process.** Unlike the World Bank or the IMF, the WTO has no weighted voting based on a member's financial contribution or on a member's role in international trade. Cape Verde has the same voting power as the U.S., China, or every other member. Unlike the U.N., there is no Security Council, nor an executive committee. Decisions are not made by majority vote, nor even a super-majority vote. They are made by "consensus." This is a harmless enough sounding word, but in practical terms it means that every one of the 153 members must agree. Consensus really means unanimity. As a result, there are 153 trade agendas that become difficult to harmonize.

Since all results – all results – have to be done by consensus, this places enormous power in the hands of outliers, those with diverse or exotic goals. Minor trading states with niche agendas can grind the entire body to a halt.

Indeed minor states might achieve little benefit from a successful WTO process as they are too small to enjoy much of an upside, but they potentially receive value by impeding the process, which allows them to maximize their power. Negative power the ability to obstruct or veto exceeds positive power.

And given that a majority of the WTO members are not seriously involved in trade, there is a risk of side issues being injected, the "UN-ization" of the WTO as it is compelled to address issues from income distribution to global warming and environmental issues. But this makes sense for the smaller countries. If trade means little to you why not use your voice at the WTO to speak about AIDS or debt forgiveness?

WTO provides the architecture, but not leadership, vision, or mechanism to get results. To move ahead on trade, some changes are needed.

If the U.S. has no appetite for leadership, and the WTO is not capable of leadership, and no other country is stepping up, then we must identify initiatives that will be significant enough to be economically consequential yet will not fall victim to trade posturing. Big enough to count but unobjectionable enough to be adopted. It is time to think small.

3. FIVE STEPS TO MAKE TRADE WORK AGAIN

First, we need an approach that will allow trade to move ahead in the absence of universal consensus. The Big Three trading powers, the U.S., EU, and Japan, that together account for almost 52% of world GDP[15] and 47%[16] of world trade, should establish a consultative body on trade (sorry, Britain, but you made the decision to step out).

Notably, this does not include one of the more important trading powers, China, at least at this point. This absence would make consensus easier to obtain, but at the same time make it less meaningful. However, to keep the process open to China and others, it should be a 3+X

[15] International Monetary Fund, World Economic Outlook Database, April 2019.

[16] In 2018, the EU, Japan and the U.S. represented 47% of world imports and 48% of world exports. World Bank, World Development Indicators.

approach, meaning the Big Three will shape the initiative, but China and other WTO members would be invited to join and benefit from any agreements. This recognizes the divergent political systems and appetites within the WTO and allows for à la carte support of various initiatives. We start to shape trade initiatives on the basis of support among the Big Three, rather than on the basis of a universal consensus in the WTO. Other members' support is welcome but not obligatory.

To the argument that an independent trade process would undercut the WTO, the response should be this might well be the spur the WTO needs. At a minimum, the WTO no longer holds veto power over a liberalization process and the trading community would be allowed to pursue an alternative, yet complementary, approach.

Second, no harm, no foul. Each of the Big Three should commit to zero tariffs on any items not produced in each particular market. In other words, as the United States no longer produces jeans, television sets, or light bulbs[17] why should it maintain tariffs on those items currently at 5.9%, 1.9%, and 1.3% respectively? This would provide a modest boost to specialty goods such as cranberries. It will also be a boost to innovative goods, such as digital products[18]. No tariffs where there is no local production. Cranberries forever. Digital forever.

Indeed, the specialty agricultural sector and the digital sector formed the bulk of the recent US-Japan trade agreement[19]. It is hard to liberalize sectors which have mature domestic producers. It is easier to be virtuous when virtue is cost-free[20].

Third, a de minimis strategy. Tariffs should be eliminated on all line-items where the current tariff is less than 2%. At 1.5%, for example, tariffs are simply a nuisance fee. Not high enough to deter imports but still high enough to burden trade[21]. Some 29% of the EU's tariff lines; 11% of Japanese tariffs; and 17% of the U.S.' are less than 2%[22] Why should Americans have to pay an import tariff of 0.1% on bananas; Europeans 0.3% on some plants; and Japanese consumers 0.4% on fish[23]? The figure below shows the extent of nuisance tariffs. The Big Three together have close to three thousand tariffs at six-digit level which are less than 2%.

