

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

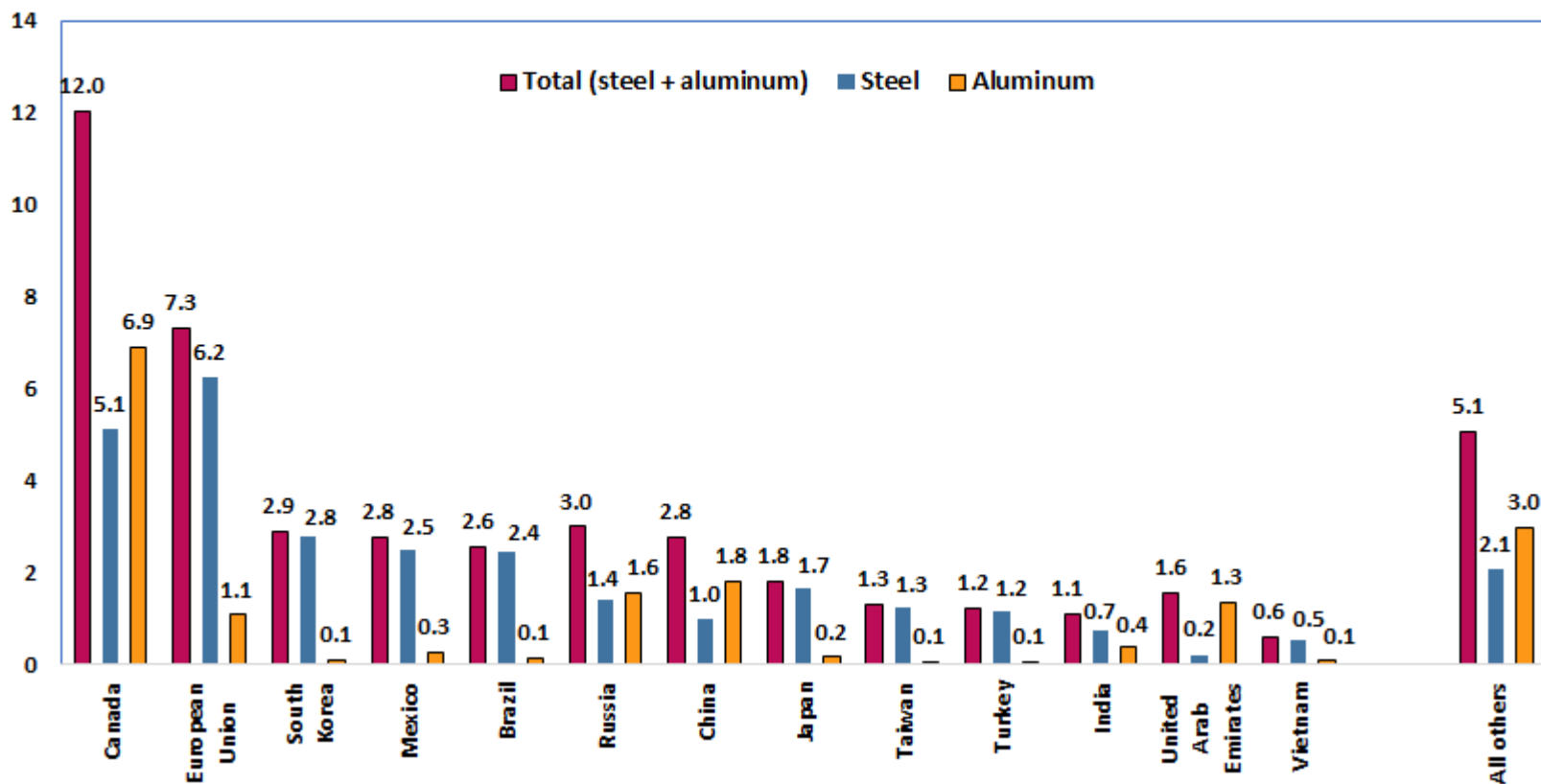
- ◆ **U.S. tariffs on solar panels and washing machines – retaliation by China on sorghum (January)**
- ◆ **U.S. tariffs on steel and aluminum – retaliation by China, EU, and Canada (March-June)**
- ◆ **Ratcheting up of war with China in phases:**

