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INTERSECTIONS
Is anyone winning the US-China trade war?
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PITA: Welcome to Intersections, the show where two exports explore and explain the angles on today's important policy issues. We're part of the Brookings podcast network and I'm your host Adrianna Pita.

During the 2016 election, Donald Trump campaigned on an antitrade platform calling NAFTA a disaster, promising to pull out of the Trans-Pacific Partnership and to cut down the U.S. trade deficit.

2018 appears to be the year that he's kicking trade protectionism into high gear, starting with high taxes on imported solar panels, a key export of China's, and moving on to tax on all imported steel and aluminum.

In the spring the U.S. and China exchanged several rounds of threatening additional import taxes, which resulted in both countries implementing another round of mutual tariffs in July.

The U.S. other major trading partners -- Canada, Mexico, and the EU -- have all promised their own retaliatory tariffs in response to the U.S.

So where are we now and what's been the outcome of this so far? Here to help us make sense of it all and to explain the local and global ramifications are David Dollar, Senior Fellow with the John L. Thornton China Center and Joseph Parilla, a fellow with our Metropolitan Policy Program here at Brookings.

Gentlemen, thank you both for being here.

PARILLA: Thanks for having us. Yeah, great to talk to you.

PITA: Joe, can I ask you to start first on the domestic side. In March when the U.S. first announced its tariffs on steel and aluminum imports, you and your colleague, Max Bouchet, looked at which states imported the most steel and aluminum and so were the most exposed to rising costs and also which states were the most exposed to the EUs retaliatory tariffs on U.S. goods.

Now that those tariffs have been in place for a couple of months and China has also imposed their own retaliatory tariffs, what effects are we starting to see in different U.S. industries?

PARILLA: Right. So you note the two sets of tariffs that have been put in place and both matter but in different ways. So on the import side, the Trump administration has targeted tariffs as you said on steel and aluminum, that's about two percent of the nation's imports initially, so not a huge share.

As we said in that post, we were looking more at potential exposure, and the time arising here is important. So what we're seeing so far is kind of a drastic shift in those states. What we're seeing is kind of anecdotal evidence that particular industries that are either reliant on steel and aluminum, industries and companies that are reliant on those as intermediate inputs are seeing their cost go up.

So even if they aren't directly importing those goods from outside of the country, the impact of the tariffs has seen prices go up. So that implicates a lot of different industries. A lot of different industries use steel and aluminum, but it concentrates most heavily in where you would expect, so at the Rust Belt, places that do a lot of manufacturing, but we're not kind of seeing the impact just quite yet on that, other than seeing some prices go up and there being some uncertainty among those industries.

On the export side, we also see the impact of these tariffs potentially. So in response, we now have tariffs from our trading partners on about 3.5 percent of U.S. exports. So again not a huge share, not enough to see this ripple through kind of bigger economic indicators, but there are kind of interesting geographic variation and exposure to those tariffs, meaning they have been very intentional, our trading partners, China and the EU and others have been very intentional both in terms of industries.

So they're targeting agriculture as well as metals production, some advanced manufacturing, and very targeted geographically. So if you look at that national share of exports that are implicated by these tariffs, it's about 3.5 percent, but that's actually much higher in rural areas, in smaller towns. Rural areas about nine percent of exports are implicated, about seven or eight percent in smaller towns, and only about two percent in the nation's large metropolitan areas. So there's a very interesting geographic variation in how the tariffs are coming to ground so far.

PITA: Is that primarily because they've been targeting agricultural goods?

PARILLA: Yes, exactly. So you're seeing particularly states in the Breadbasket, so Nebraska, the Dakotas, Iowa, Kansas. These have high shares of agriculture commodities in their export base, much of which goes to China, particularly in things like soy beans, which is a massive export to China, and I think that's intentional.

If you think about the political geography of the country, these tend to be kind of more Republican leaning districts and I think they're designed to create some political angst for the Trump administration and Congress who are now being pressured by some of these farmers and other industrial interests about the potential effect of these tariffs.