[17] Anika, A. (2010, October 21). 18 Iconic Products That America Doesn't Make Anymore. Business Insider. Retrieved from https://www.businessinsider.com/basic-products-america-doesnt-make-2010-10?IR=T

[18] The elimination of tariffs for products which are not produced domestically will generate additional trade. However, and in contrast to the other proposed measures, we have not estimated this increase in trade due to data limitations. Databases such as the CEPII TradeProd Database display production data at an aggregated level which does not allow to see the products for which there is no domestic production.

[19] United States Trade Representative (2019) Fact Sheet on U.S.-Japan Trade Agreement. Retrieved from https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2019/september/fact-sheet-us-japan-trade-agreement

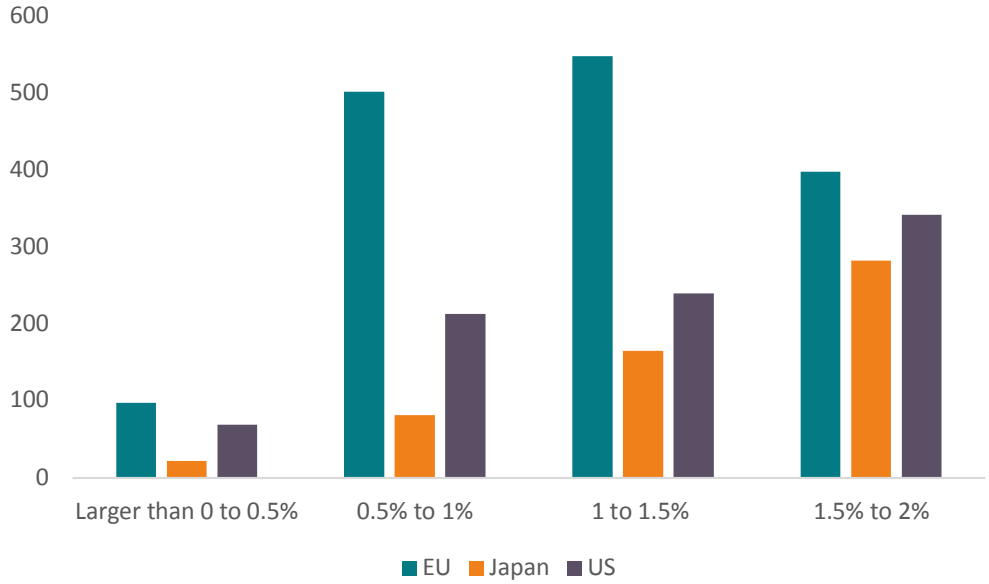
[20] For example, Hong Kong eliminated all duties on wine in 2008, resulting in wine imports quadrupling 2008-18, creating jobs in trading, specialized storage facilities, regional management, advertising, re-exporting, and auction houses. Source: Wine Hong Kong.

[21] Eliminating nuisance tariffs is possible. As an example, the UK new global tariff scheduled published on the 19 May 2020 eliminates import tariff lines that are less than 2%. Winters, A., Gasiorek, M., Magntorn, J. (2020). New tariff on the block: What is in the UK's Global Tariff? UK Trade Policy Observatory.

[22] UNCOMTRADE (2020). Data retrieved from the World Integrated Trade Solution (WITS). The calculations on the share of tariffs below 2% were made at the HS six-digit level.

[23] The quoted products are 080310 Plantains which belongs to 0830 Bananas, including plantains, fresh or dried; 121190 Other which belongs to 1211 Plants and parts of plants (including seeds and fruits); and 030119 Other which belongs to 0301 Live fish.

