

Global Economic Outlook: Risks from the Trade War

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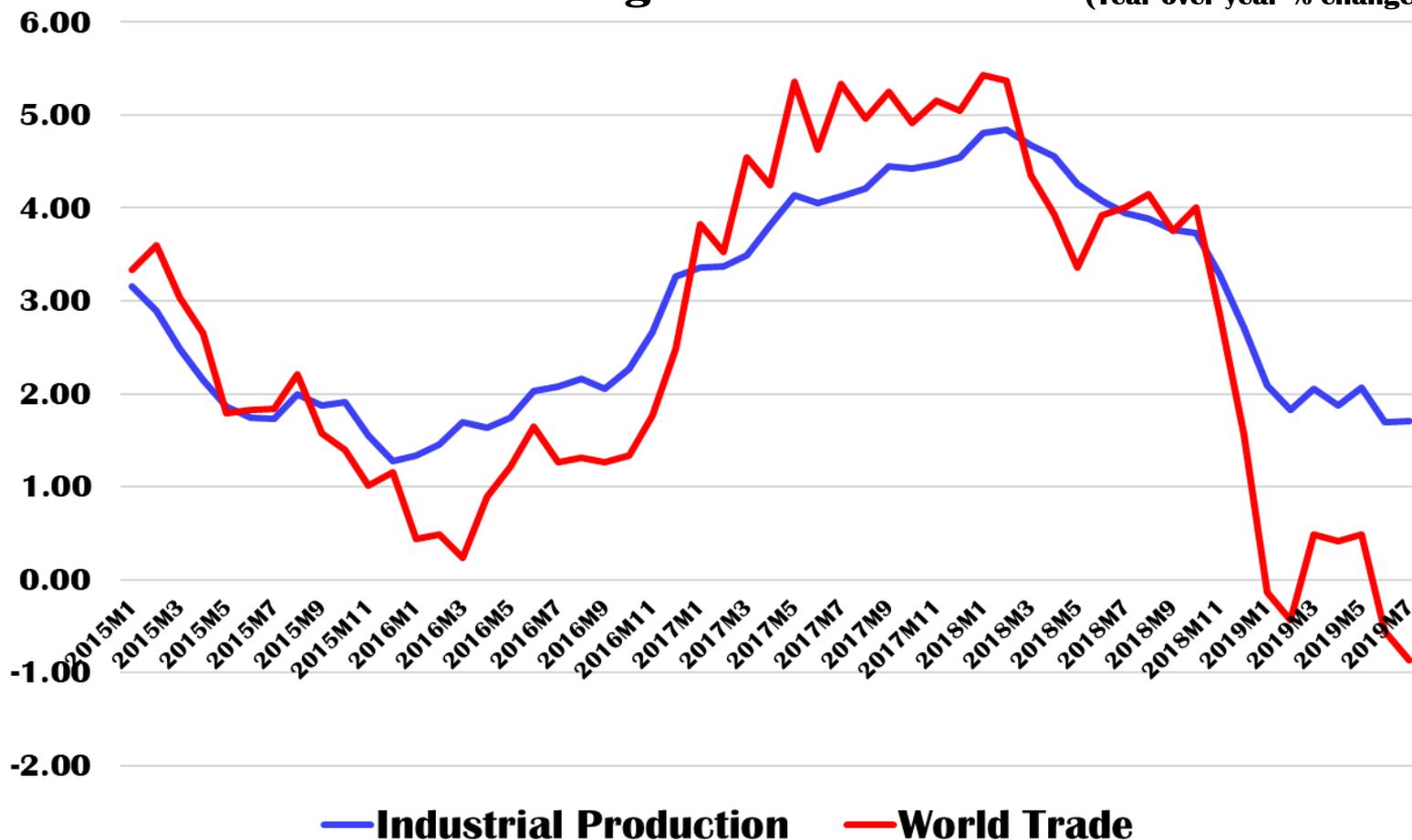
Global Economic Outlook

