Trade and Tariffs: Collateral Damage and Unintended Consequences

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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
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

- About 1% knocked off US GDP growth since start of trade war (Figure 3)

- 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

Figure 3 (% Deviation from 2017 base)


-0.70 -0.60 -0.50 -0.40 -0.30 -0.20 -0.10 0.00

- Tariffs at April 2019
- Tariffs at May 2019
- Tariffs announced August 2019
- Confidence effect
- Market reaction
- Productivity effect

Source: IMF, October 2019
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
- Exchange rate policy
Phase One Trade Deal with China

- 7 chapters in 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
- **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 $36.5 billion (2020) and $43.5 billion (2021)
- **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

◊ 2018-20 impact of tariffs:

• Costs borne by US producers and consumers in form of higher prices ≈ $138 billion
Pause in Tariff Escalation

Figure 4

Source: Bown, PIIE, 12/19/19
Assessment of Deal

Overall Import Commitments by China:

- Increasing imports up to $200 billion/annum seems inconsistent with China maintaining its average tariffs at 20.9%
- Requires 92% increase in US exports of covered goods and services compared to 2017
- Will probably require considerable trade diversion
- China also likely to import goods and services not covered by deal from elsewhere – with potential for negative effects on US jobs
Overall Import Commitments

Figure 5

Total US goods and services exports to China, billions USD

- Goods covered
- Services covered
- Goods and services not covered in phase one deal
- Export value required by phase one deal

2017: $134.2 bn


Source: Bown, PIIE (1/21/20)
Assessment of Deal

Agricultural Import Commitments by China:

- Agriculture has been caught in crossfire of trade war affecting wide range of commodities (Figure 6)
- Significant loss of market share to other major exporters such as Brazil and Australia (Figure 7)
- If deal is 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)
Figure 6: 2017 Value of US Agricultural Exports Facing Retaliation

Source: Grant et al. (2019)
Lost Market Share in China

Figure 7: US Loss of Market Share 2017-18

Source: Grant et al. (2019)
Assessment of Deal

Serious questions raised about agricultural import commitments by China:

- No commodity specifics in agreement
- Some skepticism China can import this much in relatively short period of time (Figure 8)
- Chinese reliance on “managed trade” – cedes a lot of control to them
- Potential for significant diversion of imports from Brazil and other exporters to US - could result in WTO dispute (Figure 9)
Figure 8: US Agricultural Exports to China

2018: $9 bn
2021: $43.5 bn

Source: Bown, PIIE (1/21/20)
Potential for Trade Diversion

Figure 9: Chinese Imports by Sector and Country (2017)

Chinese imports by sector and country, 2017

<table>
<thead>
<tr>
<th>Agriculture</th>
<th>Amount, billions USD</th>
<th>Percent</th>
<th>Source: Bown, PIIE (1/21/20)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oilseeds</td>
<td>US 13.9, Rest of world 25.7</td>
<td>US 35%</td>
<td>Brazil 53, Rest of world 7, Argentina 5</td>
</tr>
<tr>
<td>Meats</td>
<td>1.2 8.3</td>
<td>EU 13, Brazil 27, Australia 20, New Zealand 10, Argentina 20</td>
<td></td>
</tr>
<tr>
<td>Seafood</td>
<td>1.3 6.9</td>
<td>Russia 16, Canada 18, Norway 9, Argentina 6, New Zealand 5</td>
<td></td>
</tr>
<tr>
<td>Cereals</td>
<td>1.5 5.8</td>
<td>Australia 21, Vietnam 25, Thailand 17, Ukraine 15, Argentina 15</td>
<td></td>
</tr>
<tr>
<td>Cotton</td>
<td>1.0 1.3</td>
<td>EU 43, Australia 22, India 9, Uzbekistan 8, Brazil 8, Indonesia 45</td>
<td></td>
</tr>
</tbody>
</table>
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)
Conclusions

- Costs of trade war only partially reduced with Phase One Trade Deal, i.e., tariffs still in place

- Chinese commitments: IP protection, technology transfer, non-tariff barriers/agricultural imports, and trade in services

- Is “managed trade” the way to go?

- Will enforcement of deal work?

- Unlikely to lower US trade deficit (Figure 10)
US Goods Trade Balance

Figure 10

US Goods Trade Balance  US-China Trade Balance

($ billion)

Jan-Nov. 2019
-$791 bn.

Jan-Nov. 2019
-$321 bn.

Source: US Census Bureau, January 2020