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)

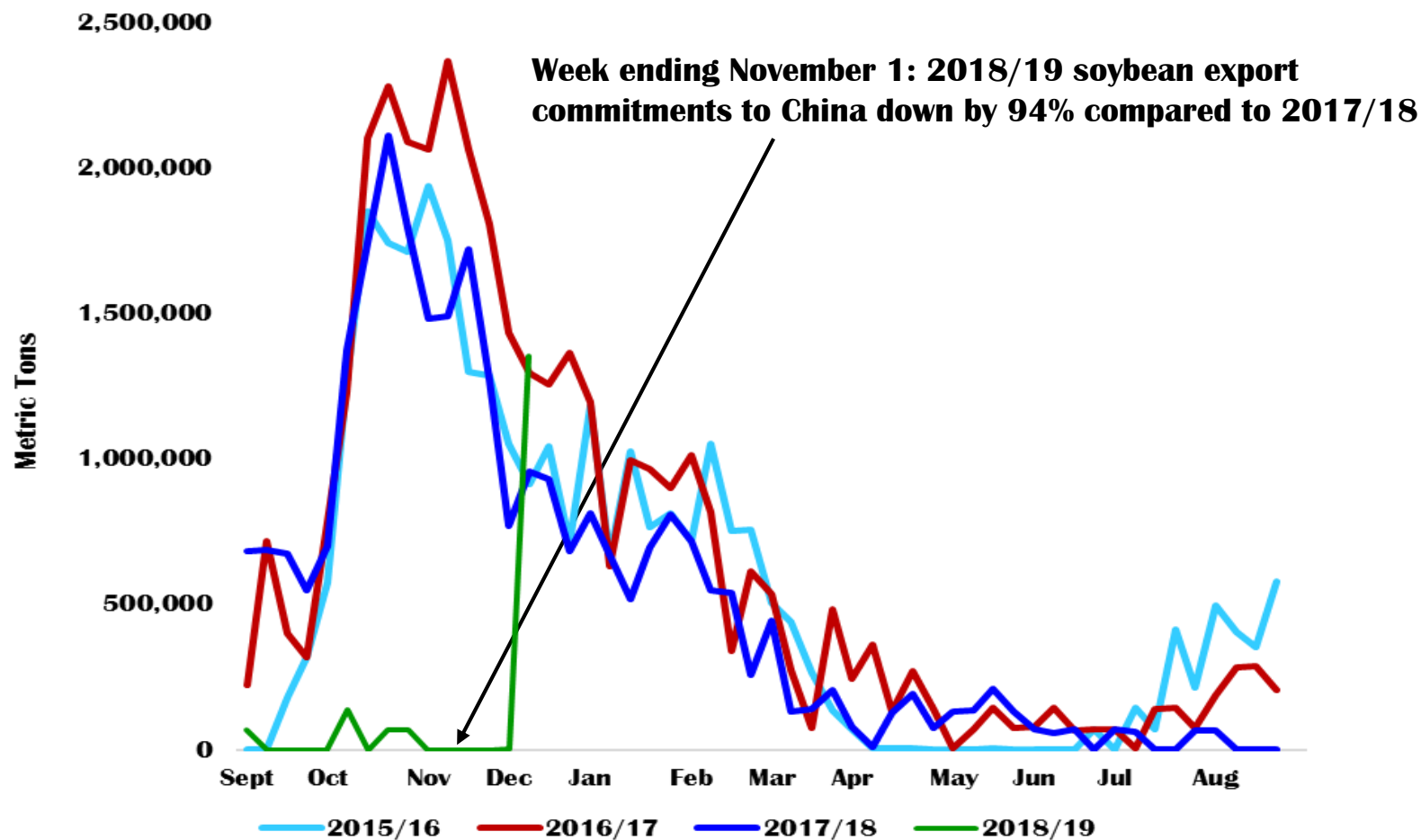
Costs of Trade War

- ◆ **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)**