- ◆ **Over past year, broad-based slowdown in global economy in terms of industrial production and trade (Figure 1)**
- ◆ **Driven by:**
 - **Downturn in auto production and sales**
 - **Weak business confidence due to US-China trade war**
 - **Slowdown in Chinese economy**
- ◆ **Slowdown in industrial production has fed into decline in trade growth (Figure 2)**

Industrial Production and Trade

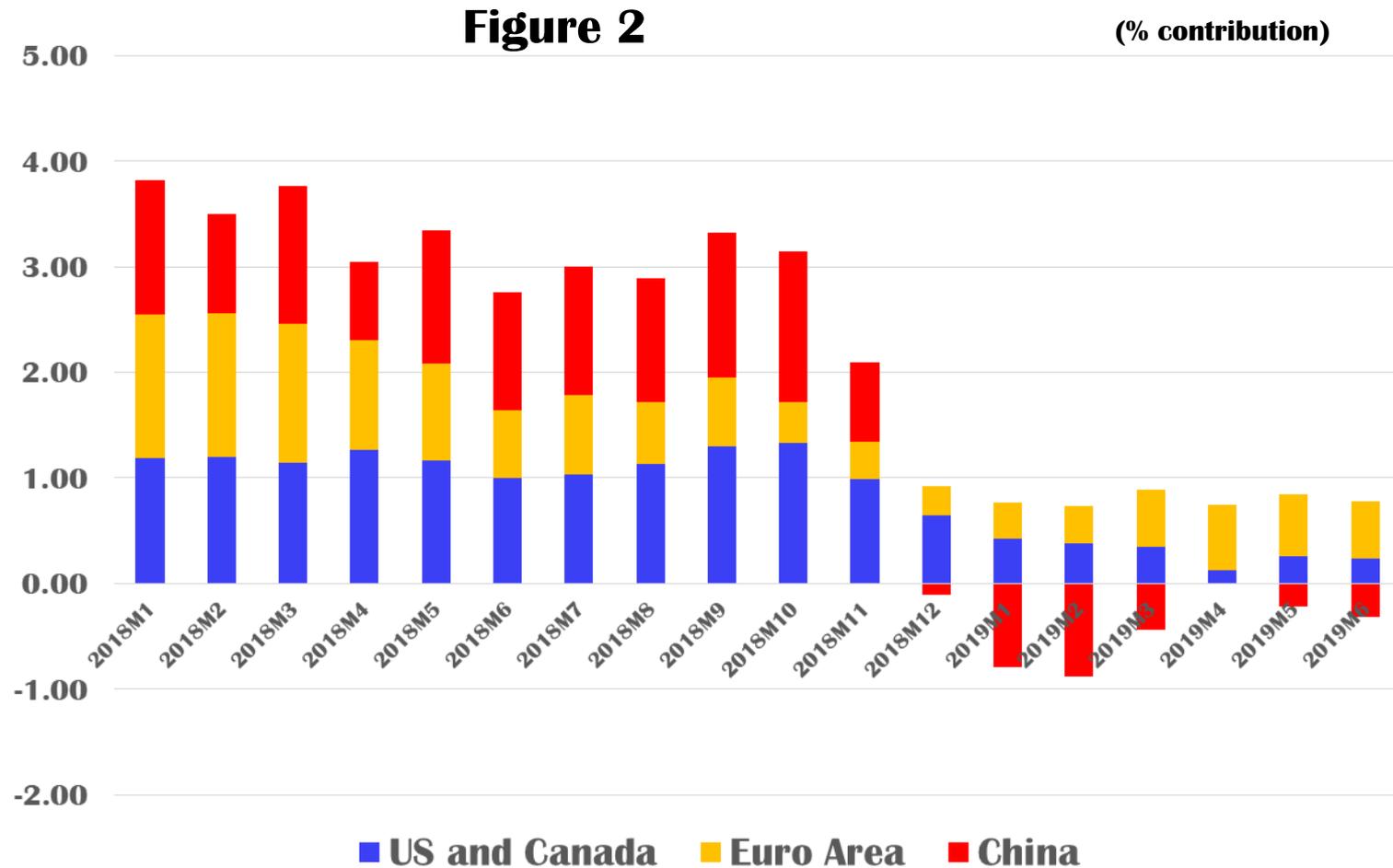
Figure 1

(Year-over-year % change)



