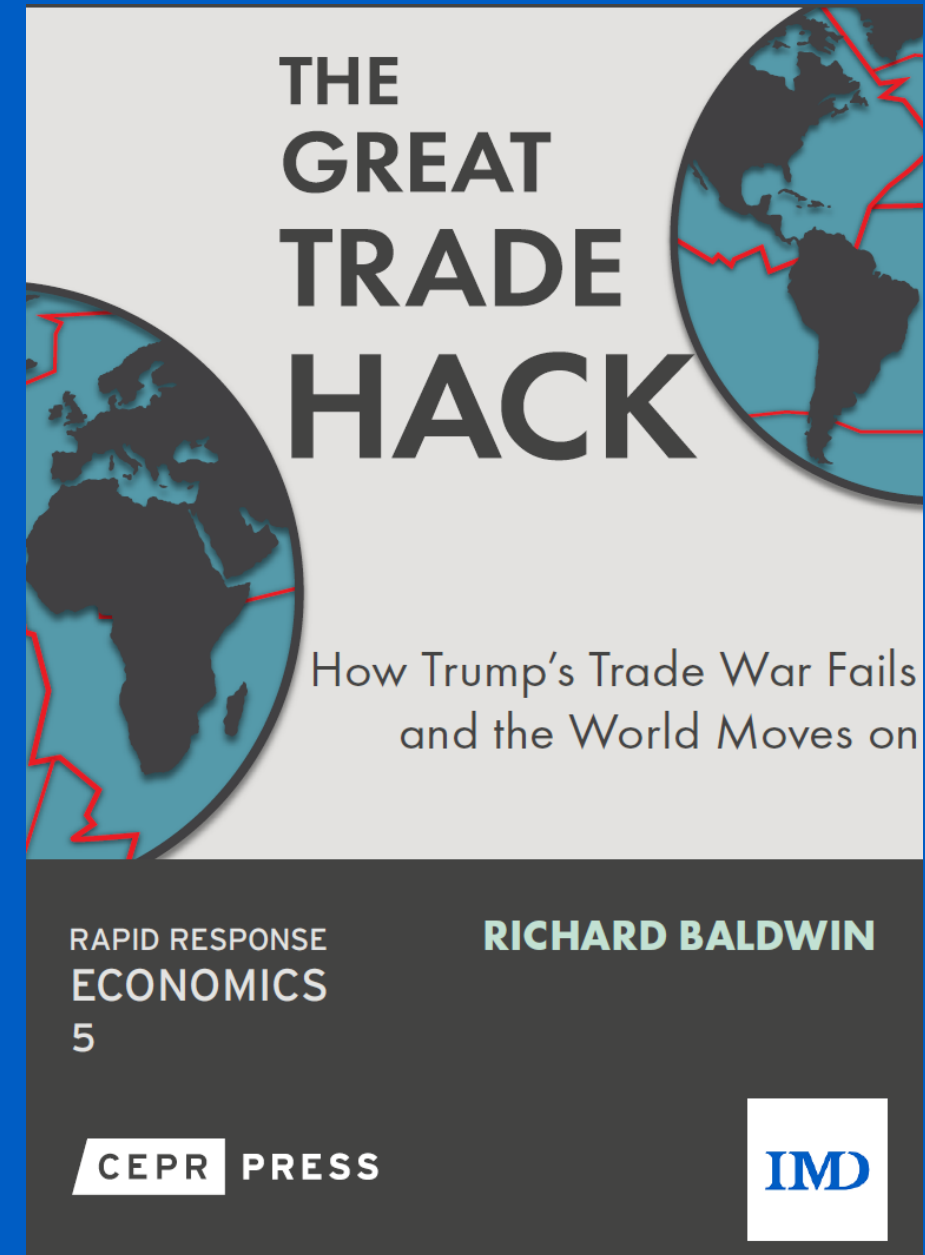


The Great Trade Hack: *Why Trump's Trade War Fails and the World Moves On*

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IMD / Real learning
Real impact



Outline:

- Introduction: The Great Trade Hack is historic.
- How should we think about Trump's motives?
- Why will Trump's trade war fail economically but win politically in USA.
- How will the world move on? Four scenarios.
- How leaders can avoid the worse outcomes?

First point:

Trump's Great Trade
"Hack" is historic.

*Beginning of post-US
trade leadership era*

The “Great Trade Hack”.

1. What was Trump trying to do?
 - a) Reform the system?
 - b) Suppress China?
 - c) Renegotiate foreign tariffs?

2. No. He was “hacking” the system.
 - a) Bypass the code, short-circuit the rules, and brute-force a quick-fix using tariffs that were big, bold, and everywhere at once.

3. Not a US trade war. A US war on the trade system.

Why April 2nd tariffs were different.

Before

- Trump tariffs were for:
 - Specific problems or
 - With specific partners.
- Trump's pre-April 2nd protection was bad but not historic.
 - Many nations have done similar.

2 April trade “Hack” was different.

1. Massively & intentionally broke ever trade promise US had made with everywhere with everybody.
 - a) All WTO commitments (bindings).
 - b) All Free Trade Agreements.
2. Intentionally and completely violated Art. 1 of the WTO rulebook (MFN).
3. This was a US war on the trade system, not US trade war.

Start of “Post American Trade Leadership” era.

- Before 2 April, US universally regarded as steward.
 - US set up, guided, & defended rules-based trade system since 1947.
 - Enlightened self-interest (economic, political, & geostrategic power enhancer).
- After 2 April, US is universally regarded with suspicion.
 - On 2 April, US broke with world trade system without suggesting reforms, or an alternative system. Just walked away...
- What most viewed as fundamentally a US-China conflict before April 2nd is now viewed as a US vs world conflict.
 - China, Russia & Emerging Economies gained politically from US status erosion.

1947 – 2025:

American Leadership Era
(enlightened self
interest).

Great Trade
Hack

2 April 2025 -

The Post-American
Leadership Era

Second point:

We need to think
differently about President
Trump's motives.

The key paradox:

Trump's tariffs are trade policy, but they are economically incoherent, so thinking about them as trade policy doesn't work.

“Grievance Doctrine”

The “Grievance Doctrine”.

- 2 April tariffs are not based on economic goals.
- Grievance guides his policy.
- His policies & reversals are designed to address Trump’s sense of national victimhood & assuage grievances of his political base.
- Q: Where does the sense of victimhood come from?
- A: Mythic tale where a naïve America played by the rules & got played by globalists abroad and traitorous globalists at home.
- America was humiliated; factory jobs stolen; middle class paid the price.
- Myth creates a mandate to strike back, erase the humiliation.
 - But comes with no specific economic goals.

Grievance Doctrine guides Trump's trade policy.

1. The Grievance Doctrine isn't a strategy — it's a story. A myth.
2. But the “Grievance Doctrine” unlocks the internal logic of the Trump's 2 April policy — what drives it, how it unfolds, and where it leads.
 - You cannot make sense of Trump's actions without grasping how grievance drives them.

