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

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Pickaway County
2019 Agricultural Outlook
January 14, 2019

THE OHIO STATE UNIVERSITY
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Key U.S. Trade Policy Actions

- Trans-Pacific Partnership (TPP) not ratified
- 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 – 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 (Sb)		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

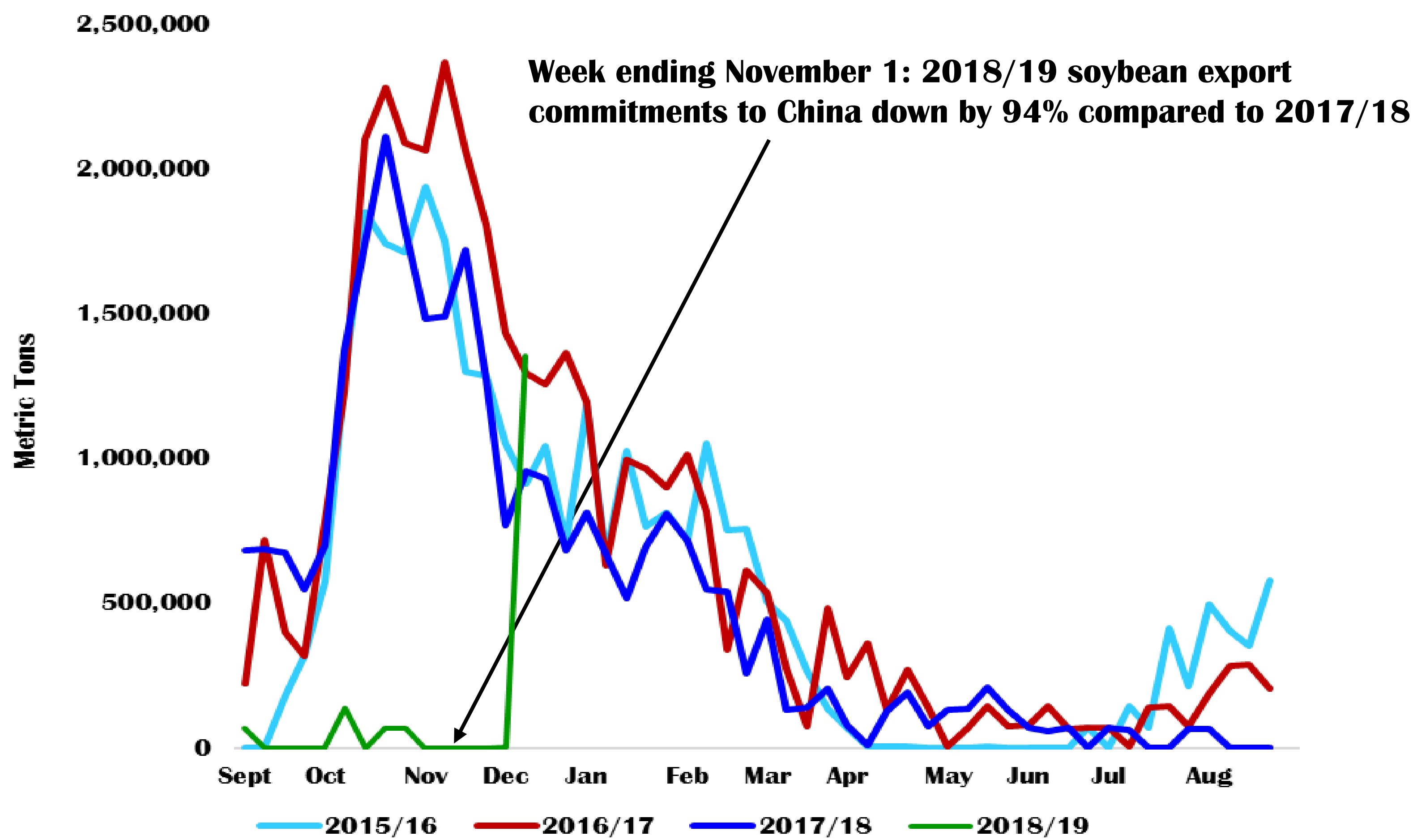
Costs of Trade War

- Harley-Davidson has shifted production overseas to avoid EU tariffs of 31% on U.S. imports
- 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)
- If auto tariffs are implemented – forecast loss of 195,000 U.S. jobs (Robinson et al., 2018)
- Potential fall in global GDP of $430 billion, with U.S. being "especially vulnerable" (IMF, 2018)

