Rethinking Globalization in the Trump Era:
US-China Relations
Joseph E. Stiglitz

The global economic and political order that was created in the aftermath of World War II is under attack by President Trump. That order has been of enormous benefit to the entire world. The first half of the twentieth century was one of the worst: two world wars and a Great Depression. Though the second half has not been without conflict, there have not been the great conflagrations that marked the previous half century. The era of colonialism was brought to an end, as hundreds of millions could once again determine their own destiny. And while there have been economic fluctuations, none of the downturns has come anywhere near that of the Great Depression. Hundreds of millions were moved out of poverty—500 million in China alone. Parts of the world that had been mired in stagnation and poverty for centuries saw unprecedented growth.

The international institutions and arrangements that have been created the last seventy years have, I believe, played an important role in these successes. These include the UN, the IMF, the World Bank, the regional development banks, and GATT and its successor institution, WTO. None of these are perfect. Indeed, in many of my books I have criticized them—as not democratic enough, too dominated by the US and other advanced countries, too influenced by special interests and particular ideologies. But I criticized them from the perspective not of walking away from globalization, but from that of making it work better, to the betterment of all individuals around the world.

Seemingly, President Trump is arguing for a new era of protectionism. I say seemingly, because there is a lack of consistency in his statements and some of those he has appointed. But in his recent message to the US Congress, he reiterate the protectionist themes that dominated the election, and it would be wise for countries to orientate their policies around the possibility, or even likelihood, that he will, to at least a certain extent, carry out his promises. These measures include a tariff of some 45% against China, a renegotiation of NAFTA, and a tariff against Mexico of some 20%.

The world is lucky: it has in place an effective set of international institutions. Some would argue that without the US, it would have been difficult to create these institutions. Doing so required a global public spirit that is not always present—the times in which most of the institutions were created were unique, the moment of solidarity as World War II was being brought to a close, or that following the fall of the Iron Curtain. But these institutions have taken on a life of their own. We have created a system of global governance without global government. These institutions can help the world maintain an open yet regulated trading and financial system, even if the US withdraws into its shell, or decides to take actions which violate its obligations.

In the following pages, after describing briefly the scope for action of the President, I suggest how countries, such as China could and should respond.

*The scope for action*

Though the President has been given considerable authority for acting in areas of international affairs, he still faces many constraints. The extent to which he will be constrained remains a subject of controversy among legal scholars in the US. The fact that this is so itself creates considerable uncertainty going forward.

For instance, while there may be some debate about whether the President on his own can withdraw the US from NAFTA, even were he to do so, the implementing legislation (which was, in effect, the Congressional ratification of NAFTA) remains on the books, and that sets tariffs and other terms of US trade relations with Canada and Mexico. That could only be changed by an act of Congress. It was the Republican President Bush who negotiated NAFTA, and Republicans have consistently supported trade agreements. It would be a remarkable abnegation of principle if the Republicans, who now control both houses of Congress, were to vote against NAFTA.

Even then, WTO remains in place. In the case of Mexico, the provisions of WTO (including those ensuring its “most favored nation treatment”—that the US cannot impose tariffs on Mexico any higher than those on other countries) mean that Mexico would face negligible tariffs; and indeed, Mexico would be able to charge the US higher tariffs than US could charge Mexico.
This, of course, oversimplifies: there are other actions, such as non-tariff barriers (phyto-sanitary conditions for agriculture) that the US could apply. And the US could break its WTO obligations. Some point out that it takes years for a WTO case to be adjudicated. At the same time, countries harmed by US actions are not likely to wait to take direct retaliatory actions, e.g. impose countervailing duties, undoing the benefit that the US might have hoped to have gained from the action; or indirect retaliatory actions, e.g. in areas not covered by existing trade agreements (government procurement).

The US could even withdraw from the WTO. Doing so would, of course, require another vote of both houses of Congress.

Within the WTO framework, there are a variety of protectionist actions the US could take—dumping duties and countervailing duties. To impose these, the US must go through certain procedures (which are time consuming). These procedures are also unfair—highly biased against other countries. And the US has, in fact, lost cases when countries against which it imposed these non-tariff barriers have appealed to the WTO.