“Evidence” for the Grievance Doctrine in THE PRESIDENT’S 2025 TRADE POLICY AGENDA

- **The Golden Age:** *“The United States of America is the most extraordinary nation the world has ever known. ... In the previous century it saved the entire world ...”*
- **The Fall:** *“Today, the upward mobility offered by the manufacturing sector is not widely available to the working class, much of our industrial might has moved overseas”*
- **The Villains:** *“These trends are the product of a withering, decades-long assault by globalist elites who have pursued policies - including trade policies - with the aim of enriching themselves at the expense of the working people of the United States. As a result, the middle class has atrophied...”*
- **The Hero:** *“President Trump alone recognized the role that trade policy has played in creating these challenges and how trade policy can fix them.”*
- **The Retribution:** *“the trade challenges facing our country will “be annihilated” because “from this moment on, America’s decline is over.”*
- **Trump’s words on 2 April 2025:**

*“For decades, our country has been **looted, pillaged, raped and plundered** by nations near and far, both **friend and foe alike**. American steelworkers, auto workers, farmers and skilled craftsmen ... watched in anguish as **foreign leaders have stolen** our jobs, **foreign cheaters have ransacked** our factories, and **foreign scavengers** have torn apart our once beautiful American dream.”*

*“In 2016, I declared I am your voice. Today, I add: I am your warrior. I am your justice. And **for those who have been wronged and betrayed, I am your retribution.**”*

Not a sales pitch;
grievance is guiding
principle.

Sounds strange, but give it a try!

- The 2 April tariffs make perfect sense.
 - Designed to stop the steal by closing the deficits.
 - Maximise US bilateral leverage.
- The flip-flops make sense.
 - His base sees him as:
 - 1) strong in outraging foreigners & domestic elite with 2 April tariffs & bold increases (145%, 50%),
 - 2) wise in showing flexibility while forcing foreigners to submit to his will.
- Tariffs are “beautiful”
 - Stop the steal; eliminate trade deficit.
 - End the humiliation; reindustrialise US.
 - Help middle class; protect jobs
 - Extract reparations; \$billions paid into US Treasury by foreigners.
- “Trade wars are good and easy to win”.
 - Using American might to stand up for the little guy.
- Without clear goals, the outrageous policy announcements & constant changes are the success.
 - Deals with foreigners just need to look like victory.

Use the Grievance
Doctrine to organise
thinking about the
April-May timeline.

April 2nd Trade Hack.

2 April 2025: Trump's Great Trade Hack announced for 9 April.

- Stock plunge; Bond yields spike (unusual).

3- 9 April: US & China escalate to over 100%.

- Market turmoil intensifies.

9 April:

- 1) US tariffs imposed; hours later Trump backs down (not on China)
- Stocks surge; bond yields continue climbing.

14 May:

- US-CN deal moves all 2 April 2nd tariffs to 10%.
- At least till 9 July.



Source: LSEG

U.S. Treasury yields



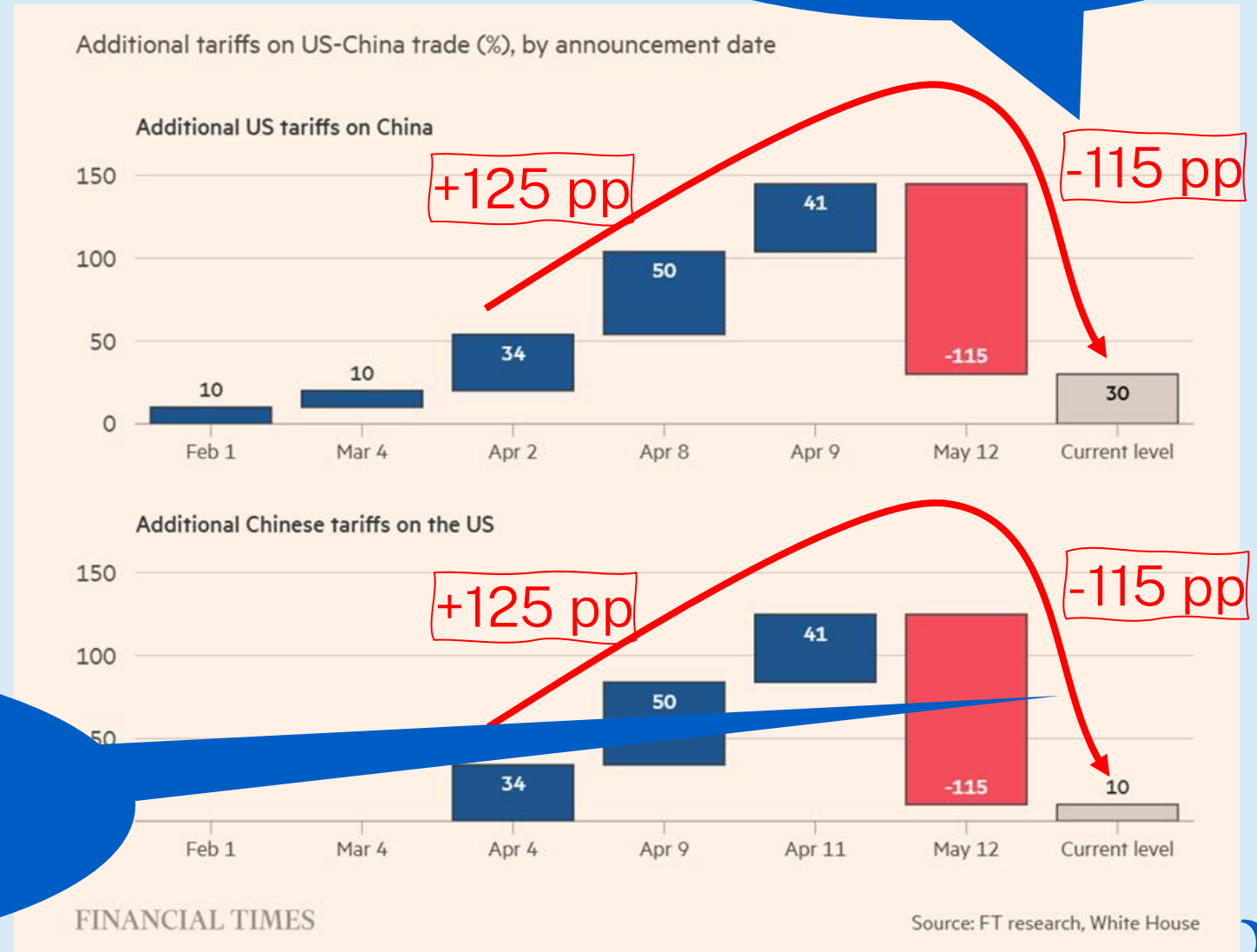
Note: Data as of 8:30 a.m. Eastern time • Source: FactSet • By The New York Times

US-China 12 May 2025 deal.

This undermined whole logic of the April 2nd tariff formula.

- US & China went up +125pp from 2-9 April.
- 12 May, both went down -115pp.
- Now 10% each way + preexisting tariffs (US Fentanyl 20% & Chinese retaliation).

13 May: China forced US to take back ALL April 2nd trade balance premium (34%) & accept retaliatory 10% without making any concessions to US.



Why did China win so big?

- By following the Grievance Doctrine, Trump put himself into a “narrative trap”.
- 145% tariff causing severe damage to US economy & his political base.
 - mounting as supply pipeline disruption showed up in Los Angeles.
 - But POTUS couldn't be seen as backing down since it about grievance, not goals.
- Trump insisted China ask for talks, but China refused (Opium Wars).
- Finally, Trump relented, said US could cut tariffs unilaterally to 80%.
- That was the face-save China needed to start talks.
- China held out for full reversal of April 2nd tariff add-on & US acceptance of Chinese 10% retaliation against US 10%.
- China let USA portray this as big win for America (30% v 10%).

