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:

<table>
<thead>
<tr>
<th>Phase</th>
<th>Tariff Rate (%)</th>
<th>Trade Value (Sb)</th>
<th>Products</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>U.S.</td>
<td>China</td>
<td>U.S.</td>
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<tr>
<td>1 - April</td>
<td>25</td>
<td>25</td>
<td>50</td>
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<tr>
<td>2 - June</td>
<td>10-25</td>
<td>5-10</td>
<td>200</td>
</tr>
<tr>
<td>3 - Sept</td>
<td>?</td>
<td>?</td>
<td>267</td>
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U.S. Steel/Aluminum Imports

Figure 1 US imports of steel and aluminum in 2017, by selected trading partner

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.
- 200 percent increase in Canadian wheat exports to China in 2018 at expense of U.S.
- 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).
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

Week ending November 1: 2018/19 soybean export commitments to China down by 94% compared to 2017/18

Source: USDA-FAS
Soybean Export Prices - \$/bu.

September 2018 - average spread 26%
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: 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
- Might this herald reappearance of the “twin deficits”? (Orden and Zulauf, 2019)
U.S. Trade Deficit

As of October 2018: cumulative trade deficit of -$502.7 billion

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

Source: U.S. Census Bureau

- Goods and Services
- Goods Only
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 \text{NNIP} = -8.4 \text{trillion}, \text{ i.e., } -45\% \text{ of GDP and expected to increase to } -53\% \text{ 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

Current account, net foreign wealth (billions of dollars)

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)
China’s incomplete transition to market economy:
- promotion of state owned enterprises (SOEs)
- intellectual property (IP) theft of up to $50 billion/year (USTR, 2018)
- 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
U.S. - China Trade Issues

- 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.
Is a Recession Coming?

- World economy forecast to slow down in 2019-20 (IMF, 2019)
- Pessimism 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 (World Bank, 2019)
- 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)
Possible Impact of Trade War

Impact of Trade Tensions on Real GDP (deviations from benchmark)

Source: IMF (2018)
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
- 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 exacerbate decline in global GDP growth
- Slowdown in global economy increasing likelihood of U.S. economy going into recession