Trade and Tariffs: Collateral Damage and Unintended Consequences

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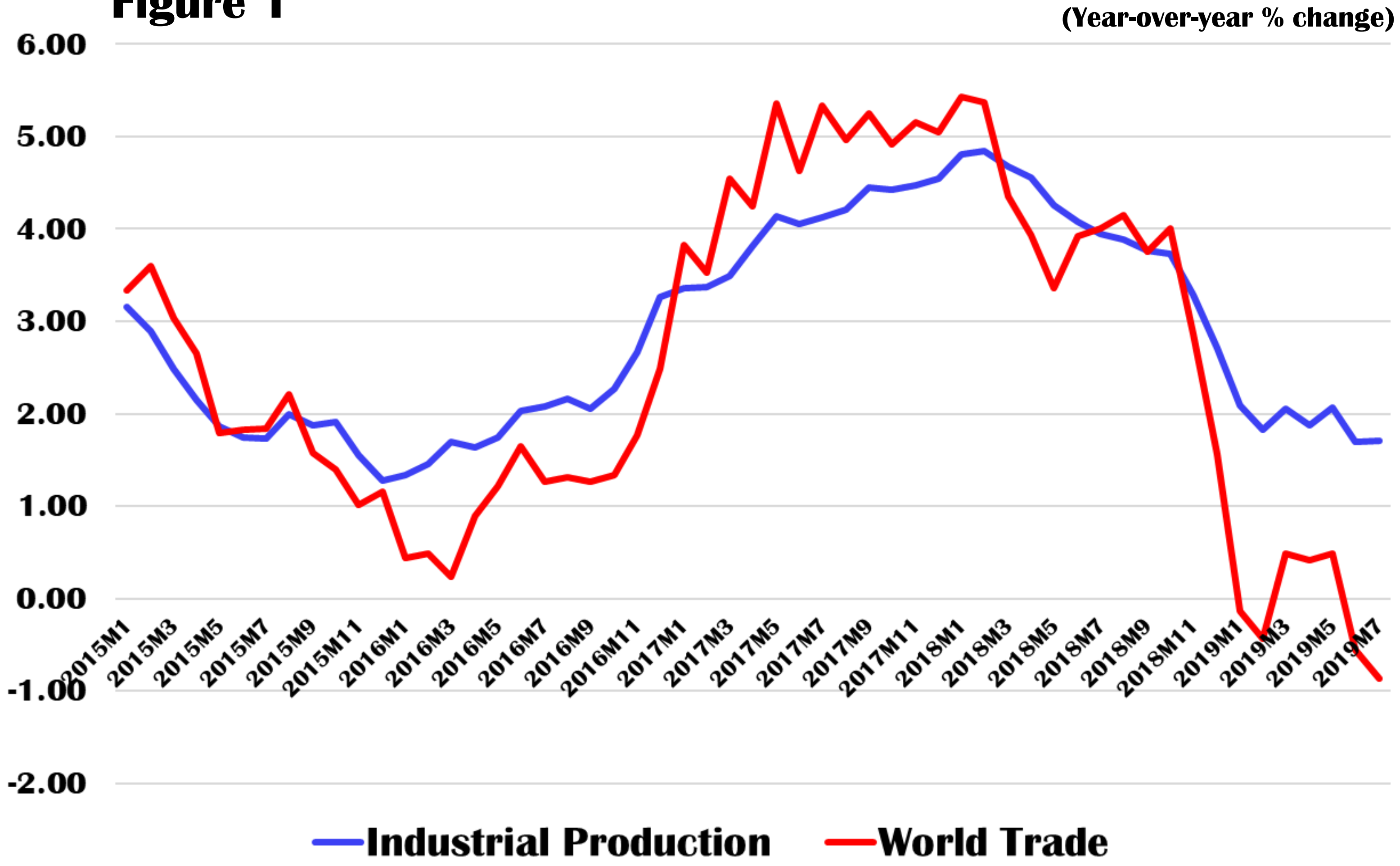
Global Economic Outlook