FIGURE 4: NUMBER OF IMPORT TARIFF LINES BELOW 2% IN THE U.S., JAPAN, EU



Source: Authors calculation. HS Combined. Tariff data for 2018

Eliminating these nuisance tariffs could add US$16 billion to total trade.[24]

Fourth, mind the social costs. Expand the Nairobi Protocols to include health products and green tech.

In 1950, the United Nations Educational, Scientific, and Cultural Organization (UNESCO) met in Florence Italy to adopt the Agreement on Importation of Educational, Scientific and Cultural Materials[25]. More commonly known as the Florence Agreement, it provided for duty free treatment and the reduction of trade obstacles for imports of educational, scientific, and cultural materials.

In 1976, UNESCO adopted the Nairobi Protocol[26] to the Florence Agreement, which expanded the scope of products to include materials specially designed for handicapped persons. This was enshrined in the U.S. through various legislative initiatives and presidential proclamations[27].

[24] The SMART Partial Equilibrium Model included in WITS was used to calculate this figure. We estimate the impact of setting all the HS six-digit tariffs which are less than 2% in the EU, U.S. and Japan to zero. The partial equilibrium analysis does not account for the interactions and feedback between markets. In particular, it neglects the importance of intersectoral linkages. It also misses the existing constraints that apply to labor, capital and land. The figure was calculated to illustrate the potential effect of the measures but further analysis using computable general equilibrium modelling would be need to assess the precise impact of this measure.

[25] Additional information on this agreement can be found at the UNUESCO website. Retrieved from http://portal.unesco.org/culture/en/ev.php-URL_ID=35104&URL_DO=DO_TOPIC&URL_SECTION=201.html

[26] Additional information on this agreement can be found at the UNUESCO website. Retrieved from http://portal.unesco.org/en/ev.php-URL_ID=15224&URL_DO=DO_TOPIC&URL_SECTION=201.html

[27] For example, the Agreement on the Importation of Educational, Scientific, and Cultural Materials Act of 1982, established the duty-free treatment for certain articles for the handicapped; the Presidential Proclamation 5978 and Section 1121 of the Omnibus Trade and Competitive Act of 1988, provided for the implementation of the Nairobi Protocol; and the Presidential Proclamation 6821 (1995) provided for "parts and accessories specially designed or adapted for goods that are specifically designed or adapted for use of physically or mentally handicapped persons".

The Florence Agreement and the Nairobi Protocols represent two welcome steps ahead, but why stop with educational and handicapped-related products? Why not facilitate trade in all health-related items, such as pharmaceuticals and medical technology[28] Why not other segments where there is a strong social benefit such as anti-pollution technology or electric batteries?

The WTO took an important step toward that goal in 1995 with the Pharmaceutical Tariff Elimination Agreement, a "zero-for-zero" agreement that has been expanded to cover some 10,000 items. Yet the Hinrich Foundation notes there remains some 1,000 products and some 700 ingredients that are not yet covered. And neither China nor India participate in this agreement, with China's average applied tariff on pharmaceuticals at 5.2% and India's at 10%[29]. As noted by Hinrich, "the value of global trade included in duty-free treatment decreased from 90 percent in 1995 to 81 percent in 2009 to 78 percent in 2018."[30] Beyond China and India, the U.S., the EU, and Japan have problems as well, even as they have made trade in medical goods less restrictive in their response to Covid-19[31]. The Peterson Institute for International Economics notes that the tariffs President Trump has imposed on China adds costs to some $5 billion of U.S. medical imports from China, which account for 26% of U.S. health care imports[32]. The EU applies an import tariff of 3.8% on some organic chemicals which are necessary for medical purposes[33] while Japan applies a tariff above 3% to pharmaceutical goods used during ostomy[34].

We see a similar pattern in green energy. In 2013, Angela Merkel decided not to pursue a WTO dumping case against Chinese solar manufacturers[35], concluding that the economic and social benefits of inexpensive solar energy exceed the supposed utility of protecting Germany's solar panel manufacturers. Can this principle not be expanded across the Big Three, so that wind turbines, battery storage systems, and other elements of green energy are all tariff-free as well? The fact that the EU and the U.S. impose import tariffs of 6% on some environmental goods is certainly not good for the planet[36].