PITA: Now, David, both the U.S. and China's mutual tariffs they've been targeting an increasingly wide range of goods. I think the line you used in one of your pieces is that we're moving toward complete taxation of trade in both directions. Can you talk a little bit about how this has been affecting China, are they starting to see any effect at all?

DOLLAR: Definitely starting to see some effect. China's economy was already slowing down at the beginning of 2018, so the timing for them is quite unfortunate. Trade war then comes on top of their already decelerating economy.

I wouldn't exaggerate the direct effects too much. Their economy is still growing quite well. The July data was a little bit soft. Curiously their exports grew at 12.2 percent in July. So export sector, direct effect doesn't seem to be that great so far. You can see it some specific products. But investment is down very sharply in China and clearly sediment is quite negative, so I think people are worried about this trade war. They're mostly worried that it's going to accelerate, cover more and more trade as I worried about in some of my writings. Their stock market is already in bear territory. It's down 23 percent from a high in January, that was already happening before the trade war started, but then the trade war is just additional bad news. So I think people are worried, but the direct affect so far is not that great.

Then I would add one more thing, I was there the first couple weeks in August. Their technocrats seemed pretty relaxed, because they have a lot of tools in their quiver. They're in pretty good physical shape, so they're going to roll out some fiscal stimulus. If they're smart, they can turn this in a positive direction. So instead of making so much stuff for Americans, they can do more things for Chinese people, including education, health, environmental cleanup. They're trying to target their fiscal stimulus at things that are missing so far in China.

So potentially they can turn this into a good direction and I certainly wouldn't expect them to make any big concessions quickly, because basically their economic situation is pretty good.

PITA: Is that part of the prodigious goal that they had of the Made in China 2025 goal that they were shooting for, increasing domestic consumption of their own goods?

DOLLAR: Well, they've got a lot of different targets and goals. So the Made in China 2025, that's really specifically about upgrading manufacturing, and a lot of that is directly related to these trade issues that they wish they weren't so dependent on imported technology from Taiwan and the United States and they wished they were exporting more high-tech things.

A lot of that Made in 2025 is vague aspirations rather than specific policies, but it definitely is related to this trade war.

PITA: Joe, for some of the industries that have been targeted by these retaliatory tariffs, are any of them starting to respond or talking about how they will respond both to losses in either the China or EU markets?

PARILLA: Yeah, again this is anecdotal, meaning there have been proclamations like from Harley about how this is going to change their operations, and I think the networks that we talked to kind of locally are also seeing some of the impact on smaller and mid-size businesses, which have a slightly different calculus then say Harley.

What I mean by that is Harley has operations all around the world. So if they see changes in trade policy that are going to change their bottom line, their logistics team may approach it kind of like a math problem and say where do we need to switch resources to make this kind of work best for our revenue and our profit, and they have the luxury of doing that because they have a scale and a sophistication that allows them to do it.

It still can be impactful for the communities where they move investment out of, so I'm not diminishing it. But for the company while it's a little bit painful, they can kind of make those changes.

We're seeing other companies think about that calculus themselves, so staying in Wisconsin. There's a company called Husco International that provides automotive components to the auto industry, so they have a contract with Ford. They estimate that these tariffs are going to make it much harder for them to produce in Wisconsin and Iowa, because they rely on Chinese components to go into their components which in turn go into -- so you see the complexity of these supply chains.

Given these costs, they're thinking about either switching who they import from, out of China into other markets where they can avoid these tariffs, which wouldn't be detrimental for their operations necessarily in Wisconsin, but it also wouldn't solve our, quote/unquote, trade deficit problem, which the administration has talked a lot about.

Or they've considered moving manufacturing into locations in Europe or China or Indiana, right, and they say that could potentially cost a hundred jobs in Iowa and Wisconsin where they have operations.

