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

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Key U.S. Trade Policy Actions

- 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 – 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:

<table>
<thead>
<tr>
<th>Phase</th>
<th>Tariff Rate (%)</th>
<th>Trade Value (Sb)</th>
<th>Products</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>U.S.</td>
<td>China</td>
<td>U.S.</td>
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<tr>
<td>1 - April</td>
<td>25</td>
<td>25</td>
<td>50</td>
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<tr>
<td>2 - June</td>
<td>10-25</td>
<td>5-10</td>
<td>200</td>
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<td>3 - Sept</td>
<td>?</td>
<td>?</td>
<td>267</td>
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U.S. Steel/Aluminum Imports

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

Source: Chad Bown, PIIE (March 5, 2018)
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 to 624,000 U.S. jobs, depending on foreign retaliation (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

Week ending November 1: 2018/19 soybean export commitments to China down by 94% compared to 2017/18

Source: USDA-FAS
Soybean Export Prices - $/bu.

- September 2018 - average spread 26%
What is Driving U.S. Trade Policy?

- 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**

- 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

As of October 2018: cumulative trade deficit of -$502.7 billion

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 Unlikely to 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 (IP)
  - 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
- A form of technological import substitution
U.S. - China Trade Issues

- Current truce in trade war contingent on China addressing U.S. concerns over IP 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.
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)
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
- Forecasters placing 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

10-Year to 1-Year Real Yield Spread and Real Growth, 1985-2018

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

- Import tariffs unlikely to solve U.S. trade deficit
- Legitimate concerns about trade with China: e.g., theft of U.S. intellectual property rights – $50 billion/year (USTR, 2018)
- 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 cause slowdown in both global and U.S. GDP growth
- Expected slowdown in global economy raising likelihood of U.S. economy going into recession