

America, China and protectionism

Wearing thin

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How strong is Barack Obama's belief in free trade?

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ALTHOUGH Barack Obama alarmed free traders last year with protectionist-sounding pronouncements on the campaign trail, such as one about the need to renegotiate NAFTA, optimists among them dismissed this as mere posturing designed to placate restive trade unions. Yet a decision by the White House to impose punitive tariffs (35% for the first year, falling by five percentage points a year, to 25% in the third year) on Chinese-made pneumatic tyres now raises serious doubts about Mr Obama's commitment to free trade.

The duties are to be imposed on September 26th under a part of American trade law known as "Section 421". The American government argues that these tyres are being imported into America from China in "such increased quantities and under such conditions as to cause or threaten to cause market disruption to domestic producers" of competing tyres.

America imported tyres worth \$1.3 billion from China between January and the end of July this year. Under the terms of China's accession to the WTO in 2001, countries have the right to impose tariffs in response to a "surge in imports" from China. But there is always scope for dispute about what constitutes enough of an export surge to justify the use of tariffs, and China has already notified the WTO of its intention to file a case against America. It has also said that it is considering the imposition of retaliatory tariffs on American exports of car parts and chicken meat.

Poultry and tyres sound like small change in the context of the economic relationship between the two big economies. But Eswar Prasad, a professor of trade policy at Cornell University and a former head of the IMF's China desk, argues that the American action and Chinese retaliation may presage "more protectionist measures to come from both sides". He notes that China could retaliate much more broadly than by raising a few tariffs: it could, for example, supplement its implicit export subsidies, including an undervalued exchange rate, with more explicit

measures to support its export industries and block imports. This could “easily ratchet up into a broader trade war and inflict economic damage on both countries”.

The decision to use Section 421 is a disturbing one. John Veroneau, a lawyer and a former deputy trade representative, points out that this particular rule “doesn't require any finding of unfair trade practice by China... Chinese tyre exporters were not found to be doing anything wrong or illegal.” This means that it is hard for the administration to pass off the decision as being about tougher enforcement of existing trade agreements, which has been the focus of Ron Kirk, the new American trade representative, since his appointment.

Mr Obama's decision also marks a clear break with recent American policy. His predecessor, George Bush, had four opportunities to take such a step against China, but in each case chose not to do so. Mr Veroneau, who worked on those cases, argues that “based on their negotiations with the Clinton Administration on Section 421, China expected this tool to be used, if ever, only in the rarest and most exceptional of cases”. So China's pique is understandable, as are worries that this could lead to a slew of other American industries demanding protection against competition from Chinese imports.

Simon Evenett, a trade economist at the University of St Gallen in Switzerland, argues that Mr Obama's decision is a clear affirmation of the power of American labour unions in shaping its trade policy. It appears that Mr Obama is desperate to shore-up support from unions and the left of the Democratic Party for health-care reform—his most pressing domestic concern—and is prepared to risk repercussions on trade.

If so, heightened economic tensions between America and China are a heavy price to pay. Mr Prasad says that “an escalating trade war between these two large economies has the potential to disrupt the world trading system”. The China-America spat also comes soon before the leaders of the G20, the group of big rich and emerging economies, meet in Pittsburgh on September 24th. Global co-operation has been crucial amid efforts to encourage economic recovery. It would be a tragedy if it that were derailed by posturing over tyres and chicken.