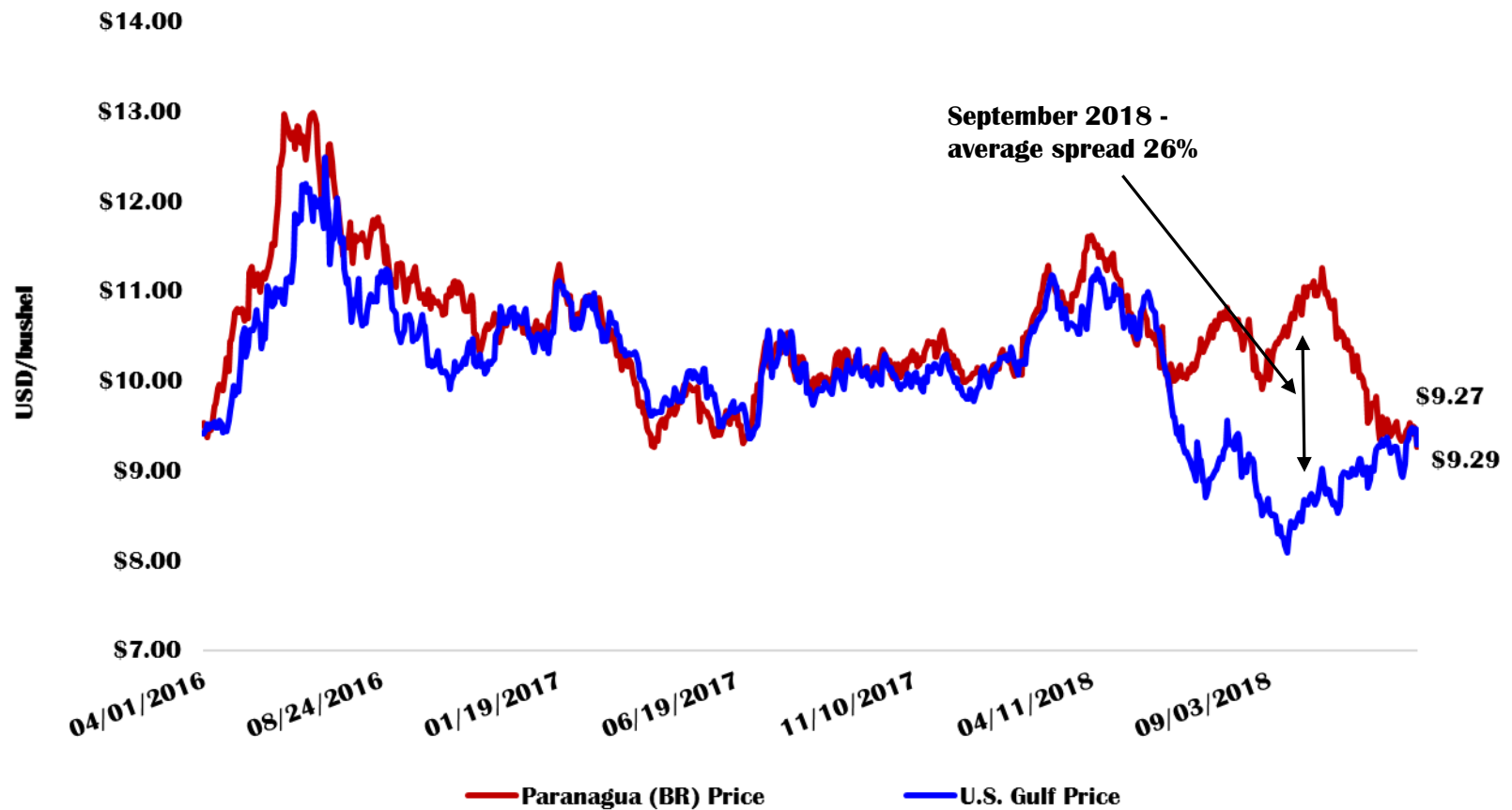
Soybeans in the Crossfire

- ❖ **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



Soybean Export Prices - \$/bu.



