The Trade Outlook: Where Are We Headed?

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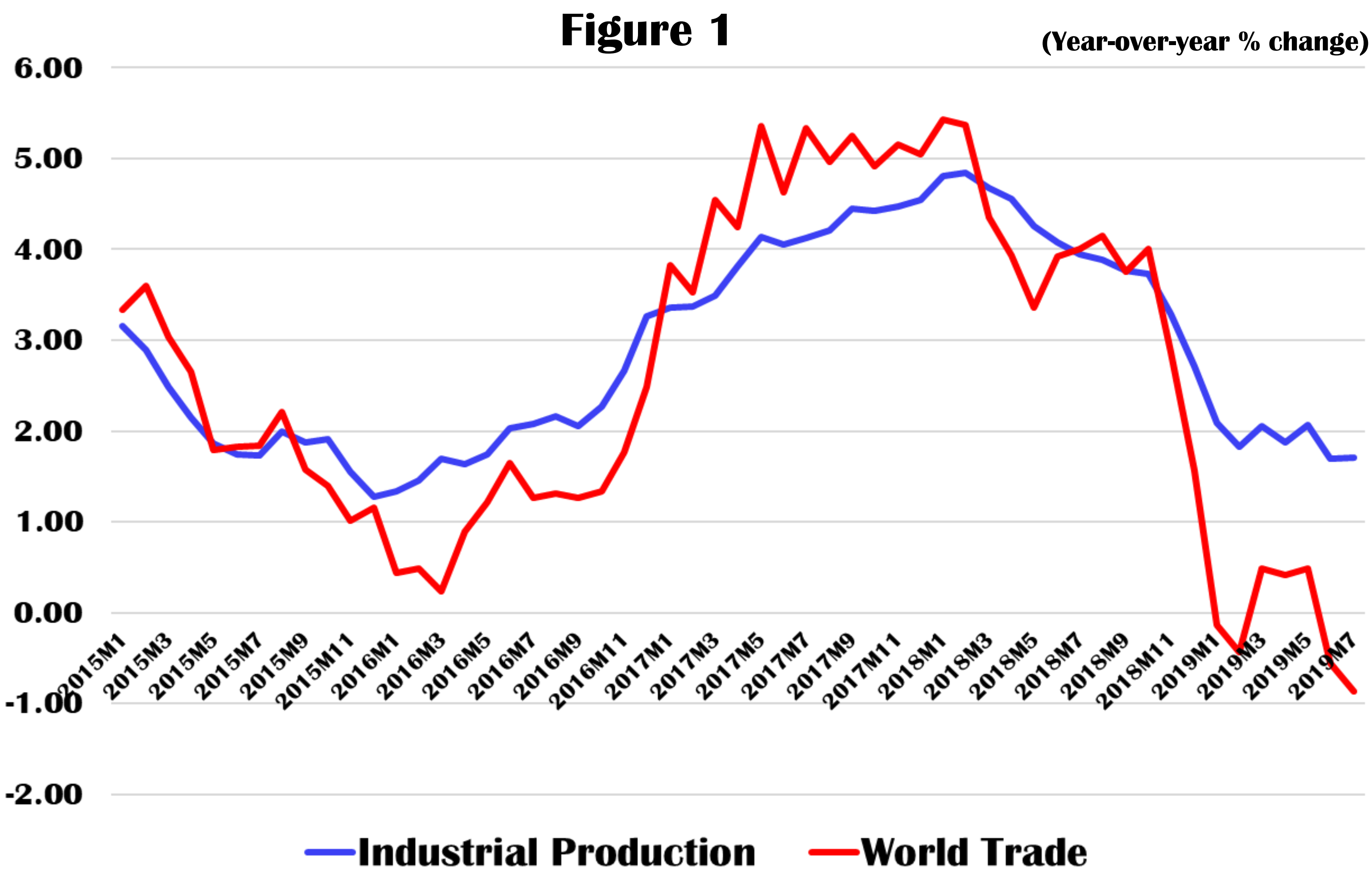
Global Economic Outlook

- 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)