Key lessons from the 2 April formula:

The formula:

- Minimum 10% plus add-on to eliminate bilateral deficits.
- “By coincidence”, close to his campaign promise (10% on all & 60% on China).

The diagram illustrates the formula for calculating a tariff. At the top, the word "Tariff" is written in a stylized font. Below it, the formula is presented as $\Delta\tau_i = \frac{\text{Trade deficit}}{\text{Elasticity} * \text{Imports}}$. The "Trade deficit" is represented by the expression $x_i - m_i$ in a box. The denominator consists of two parts: "Elasticity", represented by ε , and "Imports", represented by m_i . Both are in boxes and connected by a multiplication symbol. A blue speech bubble with the number "2" points to the multiplication symbol, indicating that the formula is squared. The word "Elasticity" is written below the ε box, and "Imports" is written below the m_i box.

The Lessons:

skip

- Trump views every foreign trade barrier as having a tariff equivalent (VAT, standards, ER undervaluation, etc.)
- The bilateral deficits are:
 - Due to foreign “tariffs”.
 - Measure of the foreign “theft”.
 - Used deficit to “estimate” foreign tariff & applied “reciprocal” to them.
- Goal is to “stop the steal” by closing bilateral deficit.
 - Bilateral surpluses don’t count since the US plays fair.

2 April tariffs meant to eliminate bilateral deficits.

Here “m” is the bilateral import, “x” is the bilateral export, p_m is the bilateral price of “m”, and ε is the elasticity of import demand.

The elasticity of import demand is defined as:

$$\varepsilon \equiv \frac{dm/m}{dp_m/p_m}$$

The impact on imports of a change in import price

$$dm = \varepsilon \frac{dp_m/p_m}{m}$$

skip

Here φ is the pass through elasticity.

The pass through elasticity of tariffs to the import prices is defined as:

NB: The tariff is in percentage point form already so we don't have the usual $(dx/d)/(dy/y)$ form.

$$\varphi \equiv \frac{dp_m/p_m}{\tau}$$

The impact of the tariff on p_m is:

$$dp_m = \varphi * \tau * p_m$$

Combining these yields the link between the tariff and US imports.

$$dm = \varepsilon \frac{\varphi * \tau}{m}$$

Next we assume that the whole change in the bilateral deficit will come from by reducing bilateral imports, namely: 1) there is no foreign retaliation, 2) offsetting exchange rate and general equilibrium effects are small enough to be ignored,

Size of import reduction necessary to close the deficit, call it, dm' , is:

$$dm' = x - m$$

Substituting and solving for the implied tariff, τ' , is:

$$\tau' = \frac{x-m}{(\varepsilon\varphi)m}$$

The authors take, $\varepsilon = 4$, and $\varphi = 0.25$, so their product disappears.

For reasons that are not explained, the tariff needed to close the deficit is divided by 2.

Third point:

Why Trump's tariffs fail
economically but win
politically inside USA.

Tariffs fail economically.

1. Tariffs cannot fix the trade deficit.

- Deficits \equiv spending - production. Tariffs can't lower spending or raise production of full-employment economy.

2. Tariffs cannot reindustrialise US.

- Requires coordinated, long-term investments, trained workers, and worldclass infrastructure. Tariffs achieve none of these goals; just the opposite (especially volatile tariffs).

3. Tariffs can't help US middle class.

- Tariffs protection goods-producing sectors, but 90% of middle class works in service sectors, where tariffs only raise cost of living.

Tariffs: substitute for real solutions & deflect blame.

Real economic solutions are politically impossible.

- Policies, like Canada-style social policies would help the US middle class as they have done in every other advanced economy.
- But this would require higher taxes & bigger government, so politically impossible in today America.

Anti-globalisation as “policy placebo”.

- Tariffs (and anti-globalism more generally) are the “policy placebos” given in lieu of effective medicine.
- Democrats & Republicans use the placebo to divert blame for domestic failure.
- *They all buy into some version of the Grievance Doctrine.* **IMD**

Fourth point:

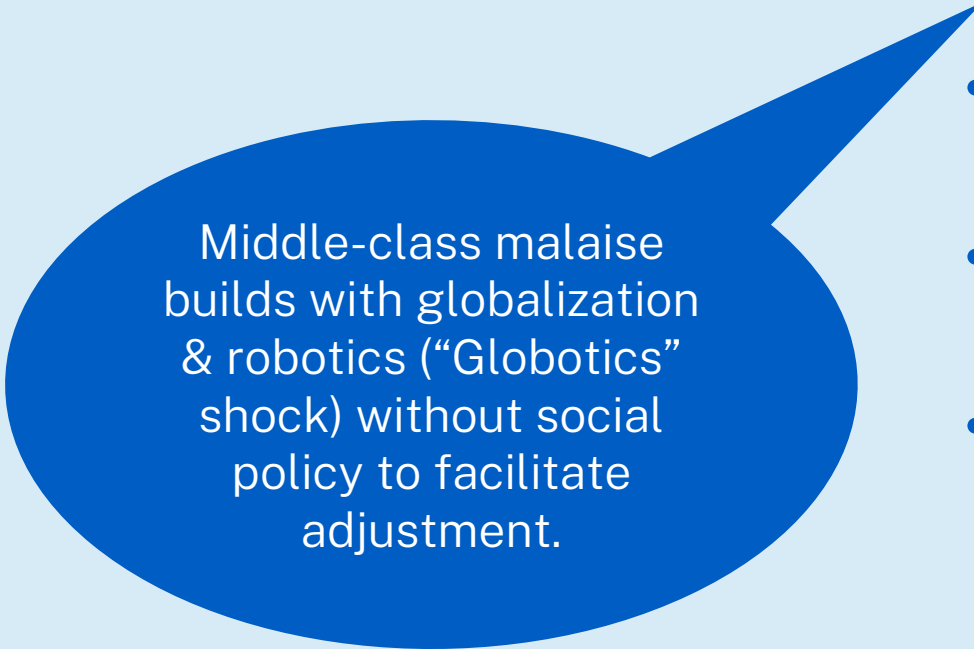
US trade
hesitancy/hostility is

1) Not new.

2) Here to stay.

US trade hesitancy/hostility is not new.

