Economic Competition & International Trade: From Decoupling to Industrial Policy

A Response from Jonathan Burks

Since the Second World War, American trade policy has been driven by a core conviction that the United States has more to gain—both economically and strategically—from free trade than it stands to lose from increased competition from abroad. Brent McIntosh's call for a "mindset that consistently puts the strength and dynamism of our national economy at the center of policy deliberations" challenges policymakers to look afresh at whether that trade policy consensus should still hold. In the context of the competition with China, the answer is not a simple one. Free trade still provides the greatest economic benefits, but in terms of strategic concerns, the calculus is much more difficult than during the Cold War when the strategic threat was distinct from the economic challenge.

The Postwar Consensus

At the close of World War II, the United States was the only major economy undamaged by the war. Enjoying absolute advantages in almost every category of production, U.S. policymakers did not view any other state as an economic threat. The war had spurred massive increases in industrial capacity and a significant increase in the dispersion of skilled labor across the country. Moreover, it was a common belief among policymakers that prewar tariff increases had contributed to—if not outright caused—the Great Depression, which policymakers in the immediate postwar years feared could return once the demand stimulus from wartime was removed.

Summoning economic concerns to argue for liberalized trade, policymakers felt comfortable leveraging the strategic value of access to American markets and financing as a prime inducement for countries to choose the non-Communist West over alignment with the Soviet bloc. Indeed, the postwar architecture of global economic institutions that included the World Bank and the International Monetary Fund was originally intended to include an International Trade Organization. While the latter was never created, the General Agreement on Tariffs and Trade, which eventually became the World Trade Organization, was the substantive realization of the same goal, establishing liberalized trade as a bedrock of the Western economic order.

America's postwar economic predominance inevitably declined as the world recovered from the ravages of war. This meant more competition from abroad for American industry, and, predictably, it translated into diminishing domestic political support for free trade. Still, the broad consensus held, with each administration during the Cold War playing some role in expanding the community of countries participating in the market-driven, global economy.

The Present Challenge

More recently, that consensus has frayed in the face of long-standing concerns about a perceived decline in U.S. manufacturing, exploitative trade and industrial practices by a very large entrant into the global economy, and worries about the strategic implications of reliance for manufactured goods on the People's Republic of China.

While the consensus view of economists remains that free trade is the most economically efficient arrangement (i.e., it results in the most output for the given inputs), there is a much greater level of debate around the reality that the costs and gains from trade are not equally distributed. Workers in import-competing industries bear a disproportionate share of the costs, while the gains to consumers and to workers in industries that rely on imported inputs are more broadly shared but relatively smaller. This distributional disparity matters because it undermines the political consensus that is necessary for modestly consistent strategy over time. Moreover, if the "loser" from trade is the domestic manufacturing sector, then the United States may lose a measure of strategic autonomy given the centrality of some manufacturing to the generation of national security. What is economically efficient is not necessarily optimal across other important indicia of strength.

How then should policymakers with the McIntosh mindset develop a trade policy optimized for the competition with China? The following considerations are a useful guide to policymakers who will have to grapple with this question day-to-day and not just in terms of an abstract commitment to an "America First" philosophy or to a trade policy that "works for the middle class."

• *Bilateral deficits are economically meaningless but could have strategic and political importance*. In economic terms, it does not matter if the United States has a trade surplus or deficit with any given country. The national income accounting system is just an artifice. In domestic political and strategic terms, however, bilateral deficits can have real importance. Domestically, they can shape popular perceptions about the nature of our relationships with adversaries and partners alike. In strategic terms, the nature of the deficit could be a sign of real dependence and thus vulnerability in either direction—or in both directions.

• *Policies to address bilateral deficits have multilateral effects*. Bilateral trade disputes can rearrange trade—and thus political—relationships in unintended ways. The trade war with China is a case in point. As China imported fewer U.S. goods, it increased imports from the rest of the world. The net effect was that China deepened economic relationships with many countries that might otherwise have been natural U.S. allies. Steps taken for economic reasons can have a profound impact on the strategic sphere.

• *Many countries in Asia share our strategic concerns, and working with them can lessen the economic costs of action*. Almost any government intervention to change the shape of the economic relationship with China—whether full decoupling, more modest redesign of select supply chains, or anything in between—will entail real costs to the U.S. economy. How many of those costs we bear alone is a choice. Other states in the region share our strategic concerns and, if engaged intelligently, can help to reduce some of the costs. For example, policies to facilitate foreign direct investment could lower the costs to U.S. suppliers of relocating supply chains out of China.

• *Access to the U.S. market benefits U.S. consumers and can attract allies*. The ability to import relatively inexpensive consumer goods is a core element of the high living standards enjoyed by Americans across the income spectrum. In addition to being good for U.S. consumers, access to our market is also of tremendous value to potential allies in the competition with China. Just as strategists worry that the U.S.–China economic relationship might limit our freedom of action, robust and growing trade relations with third countries can help them choose the right side in the competition with China.

• *Our traditional allies in Europe have long had competing economic philosophies and are unlikely to be reliable partners in the economic competition with China*. Some of the principal beneficiaries of the U.S.–China trade war have been European countries. Moreover, as a matter of principle, most European governments believe in industrial policy as a normal policy tool, have less of an aversion to economic espionage, and have no ideological commitment to limited government intervention in the economy. While they may share some of our strategic concerns about China, they are not natural allies on the most important elements of the economic competition.

Conclusion

Trade policy can do only so much. A complete decoupling of the American and Chinese economies would not mean victory in our present strategic competition—nor would it cripple the U.S. economy. It would be costly and disruptive but, ultimately, inconclusive. Measures short of decoupling can have incremental effects and should be evaluated with the considerations outlined above. Ultimately, the greatest contribution trade policy can make in the competition with China is to help the American economy grow faster and maintain its dynamism, which historically has been our path to success.