So I say all that because for companies like that, there's still a fair amount of uncertainty as to, A, whether these tariffs will be permanent; B, they're still sorting through the math problem of where it makes most sense to produce, but they have some choices as well and Husco's got about 1,100 employees.

Then for the small businesses, this can be really tough. I think about again in Wisconsin a family farm called Hillcrest Farms that has already indicated that they've lost tens of thousands of dollars in sales. They do about a million dollars a year in sales, and they don't really have a choice in the matter. It's hard for them to shift what they're doing, they obviously can't uproot their farm, and that's the example of a story that I think we should pay attention to. It's isolated. It is not going to automatically lead to a recession, but for that family, for that community that's a really big deal. I think now you're seeing those stories start to bubble up.

Just this week we have hundreds of companies that have come to Washington to talk about how these tariffs are going to impact their business models. These are just a few examples of how that could play out.

PITA: I'm glad you mentioned the trade deficit question, because, David, this was also something that you had written about that while the Trump administration's rationale for a lot of these tariffs is about dealing with the U.S. trade deficit, both with China as well as other countries, you've talked about how trade protectionism does not decrease the trade deficit and it's really only going to increase it.

Can you explain that a little bit?

DOLLAR: Right. So the protection that we're putting particularly aimed at China, the intention is to raise the price of the things we're importing from

China and discourage Americans from using these things.

Now, about half of what we import from China these days would be inputs into production, so materials like textile fabric, or auto parts, different types of components. So about half of what we import are used by American firms, not by American consumers.

As we impose the tariffs and we raise the price on many of these things, as Joe was just saying, firms will adjust. One of the things they'll do is they'll look around and see can they buy something similar say from Mexico or from some other location.

In the short run that may be somewhat difficult, but if this stays in place then value change will adjust and you'll start seeing more assembly in Mexico, Vietnam, Bangladesh, countries like this, so we'll end up diverting some of the trade. So instead of importing from China, we'll import from other countries. So, that's one reason why the overall deficit is not going to change as much as you might think.

But then you also get into indirect effects. American firms use a lot of these products to be competitive. So as their costs go up, they're going to lose some exports. It might be small for each industry, but when you aggregate it, it's actually going to be significant.

And then there's the important issue that we're pretty much in full capacity right now. Unemployment is very low, we're producing at high capacity.

So we should admit some of the protected industries are going to expand in the United States. There will be more production in some of these protected industries. But since we're already close to full capacity, that tends to be inflationary and it's going to encourage the Federal Reserve to raise interest rates faster than they would otherwise, and the value of a dollar is going to go up.

All of that's happening, so it seems a little theoretical, but all of that's happening right now. As that happens, we export less. In fact, we import more from lots of other countries.

So historically we've tried this a couple of times in the past, most notably in the 1930s the famous Smoot–Hawley Tariffs. But more recently we had a bought of protectionism when Reagan was president and we arm twisted Japan into reducing its exports of automobiles and other products to the U.S.

In these historical cases, there was always a concern about the U.S. trade deficit and in all those cases it went up, it didn't go down. So I don't think it automatically has to go up, but there's no reason to think it's going to go down.

Because all of this interference will reduce some imports, probably increase some others, and it will reduce our exports, and then that affect is likely to be small and not necessarily in the direction the administration hopes.

PITA: So the other rationale for the tariffs, particularly about the steel and aluminum tariffs, is of course about protecting U.S. steel industries. Understanding that this is all still at the anecdotal stage, are we seeing any positive effects for U.S. business at all, is there anywhere this idea is succeeding?

PARILLA: Yes, so President Trump was in Illinois I believe at a steel manufacturing plant in Granite City, which is near St. Louis, where he was talking about how they had restarted two blast furnaces and hired 800 workers that were previously idled and that was a statement that the tariffs were helping jump start of the U.S. steel industry.

U.S. steel itself is now planning to invest $750 million in one of its plants in Gary, Indiana, which is obviously a struggling older industrial community, so the symbolism there I think can be potentially potent.

