

# **U.S. Trade Policy: Where is it Headed?**

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COLLEGE OF FOOD, AGRICULTURAL,  
AND ENVIRONMENTAL SCIENCES

# **Key U.S. Trade Policy Actions**

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- ◆ **KORUS renegotiated – Korean steel export limit**
- ◆ **Broad-based tariffs on steel/aluminum imports on grounds of national security**
- ◆ **Renegotiation of NAFTA as USMCA - key change to “rules of origin” in North American auto sector**
- ◆ **Escalation of trade war with China over “unfair” trade practices**
- ◆ **National security investigation into U.S. auto imports and parts – potential for 25% tariffs on imports from key allies**

# Path to Trade War in 2018

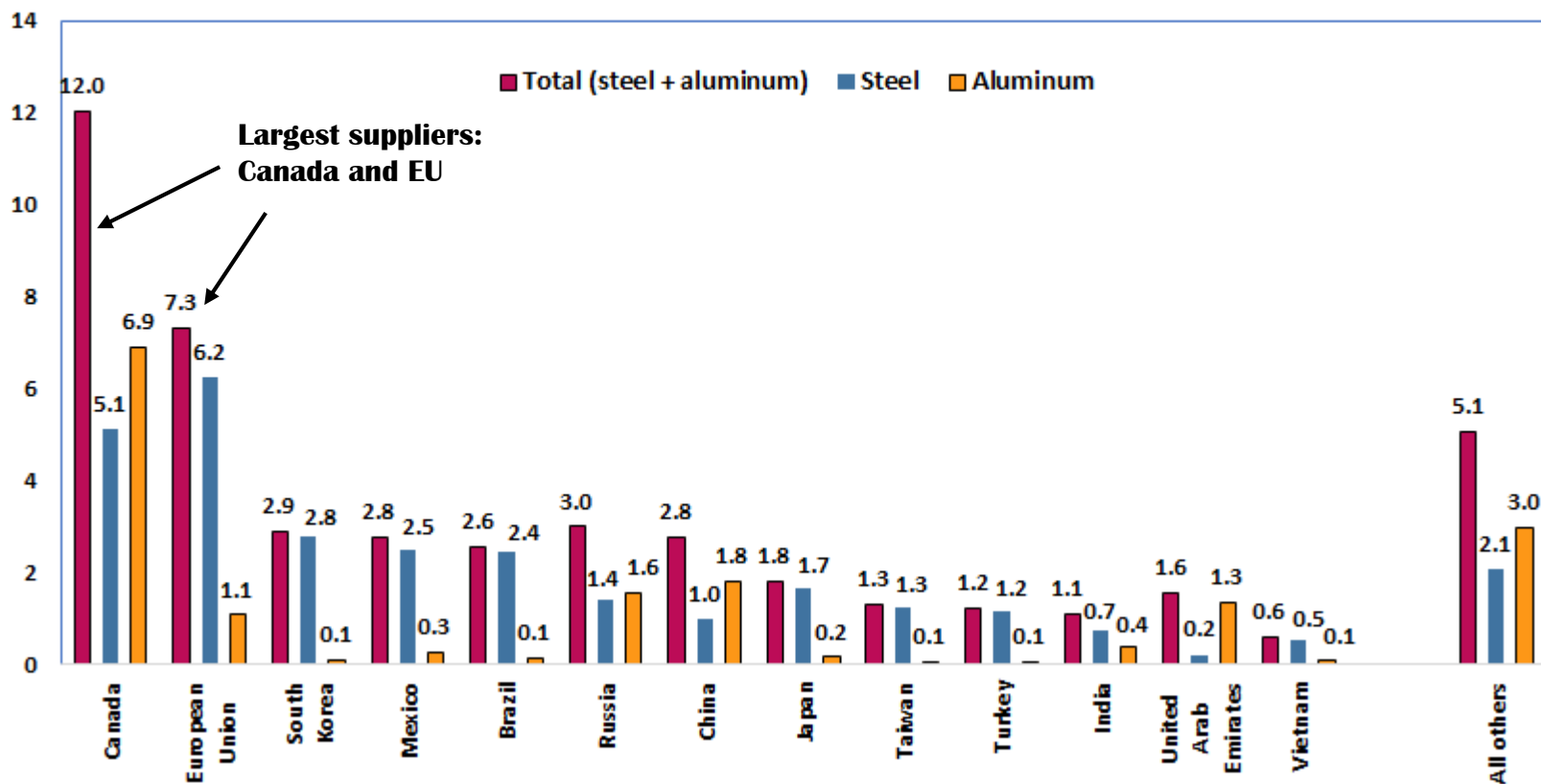
- ◆ **U.S. tariffs on solar panels and washing machines – retaliation by China on sorghum (January)**
- ◆ **U.S. tariffs on steel and aluminum – retaliation by China, EU, and Canada (March-June)**
- ◆ **Ratcheting up of war with China in phases:**