What is Driving U.S. Trade Policy?

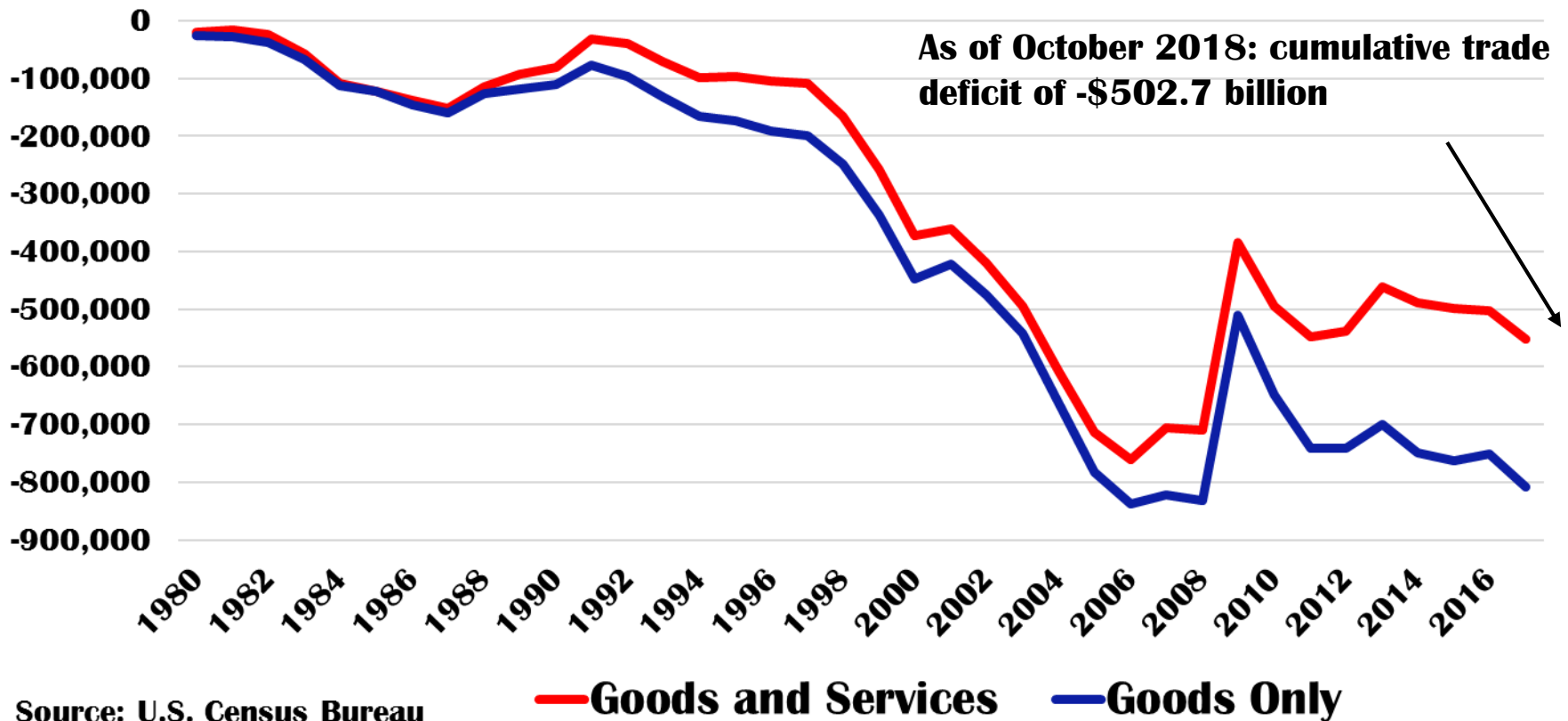
- ◆ **U.S. trade policy based on three objectives:**
 - **Reducing trade deficit – especially bilateral deficit with China**
 - **Getting China to reform economic system that discriminates against U.S. firms, e.g., forced transfer of U.S. technology in joint-ventures**
 - **Negotiating with trading partners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