- 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

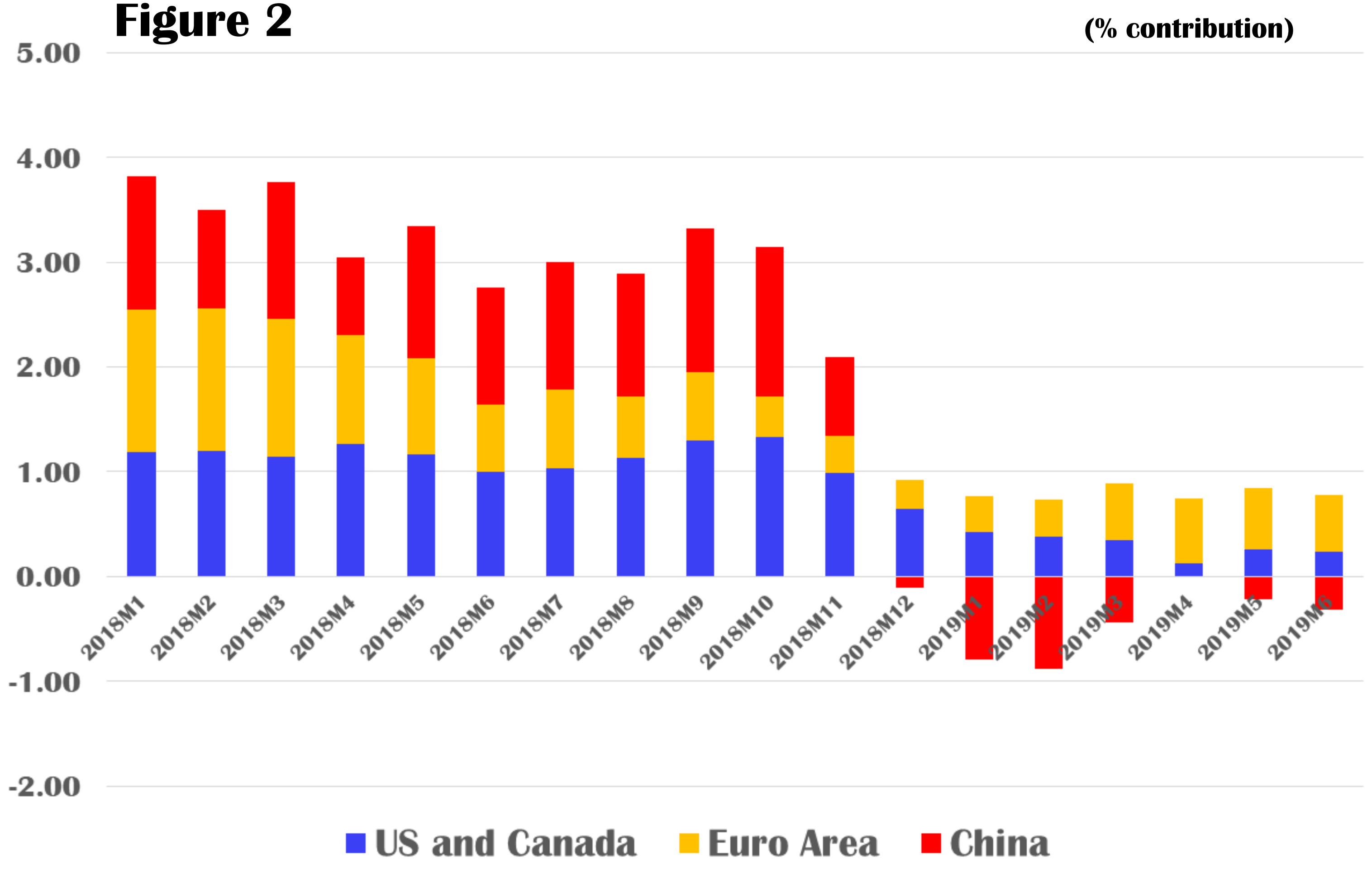
Figure 1



Source: IMF, October 2019

Contributions to Global Imports

Figure 2

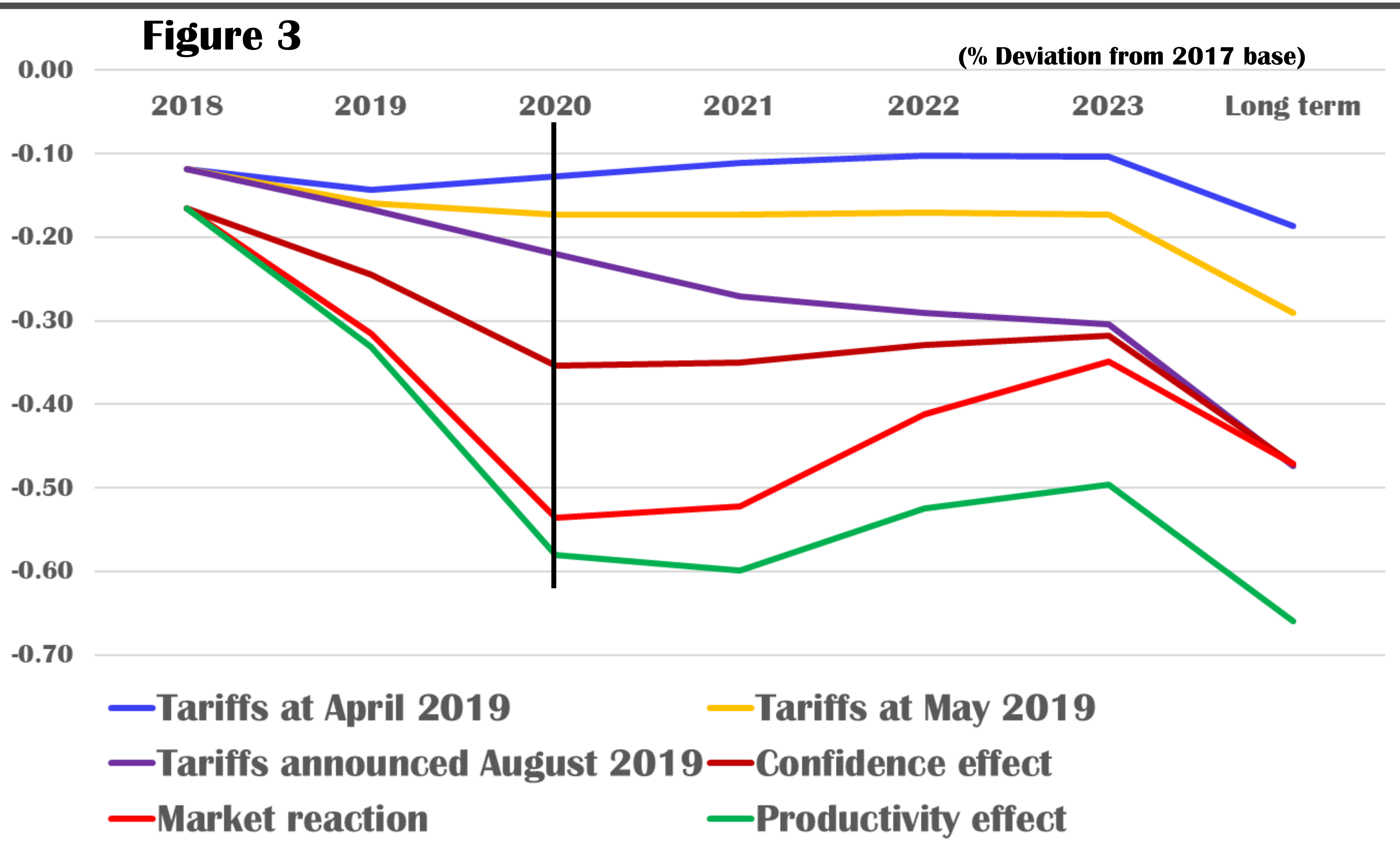


Source: IMF, October 2019

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



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
  - 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 (2021)