Phase	Tariff Rate (%)		Trade Value (\$b)		Products	
	U.S.	China	U.S.	China	U.S.	China
1 – April	25	25	50	50	Intermediate	Soybeans, autos, and aircraft
2 - June	10-25	5-10	200	60	Intermediate and consumer	Intermediate and consumer
3 - Sept	?	?	267	53	Intermediate and consumer	Intermediate and consumer

# U.S. Steel/Aluminum Imports

Figure 1 US imports of steel and aluminum in 2017, by selected trading partner

billions of dollars



Source: Chad Bown, PIIE (March 5, 2018)

# Costs of Trade War

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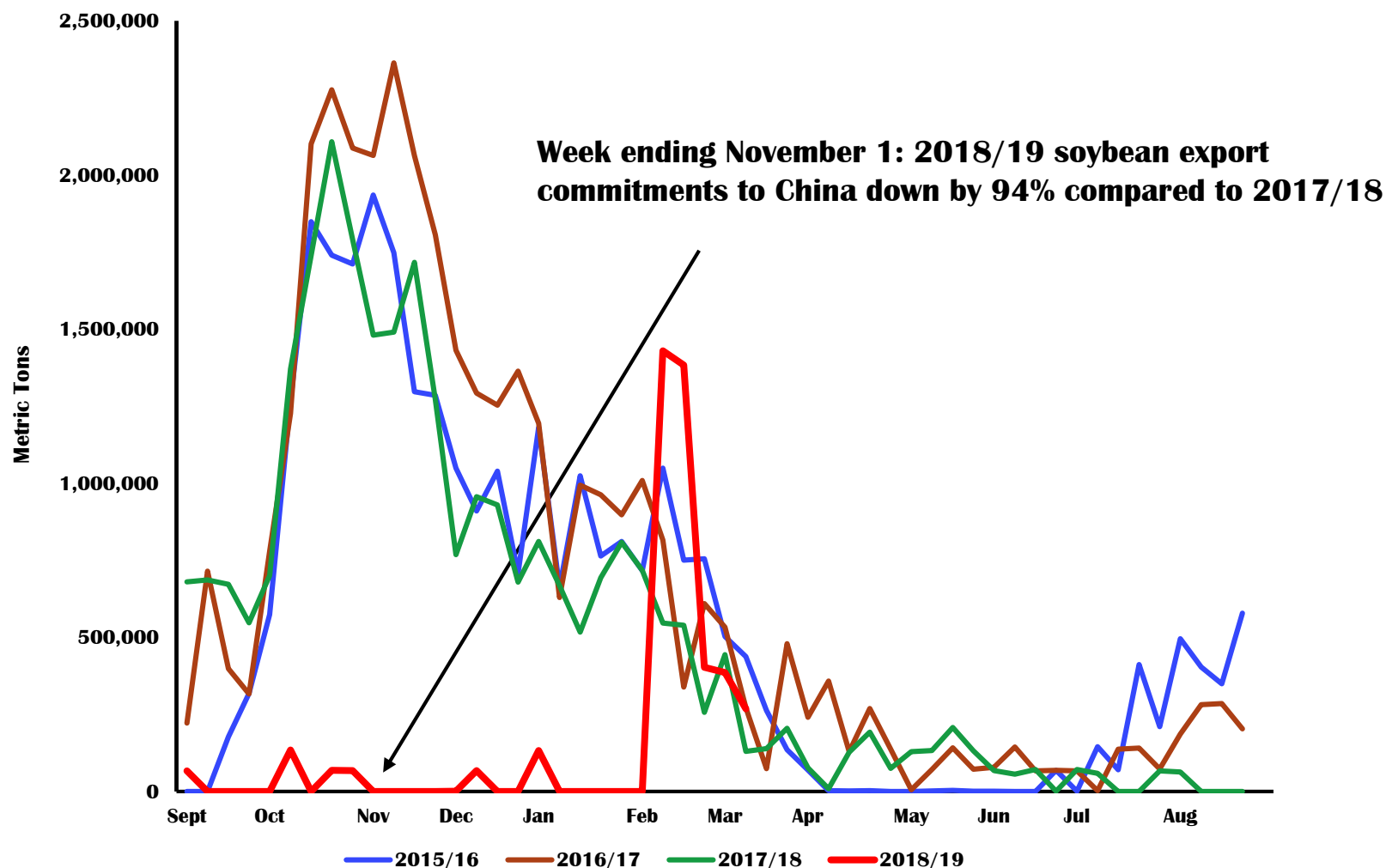
- ◆ **Harley-Davidson has shifted production overseas to avoid EU tariffs of 31% on U.S. imports**
- ◆ **200 percent increase in Canadian wheat exports to China in 2018 at expense of U.S.**
- ◆ **Steel tariffs cutting into company profits, e.g., Ford, Caterpillar, Cummins (Bloomberg, 2018)**
- ◆ **\$450 million gains to U.S. agriculture from USMCA matched by \$7.9 billion losses to sector from tariff retaliation (Tyner et al., 2018)**
- ◆ **Reduction in U.S. monthly real income of \$1.4 billion by end of 2018 (Amiti, *et al.*, 2019)**