The U.S. Trade Deficit

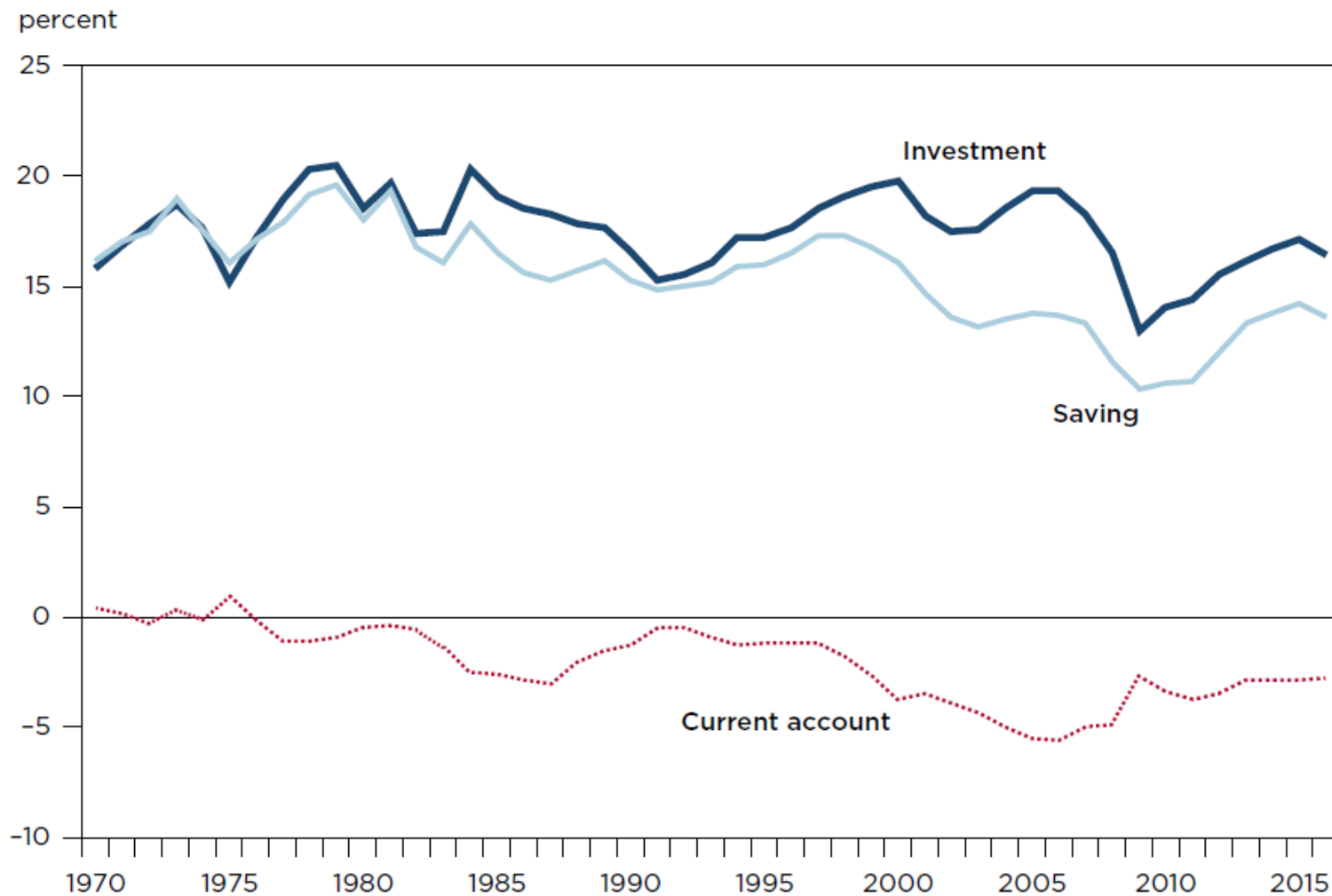
- ◆ **U.S. has run a trade deficit since early-1980s**
- ◆ **Macro-economists agree: U.S. trade deficit driven by decline in national savings rate**
- ◆ **U.S. households have high marginal propensity to consume and U.S. government has propensity to run fiscal deficits**
- ◆ **Trade deficit will continue 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