- ***Dispute Resolution***: arrangement to ensure effective implementation of agreement and timely resolution of bilateral disputes

Tariff Commitments

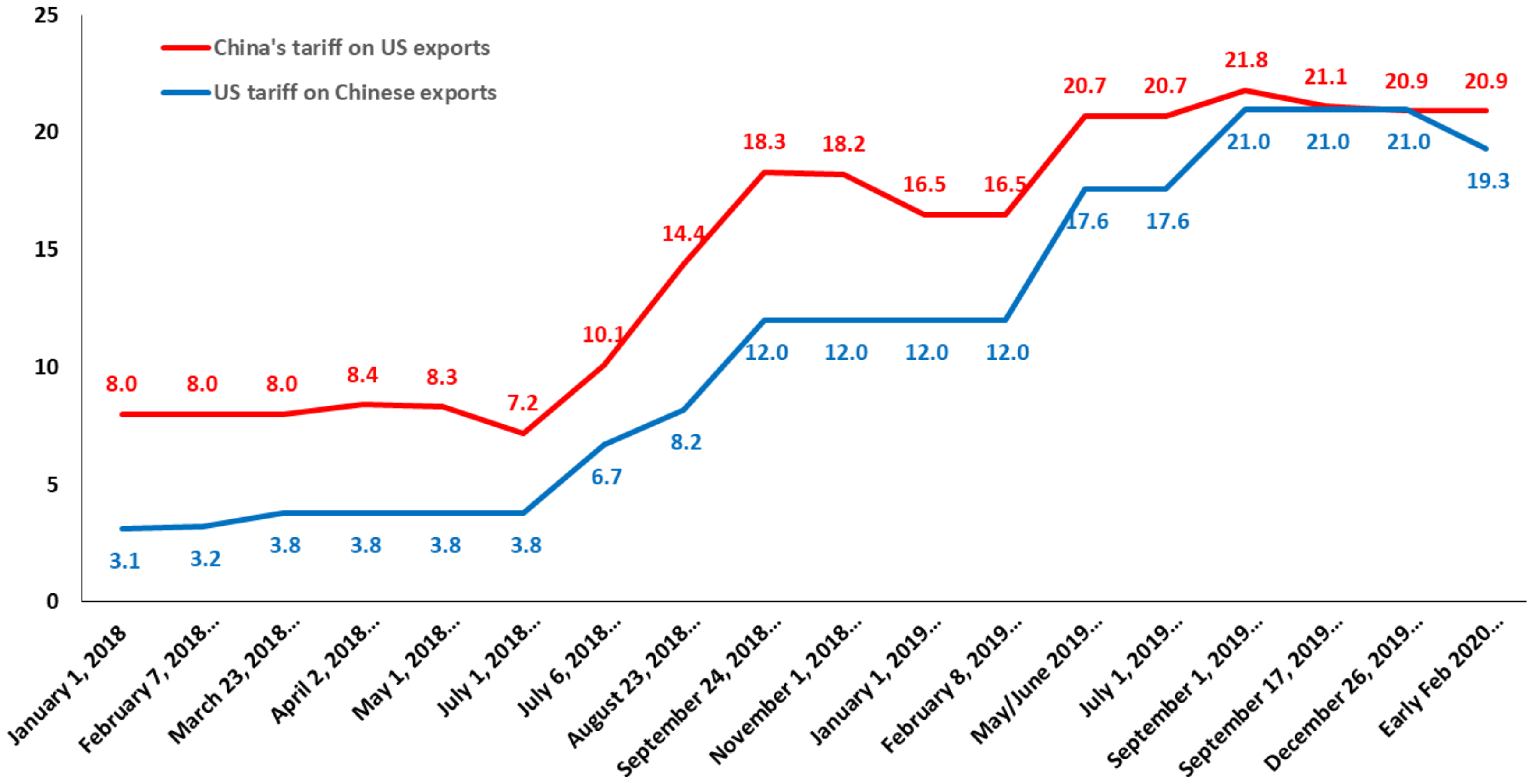
- US actions on tariffs:
  - 15% tariffs on $162 billion of imports, scheduled for December 15, not imposed
  - Tariffs on $100 billion of imports imposed on September 1, 2019 will be reduced to 7.5%
  - 25% tariffs on $250 billion introduced in 2018 will remain in place
- China's actions on tariffs: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