Soybeans in the Crossfire

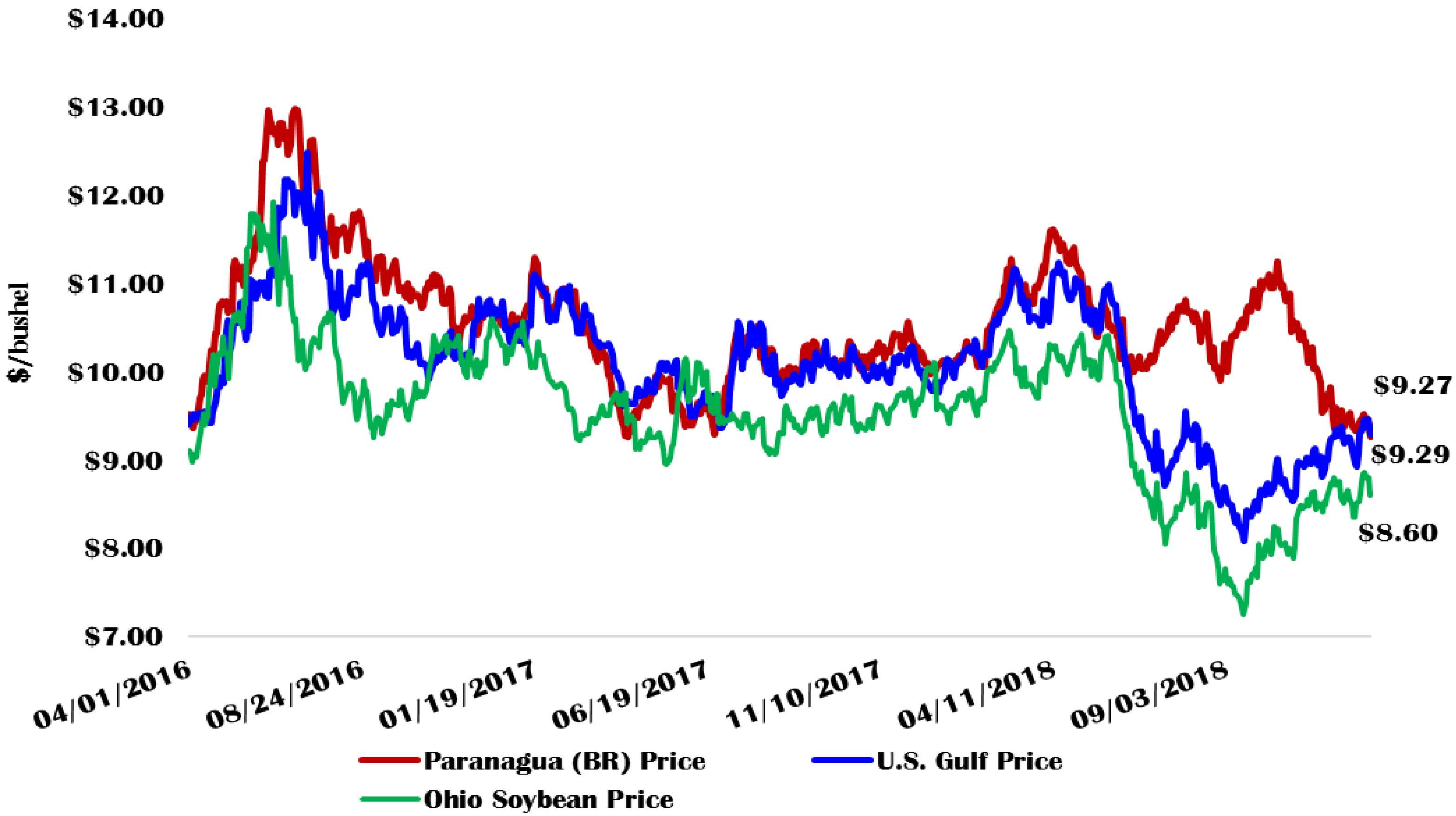
- **China implemented discriminatory tariff of 25% on imports of U.S. soybeans**
- **Significant reduction in U.S. soybean exports to China compared to previous marketing years**
- **Gap between U.S. and Brazilian export prices has narrowed from average of 26% in September:**
  - **- announced Chinese 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 (Wally Tyner, Purdue University, 2018)**