Interestingly those investments are all going into capital and technology. They're not actually hiring new workers, which I think we should pay attention to.

But I think there are also again always unintended consequences, even within that industry. So you look at Alcoa has actually applied, who is one of the largest aluminum producers in the world, they've applied for an exemption for the aluminum tariffs, because they import aluminum from their Canadian operations, which these tariffs target. They bring that in for further production in their Indiana facility, which itself employs 1,600 people.

I say that because even within those industries that are kind of the, quote/unquote, winners, there are potentially losers.

Certainly the users of steel and aluminum who have to either absorb these higher costs, pass them on to the consumer, and as David said, if they're competing with companies outside of the United States that don't have to have those cost pressures, they could lose some business in global markets. The ripple effects are going to likely be much more significant on the downside than the benefits to these particular industries and producers, although we have to acknowledge that those may occur as well.

DOLLAR: Can I add -- I think Joe just made a really important point that we often think of protection as protecting workers or its often justified on those grounds, but point really is to raise prices, increase the profitability of American companies.

But often the companies don't expect this to last forever, so they use the money to either move abroad or automate and in the end, you're not really going to save jobs. So you're really protecting a few firms, you're not really protecting workers.

PITA: That's a really good point to make. Thank you for adding that.

We've talked a little bit about the time horizon issues about stuff we're seeing now. If we assume that these tariffs stay in place, at what sort of time horizon do you think we might see either more significant employment effects or some of these trade changes that may be more deleterious?

PARILLA: Well, I think if a lot of this protection stays in place, you're going to see significant shifts in global value change. Right now there are a lot of global value change that end in China. China is the final assembly.

For the Chinese electronics that come to the U.S. for example, all the toys Americans love, Smartphones, tablets, laptops, these products, about half the value added comes from other countries other than China, Taiwan, South Korea, Japan, for example, they send a lot of sophisticated components to China. Final assembly there, comes to the United States, counts as a Chinese export to the United States.

If you keep 25 percent tariffs in place permanently, those value change will adjust. There will still be a lot of production in China. China is moving up the value chain. So it will do more of the sophisticated stuff that now occurs in other countries, but final assembly will go to Mexico, assuming that we preserve NAFTA, or perhaps Vietnam or Bangladesh. So there will potentially be some winners. The one thing in the U.S./China trade war, the U.S. and China will definitely each lose. We can argue about who's going to lose more. There could be some marginal winners out there.

A country like Vietnam could get a lot of new investment to be the final assembly point. Now, again, none of this is going to change the overall U.S. trade balance. We're basically shifting production from China to Vietnam, might be a little bit helpful to Vietnam, but it's going to be costly. That's why China and the U.S. are both going to lose out in this.

PITA: Can I ask you to talk a little bit more of some of the ripple effects on countries that aren't directly involved in this. Like we still have Brazil. Brazilian soy bean farmers are thrilled, because their prices have already gone up even before the tariffs on American soy beans went into effect. Is there any other example like that?

DOLLAR: Well, agriculture is a great example of soy beans is the poster child, but there will be other agricultural products, so that's one of the important exports from the U.S. to China.

So if we really put permanent protection in place, you'll get permanent shifts so other Latin American countries -- Australia exports a lot of primary products to China. Some of those don't compete with the U.S., but Australia exports a lot of meat and milk and things that do compete with the U.S.

So you'll be opening up -- for some of these mid-size economies, it may all end up being a net benefit for them. U.S./China trade will definitely diminish to some extent, but it will be diverted into other areas.

PITA: On the NAFTA point, Joe -- NAFTA renegotiations are still ongoing. Can you talk a little bit about how this round of tariff threats and retaliation, how that's playing into those negotiations?

PARILLA: Yeah. I certainly think it's an important context as those negotiators -- they've been at it for months and months now and have shown progress and then it's a step back, and they continue I think to move in a positive direction. Although, the elections in Mexico and our midterm elections are going to complicate the timeline of whether those renegotiations get completed by the end of the year I think.