Historically, they have been especially unfair to China, because there were special provisions applying to non-market economies that enable the levying of especially high dumping duties. These special provisions were supposed to have already expired, but the US is claiming otherwise. There is a case on this matter now before the WTO.

Even when the US engages in a WTO-non-compliant action, the WTO does not prohibit the US from continuing these actions; it only allows the aggrieved country to apply compensatory duties. Countries have learned how to direct their retaliatory actions in ways which have the most political effect—targeting goods which are politically sensitive, often in districts of influential Congressmen. In most cases, these compensatory duties have the desired effect—the country engaging in the non-compliant action changes its policy.

In short, the US could impose tariffs against selected products from China, if it follows certain procedures; and it could simply ignore its WTO obligations. In either case, it risks retaliation, a subject which I shall discuss further below.
The WTO was designed to try to prevent trade wars. If the US were to impose a WTO-non-compliant tariff, and China won its WTO case, it could and presumably would impose compensatory actions to the extent authorized. That was supposed to end the matter. The US wouldn’t (or shouldn’t) respond by then taking a further action. But, of course, it’s hard to know how a President who simply breaks America’s obligations might act.

**Consequences**

President Trump has focused on bilateral trade deficits. Economists have long argued that what matters is multilateral trade deficit—we’ve moved away from simple barter, because doing so allows us to have higher standards of living. (One of the weaknesses of the old Soviet model was that it too was focused on bilateral trade deficits.) And, of course, the US-China trade deficit is large.

But even were the US to impose tariffs on China, it would not have any significant effect on its *multilateral* trade deficit—that is affected by macro-economics, by the level of domestic investments and savings. A tariff against China simply diverts trade to some other developing country or emerging markets. Production won’t, for the most part, come back to the US. And when it does come back, it won’t bring back the jobs that were lost (mostly to technology, though some to trade.) The new production will be highly capital intensive, and likely in a different places from those where jobs were lost.

Thus, the tariffs won’t lead to more jobs: they will lead to lower standards of living. And if the new protectionism sets off a trade war, the effects on living standards will be all the greater.

**Responding**

While it is thus foolish for the US to engage in the New Protectionism, it won’t be the first time countries with populist demagogues have undertaken counterproductive policies. The question facing the rest of the world is, how should they respond? It is important that any response be guided by a sound understanding of the underlying economics.

*Underlying economic principles*
Trump seems to argue that trade is a zero sum game, and America’s negotiators have gotten a bad deal. The central lesson of trade theory is that trade is a positive sum game—that when the rules are written correctly, both countries as a whole are better off.

But what was not noted as much as it should, is that there can be large distributive consequences—some individuals within the country can be worse off, even if the country as a whole is better off. The winners could have compensated the losers, but often they do not. And when the losers are very numerous—as they have been in the US—and they are those who already are among those not doing well, then trade will be viewed badly. It is not that the US trade negotiators negotiated badly; they got most of what they wanted. It is that they were bargaining for the wrong thing. They were pursuing the interests of America’s large financial institutions and corporations.

Thus, Trump has tried to make the issue a North-South one: the developing countries out bargained the US. In the face of it, to anyone who has watched trade bargaining, this accusation (leveled against his own party) is absurd. So too for anyone who understands bargaining theory. For years, I have written how the trade agreements have been unfair to developing countries.