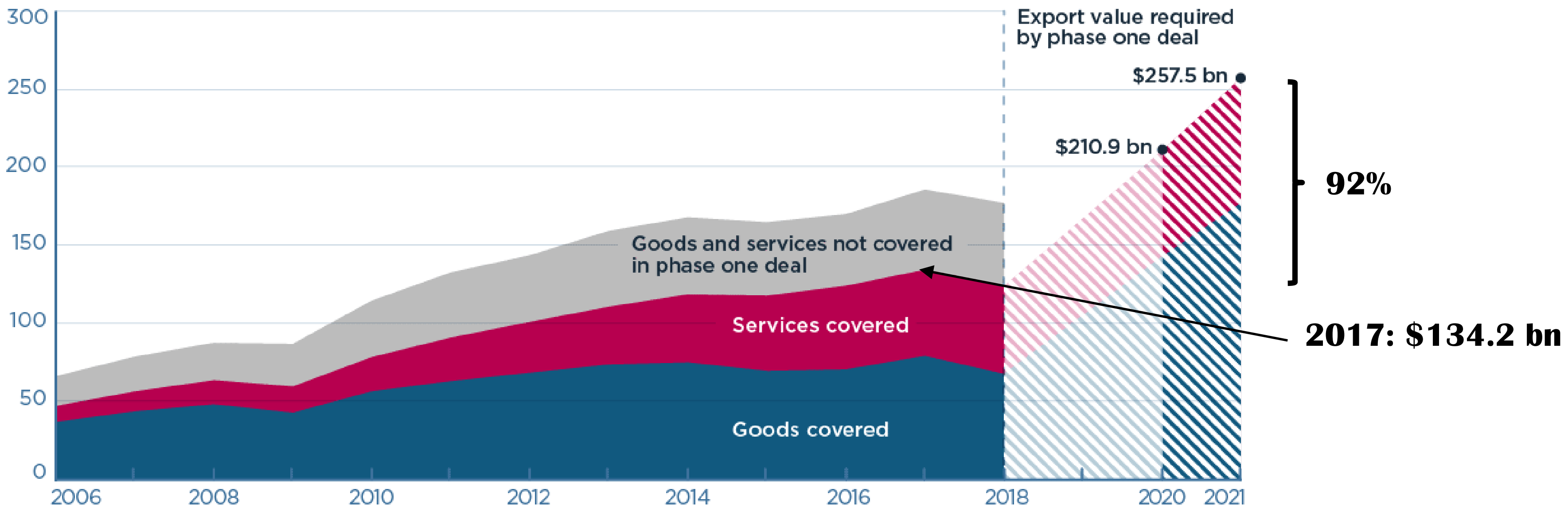
Assessment of Deal

- **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



PIIE **Sources:** Constructed by the author with US export data from US Census Bureau, US Bureau of Economic Analysis, and Annex 6.1 of "Economic and Trade Agreement Between the United States of America and The People's Republic Of China: Phase One."