But it's interesting, you think about that trading relationship in NAFTA, it's 1.2 trillion between the three, and we basically put that agreement on hold. It's still in effect, but the changes that could be coming, I think there's a lot of companies that are going to implicated by that of course, because NAFTA created essentially a trading architecture that allowed companies to spread their operations across the three countries.

The best example of this is our automotive industry, which kind of exchanges a lot of parts back and forth across the border multiple times. So if all of a sudden that trade didn't become free, you would see those costs rise significantly because components are bouncing back and forth multiple times and you're getting the tariff applied each time.

So in that sense, it's almost a little surprising that there isn't more worry about NAFTA. I think China's been the big kind of discussion point. Obviously it's a huge trading relationship and geopolitically, I think China presents kind more of an equal to the United States on the global stage, so I think there's a little bit of geopolitics that are playing into those discussions more so than NAFTA.

But I'm frankly surprised at how much -- there seems to be a confidence that this will all be sorted out within NAFTA, and I think that most prognosticators suggest that it will. This is too big of a disruption for this administration to pull out of the agreement, for instance, and they've given themselves the political space to declare victory on renegotiations, so I think it's likely that it will occur.

But the fact that it hasn't been settled yet and there's not a whole lot of worry about it seems, it's a little bit surprising.

PITA: David, on top of this, Trump just recently accused China as well as the EU of manipulating their currencies. He had promised during the campaign that he would label China as a currency manipulator, but he originally pulled back while he was trying to get China to weigh in more on the North Korea side.

So although this isn't new from him, it is new in that he's now president, he's not just a candidate anymore. For the EU this seems pretty out of the blue. He just had that really promising meeting with the EU commission president, President Juncker.

So how serious an accusation is this and what happens?

DOLLAR: Right. So we have a definition of currency manipulation, which involves central banks intervening in currency markets to push the value of currencies down. EU is definitely not doing that. European Central Bank is definitely not doing that. China's not doing that. China's Central Bank has not been intervening much. When it has, it's intervened a little bit to keep the value of the currency high, not low. So I don't know any serious economist who thinks that either the European Union or China is manipulating their currency.

Now that said, I can understand why a politician would be worried about some of the trends in the currency markets, because what's happened over the last few months is the U.S. dollar has appreciated against just about everybody.

So an index of the U.S. dollar against major currencies is up about seven percent since April, so that's a pretty significant move. Over that same period, the Chinese currency's depreciated eight percent against the U.S. dollar. It's almost exactly the same number.

What I take away from this is the dollar is appreciating and it's what you would expect. First we had this big fiscal stimulus. We cut taxes and we raised spending. At a moment when we're pretty much at full capacity, you'd expect that to raise interest rates and the value of the dollar. And then the trade war on top of that, trade war also tends to appreciate the value of the dollar.

So what's happening -- these are all part of the reasons why the trade war is not going to have a positive effect on the U.S. economy, it's not going to reduce the trade deficit. These are natural results from the policies that the United States is following, but I can understand for politicians it's frustrating.

If you just think very simply, quite a few Chinese products now we've put a 25 percent tariff. Well, the depreciation undermines about a third of that, and then there's still a lot of products from China we haven't put tariffs on.

So now all of a sudden, they're eight percent cheaper. We know at this point just our bilateral inbounds with China is getting bigger, our bilateral deficit with China is getting bigger. If we put enough protection in place, we can work that down. But for the moment, that's getting bigger and partly it's because of these currency moves.

PITA: A few weeks ago there was an episode of the Brookings Cafeteria podcast where our colleague David Wessel remarked that one of the reasons that the tariffs weren't yet having a large effect on the U.S. economy broadly is, one, that it is early days yet and, two, while we've had a couple rounds of these tit-for-tat retaliatory tariffs, everyone is still holding out hope that this isn't going to spin out of control.