U.S. Soybean Exports to China



Source: USDA-FAS

Soybean Export Prices - $/bu.



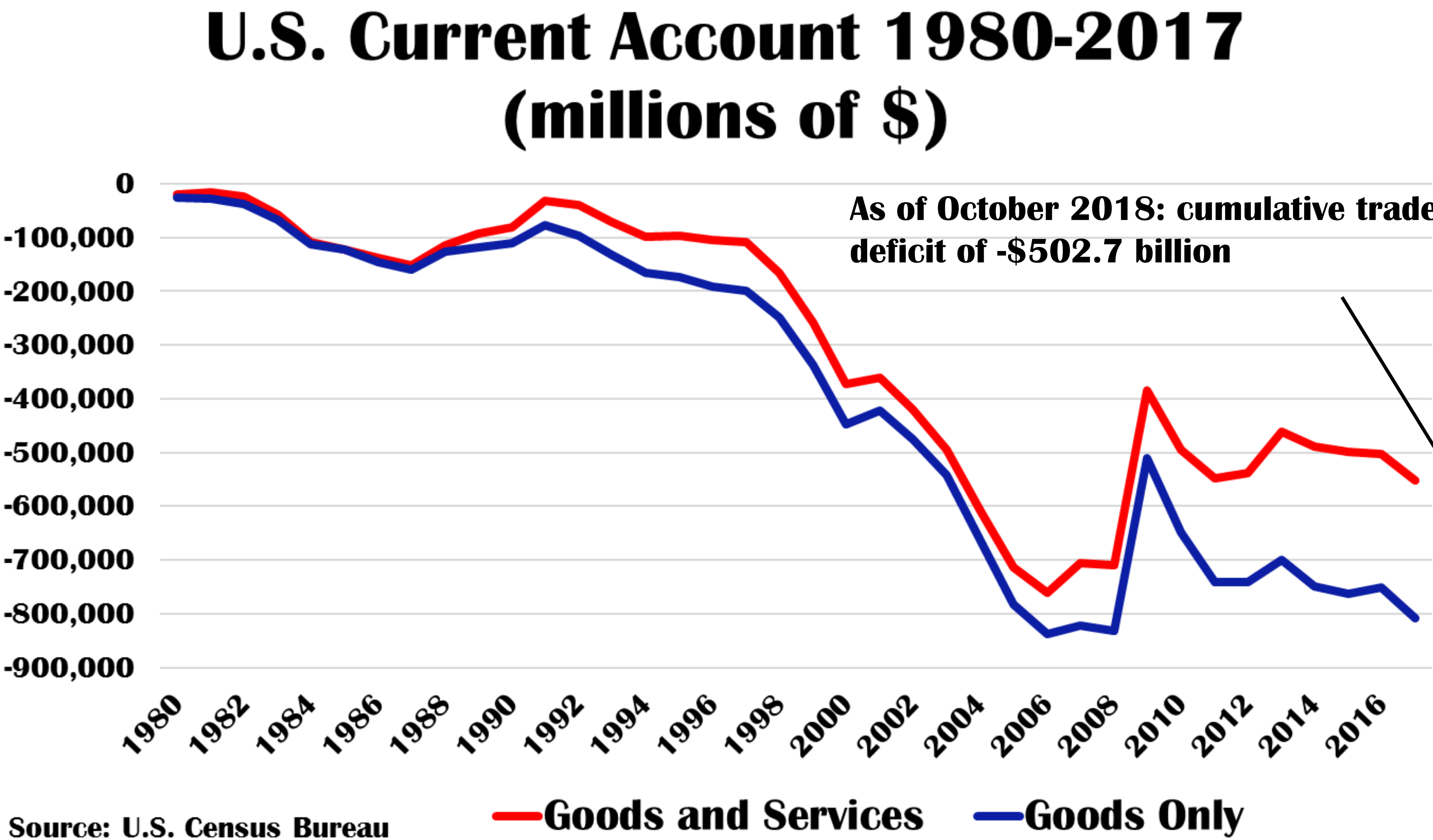
What is Driving U.S. Trade Policy?

