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Article

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Comment on “The impact of trade wars on Switzerland: A quantitative assessment” by Laurence Wicht

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The paper by LAURENCE WICHT addresses a hotly debated and highly policy-relevant topic. It analyzes the implications for Switzerland of a trade war between the United States and China. The author uses a state-of-the-art structural trade model to study the long-term welfare and trade effects that follow from a bilateral US-China trade war. The paper compares the steady state with tariffs that prevailed before the escalation with tariff increase scenarios. Thus, the focus is purely on the long-term effects. The main question is how Switzerland, as a third country, is impacted by a bilateral tariff escalation between the United States and China.

In order to make a quantitative assessment of the long-term impacts of a trade war, the study uses a quantitative general equilibrium model of international trade. The theoretical framework closely follows the model of CALIENDO and PARRO (2015). This is an extension of the Ricardian workhorse model of modern quantitative trade theory introduced by EATON and KORTUM (2002). The extension explicitly models input-output linkages. Moreover, the model used by Wicht allows for endogenous trade balances, which is a relevant feature in the context of trade wars. Thus, Wicht builds on the latest developments in the international trade literature to conduct a counterfactual analysis to study the long-term impacts of a trade war on Switzerland.

The study is closely related to CHARBONNEAU and LANDRY (2018), who use a similar framework to analyze the effect of recent tariff increases on other countries' welfare. The contribution of the paper by LAURENCE WICHT is in the Swiss-centric approach of the analysis. The study builds on another paper by the same author. WICHT (2019) applies the framework outlined above to analyze Switzerland's gains from trade and describes the novel dataset on Swiss input-output tables. As there are methodological issues with existing input-output tables for Switzerland, using a dataset that relies on a different approach to estimate international input-output linkages is a nice feature of the paper.

Wicht estimates small welfare effects for the tariff escalation scenarios. In the case of a bilateral US-China trade war, where both countries impose a tariff rate of 25% on all imports from the other country, real GDP declines by 0.2% in the United States and by 0.25% in China. Other countries are relatively unaffected.

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In Switzerland, real GDP remains more or less unchanged (+0.03%). Structural trade models in the spirit of EATON and KORTUM (2002) usually find small costs from tariff wars. There are two main reasons for this. First, bilateral trade wars typically generate small welfare effects in a modern Ricardian trade model because of trade diversion. Second, these models make steady state comparisons and therefore cannot take potentially costly transition effects into account. There is, for example, no role for adjustment costs or uncertainty.

Transition effects are hard to quantify. Although they might be sizeable, the economic literature has not yet established a thorough framework for their quantification. However, even a structural model focusing on long-term outcomes can provide some insights into the short-term effects. The counterfactual analysis by WICHT illustrates that a bilateral US-China tariff war induces a significant reallocation of trade flows across trading partners and sectors. In the short-term, such reallocation effects can be very costly (e.g. firms need to locate alternative supplies of inputs or find new destination markets for their products). Trade volumes that are diverted to new destination markets typically involve adjustment costs for firms. Moreover, if the sectoral trade structure changes, adjustment costs for workers, who potentially need to switch industries, could also be significant.

Two aspects of the analysis could be extended for future work. First, the author could analyze the reallocation effects in more detail in order to gauge the magnitude of the transition effects. For instance, one could try to provide a rough estimate of the resources that are reallocated in the long-term, measured in terms of GDP. As the focus of the paper is on Switzerland, a more detailed discussion about the changes in the Swiss trade structure would be particularly interesting.

Second, other aspects of the impact on Switzerland could be explored further. How does Switzerland, as a small open economy, differ from other third countries, such as Germany? Wicht decomposes the welfare effect into final goods, intermediate goods, and sectoral linkage effects. A discussion about the importance of the various channels compared to other countries could shed more light on the role of certain characteristics of the Swiss economy. Finally, how does the effect on Switzerland depend on the fact that Swiss exports are relatively specialized on electronics and optical goods, which is one of the main areas of trade between the US and China?

To sum up, the paper by LAURENCE WICHT uses a state-of-the-art structural trade model to analyze the long-term trade and welfare effects on Switzerland of a bilateral US-China trade war. It makes a very valuable contribution to the debate over the consequences of trade wars for Switzerland. In future work, a more detailed analysis of the magnitude of the reallocation effects and the role of certain Swiss-specific characteristics could shed light on further aspects of this highly policy-relevant topic.

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