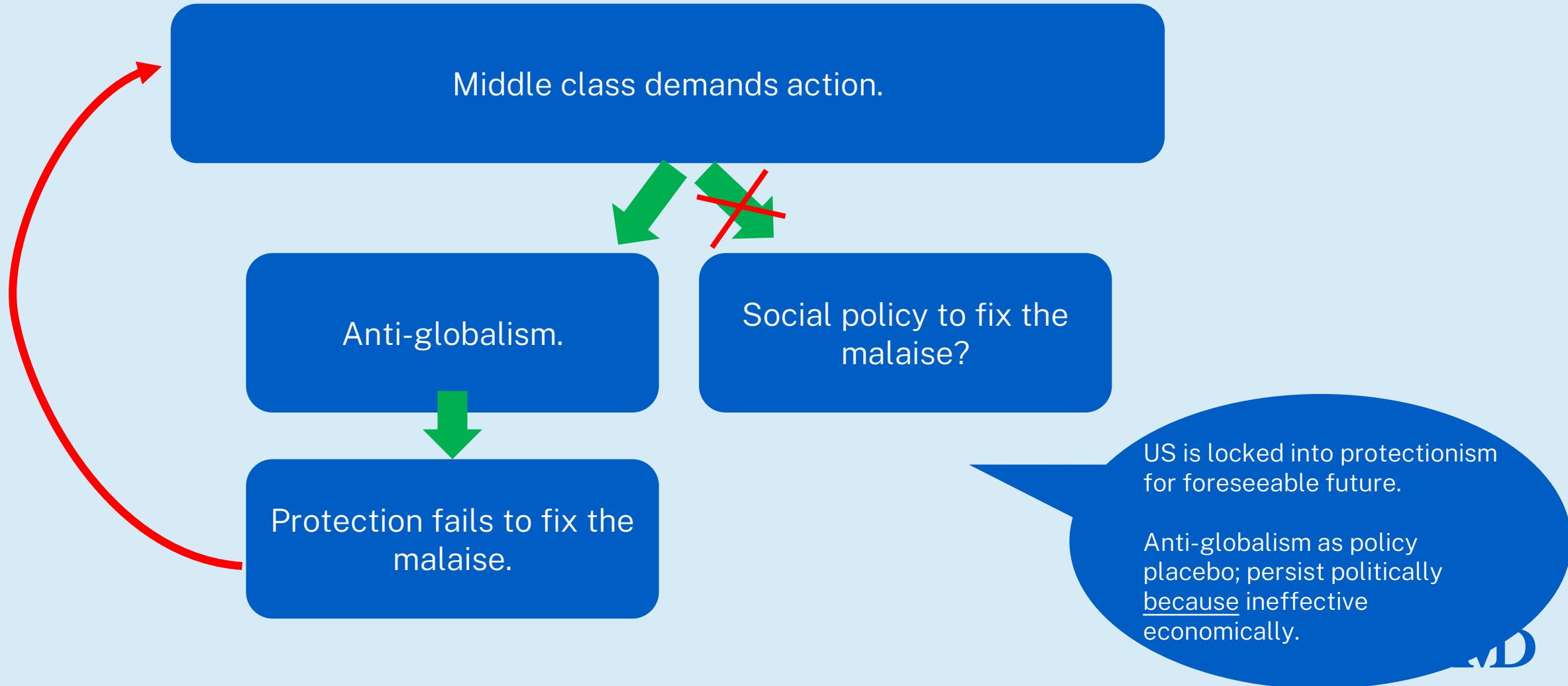
- US switched from “super pro-trade” to “trade-hesitant” after Global Financial Crisis & Great Recession.



Middle-class malaise builds with globalization & robotics (“Globotics” shock) without social policy to facilitate adjustment.

- 1981-1993: Reagan to Bush Sr
 - Super pro-trade.
- 1994-2008: Clinton to Bush Jr
 - Super pro-trade.
- 2009-2016: Obama I & II
 - Trade hesitancy.
- 2017-2020: Trump I
 - Trade hostility.
- 2021-2024: Biden
 - Trade hesitancy.
- 2025-2029: Trump II:
 - Trade hostility unbound.

US protection loop: Why US protectism is permanent.



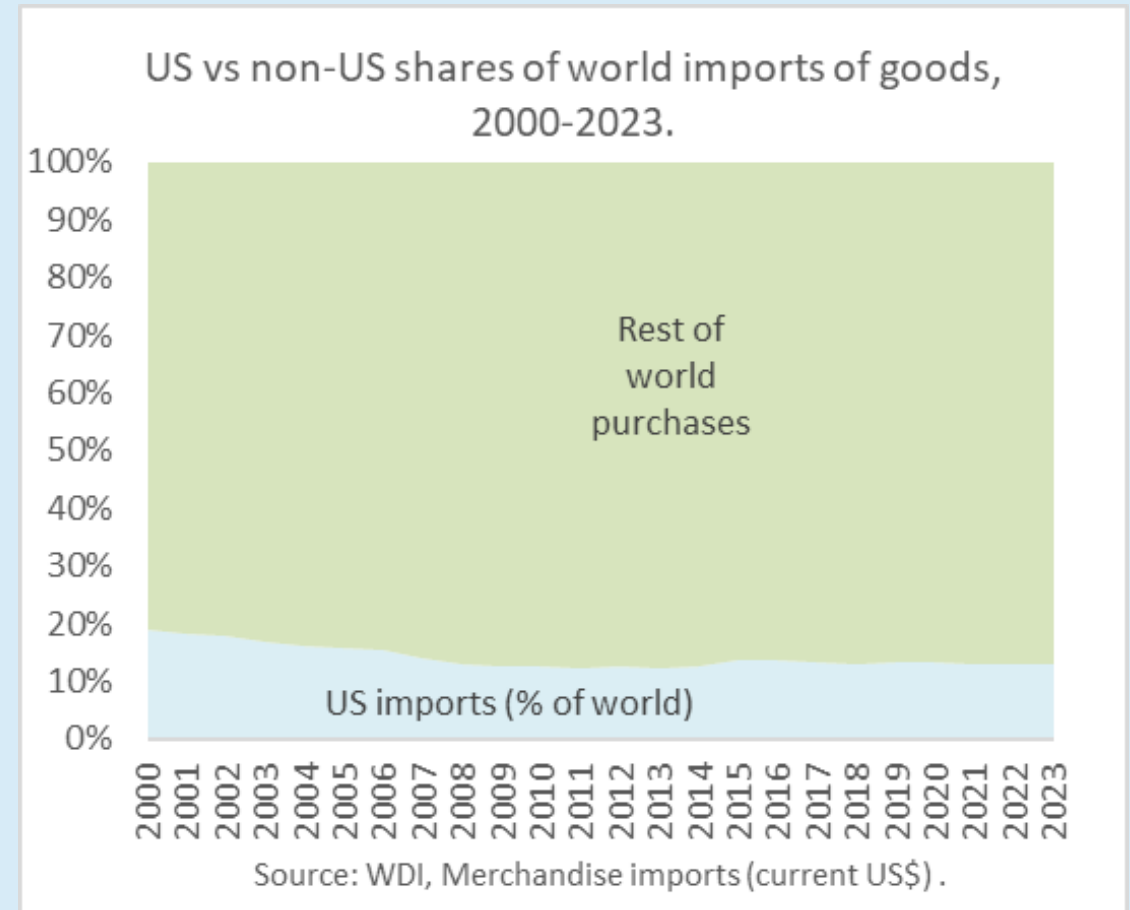
Fifth point:

How the world moves
on: 4 scenarios.

April 2nd tariffs & rules-based system: Wounded but it survives.

2 April US violations:

- Non-discrimination (MFN).
- Promise keeping (tariff bindings).
- US is the largest importer of goods but hasn't been dominant for over 25 years.
 - US only 15% of world trade.



Ripple effects of the
April 2nd “Hack”.