# **Soybeans in the Crossfire**

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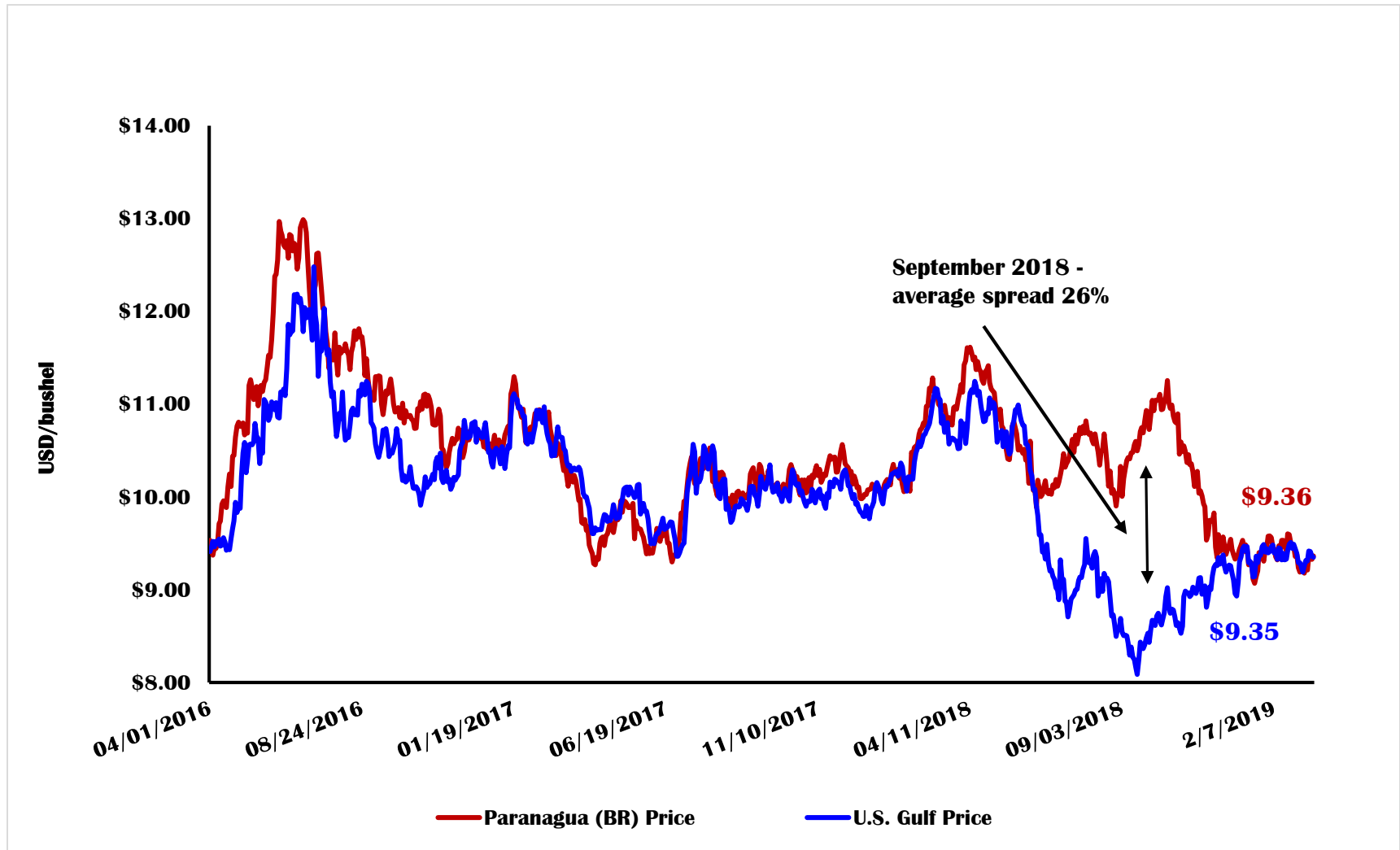
- ❖ **China implemented discriminatory tariff of 25% on imports of U.S. soybeans**
- ❖ **Significant reduction in U.S. soybean exports to China compared to previous marketing years**
- ❖ **Gap between U.S. and Brazilian export prices has narrowed from average of 26% in September:**
  - **announced Chinese purchases from U.S.**
  - **China running down stocks**
  - **expectations for Brazilian crop**
- ❖ **If trade war persists, clear potential for U.S. to lose market share to Brazil – 9 million acres of soybeans (Tyner, Purdue University, 2018)**