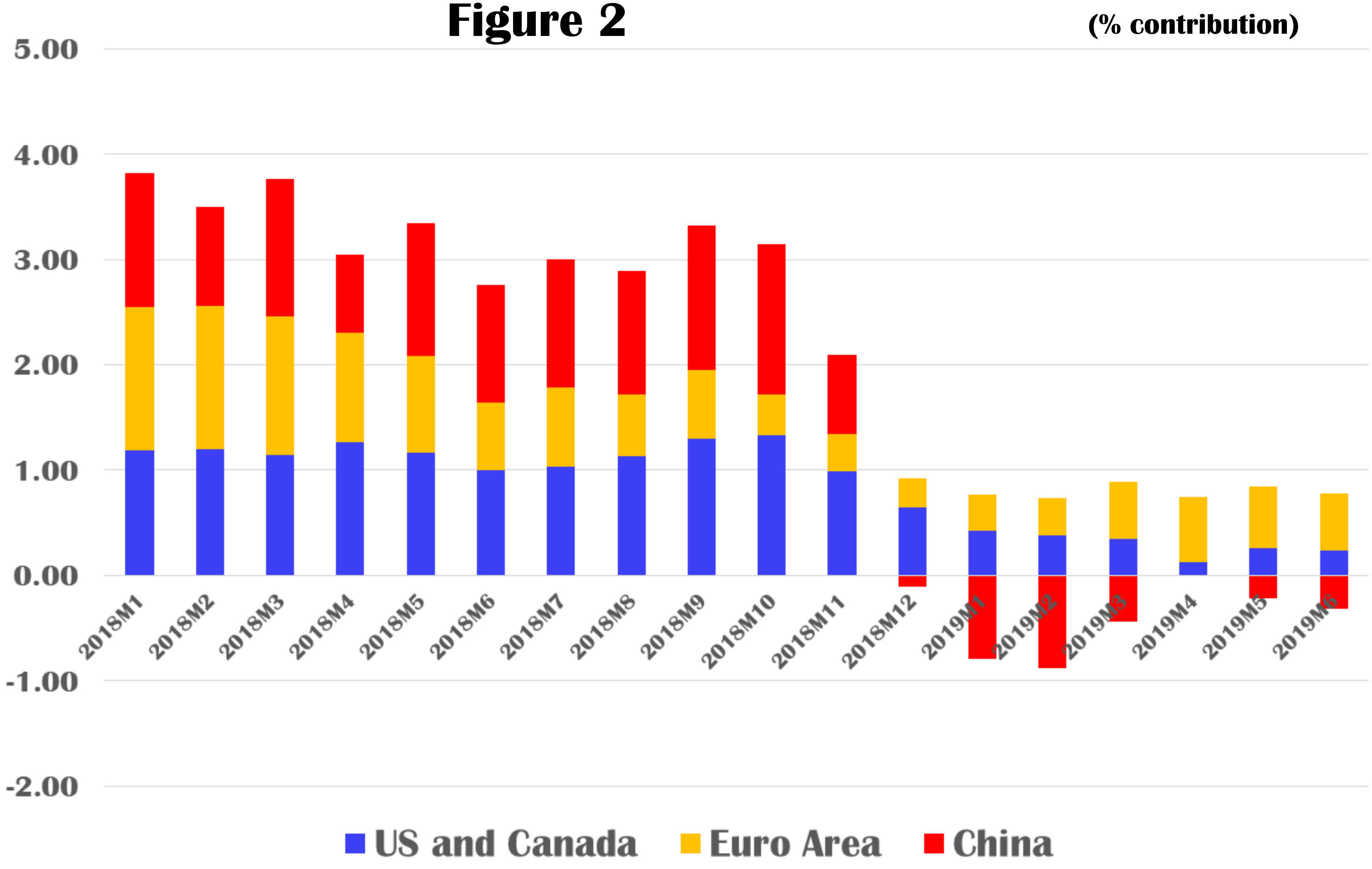
Industrial Production and Trade



Source: IMF, October 2019

Contributions to Global Imports

Figure 2

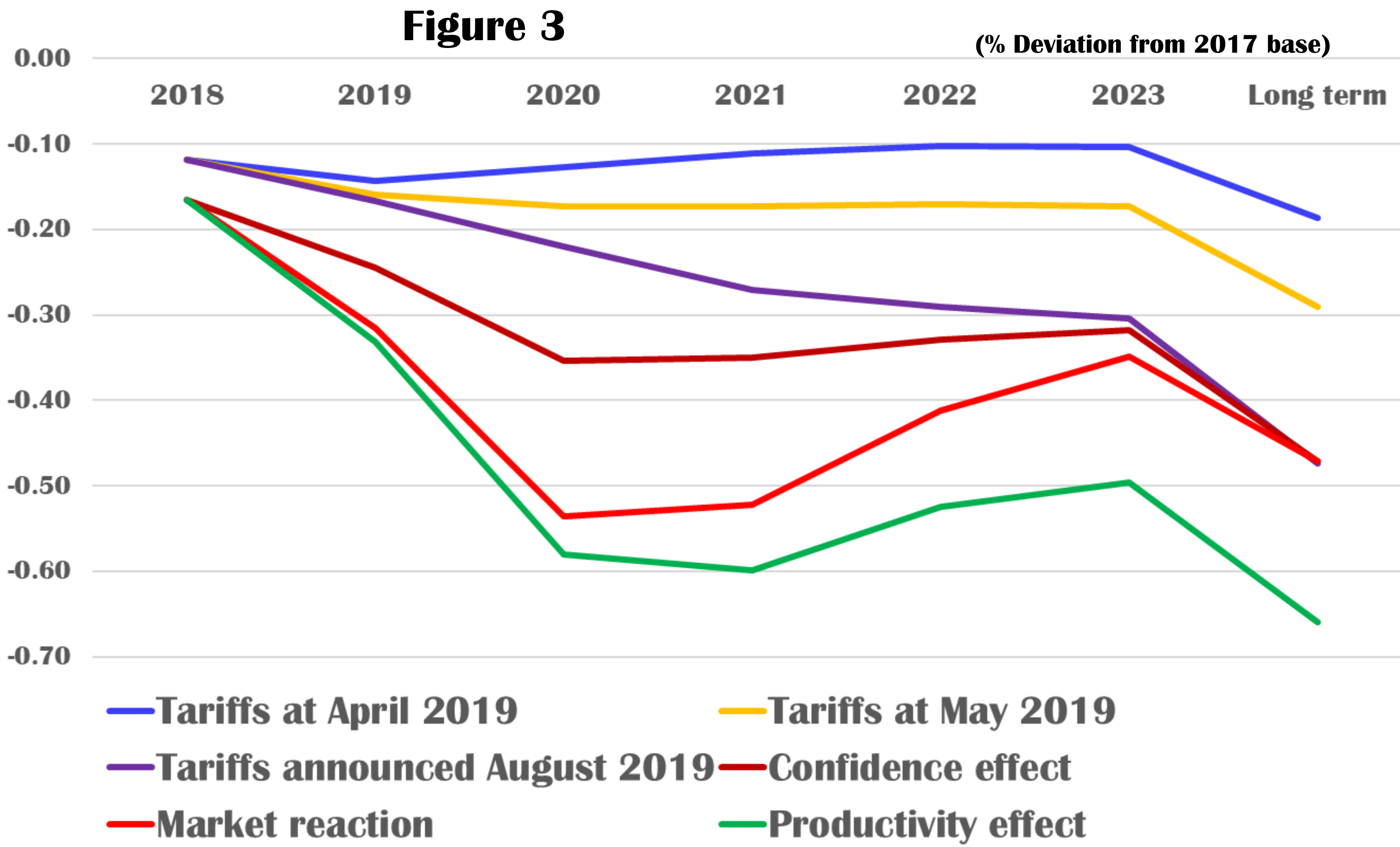


Source: IMF, October 2019

Risks Skewed to Downside