Source: Bown, PIIE (1/21/20)

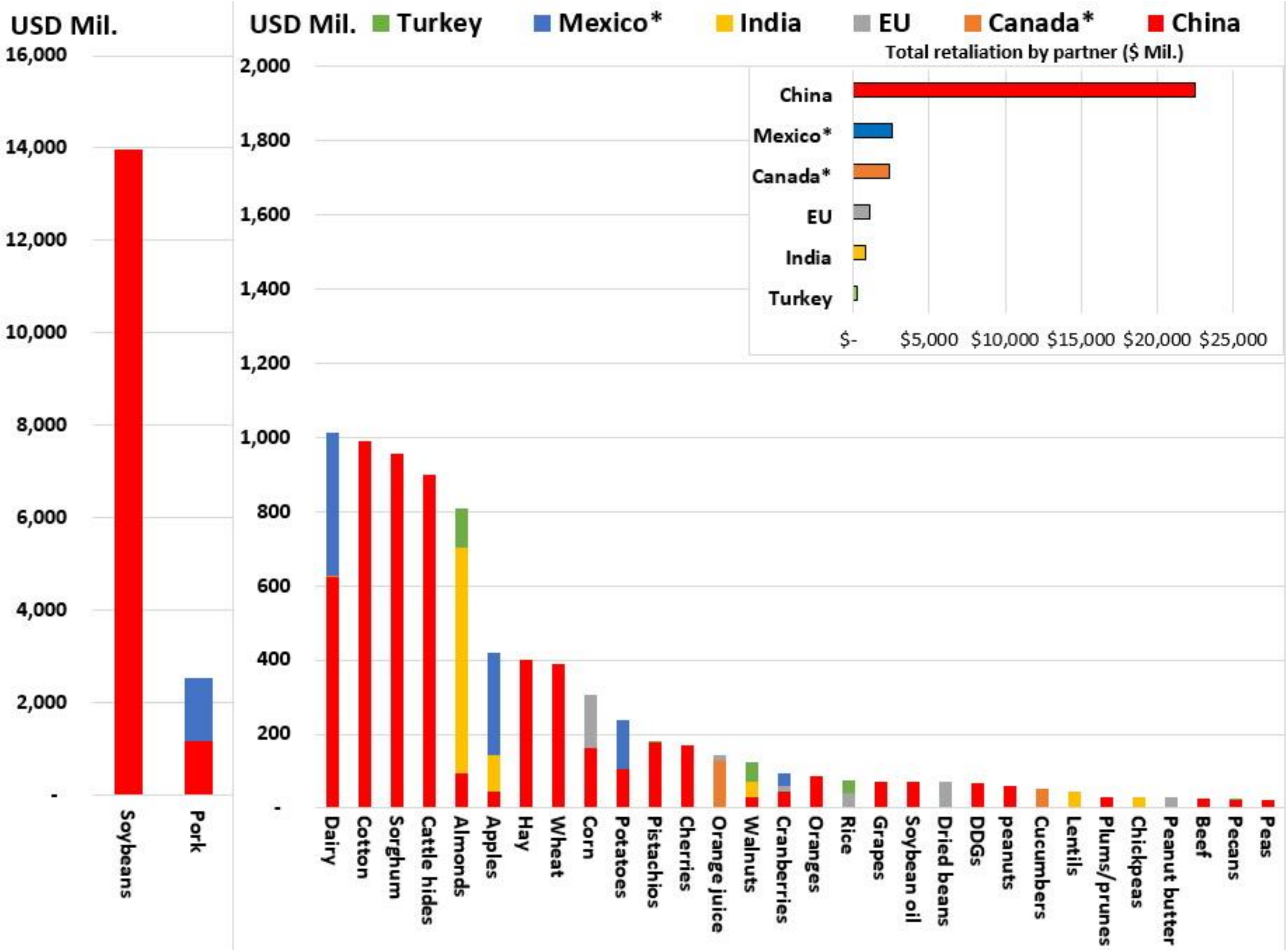
Assessment of Deal

◈ 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)