U.S. Current Account 1980-2017 (millions of \$)



U.S. Savings and Trade Balance

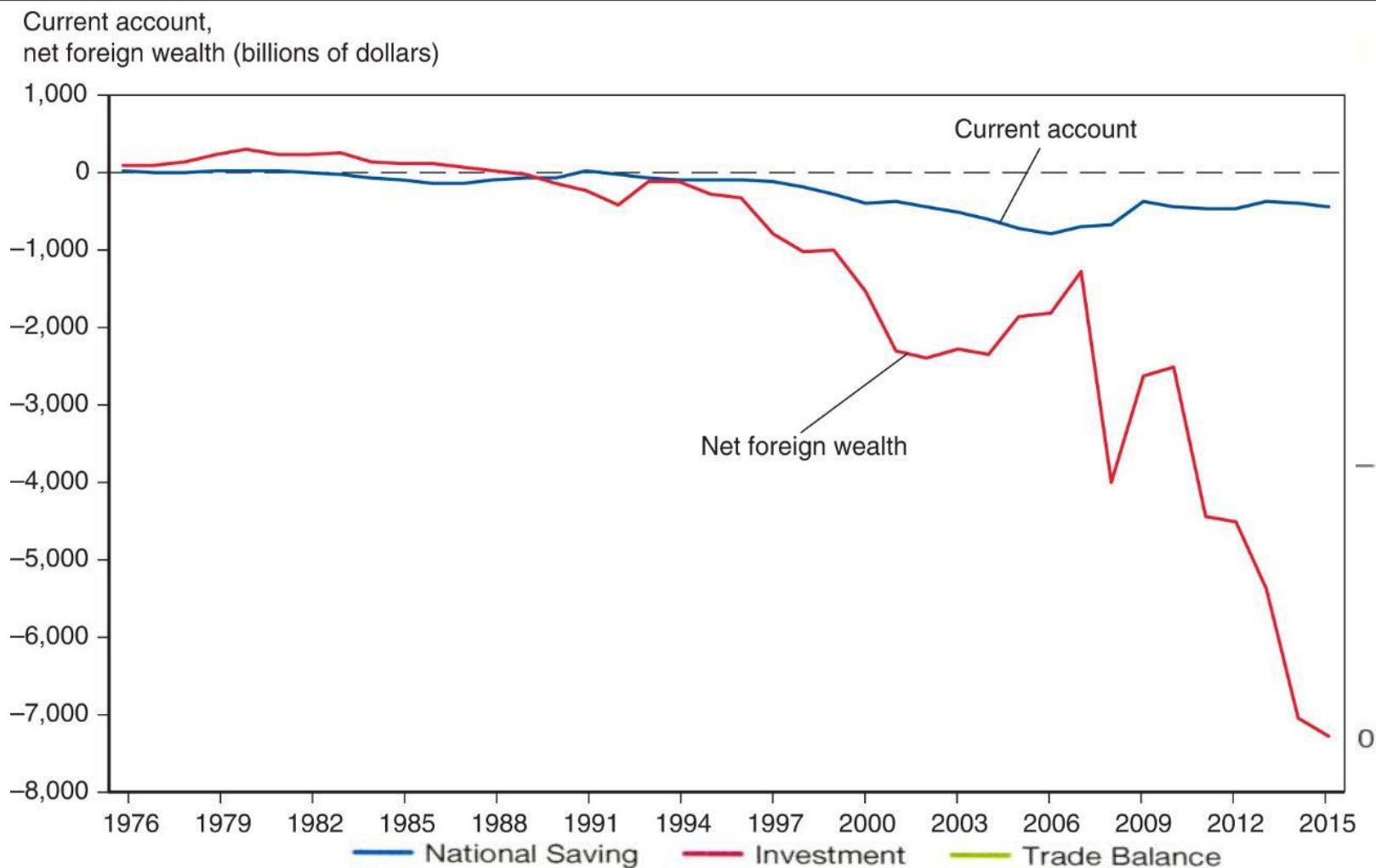


Source: Bureau of Economic Analysis

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**