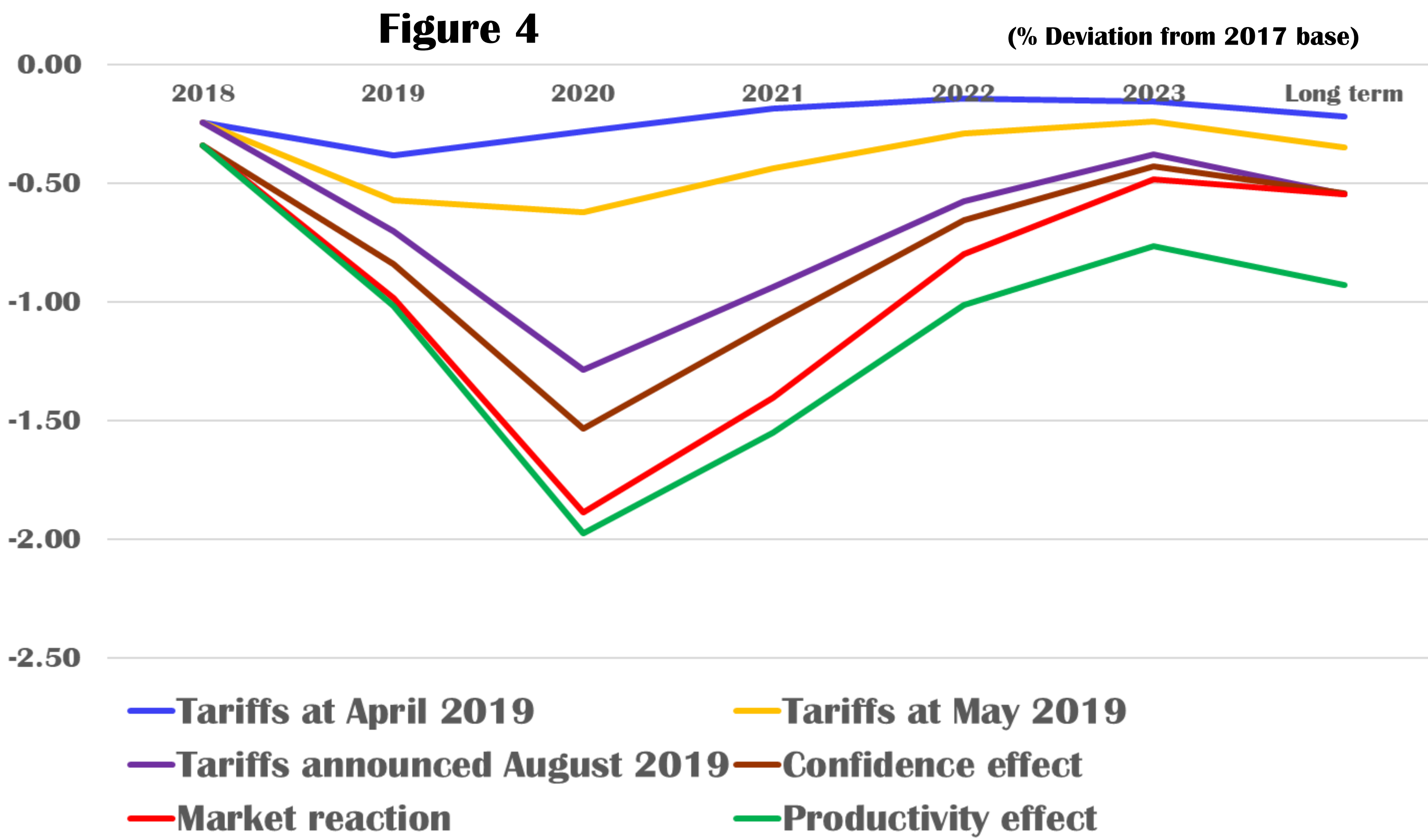
- Risks: (i) disruptions to trade/supply chains, (ii) declines in risk appetite/flight to safe assets, (iii) political uncertainty and conflict
- IMF forecasts that if US-China trade war were to continue, cost to global economy of $700 billion by end of 2020
- Both US and China affected by ratcheting up of trade war (Figures 3 and 4)
- View of IMF, World Bank and others: 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