The good news is that the Big Three have scope to eliminate tariffs on medical and environmental goods. The figure below shows that the U.S., Japan, and the EU together continue to apply import duties on more than nineteen thousand tariffs lines for medical and green goods.

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[28] Frank Lavin, one of the co-authors of this paper, serves on the board of a medical technology company.

[29] Banik and Stevens (2015). Pharmaceutical tariffs, trade flows and emerging economies. Geneva Network. Retrieved from https://geneva-network.com/wp-content/uploads/2015/09/GN-Tariffs-on-medicines.pdf

[30] Durkin and Calder (2020, March 19). Free trade in medicines and supplies is the healthiest approach. Hinrich Foundation. Retrieved from https://tradevistas.org/free-trade-in-medicines-and-supplies-is-healthiest-approach/

[31] Evenett, S. (2020). Tackling Covid-19 together – the Trade Policy dimension, Global Trade Alert, March 2020.

[32] Zoellick (2020, 18 March). Trump's Tariffs Leave the U.S. Short on Vital Medical Supplies. Wall Street Journal. Retrieved from https://www.wsj.com/articles/trumps-tariffs-leave-the-u-s-short-on-vital-medical-supplies-11584551602?mod=opinion_lead_pos5

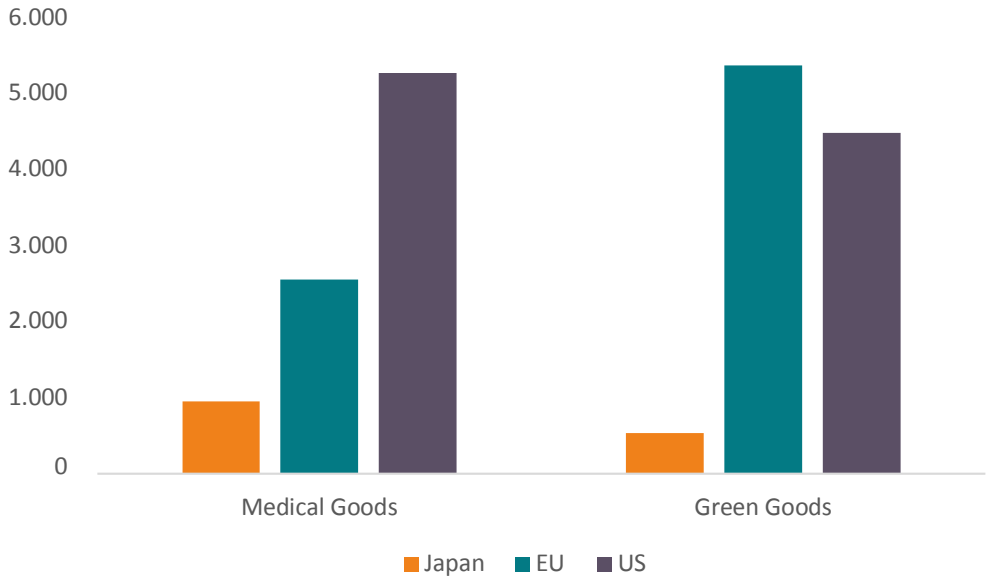
[33] The EU applies an MFN tariff of 3.79% for salts and esters of tartaric acid (291813); 3.16% for other Hexamethylenediamine and its salts (292129); and 3.15% for aniline derivatives and their salts (292142).

[34] Japan applies an MFN tariff of 3.43% for appliances identifiable for ostomy use (300691).

[35] Bradsher, K., Eddy, M. (2013, May 28). China Divides Europe in Fight Against Tariffs. The New York Times. Retrieved from https://www.nytimes.com/2013/05/29/business/global/china-divides-eu-in-fight-against-tariffs.html

[36] Bucher, H., Drake-Brockman, J., Kasterine, A., and M. Sugathan (2014). Trade in Environmental Goods and Services: Opportunities and Challenges. International Trade Centre Technical Paper, Geneva.