- Administration has expressed view international trade is a zero-sum game
- Trade deficit seen as evidence that U.S. is losing and other countries must be winning
- Focus on negotiating bilaterally rather than multilaterally through WTO dispute resolution mechanism
- Key objective of getting China to reform system that discriminates against foreign firms, e.g., theft of intellectual property

The U.S. Trade Deficit

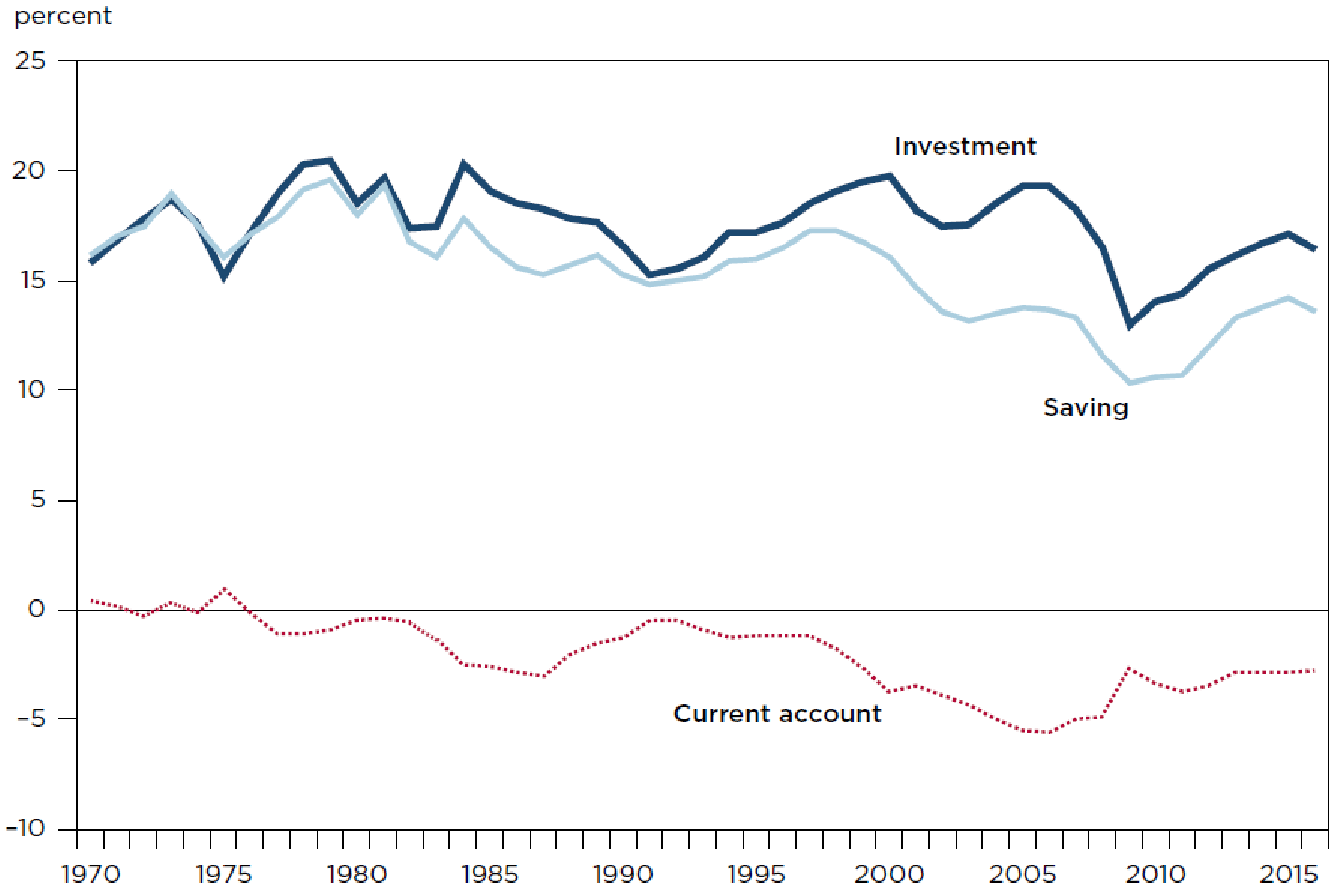
- U.S. has run a trade deficit since early-1980s
- Macro-economists agree: U.S. trade deficit driven by decline in national savings rate
- U.S. households have high marginal propensity to consume and U.S. government has propensity to run fiscal deficits
- Trade deficit will continue unless savings increase and/or investment demand falls
- Any increase in fiscal deficit will feed into trade deficit – exacerbated by fact that U.S. economy is running at full employment