But it is true that large swaths of those in the developed countries have not done well, and that’s because (a) the distributive effects of the agreements, especially as shaped by corporate interests, have been large, outweighing any growth gains (even if the size of the pie increases, if they get a smaller share, they can be worse off); these distributive effects are not just those predicted by the standard theory of comparative advantage (the famous Samuelson-Stolper theorem), with trade in goods substituting movement of factors, so that the demand for unskilled labor if advanced countries declines with the opening of trade, and with that its wage; but also include those arising from weakened workers’ bargaining power, as firms threaten to relocate if workers do not accept lower wages or worse working conditions. And (b) the aggregative effects have been overestimated—and when trade agreements have been mismanaged, even negative. Estimates, for instance, of the effect of TPP after being fully implemented in some 15 years have ranged from a miniscule .15% of GDP (the official government estimate) to negative (a Tufts University study). Standard models, based on the theories of
comparative advantage, show a (possibly very small) positive gain. But the standard model leaves out four important factors: (a) risk—trade can increase in risk, and in the absence of a full set of insurance markets, the net effect on GDP and well-being can be negative. Indeed, everyone, in all countries, could be worse off\(^2\); (b) employment—the standard model assumes full employment; in reality, there are often large departures from full employment. Trade agreements that are not well managed can result in jobs being destroyed faster than new jobs are created. The welfare consequences of these macro-economic effects typically swamp the small gains associated with comparative advantage, especially when tariffs are already relatively low. While this problem is rampant in developing countries\(^3\), it arises even in developed countries like the US. (c) Monopoly and imperfections of competition. Standard theory has been predicated on there being fully competitive markets in all countries. In fact, imperfections of competition are pervasive, and there is evidence of increasing market concentration across a wide swath of industries. The competitive model seems increasingly irrelevant in providing a good description of the economy, and accordingly, analyses based on the gains from trade using models assuming competition are suspect. Traditionally, trade has been thought to increase competition, as it brings more competitors into the market place. But more recently, it has become evident that it may provide more scope for the development of global monopolists and monopsonists. A firm with monopsony power in one country can use the advantages gotten there to outperform smaller firms in other countries. (d) Managed trade. The so-called free-trade agreements are really managed trade agreements, and managed, as I suggested, more for large corporate interests than for the interests of society as a whole. This is especially so of the investment and IPR (intellectual property rights) provisions of these agreements. The former, for instance, restricts country’s ability to impose necessary regulations for health, safety, the environment, or even financial and economic stability; the latter typically includes provisions which favor big pharma over generic medicines, and corporate innovators over small innovating firms.

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Thus, what Trump and some others have framed as a North South battle over trade is more a distributive battle—but not a distributive battle of the gains of trade between North and South, but a distributive battle between workers and corporations, or more broadly, the “1%.” Interestingly, adverse distributional effects have also occurred in some developing countries.

**Principles that should guide China’s response**

Below, I list ten a set of principles designed to enhance to create a more stable and efficient multi-polar system of global governance, which in turn can contribute to a stronger global economy, in which there is greater equity.

1. **Take high road, even if Trump takes the low.** This means respond *within the international rule of law*, even if the US actions seem counter to the spirit, and even the letter, of the law. There are many areas not governed by WTO commitments, e.g. government procurement.

2. Recognized that **trade is a positive sum multilateral game**. Trump’s failure to recognize this—to view it as a zero sum game and to focus on bilateral relations (including the bilateral trade deficit)—are among the key failings in his trade policy. Indeed, the move away from globalization is likely to turn out to be negative-sum. There have been significant cost savings from the creation of global supply chain; the disruption of these global supply chains will be costly.

Trump’s policy will open up **new avenues of cooperation**. Other countries, such as Mexico, have been victimized by Trump. Others that have not are worried that they might be. After striving for three quarters of a century to create a world where, for purposes of economic prosperity, borders don’t matter, the Trump Administration has reverse course 180 degrees. Countries around the world will be forging new alliances and strengthening old. China has the skills and resources to help others. **It can help create a high speed train system for Mexico.** Potentially linking the Atlantic and Pacific, such a scheme could be part of a New World silk route, providing faster and less costly linkages between the Atlantic coast of Latin America and China.
China has already been active in the establishment of new multilateral institutions, including the Asian Infrastructure Investment Bank and the New Development Bank (the BRICS Bank), which open up new opportunities for South-South cooperation and provide new resources for addressing global problems like climate change.

3. Respond in a way which is consistent with a rule of law. One of the most disturbing aspects of what Trump has done since taking office is the wholesale breaking of the rule of law. If one believes it is bad policy for American firms to invest abroad, one passes laws to that effect, for instance tax laws to disincentivize individuals from doing so, or regulations that prohibit them from doing so. It is then the responsibility of the executive branch to enforce those laws in a fair way, not selective enforcement, e.g. against firms with which the executive branch has a disagreement. Trump picks on particular firms to tweet, twists their arm publicly to do what he wants them to do, then, in return for doing so, seemingly arbitrarily and capriciously awards them tax incentives not available to others. All of the elements of this selective policy run against the principle of the rule of law. Responding in a way which is consistent with both a national and international rule of law still provides ample scope for effective action.