This is for both of you. Can I get your take on that, I don't know whether to call it cautious optimism or merely just a lack of panic, in the U.S. markets about how long do you think that this will last while all of our various other negotiations are going on and if the U.S. does manage to settle things with our other partners like Canada, Mexico, and the EU but we continue the trade war with China, what will that do to expectations and panic or lack thereof?

MR. PARILLA: Yeah, I can start. I think that, to go back to a previous point, that at first this is really kind of an uncertainty story, rather than immediate pessimism story.

So I agree with David in the sense that partly because this is still a slim share of trade and exports are 13 percent of the U.S. economy or 12 percent of the U.S. economy, so it's just a sliver of a sliver, that we're not seeing kind of really deleterious effects across the economy yet.

Now if all of a sudden we have tariffs on 200 billion worth of products in China, that changes. But the fact that markets kind of haven't responded with a lot of pessimism, I think is partly due to the fact that there's still some questions around permanence.

So business leaders still think that they can get through to kind of Republican led administration in Congress, who has traditionally been the party of business, that this is going to be bad for the economy and, therefore, they can kind of stave off the worst of the effects and second there's going to some resilience in terms of responding on the part of a lot of businesses, so there might be some short-term pain, but in the medium and the long term they can still accomplish their goals just by kind of changing the way that they trade within these supply chains and that those will take a little bit of time but are kind of something that's doable and won't have a huge, huge impact.

DOLLAR: Yeah, I think there was a moment where it seemed the U.S. was pursuing trade wars with everybody, Canada, Mexico, European Union, Japan, China. I guess I was surprised that markets weren't more nervous, because that really seemed like a dangerous moment.

But the more recent trend is the U.S. seems to have made a deal with the European Union. I have to see how robust that is and the rumors are that we're going to reach an agreement with NAFTA, particular with Mexico first, then with Canada.

So I think politically, it be would a smart strategy to make peace with most of these partners and then interesting question will be is that, per se, some kind of settlement with China or are we actually going to really then focus a laser beam on China. I think there's a lot of uncertainty around that.

It will be easier for U.S. firms to adjust if we're still in NAFTA and we're strengthening our relations with the European Union, Japan, South Korea. I think if we're breaking up all the global value chains, that's going to be costly and difficult.

But just reorganizing the value chains out of China, that's also going of to be a pretty significant issue and problem for U.S. firms. So the market reaction suggests that people think this will all get settled within a reasonable time frame, meaning within the next 12 months.

PITA: Are we seeing any of our trading partners starting to increase trade with each other, basically going around the U.S. while we're still struggling with this, whether it's China and the EU or Canada or anything like that?

DOLLAR: Well, there's some obvious examples, because Brazil is happy to jump in and sell soy beans to China. But I think for the manufacturing value chains, it would take longer to reorganize and firms are kind of in a waiting -- wait-and-see attitude before they make the major investments involved in changing that.

PARILLA: I'll just add one thing. I was thinking of another anecdote of a manufacturing company that had -- I think they said they had like 12 open positions that they needed to hire and that basically they were just going to hold on doing that until all of this gets sorted out.

So sometimes it's not kind of active regression that we'll see, but more of just kind of a holding pattern. We wouldn't see the types of investment or hiring that we would have seen without the uncertainty that these policy changes have brought, which is a little bit I think harder to see in the consciousness of the public or of markets.

PITA: It's hard to quantify.

PARILLA: Exactly, what would have occurred if this hadn't have happened. Because to David's point earlier we had really stimulative policy in other ways coming out of this administration that has kind of juiced a lot of confidence and things like that.

In some ways those may be stronger drivers than the kind of negatives through the trade war. So one reason the markets may be feeling a little bit better is they're saying on net public policy has actually been kind of favorable to growth conditions here, at least in the short term.

DOLLAR: Don't forget corporate profits were up 25 percent in the second quarter compared to year before, so that's a huge effect of the tax cuts, so some ways it's surprising.

The stock market's been pretty flat this year, just slightly up in New York, despite 25 percent increase in profits. So I see that as you've got the very stimulative policies that are beneficial for a lot of companies and then you've this worry about the trade war and the net is small positive.