# U.S. Soybean Exports to China



Source: USDA-FAS

# Soybean Export Prices - \$/bu.





# **What is Driving U.S. Trade Policy?**

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- ◆ **U.S. trade policy based on three objectives:**
  - **Reducing trade deficit – especially bilateral deficit with China**
  - **Getting China to reform economic system that discriminates against U.S. firms, e.g., forced transfer of U.S. technology in joint-ventures**
  - **Negotiating with trading partners bilaterally rather than multilaterally, as well as pulling back from WTO dispute resolution mechanism**

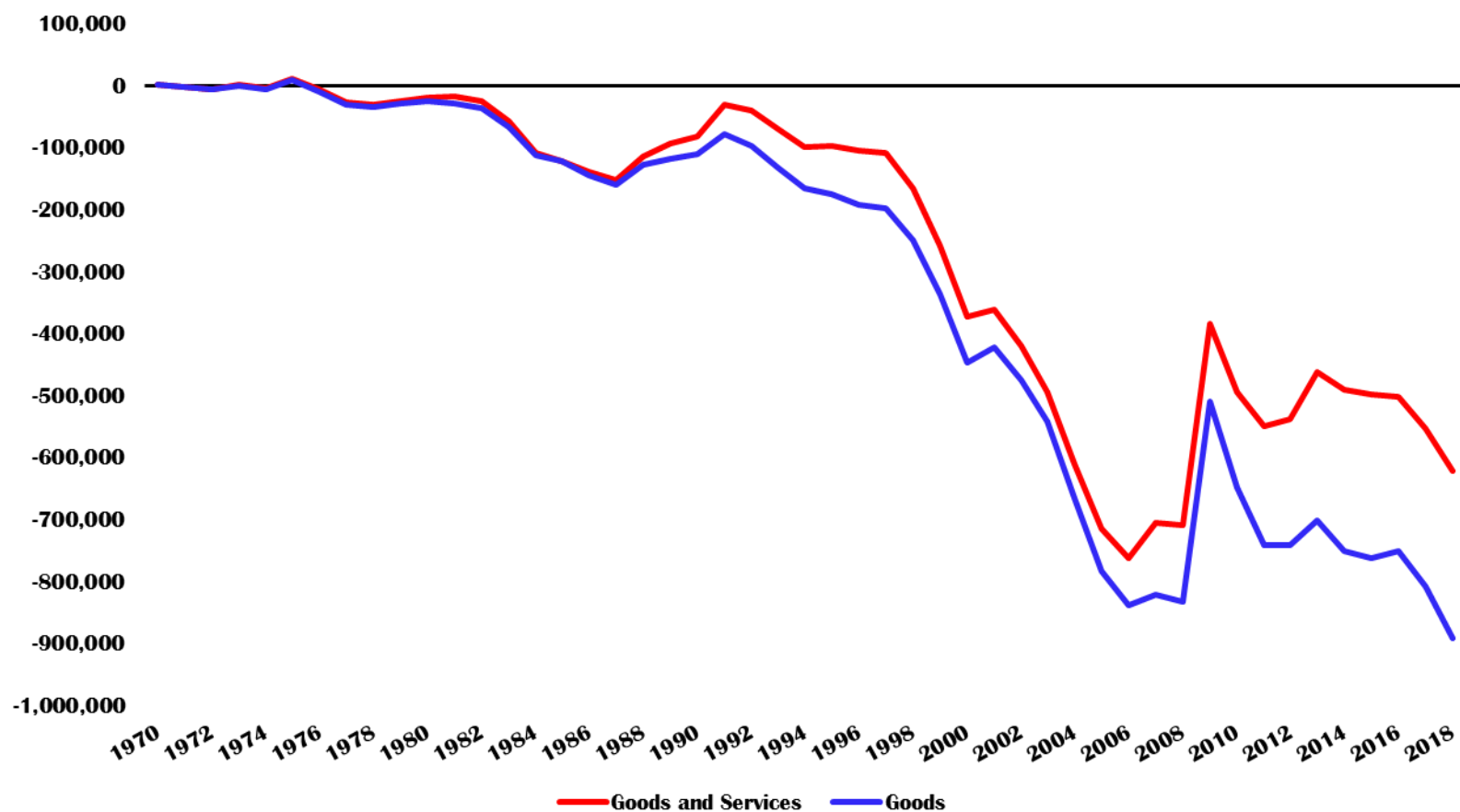
# The U.S. Trade Deficit

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- ◆ **U.S. has run a trade deficit since mid-1970s**
- ◆ **Macro-economists agree: trade deficit driven by decline in national savings rate**
- ◆ **U.S. households have high marginal propensity to consume and U.S. government has propensity to run fiscal deficits**
- ◆ **Trade deficit will continue unless savings increase and/or investment demand falls**
- ◆ **Might this herald reappearance of the “twin deficits”? (Orden and Zulauf, 2019)**