Context: US-China Trade Issues

- Tensions have risen over Chinese trade and economic policies – key reason for current trade war:
  - Extensive network of industrial policies that protect domestic sectors/firms – especially state-owned enterprises (SOEs)
  - Failure to provide protection for intellectual property rights (IPRs) and forced technology transfer
  - China has not met all obligations since accession to World Trade Organization (WTO) in 2001
  - Government-directed financial policies promoting high savings (low private consumption), investment (creating excess capacity), and exchange rate policy

Phase One Trade Deal with China

- USTR Fact Sheet (December 13, 2019) outlines 7 chapters of Phase One Trade Deal:
  - *Intellectual Property*: commitment by China to prevent theft of IPRs
  - *Technology Transfer*: commitment by China to stop forced transfer of technology as condition of market access
  - *Agriculture*: removal of non-tariff barriers on US products such as meat and poultry
  - *Financial Services*: removal of barriers to US providers of financial services

Phase One Trade Deal with China

- ***Currency***: commitments by China to refrain from competitive devaluation of RMB, and to promote transparency in accounting
- ***Expanding Trade***: China has committed to expanding imports of goods and services from US by $200 billion/annum over next two years

  Specific commitment to increase agricultural imports to $40 billion/annum by 2020
- ***Dispute Resolution***: arrangement to ensure effective implementation of agreement and timely resolution of bilateral disputes

Tariff Commitments

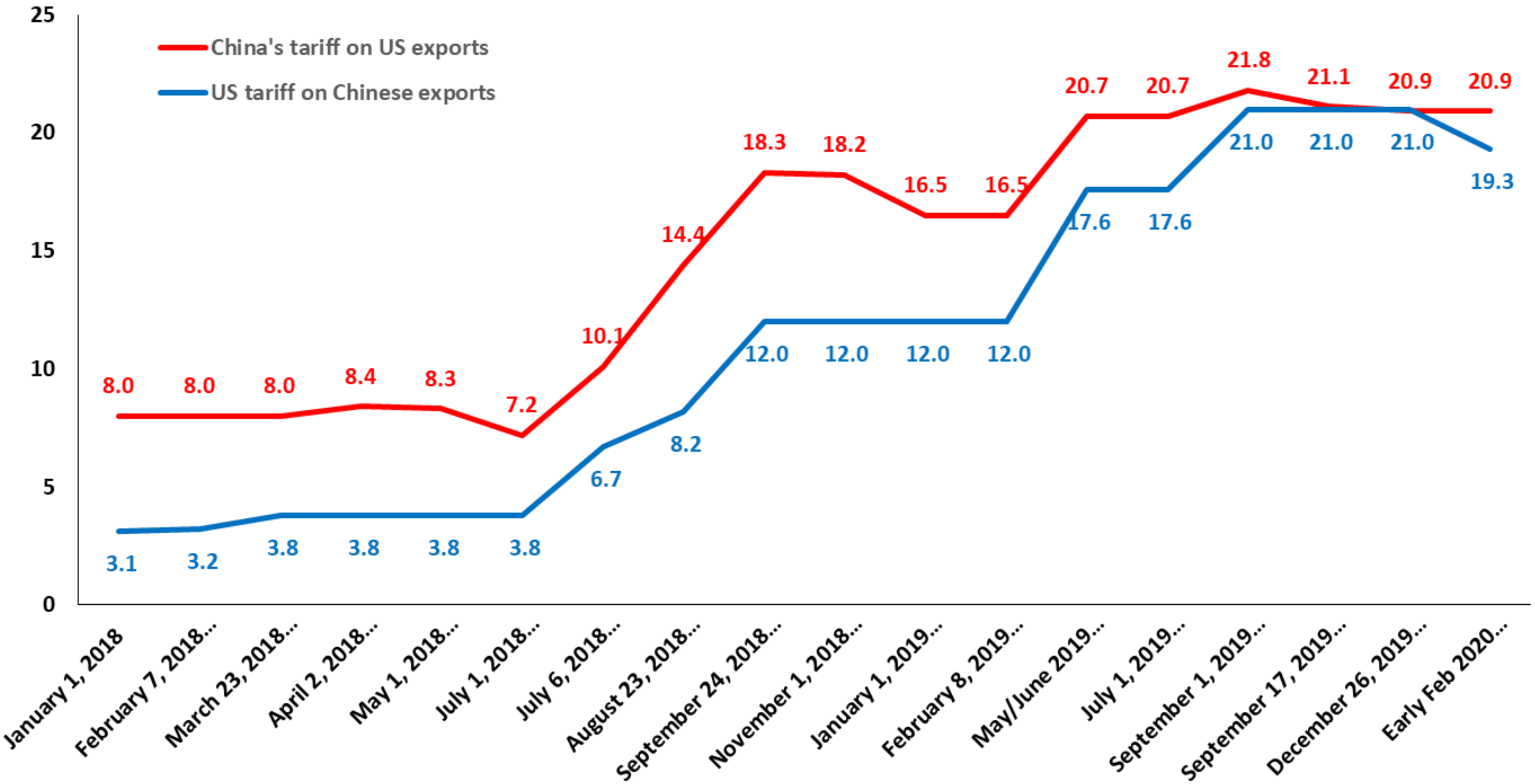
- US actions on tariffs:
  - 15% tariffs on $162 billion of imports, scheduled for December 15, not imposed
  - Tariffs on $100 billion of imports imposed on September 1, 2019 will be reduced to 7.5%
  - 25% tariffs on $250 billion introduced in 2018 will remain in place
- China's actions on tariffs:
  - Will not impose retaliatory tariffs due on December 15