Source: IMF, October 2019

Contribution to Global Imports

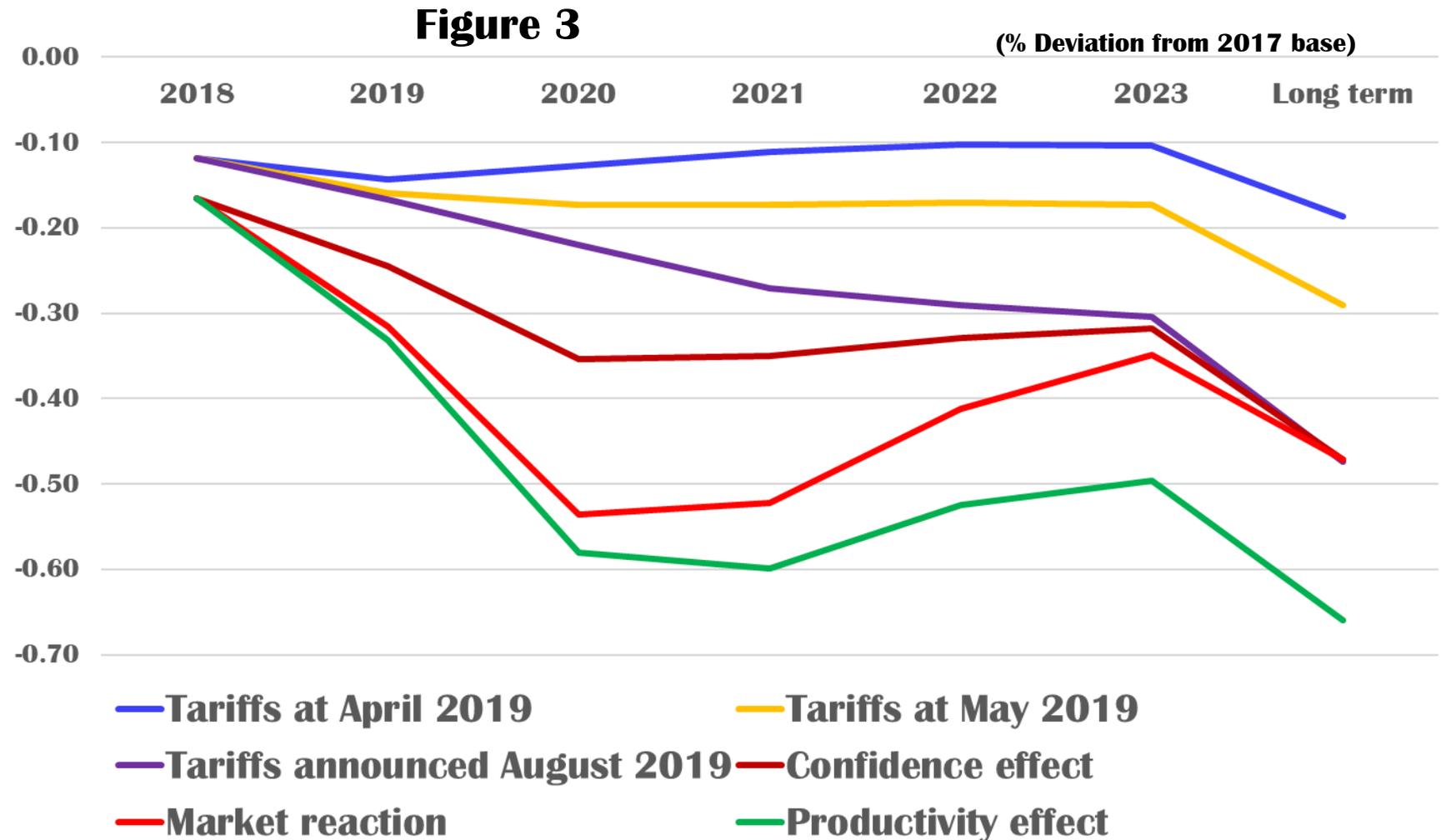


Source: IMF, October 2019

Risks Skewed to Downside

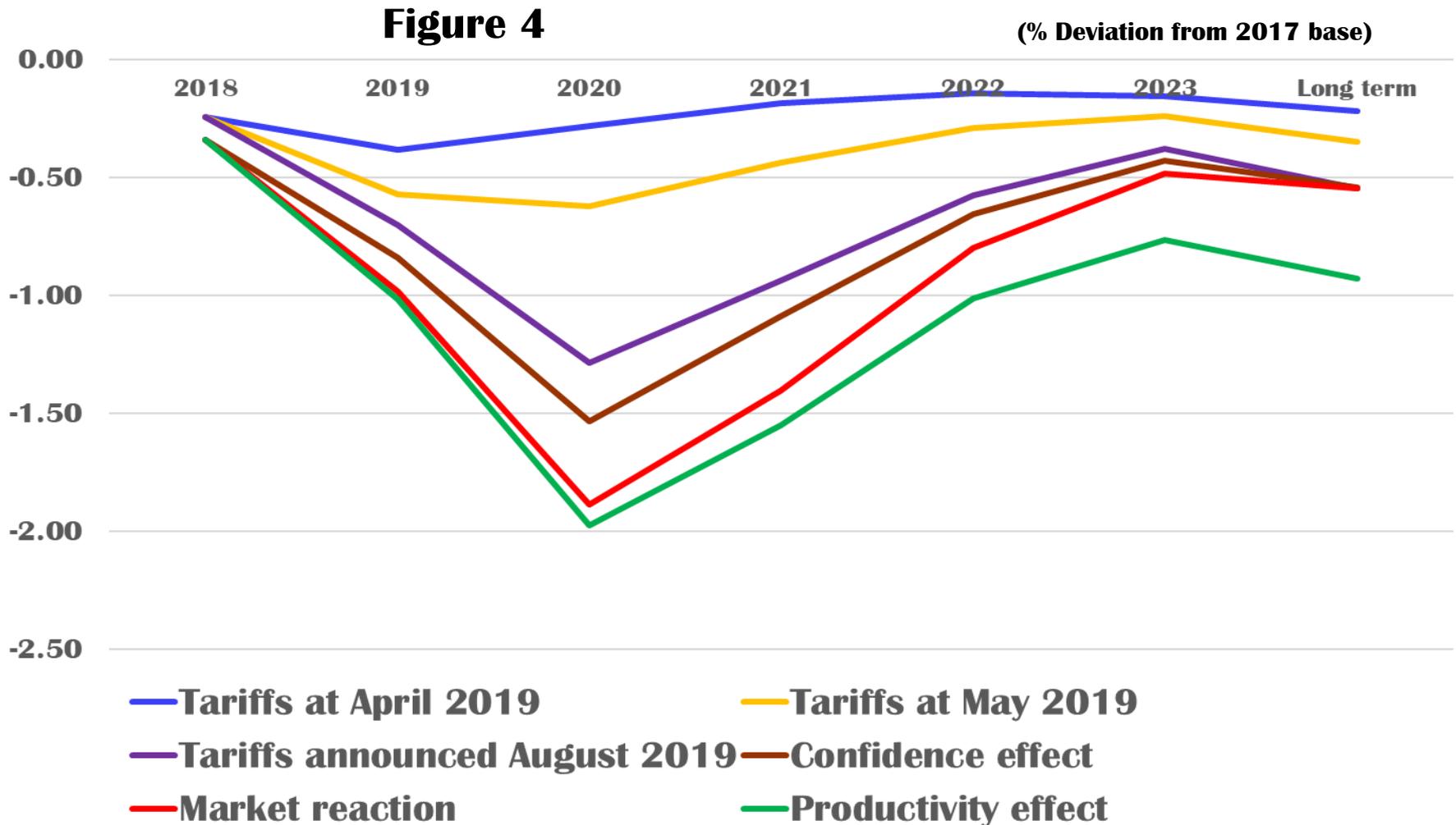
- ◆ **Risks: (i) disruptions to trade/supply chains, (ii) declines in risk appetite/flight to safe assets, (iii) political uncertainty and conflict**
- ◆ **IMF forecasts that if US-China trade war continues, cost to global economy of \$700 billion by end of 2020**
- ◆ **Both US and China affected by ratcheting up of trade war (Figures 3 and 4)**
- ◆ **General view: reduce trade tensions and return to solving issues via multilateral system, i.e., WTO**