Scope of Trade War

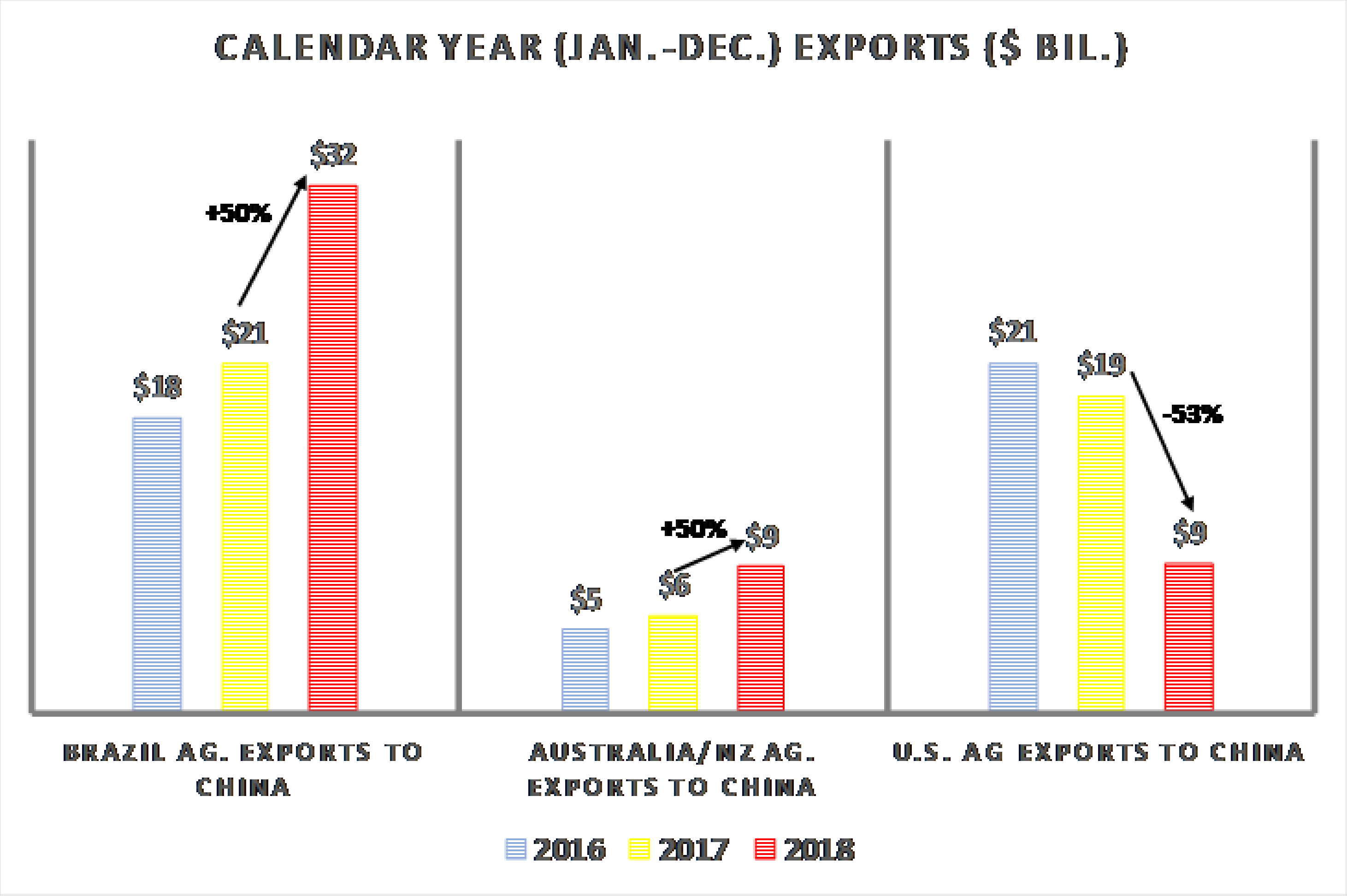
Figure 6: 2017 Value of US Agricultural Exports Facing Retaliation



Source: Grant et al. (2019)

Lost Market Share in China

Figure 7: US Loss of Market Share 2017-18



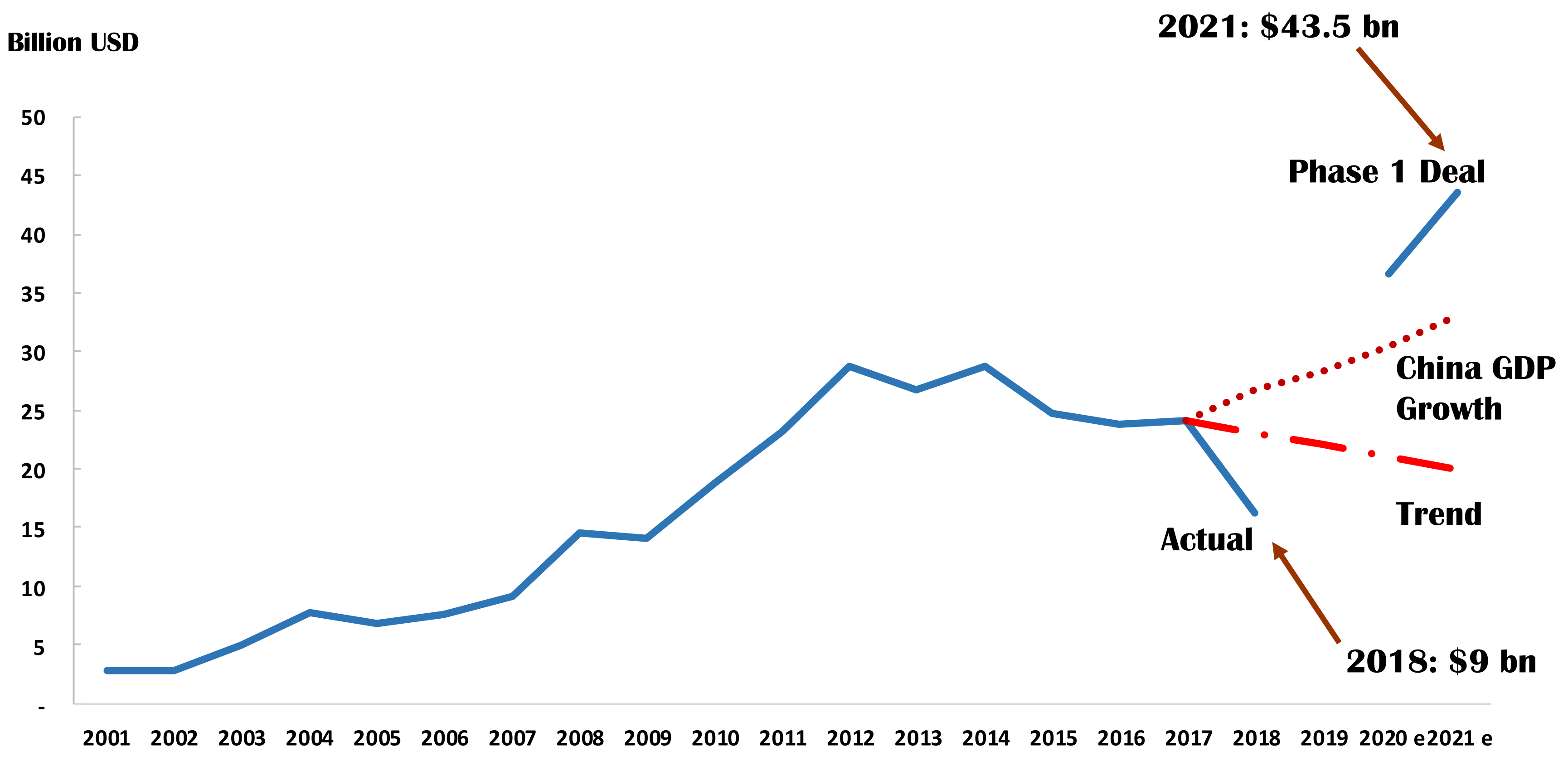
Source: Grant et al. (2019)