Thus, it might be tempting to respond to US actions which violate WTO rules by taking actions, like special levies, against American firms, especially those which are highly dependent on China as a source of profits. Such a temptation should be resisted.

4. Look for areas of cooperation—reminding Trump that the US-China relationship is about more than trade. The US, for instance, is rightly very concerned about North Korea. Many believe that China is the only country that has much leverage over that country. There are many other areas where the US and China could cooperate—China has the knowledge and capital to invest in key elements of the infrastructure that the US needs, such as high speed railroads. Unfortunately, I would not hold out much hope for this kind of economic cooperation: Trump and many members of his team often show isolationist sentiments, and it is questionable whether
they would be receptive to this kind of cooperative investment. (Similarly, any offer by China to buy currently proscribed hi-tech products—which would help correct the bilateral trade deficit—are likely to fall on deaf ears.)

5. But be resolute—Trump is a bully, has no sense of fairness, decency, or fair play and giving in will only lead to more unreasonable demands, as he “smells” weakness, though, that he may feel no boundaries to his actions. Some interpret his early actions put in doubt his commitment to the One China policy as part of his long run bargaining game—if China does not take actions to curtail exports, he will make China’s life in other areas difficult. China’s forceful response was helpful: the One China policy was not up for debate. But China may have to respond in kind, broadening responses beyond just those involving economics.

It is quite possible that the Trump administration will use the Reagan rulebook, putting pressure on China to impose voluntary export restraints, threatening to impose trade restraints on Japan if it didn’t. (Though voluntary export restraints were not really voluntary.) Japan gave in. But Japan was totally dependent on the US for its defense, and had a special relationship with the US going back to the surrender at the end of World War II. It would do enormous damage to the rules-based global trade regime were China to accede to Trump’s demand. Why wouldn’t the larger country facing a trade deficit with any other country make a similar demand on its weaker trading partner?

Trump thinks of trade as a simple deal, like a real estate deal. He doesn’t fully understand governments only set the rules and regulations. It is the private sector that makes the decisions. And, as I suggested earlier, it is the underlying macro-economics that largely determines the overall trade deficit; and it that, not the bilateral trade deficit that matters. Indeed, protectionist measures not only are likely to lead to a lower standard of living, but also lead to an appreciation of the dollar—and the appreciation of the dollar could lead to global macro-economic instability.
As he contemplates launching a global trade war, his calculus is like that of a general counting his tanks in comparison with the enemies. He looks at the trade deficit, and infers from that that China is more dependent on the US than the other way around. But matters are far more complicated than this simplistic analysis would suggest. Certainly, America’s workers will be badly hurt—and for what? There is dissension in the US about Trump’s policies because among economists there is almost unanimity: his analysis of trade and globalization is wrong, and so too for his seeming analysis of the consequences of a trade war. **This is particularly true because China already is engaged in a transition from export led growth to domestically demand driven growth. Trump’s policies will only hasten that inevitable shift.** Moreover, as Trump has antagonized former friends of the US all over the world, there are new alliances (discussed below) to be forged, e.g. with Latin America and Europe. China is sitting on a large amount of reserves. China has far more instruments available to enable it both to absorb the shock and redirect the economy. Any trade war would have very adverse effects on particular sectors and regions in the US economy, and the fiscally constrained US government would be hard pressed to provide the assistance that they require. China has shown in the past the ability to target responsive actions in ways which maximize impacts, including on politics and economics. Trump has focused his attention on manufacturing, which employs but 8% of America’s workforce. Agriculture has disproportionate political influence. Some Congressional districts are particularly dependent on exports. Moreover, the Republican Congress has consistently opposed trade assistance for those adversely affected by trade shocks. To provide that now would be again a major reversal of policy. While “consistency is the hobgoblin of small minds,” America’s political process is slow, and this makes the *timely* provision of the needed help even more problematic.