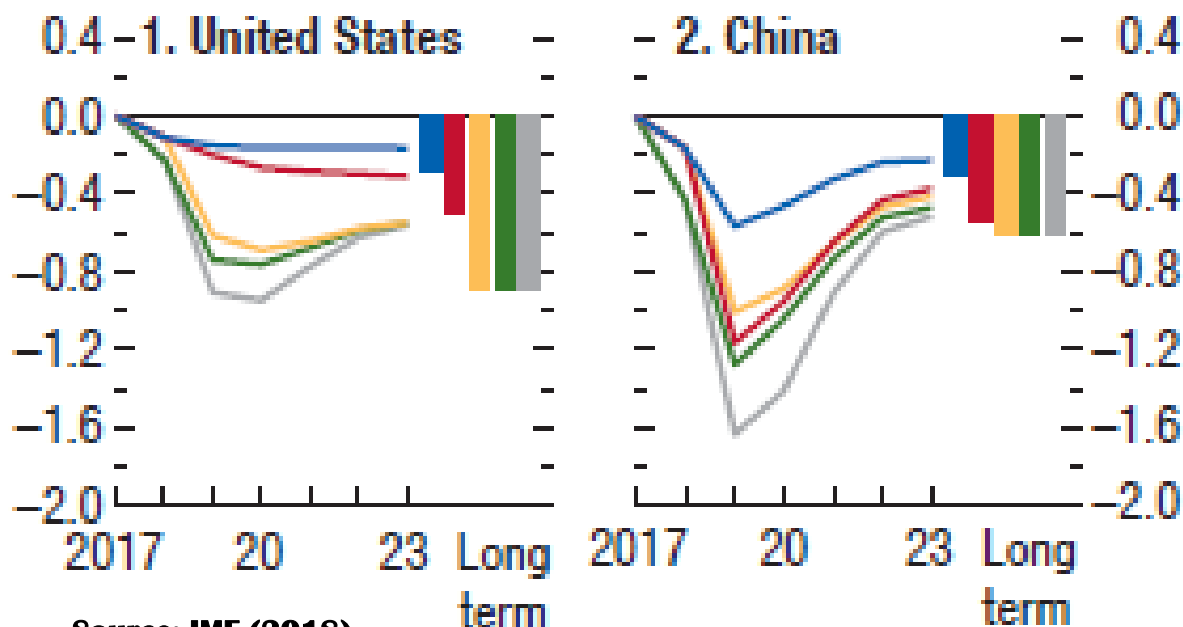
U.S. - China Trade Issues

- ◆ **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.**

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)

Is a Recession Coming?