Assessment of Deal

- **Tariffs:**
  - **Pause in tariff escalation – but no removal of existing tariffs**
  - **Average US tariff remains at 19.3%, covering 65% of imports from China**
  - **Average Chinese tariff remains at 20.9% covering 57% of imports from US**
- **Overall Import Commitments by China:**
  - **Increasing imports of goods and services up to $200 billion/annum seems inconsistent with China maintaining its tariffs**

Pause in Tariff Escalation

Figure 5



Source: Bown, PIIE, 12/19/19

Assessment of Deal

◈ Agricultural Import Commitments by China:

- If met, would be significant boost to US agriculture – dwarfing forecast benefits of USMCA ($2.2 billion/annum increase in exports, USITC, 2019)
- Should be put in context: prior to trade war, China imported $24 billion in 2017, and record of $29.6 billion in 2013 (USDA)
- However, raises several questions:

  (i) Chinese reliance on SOEs to meet commitments

  (ii) Skepticism US can export this much in a year

  (iii) Significant diversion of imports from Brazil to US - could result in WTO dispute

What's Missing?

- No mention of China's use of subsidies and role of SOEs – key to trade war starting in first place
- Talk of additional phases of US-China trade deal probably too optimistic on this issue
- Chinese economy structured in ways not anticipated by WTO (Wu, 2016)
- WTO rules on subsidies have significant shortcomings that have been highlighted by China's economic model (Bown and Hillman, October 22, 2019)

"China, Inc."

- Party controls economy while still taking advantage of benefits of market mechanism, i.e., control is not necessarily directly via state:
  - Party controls "commanding heights" of economy
  - Party controls and directs largest banks
  - Party coordinates government agencies and firms
  - Party-set performance metrics of SOEs, banks etc.
  - Informal linkages between Party and private firms
- Subsidies to Chinese firms are opaque rather than explicitly targeted by the state

Improving WTO Subsidy Rules

- Key reforms required to WTO subsidy rules (Bown and Hillman, PIIE, October 2019):
  - Redefine what counts as a subsidy given Chinese economic model
  - Burden-of-proof needs reversing, i.e., China should have to show its subsidies are benign
  - New system of enforcement required, i.e., anti-dumping policies ineffective
- A coalition of WTO members would likely be more appropriate way to deal with “China Inc.” (Hillman, June 2018)

Conclusions

- Trade war has already imposed costs on US, which will only be partially reduced with Phase One Trade Deal, i.e., tariffs still in place
- Deal rather "shallow", i.e., targeted at US-China bilateral trade deficit, with no focus on Chinese subsidies and SOEs
- A coalition of countries probably a better way to deal with China's violation of WTO rules
- Failure of US to follow rules-based trading system (WTO) runs risk China will not follow system if (when) it becomes dominant economic power