It is true, of course, as we noted earlier, that there are certain groups that have been hurt by globalization, and a succession of American administrations should have done more to help these individuals. The fault lies in the US not providing sufficient help to those who have been on the losing side of globalization. But the New Protectionism will not help these,
and will create a new set individuals who see their standards of living falling—the very large number of individuals hurt by the New Protectionism.

6. **Go for the long play**: what will advance the interests of the global economy and China over the long term. Trump has made a great deal that from now on, US will put America First. Recognize that the US has always put “America first,” but previously, it was an enlightened self-interest, that saw peace, stability, and cooperation in countries around the world in America’s interest. Trump has taken out the word enlightened from enlightened self-interest. **One of the weaknesses in “capitalism and politics with American characteristics” is its short-sightedness.** China could not have gotten where it has if it had not taken the long view—and it should do that here as well.

Part of the “long play” is understanding where the majority of American people stand. It is natural for governments to want to work together, and thus for the government of China to want to do things that please the Trump administration. I saw a similar dynamic at play during the Bush Administration, as it put pressure on countries to join the misguided War on Iraq. I reminded the foreign minister of one country debating whether to join the US led effort of the strong opposition to that war by the majority of young people in the United States—and it is these people that one would have to deal with in the future. If pleasing the Bush Administration entailed engendering the antipathy of the next generation of America’s leaders, it was a bad bargain. This kind of analysis is even more relevant today. Trump not only got fewer votes than Clinton, but he was elected with fewer votes than Romney received as he went into defeat. Voter support for a new president is typically high—there is a honeymoon. Even this early in his presidency, support for Trump is remarkably low.

As China forges its response, it should do so pursuing an **“enlightened self-interest.” China has an interest in preserving a rules based open international system.** At Davos, President Xi was widely seen as taking up the mantel of being the champion of globalization. But China will only be able to exercise leadership if it is seen as doing so within this broader
perspective. And its leadership will be more credible the more it is seen as following a rule of law within its own country.

7. Smart negotiations includes identifying what it is that Trump wants. Often it seems that more than anything, he wants a good headline, an understandable “story” of how he is delivering what he has promised. Thus, he focuses on getting a large firm which is thinking of moving a production line to Mexico to agree publicly not to do so. He can claim that he has saved 1000 jobs. Meanwhile, his actions have led to an increase in the value of the dollar, and the loss of jobs that results outweighs by a multiple this small gain in jobs. But the very visibility of the concessions he seeks makes negotiations often next to impossible. He wants Mexico to agree to pay for the wall—a wall which most experts agree would be an enormous waste of money. No Mexican government that agreed to that would survive. A standard lesson in negotiations theory is that one has to design one’s demands so that there can be an agreement in which both sides can claim that they won, that they at least got some of what they wanted, and that their concessions were, in some sense, a reasonable quid pro quo. Each side must save face. Trump’s ego often seems to preclude this as an outcome. He not only sees the humiliation of others not just as part of a bargaining strategy ex ante but as part of the outcome which he seeks. To the extent that that is so, there cannot be a successful outcome to inter-governmental negotiations. This is, of course, markedly different from “normal” negotiations. Americans have come to understand that this is not a normal presidency. Other countries will have to realize that this is so as well.

8. Seize the opportunity of working with other countries to create a sounder, multi-polar multi-lateral international architecture, based on the rule of law. This will necessitate all countries ceding some sovereignty. There will be disputes, and there needs to be some public judicial system for adjudicating disputes—not the private arbitrary arbitration system used under bilateral investment agreements that has rightly been so criticized. The rules will need to go beyond trade narrowly defined: not paying for the environmental damage inflicted is a hidden subsidy like any wage subsidy
and a fair trade agreement has to proscribe such subsidies. But the principle of subsidiarity should prevail: trade agreements should not intrude in areas where they need not, where there is no compelling case for standardization, no compelling cross-border externality.

While the US has upheld an international rule of law, it has been a biased rule of law, favoring America and America’s corporate interests. This is an opportunity for countries with leadership potential to seize that leadership, to reconstruct a new multi-polar global order based on fairness and social justice. This new social order should be based on the principal of adhesion—any country willing to play by the rules can join the club. In four years’ time, when America may be willing to rejoin the community of responsible nations, with a renewed commitment to honor its commitments, and to act cooperatively to solve the problems facing the world, it can decide to participate in the newly crafted architecture.