Third nations tariffs rising & falling since 2 April (and since Trump I administration)

- Third countries are raising tariffs against each other (especially China)
 - e.g.: Tariffs on Chinese Electric Vehicles.
 - Countries are striking or accelerating trade deals without the USA:
 - UK-India, UK-CPTPP, China-Brazil, etc.
 - “Cascading protectionism”
 - “Domino liberalisation”
1. Both driven by export “deflection”
 - Political economy reaction of import competitors (tariffs up).
 - Political economy reaction of exporters (tariffs down with new partners).

4 scenarios.

1 unlikely, 3 plausible.

1930s

- Other nations ignore WTO rules & allow grievances to guide trade policy.
- Possible triggers:
 - Cascading protection that doesn't follow WTO rules (antidumping etc) and thus provokes retaliation.
 - China retaliates against anti-China provisions US asks for in, e.g. US-UK.

3 others:

1. Managed Multilateral Drift (underway).
More protection & liberalisation, but only US violates WTO on purpose
2. Fighting Trade blocs.
3. Reglobalisation Without America.

Sixth point:

World leaders must
step up now.

What to do?

Prime Directive:

- Save the rules-based system by following the rules (85%).

Don't do.

- Don't retaliate against US (except China & EU), negotiate using Grievance Doctrine as a compass.
- Do nothing radical until we see where the 2 April tariffs land on 10 July (or delayed).
- Keep the door open to US re-entry.

Silver lining? “Leadership Herds”.

- Who leads after the US?
 - Not EU, not China, not Japan, not UK.
- “Leadership herds”
 - e.g. Japan when US left TPP, loosely organised a ‘herd’ to save it as CPTPP without the USA.
 - When US kill WTO court, EU loosely organised a ‘herd’ to save it with Multi-Party Interim Agreement (MPIA) for appeal of WTO cases (China joined).
- “Herds” without US, could:
 - Move WTO to address the 21st challenges like trade rules for climate change, digitalisation, and cyberattacks.
 - Help smooth “systems clash” between China’s state-led capitalism & market-led capitalism.

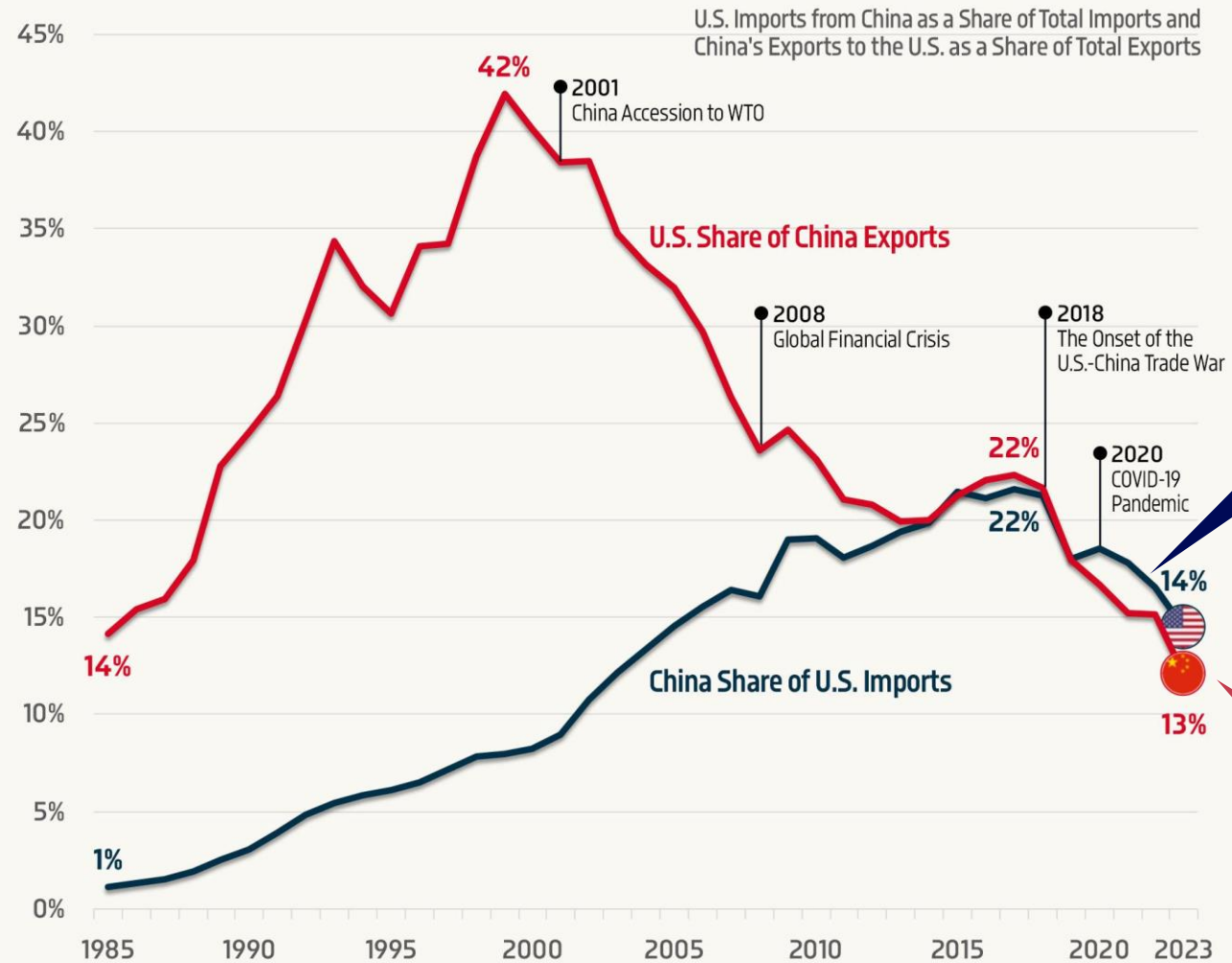
Thank you for listening.

Looking forward to the
discussion!

A few baseline facts on
the Trump's war on
trade.

US-CN
trade is not
THAT
important
for each
other.

China's Export Reliance on the U.S. Falls Sharply, Mirroring U.S. Import Shift Away from China