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)

Agricultural Import Commitments

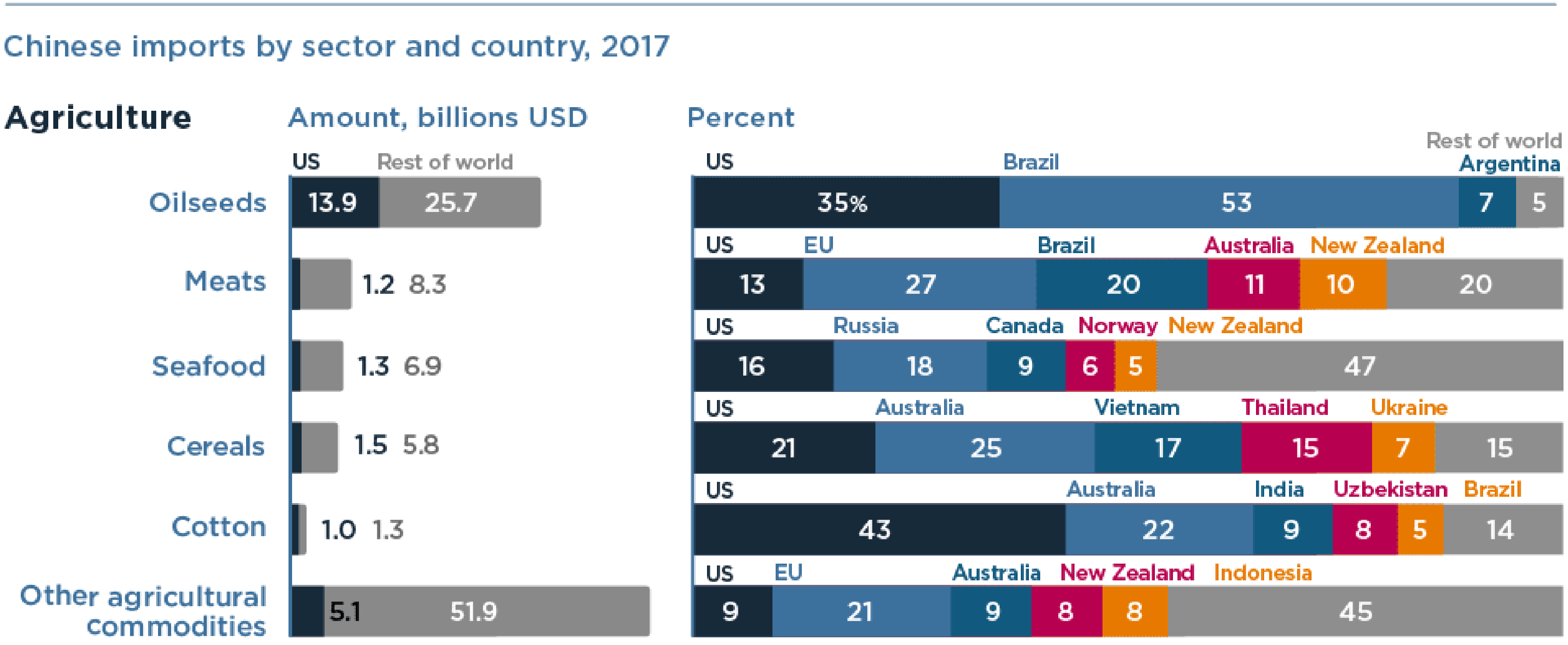
Figure 8: US Agricultural Exports to China



Source: Bown, PIIE (1/21/20)

Potential for Trade Diversion

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



Source: Bown, PIIE (1/21/20)

What's Missing?