PITA: So trade is one of those policies used that's traditionally totally federally oriented. It's a national level policy, but the effects are, as you mentioned, Joe, often felt at the local, the regional level. Is there any role for state, regional, local level governments either in responding to these issues or just helping their local businesses cope?

PARILLA: Yeah. I think there's a few things that they can do. Obviously they can't go out and set policy directly, right, so all that's going to be done in Washington. So in that sense, they are a little powerless to change the rules of the roads so to speak, but there are a few other things they can do, one is they can serve I think as important intermediaries in the information flow to their local businesses and then from their local businesses.

So what I mean by that is these can be kind of complex policy changes, so there are institutions locally, sometimes they're called World Trade Centers, sometimes they're economic development organizations that focus on trade who have spent a lot of time kind of gathering businesses together, sending them information, talking about like when these changes go into effect, how they can apply for exemptions. Particularly for small businesses, that kind of support is actually really important and the federal government doesn't have that capacity to do that. So that's really going to be done in these communities.

At the same time, I think they play an important translator role between local communities and Washington. So the anecdotes that I've gathered have partly been gathered by these economic development organizations that have done and kind of surveyed their companies. They're communicating that on to congressional leaders from their district. Obviously this week is kind of meant to explain to the Trump administration how this could impact businesses, so that's one important role.

The second is the fact that elected officials, mayors, governors, they travel abroad. They try to secure investment back to their places. They try to kind of bolster exports.

There's a little bit of damage control that I think some of these elected officials do when they go to these markets now. They're kind of like what is going on in the United States, are you guys open for business, are you antagonistic towards this, and it's a big country. There's a diversity of opinions about this issue. So there's a little bit of kind of, as I said, damage control that some of these elected officials can do as they go abroad.

Then the final aspect is just an ongoing effort to kind of help more businesses benefit from the upside of trade. I think one of the reasons that we're in this situation is that politically kind of trade has been treated as an issue where there are concentrated costs, so there's a lot of constituencies that feel like they're on the losing end on the current trade regime and President Trump tapped into that and is now responding in terms of policy.

But I think there's a lot of things that we can do to help support small and midsize businesses in particular through export assistance, through other things, through connections abroad that can help them see the benefit of trade, right, greater exports. Companies that export tend to pay better wages.

So the notion that somebody may be in a company where their livelihood is tied to an export and they don't even really know it, because they're just creating something and they don't know where it's going.

I think that's one of the challenges of concentrated costs and diffused benefits. So there's an important communication role, kind of realistic communication role, of the cost and benefits of trade within local communities that needs to occur.

PITA: David, a question for you. When our colleague Aaron Klein was in China back in early July when the U.S. tariffs went into effect and he wrote down some reflections -- he was there for a conference.

But as he talked to people, he wrote about their reflections on those tariffs and how it was going to be affecting people. He noted how much the people that he was speaking to really viewed this from a warfare perspective. To them it felt like that this was economic warfare on the part of the U.S. and that it was part of a broader containment strategy that the U.S. was trying on China.

With Trump it is difficult to tell. Of course he has a long history of trade protectionism in his business dealings, but he also seems to just have a very well-this-is-just-part-of-business approach to things, (inaudible) he can turn around from calling the EU our foes one minute and the next minute he's embracing them again.

So in your view, does China view this as more an existential threat issue than the U.S. does and if that's the case, will that make de-escalation efforts more difficult?

DOLLAR: I think on both sides of the Pacific, there are factions who feel this is really an existential issue. So there are elements of the United States who are now questioning the whole long-term strategy of engaging with China.

Trump administration put out a national security strategy last December that said explicitly that the strategy of engagement has failed and there are members of the administration that have written very harshly about China.

So I think there is definitely a group -- not a majority view, but I think there is a group -- it's not just in the administration, it's in the larger Washington policy community.