Impact on Real US GDP



Source: IMF, October 2019

Impact on Real Chinese GDP



Source: IMF, October 2019

Why Take on China?

- ◆ **Increase US market access: instigated trade war via “power-based bargaining” (Figure 5)**
- ◆ **Reduce US trade deficit: but tariffs very unlikely to succeed as it is a macroeconomic issue, i.e., low US savings rate and fiscal deficit (Figure 6)**
- ◆ **Target exchange rate manipulation: prior to August 2019, China did *not* meet key criteria of either IMF or US Treasury**
- ◆ **Concerns over Chinese trade practices: risks to unilateral approach**

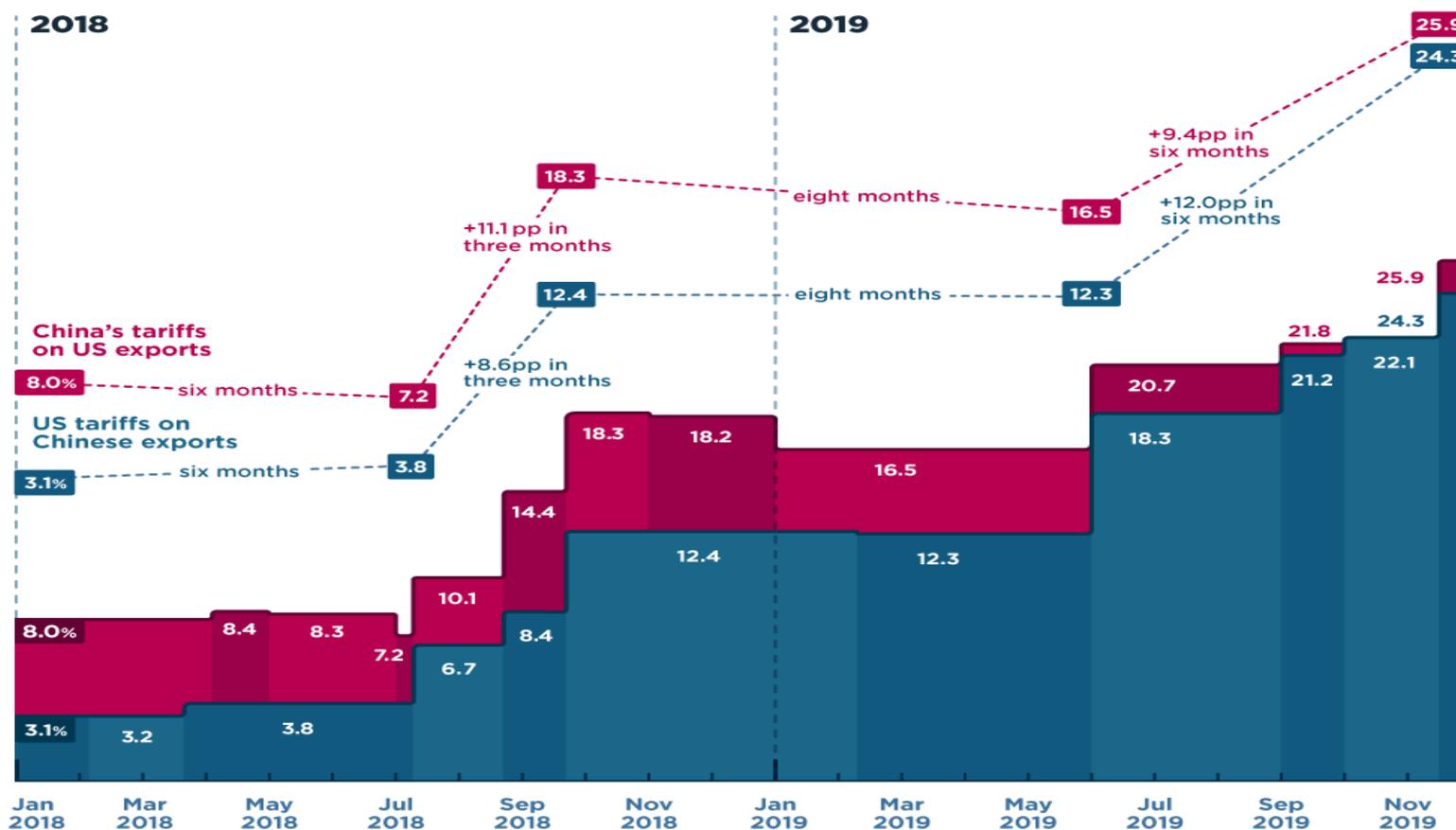
US Trade Policy: Power-Based

|   US China | LOWER AVERAGE TARIFFS | HIGHER AVERAGE TARIFFS |
|---|---|---------------------------------------|
| LOWER AVERAGE TARIFFS | GATT/WTO Average MFN=3.4% | Power-based Bargaining |
| HIGHER AVERAGE TARIFFS | Accession to WTO Average MFN=9.6% | Trade war |