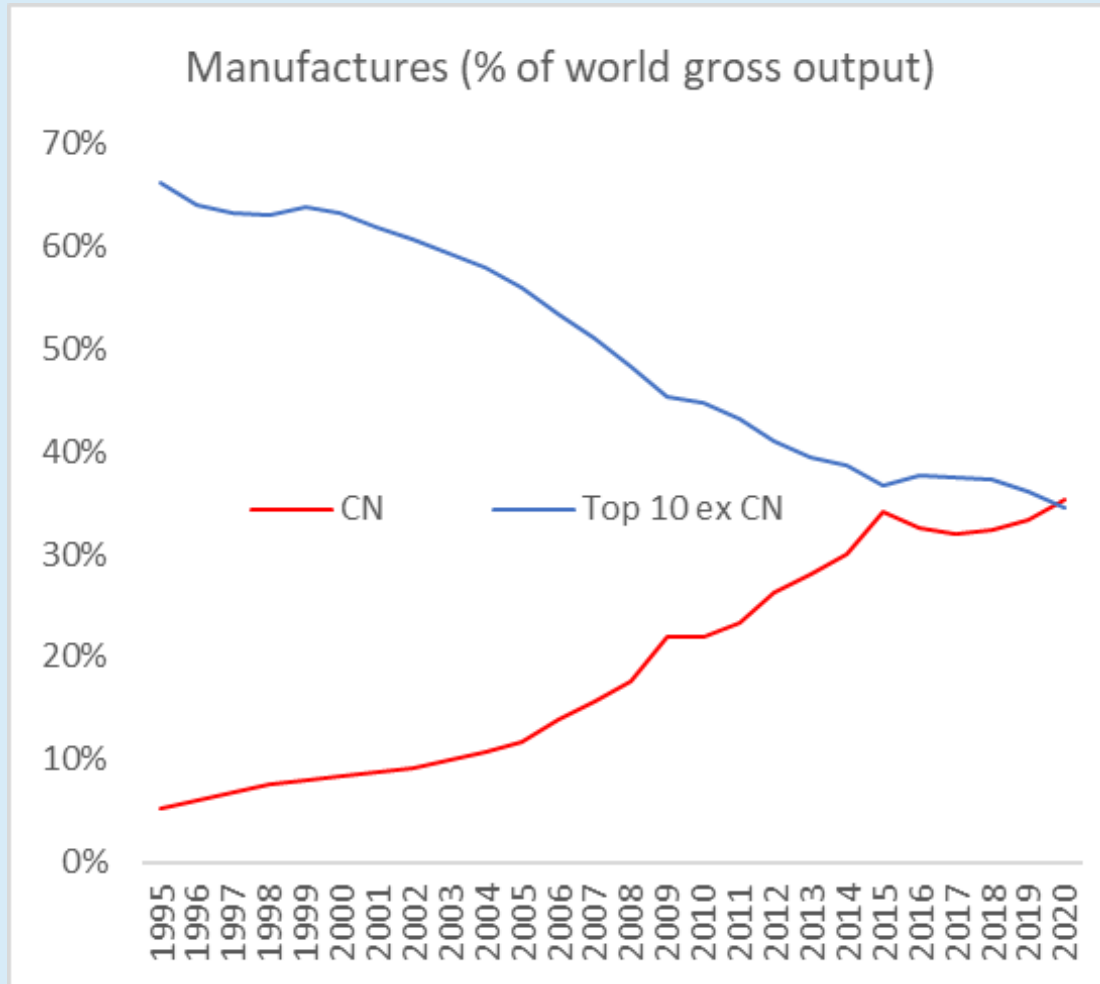


Only 14% of
US imports
from China.

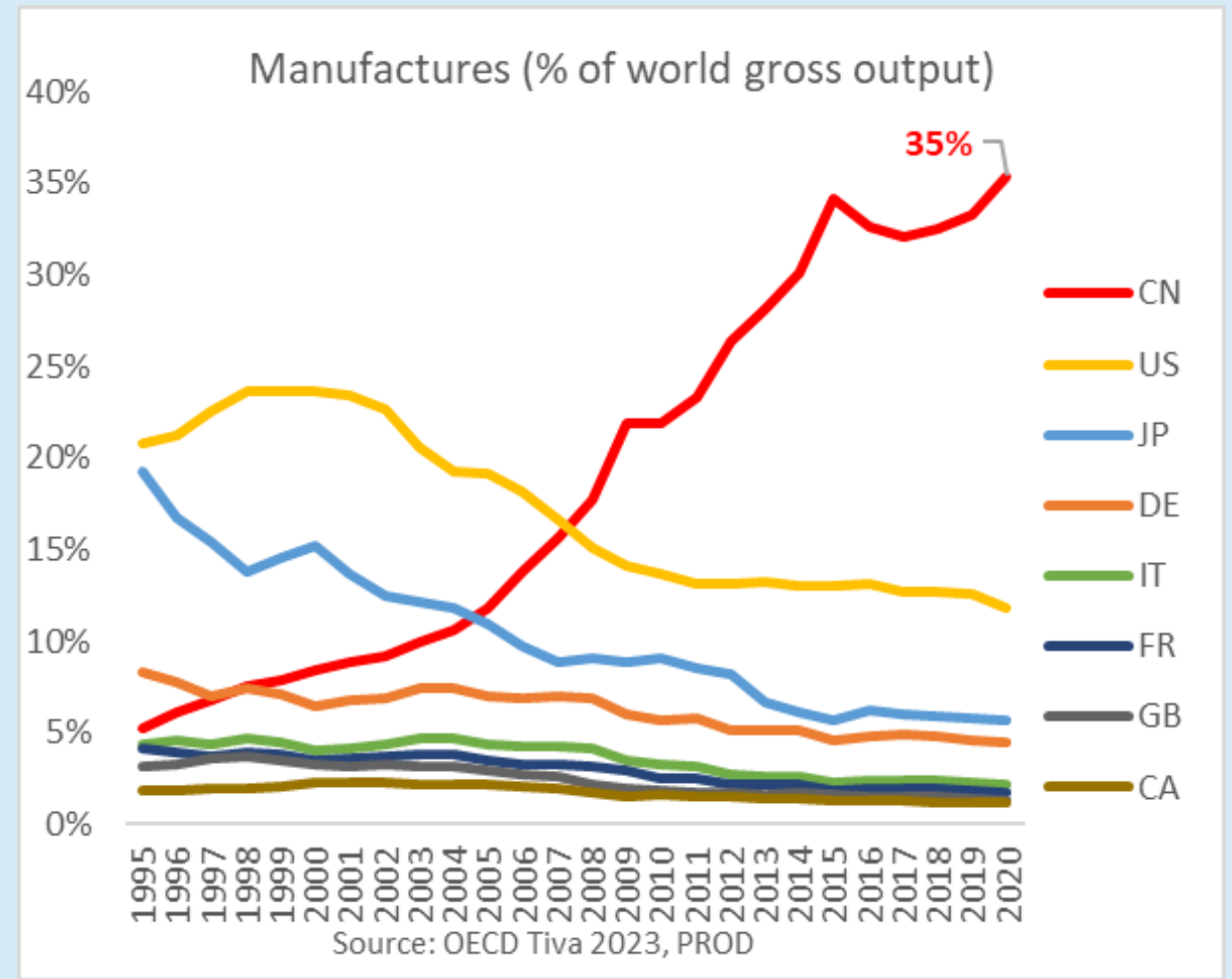
Only 13% of
CN exports
to USA.

CN dominants manufacturing: Gross output.