There's a group who thinks that the relationship with China has really been bad for the United States and that we want to disengage and then contain China in the same way we tried to contain the Soviet Union a couple of decades back.

I would say the dominant view in Washington policy circles, including the administration, views this trade war as a best tactic. China does have some unfair trade practices. China is less open, particularly to direct investment, than many other emerging markets, so I think the U.S. has legitimate trade issues with China.

I don't think the tariffs are a particularly smart strategy -- or let's call it a tactic, but it is arguably a tactic to try to get China to open up more.

So on the Chinese side, I think you have factions that mirror this. You have what I hope is a minority view, I'm pretty sure is a minority view, that the U.S. is now bent on engaging economic war against China. It cannot accept China rising up and being an equivalently large economy and global player.

In light of that, that leads to protectionist thinking on the Chinese side that instead of opening up further, they should actually close off more of their economy.

So there is a risk that these hostile factions will push each other in really bad directions. China closing up more and the U.S. continuing this economic warfare going beyond tariffs to other types of instruments.

But coming back to the market seeming pretty calm, it does seem likely the outcome will probably be some kind of agreement between China and the U.S. China is not going to do anything dramatic. In fact, they can't really change the trade balance. They don't have the power to do that.

They can agree to buy more stuff from the U.S., but that will have all these indirect effects, it won't necessarily lead to a change in the U.S. trade deficit.

But certainly China can buy more and that would generate good will. And for me more importantly, they could open up more markets and they would want the U.S. to commit to backing away from the tariffs and various other hostile acts. You can see the potential shape of an agreement, and I think the dominant factions on both sides feel that after a little time has passed they should be able to negotiate this kind of settlement.

PITA: President Trump and President Xi Jinping due to meet in Buenos Aires at the end of November at the G20 meetings. Do you think there's likely to be any substantive activity that might come out of that meeting?

DOLLAR: I think that's a good opportunity. I think it's hard to see settlement before then. In the U.S. midterm elections, this is probably not that important an issue, but I think the president believes being tough on China is a winning issue. And announcing some kind of settlement before the election, I think is not really in the political interest of the administration.

So there will probably be some low-level discussions along the way. You got two scenarios, you could do all the hard work of working out an agreement that the two presidents announce. They'll be meeting around December 1, I think that's unlikely.

I think it's more likely to be the Singapore model, as we can call it, where the two presidents launch the process. They announce, okay, we've had enough of this trade war, it's bad for both economies, so now we're delegating our key people and then Trump will have to decide who's going to negotiate for the U.S. side. For the Chinese side it's pretty clearly Vice Prime Minister Liu He, who I think would be happy to come back here and negotiate if the U.S. side is serious.

PITA: Lastly I wanted to ask where's the WTO in all of this, that's supposed to be the mechanism by which countries pursue whatever legitimate grievances they have with each other. What's going on?

DOLLAR: My view there I think the WTO has become increasingly irrelevant for a variety of reasons. Partly there are new issues that are arising about trade and services. Investment is critical. A lot of modern trade can't occur without investments or investment restrictions, state enterprises from the point of view of the Chinese economy.

So I think the WTO needs to be modernized, but it operates under this consensual framework where 200 countries have to agree, that's just really hard.

So practically what we need is the big four -- the U.S., China, European Union, and Japan -- we need to agree on some updated rules and be supportive of the WTO moderating that. We seem pretty far from that right at the moment.

PITA: Well, gentlemen, thank you so much for being here with us today and explaining this to all of us. To our listeners I'll have links s to papers from both Joe and David and additional content in the show notes as always at brookings.edu/intersections.

You can listen to the Brookings Cafeteria podcast episode that I mentioned of David Wessel and as well as all past episodes of Intersections and the rest of the Brookings podcast network on Apple, Google podcast, Castbox, Overcast, Spotify, or whichever is your favorite podcast app.

Gentlemen, thank you for being here and thanks to our listeners for listening and don't forget to follow us at policy podcast on Twitter.

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