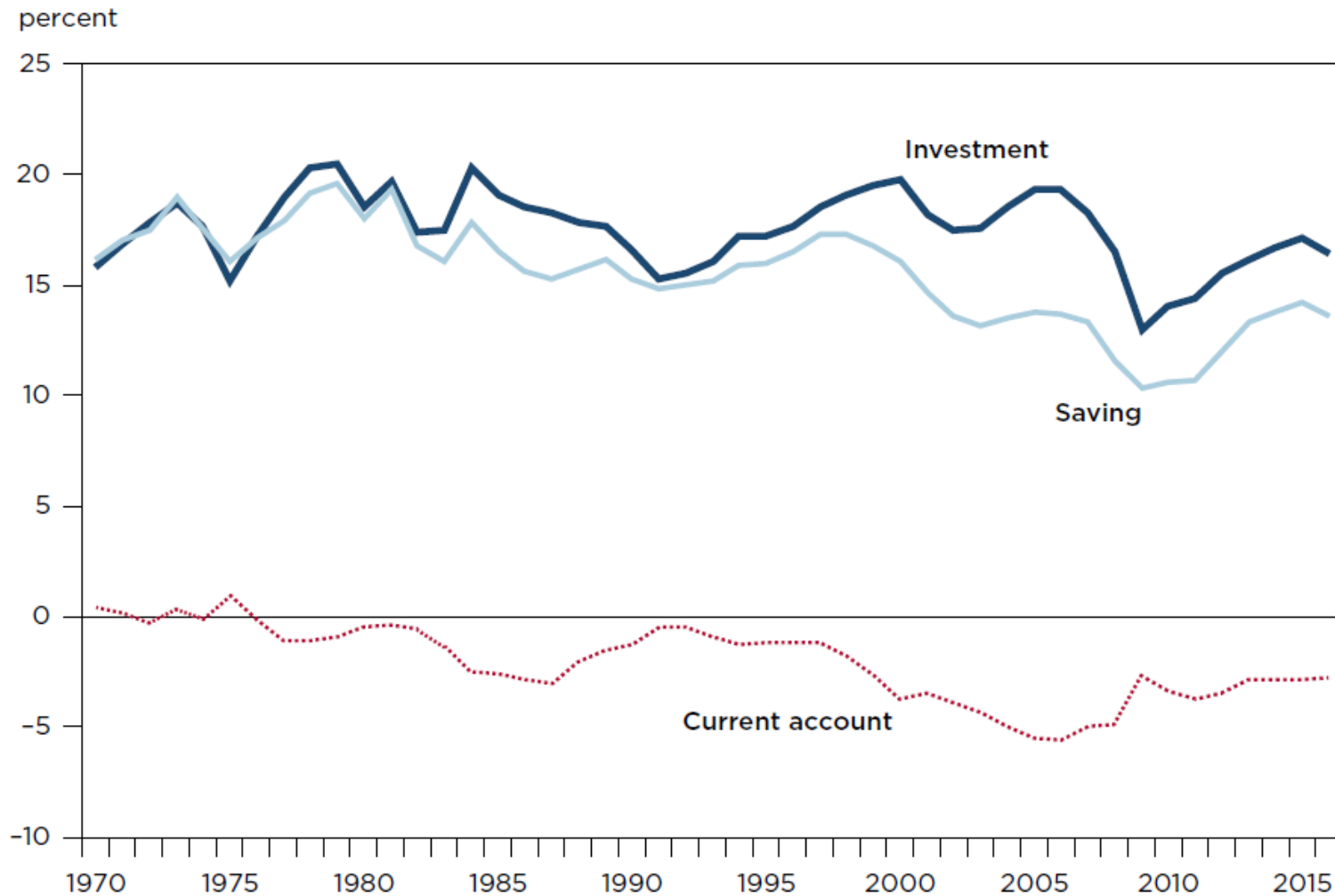
# U.S. Trade Deficit

## U.S. Current Account: 1970-2018 (millions of \$)



Source: U.S. Census Bureau

# U.S. Savings and Trade Balance



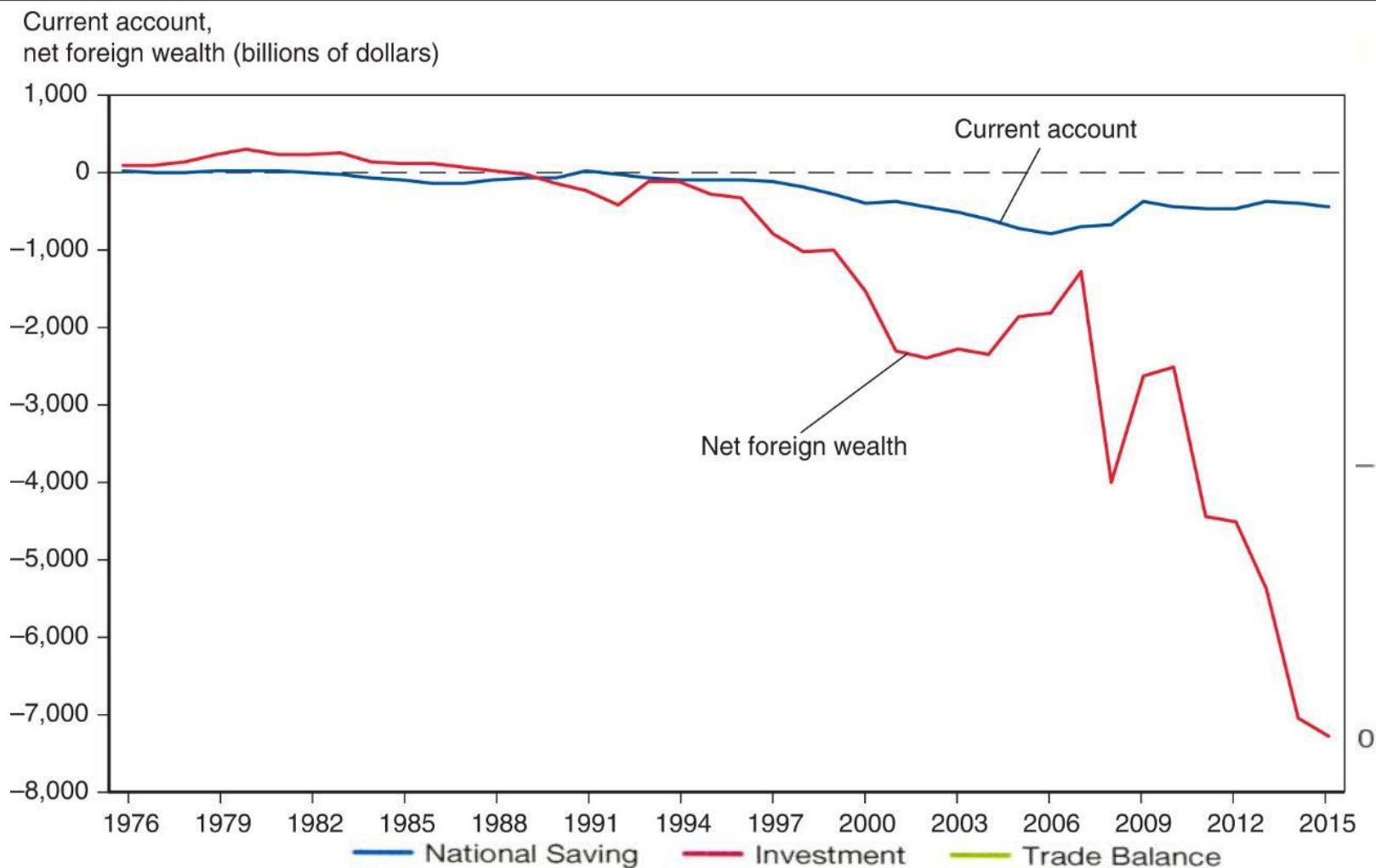
Source: Bureau of Economic Analysis

# Should We Be Concerned?

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- ◆ **To facilitate trade deficit, U.S. runs negative net international investment position (NNIP)**
- ◆ **NNIP is U.S. financial claims on other countries minus foreign financial claims on U.S.**
- ◆ **2016 NNIP = -\$8.4 trillion, i.e., -45% of GDP and expected to increase to -53% by 2021**
- ◆ **This is likely not sustainable in long run, requiring significant depreciation of US \$ with major adjustment costs**
- ◆ **The longer U.S. trade deficit continues, the more extreme relative price adjustment will likely be**

# NNIP and U.S. Trade Deficit



Source: Bureau of Economic Analysis