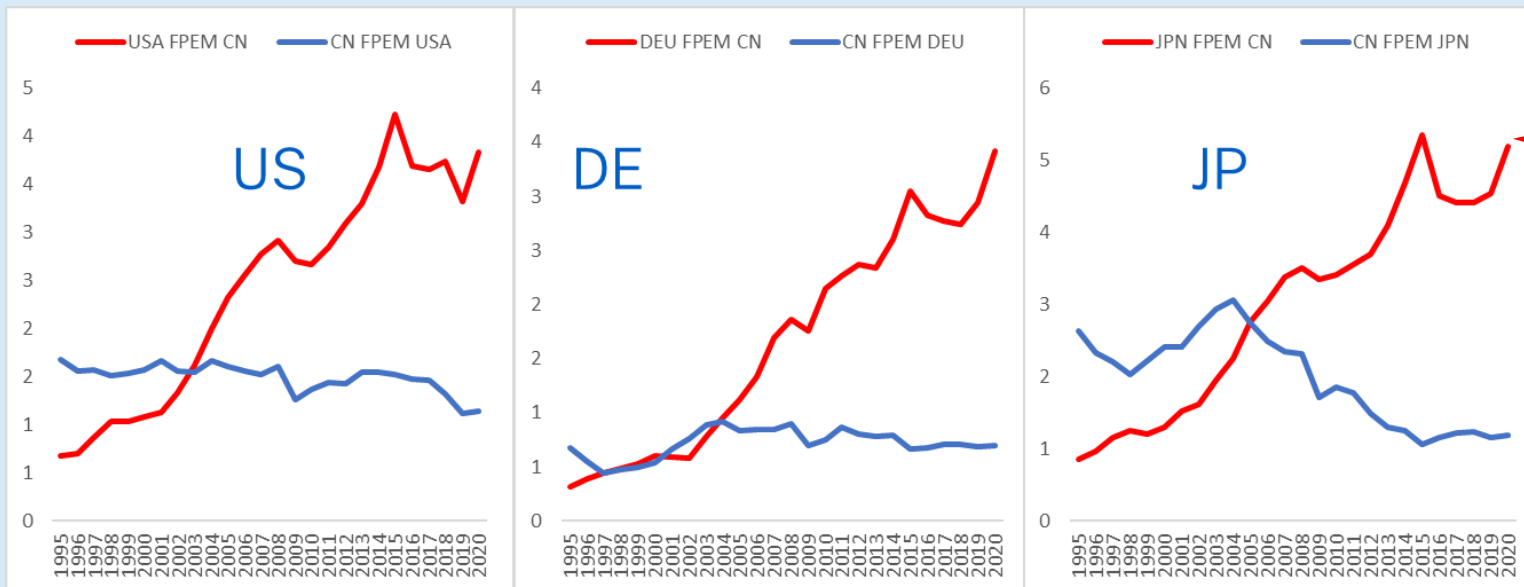
CN vs other top-10.



CN vs G7.

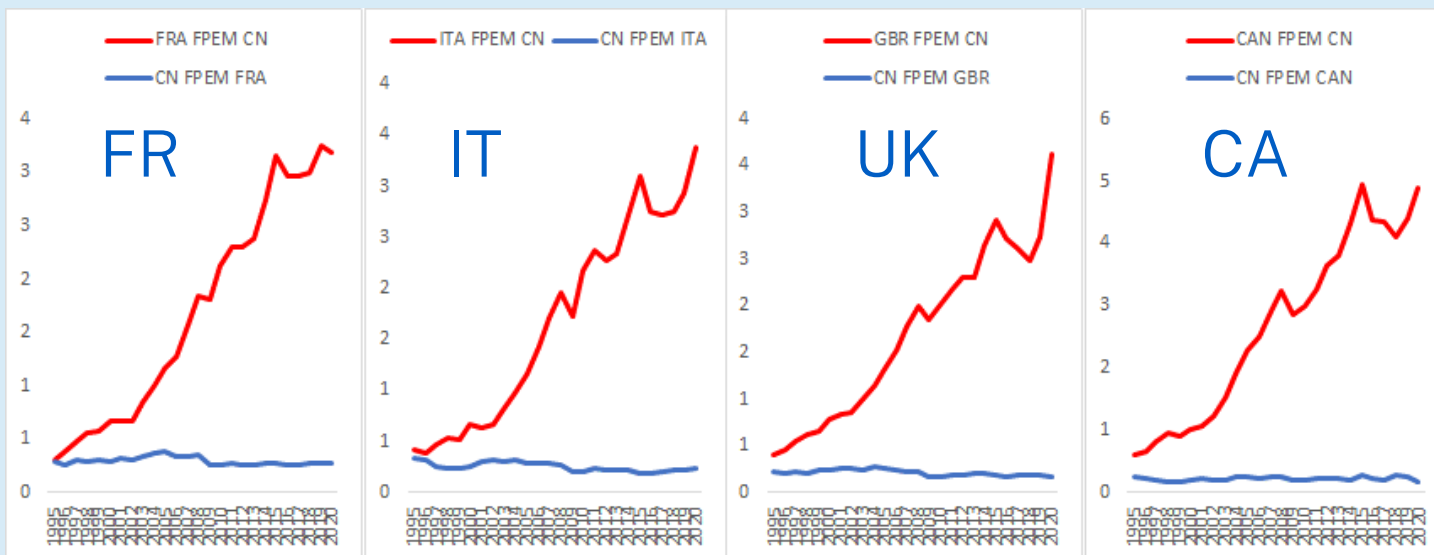


G7's asymmetric reliance on Chinese inputs.