U.S. Trade Deficit



Source: U.S. Census Bureau

U.S. Savings and Trade Balance

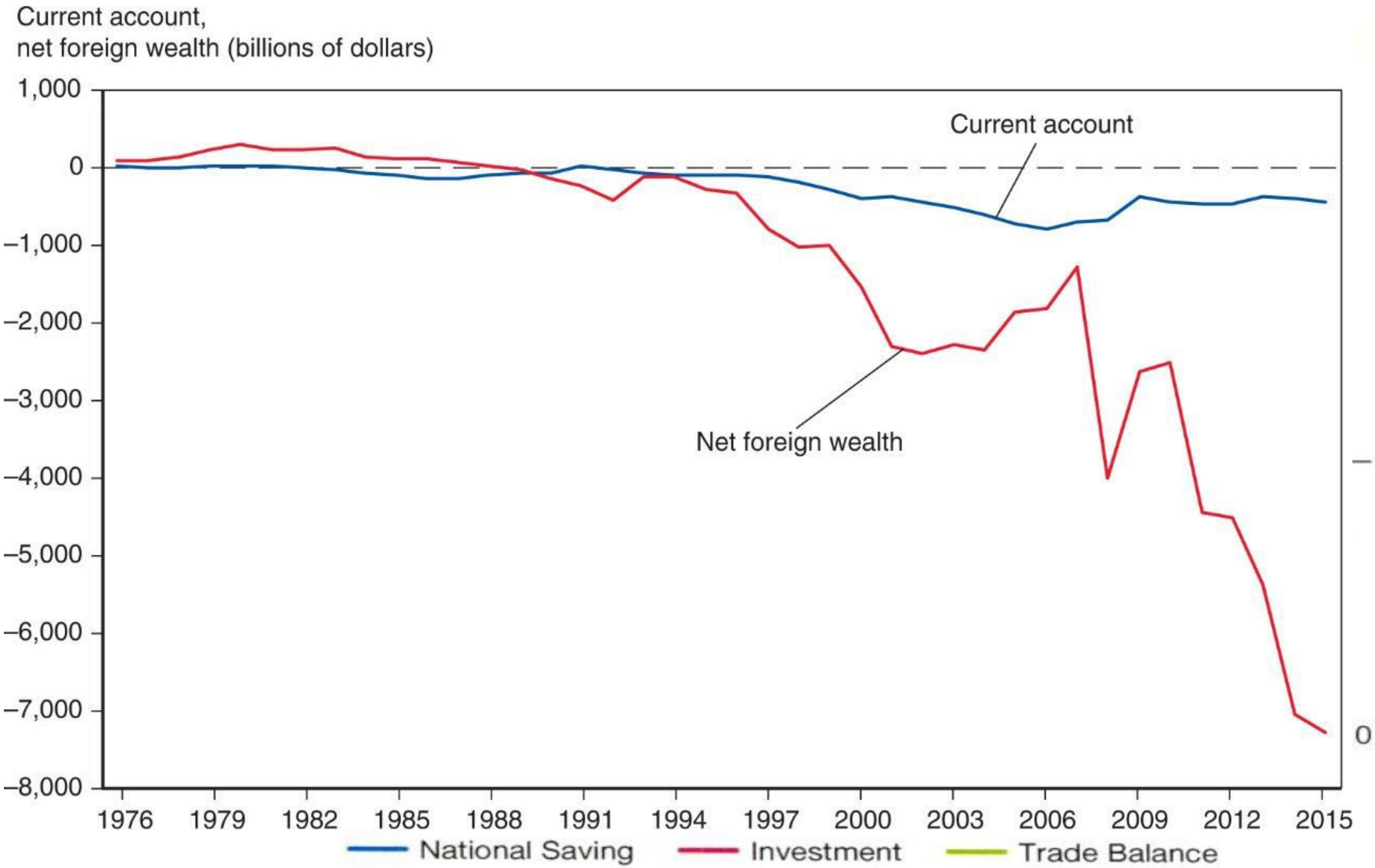


Source: Bureau of Economic Analysis

Should We Be Concerned?

- 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 Won't Fix It

- 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

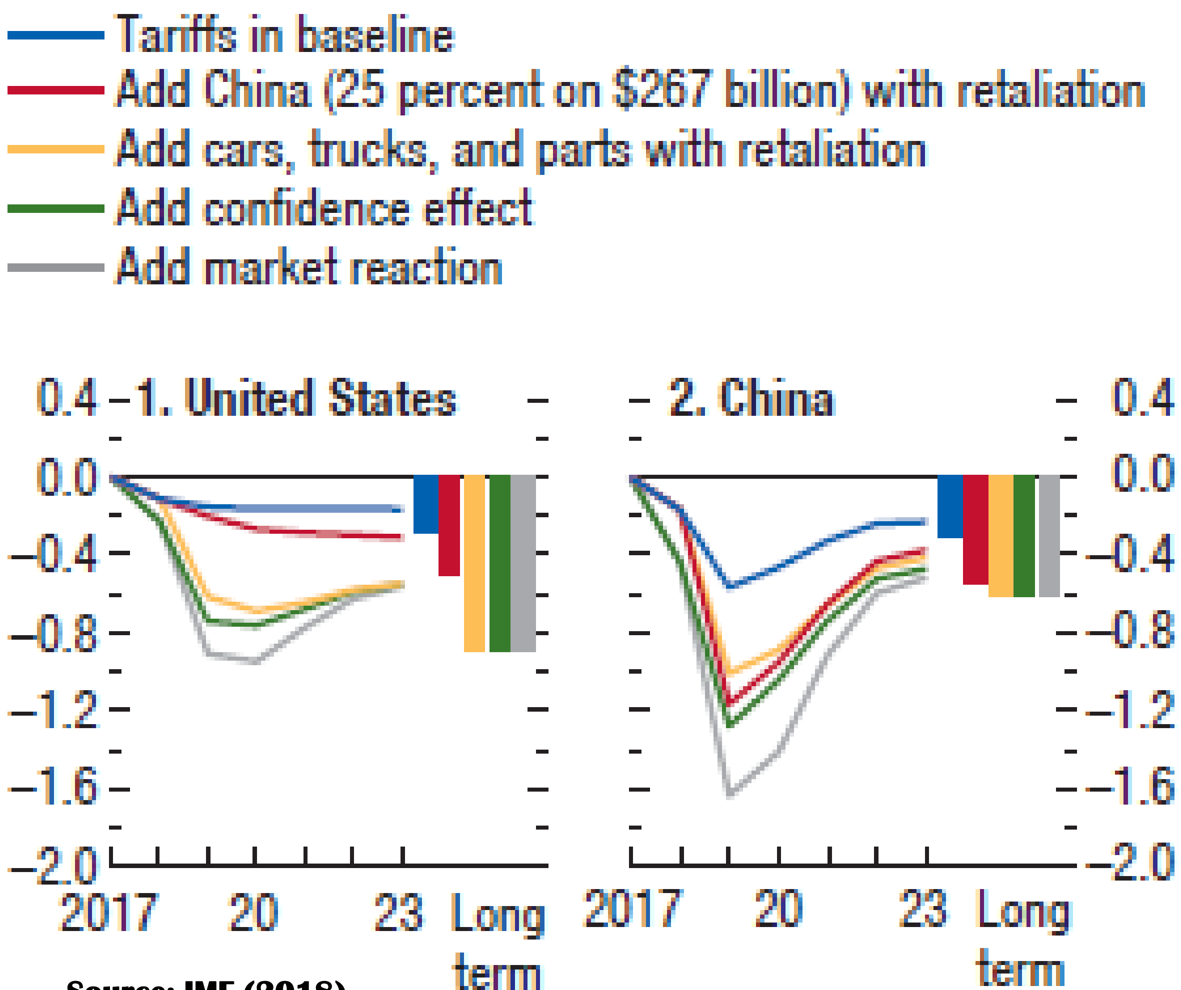
- China's incomplete transition to market economy:
  - promotion of state owned enterprises (SOEs)
  - theft of intellectual property rights (IPRs)
  - not implementing all WTO obligations
- Plans to modernize Chinese economy, with focus on reducing dependence on foreign technology – "Made in China 2025"
- Concern over attempts to either limit participation of foreign firms in innovation efforts or to condition market access on transfer of technology
- A form of technological import substitution