9. Act deliberatively. Trump wants fast results. Haste makes for waste. Do not be bullied into acting quickly. Trade agreements are complex, and have often unanticipated effects on various parts of the economy. The President on his own cannot pull the country out of the WTO. It would take a vote of both houses of Congress, and that is not likely to happen. On his own, he can impose certain measures (anti-dumping, countervailing duties, safeguards), but even then, there is a procedure that must be followed, and if that procedure is not followed, and if actions are taken that are not consistent with the law, there is a presumption of judicial relief. And then, China has within its purview a host of countervailing and retaliatory measures, which would make clear to all the benefits of maintaining good (normal) trade relations.

In particular, the US may be tempted to try to get China to agree to voluntary export restraints, which seemingly worked so well against Japan during the Reagan era. But as we noted earlier, the world has changed enormously since then, and there are large differences between Japan’s situation and that of China. Global supply chains have become enormously important. The trade deficit with Japan could be remedied by restraints on a relatively few products. Most importantly, China has been making a
move to a market economy. Imposing trade restraints would be an enormously counter-productive move in the other direction. And again, as noted above, it won’t really solve the underlying US problem associated with its multilateral trade deficit, which will probably grow worse under Trump’s policies. Given that, one cannot expect a quick turn-around in US attitudes. (Trump continues to talk about China’s currency manipulation, even though China’s intervention in the exchange rate in recent years has been to support the value of the currency. So too, Trump continues to talk about Mexican immigration, as if it is a major problem, even though there has been reverse migration in recent years, and China has been helping the US stem the wave of migrants from Central America.)

If China were to intervene, it should do so using a market based instruments, such as the system of trade chits that I analyzed in *The Euro* and in my recent NBER paper. When any firm imports a good, it receives a trade chit, and to export, it must buy a trade chit, which will be traded freely in the market. This system separates, in effect, the trade account from the capital account.

10. **Be creative** about the new opportunities this affords. **China appears to be doing this already, with the China Regional Comprehensive Partnership Agreement as a replacement for TPP.** TPP illustrates much of what is wrong with earlier trade agreements. It excluded China, thus threatening to disrupt important global supply chains. It did little to fix the deficiencies in existing investment agreements and IPR—in some ways, they were made worse. US has foisted on the rest of the world an IPR regime which does not even work well for the US as a whole. It was, to a large extent, designed by and for the drug industry and a limited number of other special interests. Intellectual property rights are important, but the current system needs reform. This may be an opportune moment to do so.

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5 I discuss some of the broader issues in designing an innovation system for China, including what kind of IPR regime maximizes innovation and societal well being in “Institutional Design for China’s Innovation System,” in *Law and Economic Development with Chinese Characteristics: Institutions for the 21st*
The set of principles that I have outlined above include many that are just conventional wisdom for achieving mutually beneficial returns in any set of negotiations—looking for areas of cooperation, of mutual gain, and thinking about what is it that Trump wants.

**Concluding Remarks**

China has gained enormously from globalization and from the open global economic order—an order which the US did so much to create. But history matters: now that that order and the institutions which help support it have been created, it can continue even were the US to go in another direction. The global geo-economic and geo-political order of the 21st century would, in any case, have to be different from that created in the aftermath of the Second World War. **Trump’s actions have only hastened the change, increasing the urgency for such change. That new order will be a much more multi-polar world.** All countries need to participate in the creation and working of that order, one based on social just and the international rule of law. China, as the world’s largest economy (in terms of purchasing power parity), the largest trading economy, the largest manufacturing economy, the largest saver has an especially important role. It might have been better had the world move more gradually towards the New Order—China, in its economic reforms, has shown the advantages of gradualism (as opposed to shock therapy.) But the world may not be given that choice.

So China, and the rest of the world, should look at what is happening from the perspective of the new opportunities that this rapid change will afford. This short note has described some of the ways that China might respond in ways which support the creation of this **new 21st century globalization**—a globalization which

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will continue to support the growth of countries and the improvements in the standards of living of citizens all over the world.