Trade War has Intensified

Figure 5

Average tariff rate, percent



2018

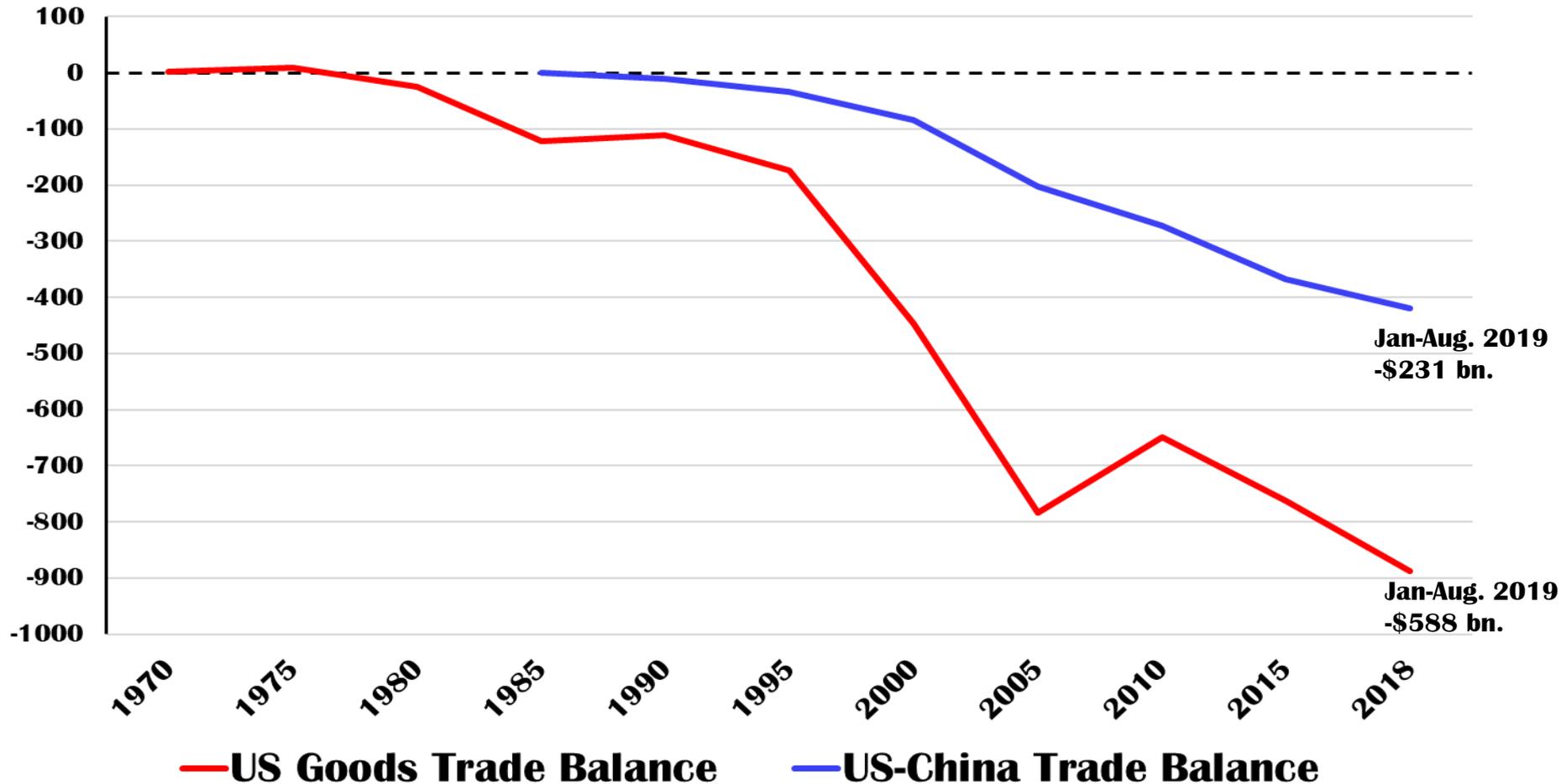
2019

Source: Bown, PIIE, 8/29/19

US Goods Trade Balance

Figure 6

(\$ billion)