U.S. - China Trade Issues

- Current truce in trade war contingent on China addressing U.S. concerns over IPR theft, forced transfer of technology, and its support for SOEs
- Bilateral approach to complex issues unlikely to make substantive progress in 90 days – previous administration unable to succeed over 8 years
- 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.

Possible Impact of Trade War

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



Source: IMF (2018)

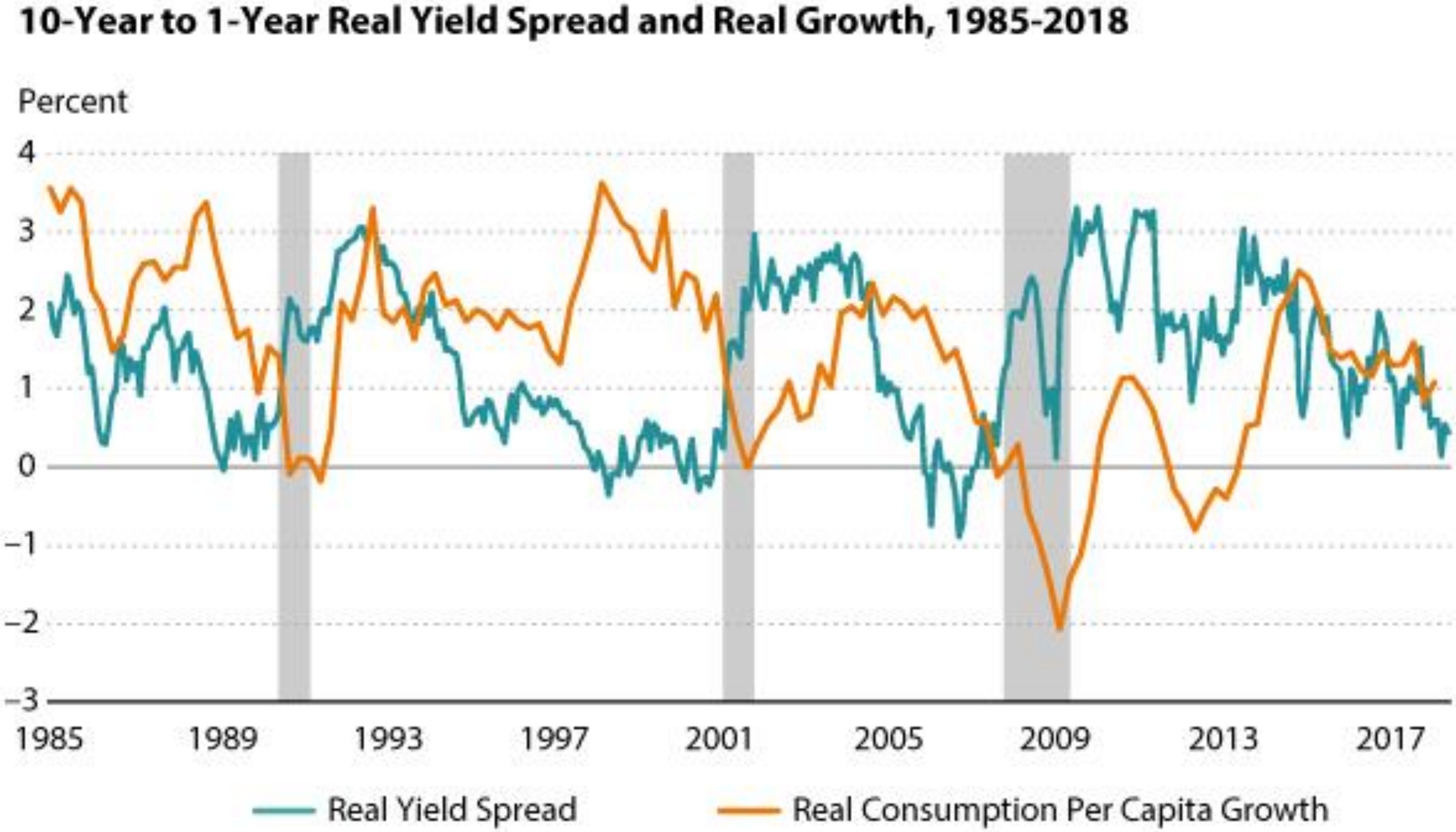
Is a Recession Coming?

- Global growth forecast to drop in 2019-20 due to slowdown in developed world (World Bank, 2019)
- Pessimism also 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
- Impact of U.S. fiscal stimulus expected to eventually wear off
- Currently, forecasters place odds of U.S. recession at 40% in the next two years (Rogoff, 2019)

The Yield Curve

- Financial analysts beginning to worry about the "yield curve" (WSJ, January 9, 2019)
- Yield curve is difference between yields on short- and long-term government bonds, e.g., 2-year vs. 10-year Treasury notes
- If economy is in good shape long-term rates should be higher than short-term rates
- Even as U.S. economy has grown, yield curve has flattened, and clear evidence there could be inversion (FRB of San Francisco, 2018)
- Past three U.S. recessions have been preceded by an inverted yield curve (FRB of St. Louis, 2018)

Yield Curve Inversion…….



NOTE: Gray bars indicate recessions as determined by the National Bureau of Economic Research.
SOURCE: Board of Governors of the Federal Reserve System, the Bureau of Economic Analysis, and the Federal Reserve Bank of Cleveland.

Source: FRB of St. Louis (2018)

Concluding Thoughts

- Trade is a positive-sum game: $2.1 trillion extra U.S. GDP since 1950 (Hufbauer and Lu, 2017)
- Import tariffs will not solve U.S. trade deficit
- Legitimate concerns about trade with China: e.g., theft of U.S. intellectual property rights (IPRs) – $50 billion/year (USTR, 2018)
- U.S. and allies should put pressure on China to conform to WTO rules (Lawrence, 2018) – but allies forced to retaliate against U.S. steel/aluminum tariffs
- U.S. trade policy a threat to post-war multilateral consensus on trade rules of GATT/WTO