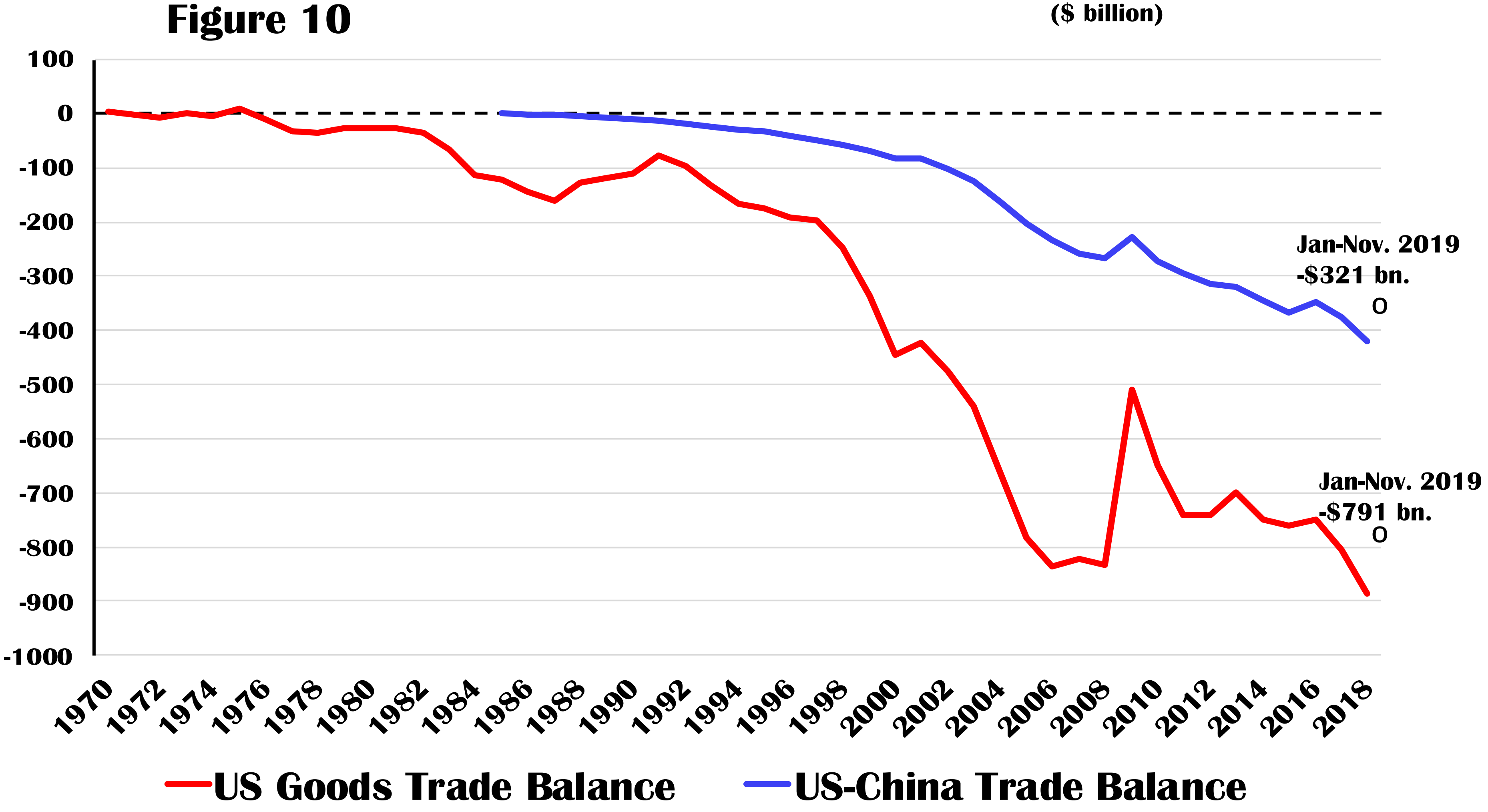
- No mention of China's use of subsidies and role of SOEs – key to trade war starting in first place
- Talk of additional phases of US-China trade deal probably too optimistic on this issue
- Chinese economy structured in ways not anticipated by WTO (Wu, 2016)
- WTO rules on subsidies have significant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



Source: US Census Bureau, January 2020