FIGURE 5: DUTIABLE IMPORT TARIFF LINES IN THE U.S., JAPAN, EU FOR MEDICAL AND GREEN GOODS



Source: Authors calculation based on a list of medical and green goods compiled in Helble (2012) and Knudson, Aspen and Hermansen (2015) respectively.

Scrapping these tariffs would not only encourage an additional trade of up to $7 billion in these goods[37] but will also provide collateral health and environmental benefits.

Fifth, harmonize down. Finally, the Big Three should commit that on every tariff line item each of the three will be no worse than the next worse. In other words, each of the Big Three will agree to reduce its tariff on every line item where it is the worst (the highest tariff) of the three. For example, import tariffs on clothes is 8% in the U.S., 7% in Japan, and 4% in the EU. Under this rule, the U.S., with the highest tariffs in this segment, would agree to lower its tariff lines to match the next worse, in this case Japan.

This measure will reduce import tariffs but without requiring each economy to match the best in each segment. It might be difficult to match the best-in-class, but it should be feasible to no longer be worst-in-class. For example, in the case of machinery, the EU would have to lower its average tariff just by 0.1% to match the second worst, in this case the U.S. Some reductions would be more meaningful, such as with food products and beverages. Japan has an average MFN import tariff of 10% while import tariffs for the U.S. and the EU are 3% and 4% respectively; so Japan would have to lower its tariffs. Overall, this simple rule could achieve US$22 billion in additional trade[38].

[37] The SMART Partial Equilibrium Model included in WITS was used to calculate this figure. We estimate the impact of setting the trade codes identified in Helble (2012) and Knudson, Aspen and Hermansen (2015) in the EU, U.S. and Japan to zero. The same caveats with regards to partial equilibrium modelling explained earlier apply here.

[38] The SMART Partial Equilibrium Model included in WITS was used to calculate this figure. We estimate the impact of setting import tariffs for the country with the highest tariff in each sector no larger than the import tariffs of the second highest. The same caveats with regards to partial equilibrium modelling explained earlier apply here.

4. CONCLUSION

The approach outlined above allows international trade to get back in forward motion through a series of small and mid-tier steps among the U.S., the EU, and Japan. It would also be set up on a plurilateral basis that would allow other trading powers such as China and the UK to participate. These steps fall short of a full-blown Free Trade Agreement, or a full WTO Round, both difficult to attain in the current environment, but these steps would nonetheless be a welcome addition to global trade.

Smaller countries would benefit as well. By reducing peak and average tariffs across the Big Three, there will be a positive effect on Global Value Chains. For instance, the U.S. has an import tariff of 5% on portable electric lamps while the EU charges 3%. On the other hand, the EU charges 5% on monitors and projectors while the U.S. import tariff is 2%[39]. Harmonizing down these tariffs would significantly reduce trade costs for what it is already a global trading system in electronic products.

In some respect, this process is already happening. The EU and Japan signed an FTA that lowers import tariffs between these two economies. Meanwhile, the U.S. and Japan agreed to negotiate a comprehensive FTA on the back of the September 2019 U.S.-Japan Trade Agreement. And there are long-standing statements in both Brussels and Washington over the desirability of US-EU free trade. As the EU and the U.S. each establish lower import tariffs with Japan, it stands to reason that the EU and the U.S. would lower import tariffs between themselves as well. So philosophically, the EU, the U.S., and Japan, have all indicated the above approach is compatible with their view of trade.

And if China is willing to step up? China should be welcomed into this group if it supports the four initiatives, changing the Big Three to the Big Four. Beyond providing a boost to the global economy these initiatives will reestablish a pattern of international economic cooperation. After a failed WTO trade round, we start moving forward. After a decade of highlighting the putative costs of trade, we remind the world of its benefits.

[39] The products mentioned refer to the following HS Combined six-digit product codes: 851310 (Lamps) and 852872 (Monitors and projectors, other, colour).

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