# Trade Policy Unlikely to Fix It

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- ❖ **Trade policy unlikely to solve U.S. trade deficit – tariffs divert trade to other countries/products**
- ❖ **Tariffs reduce imports, but also reduce exports, i.e., lower imports reduces demand for foreign currency, \$ strengthens, exports decline**
- ❖ **Essentially U.S. trade deficit is a macroeconomic phenomenon that can only be resolved through macroeconomic policy**
- ❖ **Policy choices: (i) tax consumption/reduce fiscal deficit; (ii) depreciate exchange rate; (iii) tax capital inflows (Freund, 2017)**

# **U.S. - China Trade Issues**

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- ◆ **China's incomplete transition to market economy:**
  - **promotion of state owned enterprises (SOEs)**
  - **intellectual property (IP) theft of up to \$50 billion/year (USTR, 2018)**
  - **not implementing all of its WTO obligations**
- ◆ **Plans to modernize Chinese economy, with focus on reducing dependence on foreign technology – “Made in China 2025”**
- ◆ **Concern over attempts to either limit participation of foreign firms in innovation efforts or to condition market access on transfer of technology**



# **U.S. - China Trade Issues**

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- ◆ **Truce in trade war contingent on China addressing U.S. concerns over IP theft, forced transfer of technology, and its support for SOEs**
- ◆ **View of many observers: U.S. should follow multilateral approach with EU and Japan and push for resolution through WTO**
- ◆ **Problem with bilateral approach: EU and Japan “free-ride” as any Chinese reforms cannot discriminate in favor of U.S.**
- ◆ **Also a concern that focus of any eventual U.S. agreement with China may be on bilateral deficit and not core IP issues (Hillman, 2018)**

