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Killing the Pax Americana

Trump's trade war is about more than economics.



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O.K., they weren't supposed to start the trade war until I got back from vacation. And I really have too many kilometers to cover and hills to climb to weigh in on a regular basis or at great length. But since I'm currently sitting in an outdoor cafe with my coffee and croissant, I thought I might take a few minutes to address two misconceptions that, I believe, are coloring discussion of the trade conflict.

By the way, I don't mean Trump's misconceptions. As far as I can tell, he isn't getting a single thing about trade policy right. He doesn't know how tariffs work, or who pays them. He doesn't understand what bilateral trade imbalances mean, or what causes them. He has a zero-sum view of trade that flies in the face of everything we've learned over the past two centuries. And to the (small) extent that he is making any coherent demands on China, they're demands China can't/won't meet.

But Trump's critics, while vastly more accurate than he is, also, I think, get a few things wrong, or at least overstate some risks while understating others. On one side, the short-run costs of trade war tend to be overstated. On the other, the long-term consequences of what's happening are bigger than most people seem to realize.

In the short run, a tariff is a tax. Period. The macroeconomic consequences of a tariff should therefore be seen as comparable to the macroeconomic consequences of any tax increase. True, this tax increase is more regressive than, say, a tax on high incomes, or a wealth tax. This means that it falls on people who will be forced to cut their spending, and is therefore likely to have a bigger negative bang per buck than the positive bang for buck from the 2017 tax cut. But we're still talking, at least so far, about a tax hike that is only a fraction of a percent of GDP.

This means that it's hard to justify claims that the trade war, at least what's currently in the pipeline, will cause a global recession.

If the trade war expands not just to all imports from China but to imports from Europe and other parts of the world, we could get this up to a contractionary fiscal policy of a couple of points of GDP; \$200 billion here, \$200 billion there, and soon you're talking about real money. And that

certainly could happen: Trump imagines that he's winning, and might well move on from China to European cars and so on. But we're not there yet.

But doesn't the prospect of foreign retaliation change the picture? Actually, what foreign retaliation does is prevent tariffs from being *less* bad than an ordinary tax increase. When a large country like the U.S. imposes tariffs, one effect — if we don't face foreign retaliation — is a rise in the price of U.S. exports, either through a rise in the dollar or by drawing resources away from export to import-competing sectors. This price rise is, other things equal, a gain for America (although not for export-oriented sectors like agriculture.) And this "terms of trade" effect can mitigate or even reverse the overall losses as tariffs distort the economy.

If (when) foreigners retaliate, however, the terms of trade effect goes away, and we're back to tariffs just being a tax on domestic consumers.

Maybe the larger point here is that there tends to be a certain amount of mysticism about trade policy, because the fact that it's global and touches on one of the most famous insights in economics, the theory of comparative advantage, gives it an amount of mind space somewhat disproportionate to its actual economic importance. Yes, trade policy is important; but in terms of the strict economics it's not more important than health policy, or fiscal policy, or policy in general.

I say this, by the way, as someone whose career as a professional economist was based mainly on research into international trade and finance. In general, people who actually work on these issues tend to assign them less importance than those who haven't studied them closely.

All of this, however, is only about the strict economics of a trade war, which may be the least important aspect of what's happening.

For trade policy isn't just about economics. It's also about democracy and peace.

This is obvious and explicit in Europe, where the origins of the European Union lie in the Coal and Steel Community of the early 1950s — an agreement whose economic benefits, while real, were in a way incidental to its real purpose, preventing any future wars between France and Germany. And membership of the E.U. has always been contingent on democratization — which is, by the way, why the E.U.'s limp reaction to the *de facto* collapse of democracy in Hungary and, it appears, Poland represents such moral failure.

It's more implicit in the case of the United States. But the historical record is pretty clear: the postwar trading system grew out of the vision of Cordell Hull, FDR's Secretary of State, who saw commercial links between nations as a way to promote peace. That system, with its multilateral agreements and rules to limit unilateral action, was from the beginning a crucial piece of the Pax Americana. It was as integral to the postwar order as the I.M.F., which was supposed to provide a safety net for nations having balance of payments trouble, or for that matter NATO.

And Trump's trade war should correspondingly be seen as part and parcel of his embrace of foreign dictators, lack of respect for our allies, and evident contempt for democracy, at home as well as abroad.

But wait, you say: China is neither an ally nor a democracy, and it is in many ways a bad actor in world trade. Isn't there a reasonable case for confronting China over its economic practices?

Yes, there is — or there would be if the tariffs on Chinese products were an isolated story, or better yet if Trump were assembling an alliance of nations to confront objectionable Chinese policies. But in fact Trump has been waging trade war against almost everyone, although at lower intensity. When you're imposing tariffs on imports of Canadian steel, on the ludicrous pretense that they endanger national security, and are threatening to do the same to German autos, you're not building a strategic coalition to deal with a misbehaving China.

What you're doing, instead, is tearing down what's left of the Pax Americana.

Wasn't this inevitable in any case? I don't think so. True, U.S. economic dominance has been eroding over time, not because we're getting poorer, but because the rest of the world is getting richer. But there was reason to hope that a relatively peaceable international order could be sustained by an alliance of democratic powers. In fact, until a few years ago it seemed to me that we were seeing exactly that taking place for the world trading system, which was transitioning from largely benign U.S. hegemony to a comparably benign co-dominion by the U.S. and the E.U.

At this point, however, things look a lot bleaker. It's not just Trump. And it's not even just Trump plus Brexit. The Europeans are also turning out to be a big disappointment. As I said, if they can't even deal with the likes of Viktor Orban within their own community, they're definitely not up to providing the kind of leadership the world needs.

But where the Europeans are weak, Trump is malign. He's working actively to make the world a more dangerous, less democratic place, with trade war just one manifestation of that drive. And the eventual negative consequences for America and the world will be much bigger than anything we can capture with economic modeling of the effects of tariffs.

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