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5 on 45: US imposes tariffs; China retaliates

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PITA: You're listening to 5 on 45 from the Brookings Podcast Network, analysis and commentary from Brookings experts on today's news regarding the Trump Administration.

DOLLAR: Hello, this is David Dollar from the China Center at the Brookings Institution here to talk about the import tariffs that President Trump has just imposed.

President Trump approved a 25 percent tax on 50 billion dollars of imports from China, and that raises three questions. What is the objective? Is this likely to be effective in meeting the objective? And what would be an alternative strategy?

First the objectives. The U.S. has a large trade deficit with China, more than 300 billion dollars per year. And more important, China is a partially open economy. It has a lot of sectors that are still relatively closed. A good example is automobiles. China has a 15 percent import tariff. U.S. firms produce in China, but they have to work with local state enterprises and joint ventures. They have to transfer their technology and essentially train up their future competitors. And there are lots of examples of sectors like this, so the U.S. has legitimate concerns about China's openness that leads to this kind of technology transfer. So the big issue is trying to get China to open up more.

Now do we think the tariffs will be an effective strategy for accomplishing this? The short answer is no. Some people in the administration think that China is a paper tiger, that it's very dependent on the U.S. economy, and that this kind of hardball will get the Chinese to radically change their approach. I think that's not likely to pan out.

China is a big, important economy. It's almost as large as the U.S. economy. It's not that dependent on its exports to the U.S. They used to be a big part of China's economy, now the value added in their exports to the U.S. is less than 3 percent of their economy. Perhaps just as important, the president of China, Xi Jinping, is very concerned about face. This is all very public so if China makes obvious concessions that's definitely going to hurt him politically. So I don't think it's likely that China will back down; in fact, it's already announced its retaliation. It's announced a 25 percent tax on

50 billion dollars of U.S. exports and that includes products in different sectors such as soybeans, automobiles, aircraft, and actually, there were 106 products on the Chinese list so a lot of different products—including whiskey, by the way. So the Chinese are going to retaliate.

So in that situation what do these tariffs do, tariffs in both directions? Well the U.S. will import less from China. It will be more expensive for these products and we’ll import less, but we’ll also export less because of China's retaliation. And we've tried this before in history, and in general, protection does not reduce a trade deficit because it reduces imports, but it also reduces exports, and historically it has not worked out to reduce the trade deficit.

So it's not likely to affect the trade deficit, but it will definitely affect specific markets. The administration has said that it's trying to avoid popular consumer products like smartphones and televisions. If you leave those aside, then most of what we import from China would be parts and components that our firms use to be more competitive. So we're going to be hurting our own firms by imposing these tariffs.

It's also true that in these product categories, China is involved in deep global value chains. So about half the value added in these products comes from China, and about half comes from other countries such as Japan, South Korea, Taiwan, also from U.S. firms. So we're going to be hurting a wide range of firms. We’ll also be hurting Chinese firms. Of course that's part of the objective, but it's going to be symmetric in terms of the pain and there's no reason to think that China is going to easily back down as we hurt our own economy and their economy gets hurt as well.

So what's an alternative strategy to get China to change its behavior? The obvious alternative would be to work with partners. A great example was the Trans-Pacific Partnership. This does not include China. It was designed to address a lot of the unfair trade practices that China has. So it's aimed at investment policy, opening up services, intellectual property rights protection, and the idea was to create a group of like-minded Asian-Pacific countries creating a big economy that would exclude China until it meets the standards of the TPP.

We could also work with Europe and Japan to bring WTO cases to try to address some of these Chinese forced technology transfer practices. So we're not going the multilateral route we're going the unilateral route. It's not likely to be effective.

I would end by saying that 50 billion dollars in each direction is not a lot of trade. So this is a modest distortion at this point. The real risk is that will escalate from here if the Trump administration doubles down with tariffs on more products, and China retaliates a second time then you could start getting into something significant that we could call a trade war. Import protection makes the economy less productive. So if this gets serious, American people will start to feel it in their wallets.

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