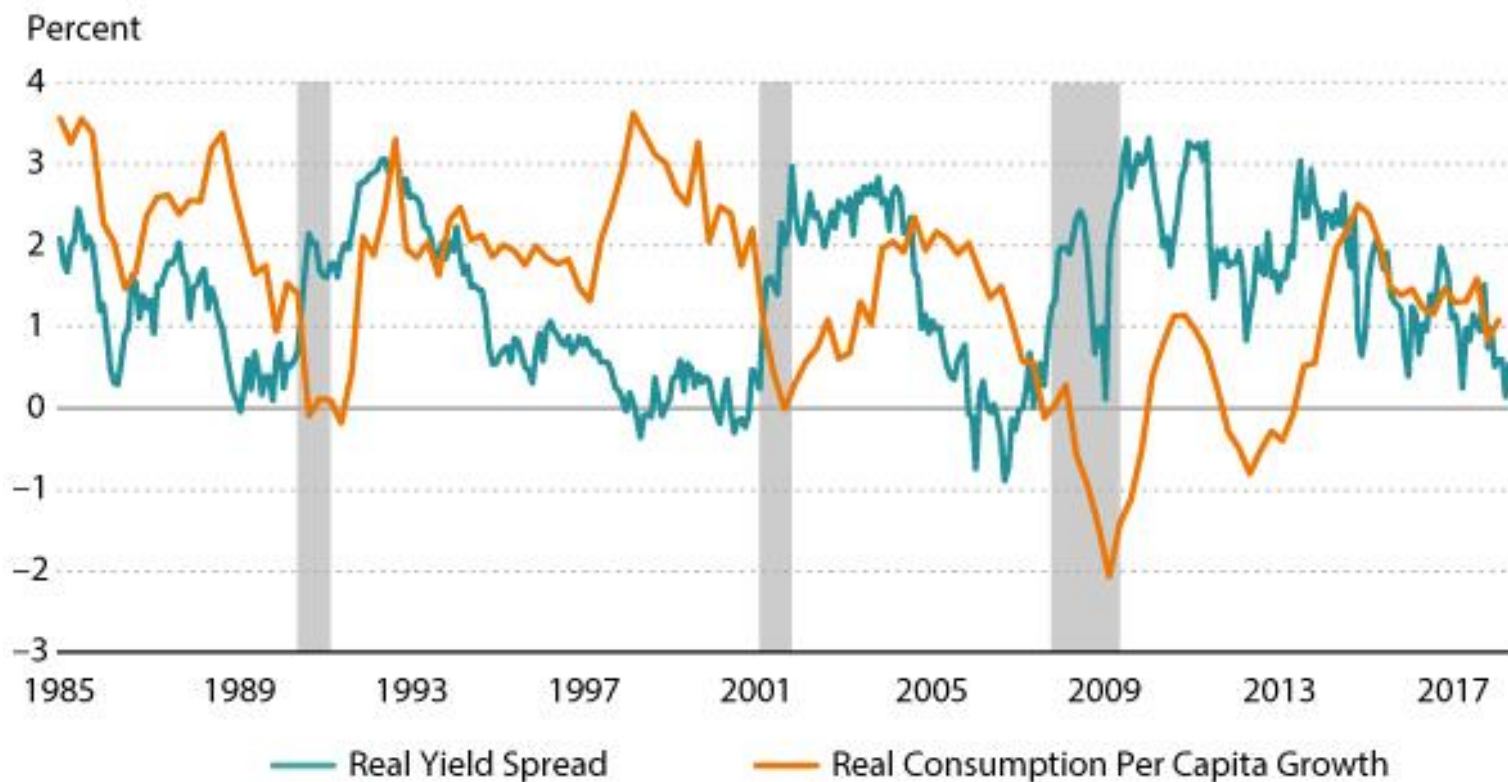
- ◆ **Global growth forecast to drop in 2019-20 due to slowdown in developed world (World Bank, 2019)**
- ◆ **Pessimism also driven by prospect of “no-deal” Brexit and more aggressive U.S.-China trade war**
- ◆ **China’s economy also expected to slow from 6.9% in 2017 to 6% in 2021, with spillover effects 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**