ifoVIEWPOINT
Munich, 5 April 2017

No. 184

What It Will Cost Us If Donald Trump Is Serious*

Free trade? Open markets? Both no longer seem to be the order of the day. Instead 2016 and 2017 may well go down in economic history as the years that ushered in a drastic change in economic policy course and saw it veer towards protectionism. Things all began with the Brexit vote by the British, with the climax to date being the Americans' decision to elect a president who openly favours isolation by voting for Donald Trump.

These developments pose a threat to Germany, primarily because international trade is more important to its economy than to that of most other states. Germany's exports accounted for around 38 percent of its gross domestic product (GDP) in 2016. In other countries that are roughly the same size this share is smaller. In France, for instance, exports total 21 percent of GDP, while in Britain they represent just 15 percent. US trade barriers would have serious consequences for German companies, especially since the USA is Germany's biggest export market. In 2016 German companies sold goods worth 107 billion euros to the USA.

Even if Donald Trump's speech to the US Congress at the end of February did not provide any further details of future US trade policy, it is clear that he is serious about his isolation policy. He has put a stop to the Trans-Pacific Partnership (TPP) and has announced his intention to roll back the North American Free Trade Area (NAFTA). He also wants to end negotiations over the Transatlantic Trade and Investment Partnership (TTIP). Trump reproaches China for behaving "unfairly" in trade with the USA and blames Germany for the high US deficit in bilateral trade.

What would be the consequences of the USA resorting to imposing tariffs on individual or all trade partners in order to isolate its domestic market? And what would happen if its trade partners were to retaliate, giving rise to a trade war?

A recent study by the ifo Institute analyses the drastic (but conceivable) scenario of the USA introducing a 45 percent tariff on imports from Mexico and China. Such a move would have a massive impact, not only on Mexico and China, but also on third countries. US imports from Mexico would plunge by 58 percent and those from China see a 52 percent drop. The downturn would partly be compensated for by higher imports from countries not subject to tariffs, with imports from the EU, for example, increasing by 11 percent. Overall, however, tariffs would lead to a total drop of 8 percent in US imports.

Punitive tariffs threaten to lower not only imports but also US exports, because US firms would sell more domestically and falling income abroad would weaken foreign demand for US products, resulting in a 13 percent drop in exports by US companies. The consequences would be even more serious if punitive tariffs were to be applied to all partners, in other words to the EU and Germany too. In this scenario Mexico would suffer slightly lower losses (43 percent), while the downturn in Chinese imports would be significantly lower (13 percent) and imports from the EU would drop by 34 percent. Overall, US imports would be 36 percent lower than without punitive tariffs and US exports would plummet by 71 percent.

If other countries decided to levy tariffs of a similar magnitude, US exports could plunge by 91 percent. If such are trade war were to break out, US GDP would drop by 7 percent. In the rest of the world the relative losses would be lower. In Germany, for instance, which sells 9 percent of its exports to the USA; GDP would drop by 0.5 percent.

Of course, simulations like these are based on a broad range of assumptions and are merely a way of giving some idea of scale. But the calculations carry three important messages. Firstly, protectionism may serve the interests of individual domestic companies or economic branches, but it is never in the interest of the entire country. Secondly, Trump may well be able to pressure certain countries like Mexico or China with protectionism and this at manageable costs for the US economy; and thirdly, the US would be one of the biggest losers from a trade war with all of its partner countries. That is why its trading partners should not agree to replace international trade agreements like the WTO with bilateral agreements with the USA.

* Published in German under the title “Was es uns kostet, wenn Donald Trump Ernst macht“, *WirtschaftsWoche*, 3 March 2017, p. 37.

Clemens Fuest
Professor of Public Economics and Finance
President of the ifo Institute