Nation's
reliance
on China
industrial
inputs

China
reliance on
nation's
industrial
inputs

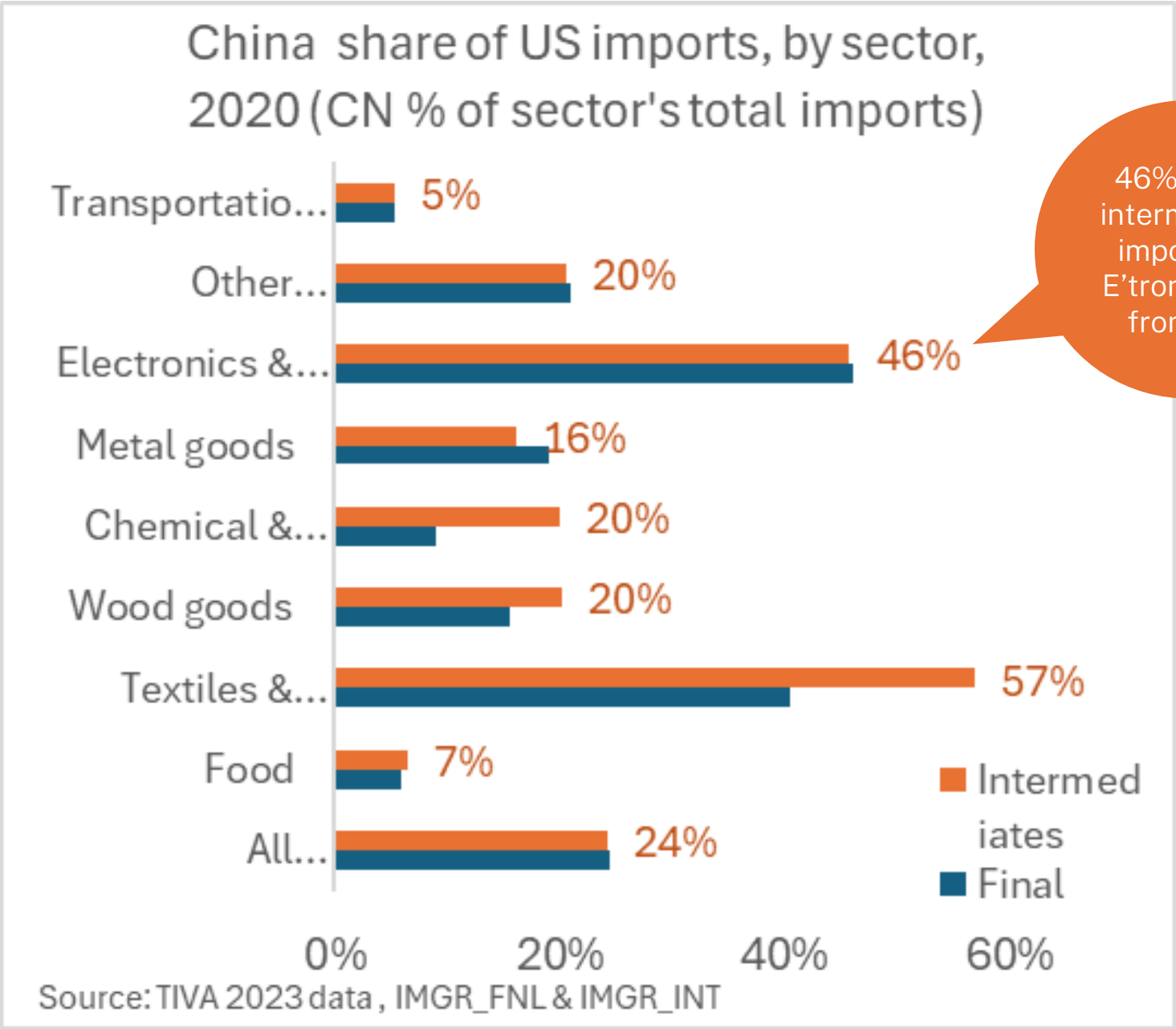


Source: Author's elaboration of OECD TiVA database 2023, left and right charts based on FPIM (total manufacturing)

FPIM is share of selling nation in buying nation's total purchases of industrial inputs from all sources. For details see, *Horses for Courses: Measuring Foreign Supply Chain Exposure*, Richard Baldwin, Rebecca Freeman & Angelos Theodorakopoulos <https://www.nber.org/papers/w30525>

US imports from CN: intermediates by sector.

(% of US total imports in the sector).



46% of US intermediate imports of E'ronics are from CN.

Source: TiVA 2023, IMGR_FNL and IMGR_INT

(US M_int from CN)Trump 60perc tariffs FF 23Feb2024(revised n reposted).xlsx



2 April Tariff Crisis timeline.

Wed, April 2: “Liberation Day” tariff shock announced.

- Stock & Bond & USD bloodbath.

Thu, April 3 – 9: US & China escalate to over 100% tariffs.

- Market panic deepens.

Wed, April 9: US tariff take effect in morning; Trump backs down at lunchtime (not for China).

- Equities surge, but bond yields continue climbing.

Wed, April 10: Bond stress peaks.

Fri, April 11: – Stabilization begins.

May 12: US-China Deal.

- Trump backs on all of 2 April add-on for China.
- China gives nothing new (only reduced its retaliation).



US imports
from China fell
of a cliff.

Container bookings from China to
the US are falling sharply

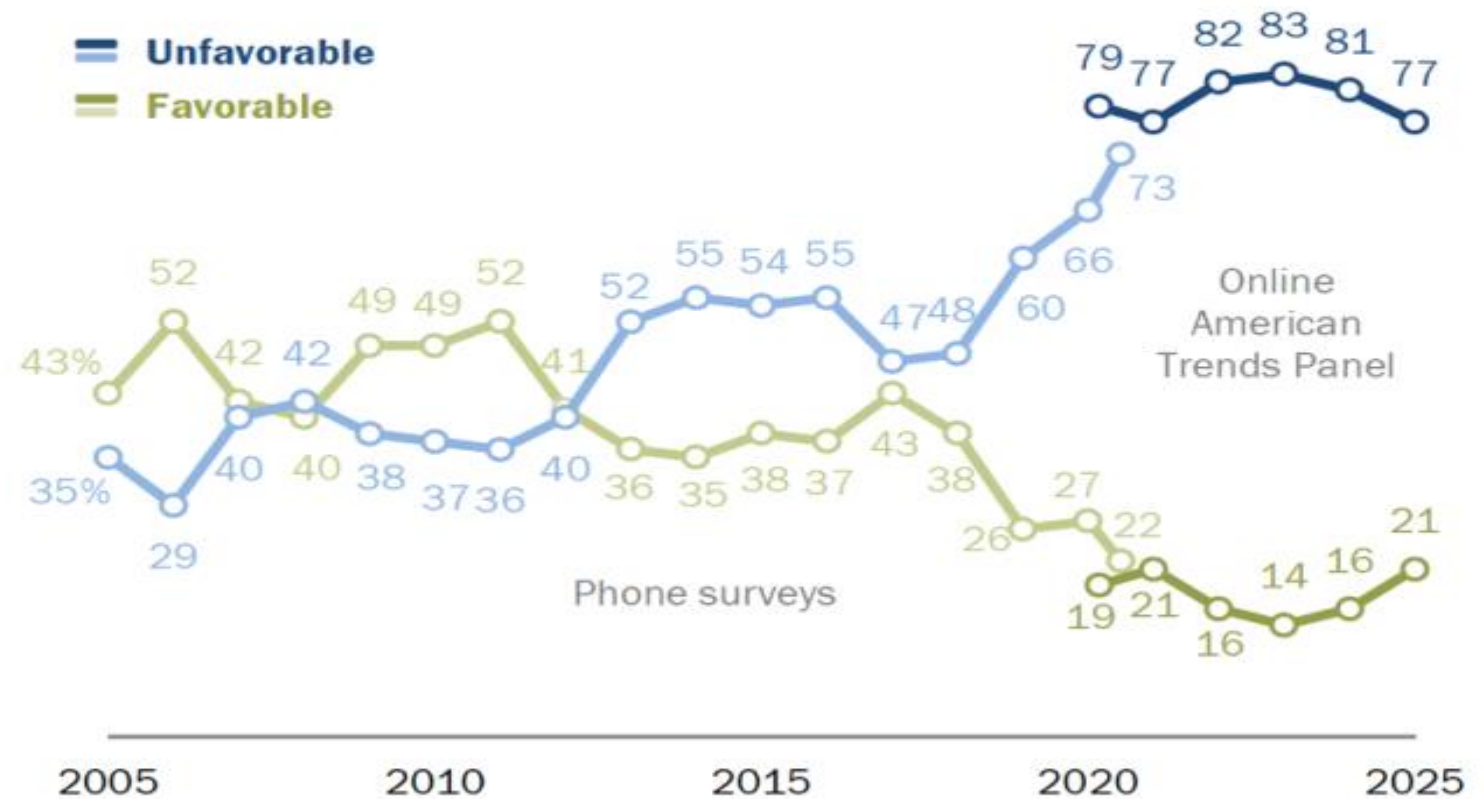
Year on year % change in TEUs*



Americans' Views of China Have Improved Ever So Slightly, But They Are Still More Negative Than After Tiananmen

American views of China warm slightly for first time since 2017

% of U.S. adults who have a(n) ___ opinion of China



Note: Those who did not answer are not shown.

Source: Survey of U.S. adults conducted March 24-30, 2025.

"Negative Views of China Have Softened Slightly Among Americans"

PEW RESEARCH CENTER

A majority of Americans think Trump's tariffs on China will be bad for the US and bad for them as well.

Americans tend to say tariffs on China will be bad for the U.S. and for them personally

% of U.S. adults who say increased tariffs on China will be/have ___ for ...



Note: Those who did not answer are not shown.

Source: Survey of U.S. adults conducted March 24-30, 2025.

"Negative Views of China Have Softened Slightly Among Americans"

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