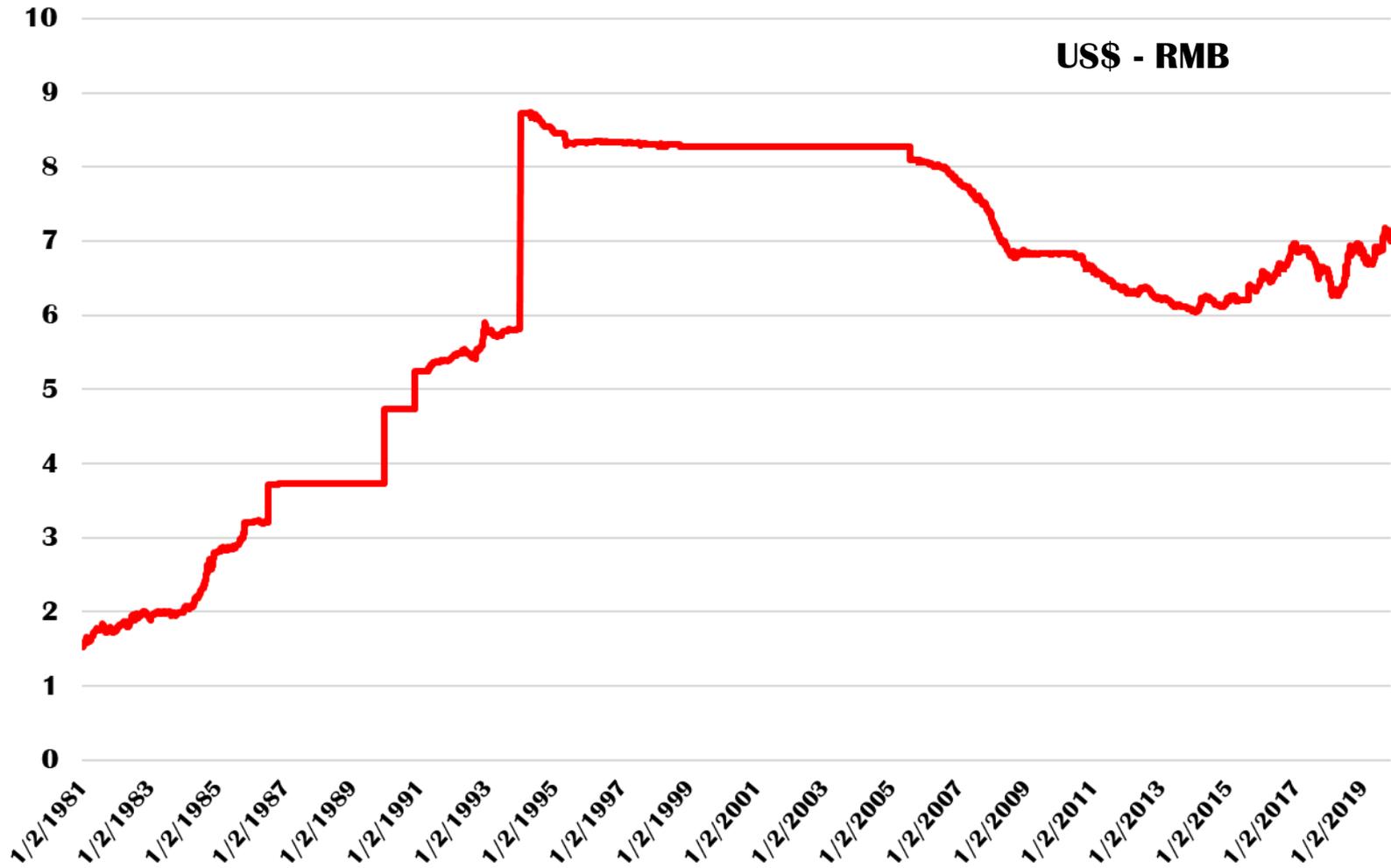


Source: US Census Bureau, October 2019

Chinese Currency Manipulation?

- ❖ **Criteria for manipulation: (i) intervention to push down value of currency, (ii) large current account surplus, (iii) bilateral trade surplus with US**
- ❖ **Pre-2014 China slowed down appreciation of RMB, but then spent \$1trillion propping up RMB over 2015-16**
- ❖ **2016-18: China's current account surplus averaged 1% of GDP (US Treasury cutoff is 3%)**
- ❖ **Even if US had balanced trade and no currency manipulation, it could still have bilateral trade deficit with China**
- ❖ **US tariffs necessarily lead to depreciation of RMB**

China's Exchange Rate



Source: Macrotrends, November 2019

Chinese Trade Practices

- ◆ **Concerns about China's trade practices well-documented (USTR, 2018):**
 - **Forced technology transfer**
 - **Discriminatory licensing restrictions**
 - **Theft of intellectual property**
 - **Investment restrictions**
 - **Subsidies to state-owned enterprises (SOEs)**
- ◆ **Key issue: extent to which “China, Inc.” makes it difficult to prove Chinese state is breaking WTO rules (Wu, 2016)**

Go to WTO with “Big Case”

- ◆ **WTO case could be made under GATT Article XXIII that one or more Chinese measures “nullify or impair” benefits of US and other WTO members**
- ◆ **Argued only way to approach this is through “grand coalition” of countries (Hillman, 2018)**
- ◆ **US frustrated with WTO dispute settlement**
- ◆ **Problem with US unilateral approach:**
 - **“Shallow” deal**
 - **“Free-riding”**
 - **Potential to undermine WTO**

Phase 1 of Trade Agreement

◇ What's In?

- **Pause in tariff escalation**
- **Concessions on intellectual property**
- **Commitments on agricultural imports**
- **Currency commitments by China**

◇ What's Not?

- **Nothing done to address China's use of subsidies targeted to SOEs**
- **Key impetus to trade war in first place – but unlikely to be solved unilaterally by US**

Conclusions

- ❖ **Trade war already imposing costs on US, which will increase as trade war intensifies**
- ❖ **Significant downside risk to global economy**
- ❖ **US-China trade deal likely to be “shallow”, targeted at trade deficit with little focus “behind the border” (except perhaps IP protection)**
- ❖ **A coalition of WTO members would likely be more appropriate way to deal with China**
- ❖ **Failure of US to follow rules-based trading system runs risk China will not follow system if (when) it becomes dominant economic power**