# Trade Deal with China?

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- ◆ **China has re-written laws on foreign investment – critics argue language is too vague**
- ◆ **Commitments made by China to increase purchases of LNG and soybeans – potentially discriminatory under WTO rules**
- ◆ **Real debate is over how any agreement can be enforced**
- ◆ **Concern U.S. either maintain existing tariffs or unilaterally implements “snap-back”**
- ◆ **Deal may well end up being superficial, with risks of continued uncertainty over tariffs**

# Is a Recession Coming?

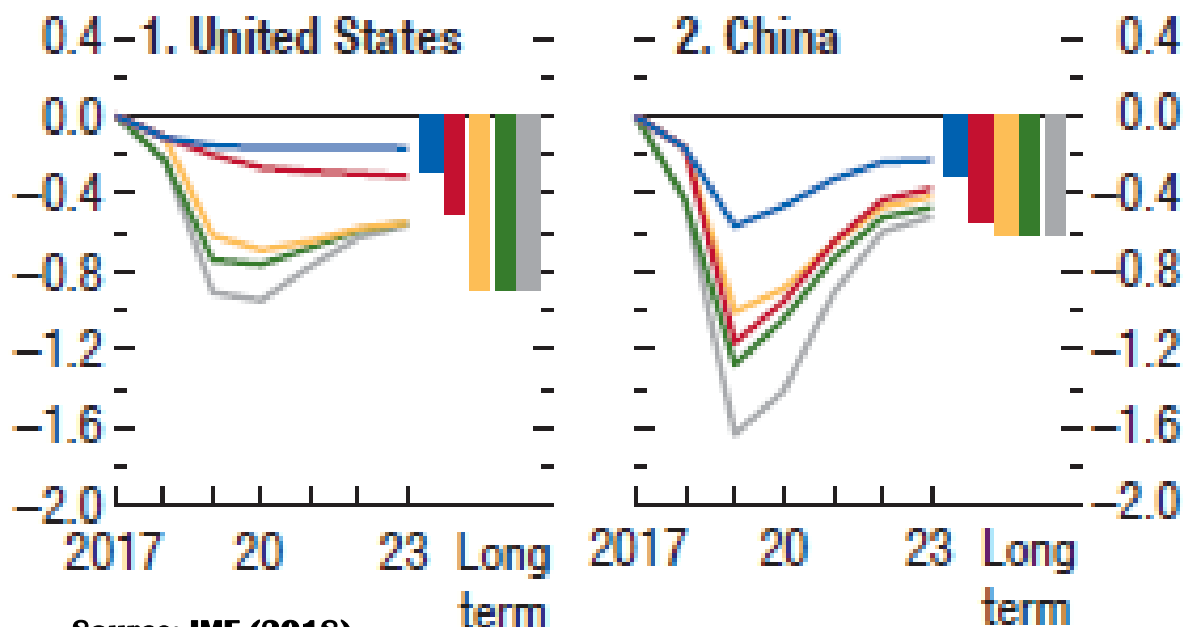
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- ◆ **World economy forecast to slow down in 2019-20 (IMF, 2019)**
- ◆ **Pessimism driven by prospect of “no-deal” Brexit and more aggressive U.S.-China trade war**
- ◆ **China’s economy also expected to slow from 6.9% in 2017 to 6% in 2021, with spillover effects on other emerging economies (World Bank, 2019)**
- ◆ **U.S. economy slowing down according to Federal Reserve (Powell, March 20, 2019)**
- ◆ **Forecasters placing odds of U.S. recession at 40% in the next two years (Rogoff, 2019)**

# Possible Impact of Trade War

## Impact of Trade Tensions on Real GDP (deviations from benchmark)

- Tariffs in baseline
- Add China (25 percent on \$267 billion) with retaliation
- Add cars, trucks, and parts with retaliation
- Add confidence effect
- Add market reaction



Source: IMF (2018)

# Concluding Thoughts

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- ◆ **Import tariffs unlikely to solve U.S. trade deficit**
- ◆ **Legitimate concerns about trade with China: e.g., theft of U.S. intellectual property rights**
- ◆ **U.S. and allies should put pressure on China to conform to WTO rules – but allies forced to retaliate against U.S. steel/aluminum tariffs**
- ◆ **Escalating trade war likely to exacerbate decline in global GDP growth**
- ◆ **Slowdown in global economy increasing likelihood of U.S. economy going into recession**