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Dollar & Sense: A back to school primer on global trade issues
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PITA: Hello, I'm Adrianna Pita, the host of "The Current," but you're listening to "Dollar and Sense." Since it's back to school season, we're doing something a little different for this episode of "Dollar and Sense." Here at Brookings we benefit from having a lot of talented students intern with us over the summer, and some of those interns are among the many students heading back to school to begin their semester this week.

Normally, host David Dollar brings you an in-depth dive on current trade and global economic issues through conversations with policymakers, experts, and practitioners, but today we're turning the tables back on him. We took the opportunity to ask our student interns what questions they have for him about pressing issues in international trade. So whether you're on your way back to school and beginning some new coursework, or if you're just in need of a refresher about what exactly is going on in trade these days, this episode is for you. We'll cover the costs of the U.S.-China trade war, the significance of trade deficits, and the role of automation and A.I.

David, thanks for being here.

DOLLAR: It's great to be here and it's fun to be interviewed instead of being the interviewer for once.

PITA: Great. So, what we've been calling the trade war between China and United States has been going on for a little over a year now. When we talk about trade wars, is there a strict definition? Does somebody declare a trade war or is it more of a fuzzy you know it when you see it?

DOLLAR: Right, so there's no formal definition of a trade war. President Trump started his round of tariffs by first putting tariffs on steel and aluminum against the whole world, and some of our partners like Europe and Japan retaliated with tariffs on things like American bourbon, but it stopped right there. So, I would call that a trade skirmish – [it] affects a pretty small amount of international trade.

What's happening with the U.S. and China – a real full blown trade war at this point – is the U.S. started with tariffs on 50 billion dollars of imports from China, ratcheted that up to another 200 billion, and now we have plans in place to cover pretty much all of the 500 billion dollars or so that we import from China and they're retaliating. So I would call this a full blown trade war.

PITA: President Trump says that China is one paying the price of U.S. tariffs, but a lot of political commentators say it's really Americans footing the bill for tariffs on Chinese goods. Who pays for tariffs and why?

DOLLAR: From an administrative point of view the importing firm pays the tariff. We import a lot of parts and components from China, so firms use those and they have to pay this tax. We import a lot of consumer goods. Our big retailers do that importing [and] they're the ones who pay the tax. To a large extent they're passing it on to consumers. This has been going on long enough now that we have evidence of this. And so, ultimately, it's really the consumers who are paying the tax. JPMorgan Chase estimates that once all of the plans are in place this is going to cost the typical American family between 1,000 and 1,500 dollars per year. Ironically, the tax cut last year gave the typical American family about a thousand dollars, and now we're taking it away with this tax increase.

PITA: Tell us a little bit more about how the tariffs affect the bottom line for American manufacturers but also American farmers.

DOLLAR: So in this case with the trade war between the U.S. and China, China has retaliated at each stage. China does not import as much from the U.S. as it exports to us, so it can't cover the same dollar, amount but it's basically taxing most imports coming from the U.S. at about 25 percent.

A great example is soybeans. Our farmers were selling a lot to China. Now that's drastically reduced, and agriculture is an area where when demand dries up you get really sharp price swings. So the price of soybeans is down about 30 percent since the beginning of the trade war. That means the whole soybean crop is worth 30 percent less. So I think farmers, particular certain types of farmers, are taking a pretty big hit from this.

In the case of manufacturing, it's more that a lot of our manufacturers import things from China that they use in production so they're now paying more for that. So just this month manufacturing started declining for the first time in 10 years and that's partly the result of this trade war. Other factors going on as well. I wouldn't exaggerate that it's only the trade war.

I guess the last point I would make is that the U.S. flip flopping on trade policy – by which I mean ratcheting up the tariffs and then announcing that prospects look good for a deal with China – this constant change creates an uncertain environment where it's hard for farmers to figure out how to invest and do business. And so we see business investment declining, and that's a key reason why U.S. manufacturing is declining for the first time in 10 years.

PITA: On the point about the farmers and in this case the cost of soybeans going down, if they can no longer sell to China because Chinese retailers and consumers don't want to buy U.S. soybeans so the price goes down, can they just shift who they sell it to? Or what does that mean for perishable goods like food?

DOLLAR: So we don't see much evidence that U.S. farmers are selling those soybeans to new markets. The U.S. is a very competitive producer of soybeans if you didn't have these tariffs in place. But with the tariffs in place, Brazil for example is putting a lot more acreage under soy, and so Brazil is increasing its exports to China. Plus, the price of soybeans has gone up in China, and that affects usage between soybeans and wheat and other complementary crops. So you end up getting a mix of reactions, but overall trade in soybeans is down, and then you've got Brazil doing more than it's done in the past plus some other producers coming in.

PITA: When we think about the actual implementation of these tariffs – when they go into effect – what sort of logistical challenges do they pose for companies who are trying to do business with China?

DOLLAR: Right. So this is a great question. I think people don't think through some of these logistical issues.

When I worked for the World Bank I had an opportunity to visit a lot of different firms around the world. So I remember visiting a Thai firm about 20 years ago. This firm was part of the Japanese auto value chain. And this small entrepreneur was importing components from Japan by air shipment, and he was putting those electrical components into things like headlamps and other electrical parts of the system and then selling that onto the Japanese manufacturers in Thailand. What stuck in my mind is this guy had to go to the airport -- it was air shipment -- once a week he spent half a day going to the airport because Thailand had a very complicated tariff schedule. And he thought his input belonged in a 5 percent tariff category -- which he could afford -- but sometimes it got put in a 30 percent tariff category that completely eliminated his profits. So he had to go out to the airport and spend half a day which is a huge waste of entrepreneurial talent.

Now that's not an exact analogy with what's happening in the U.S., but a lot of U.S. firms – a lot of small and medium manufacturing firms – import inputs from China. That's the first thing we started taxing is these components and parts. Firms can go to the Commerce Department and apply for an exemption, but that's waste of entrepreneurial time basically for small and medium firm. And in the end, it's some bureaucrat who's deciding what do we actually get to import from China [and] what are we not importing from China. So that that's kind of an administrative cost or an inefficiency that gets a little bit lost in the whole discussion of the trade war.

PITA: So there is the World Trade Organization that was created about 25 years ago precisely to settle trade disputes and hopefully keep those disputes from spiraling into wars. How has the WTO been involved in the U.S. China trade war and are there some questions about what this means for the WTO its effectiveness and sort of their future role?

DOLLAR: The trade issues between the U.S. and China go back quite a long way. If you're taking a historical perspective, the U.S. has brought quite a few WTO cases against China about various trade issues. For example, our credit card companies were supposed to be able to operate in China. There was a case over auto parts, for example. U.S. has generally won the cases it's brought to the WTO and China has mostly made the changes that were demanded, but I think, as a fair criticism, it's a fairly long and expensive process. So we don't like to bring cases on every little issue and then it can take years to adjudicate these. WTO is not really involved in this immediate dispute. I think it's too fast moving. Some of the things the U.S. is doing or WTO violations. China may ultimately take us to the WTO over this, but probably they would take so long to get a decision that it's not really going to settle this kind of a trade war.

PITA: President Trump's also really concerned about America's trade deficit and has for a long time – even before he was president – talked about how bad it was that America runs a trade deficit. Trade deficit being of course the difference in how much the US sells to its trading partners versus how much it buys from them. Is having a large trade deficit actually bad for the U.S. economy?

DOLLAR: Having a trade deficit is not necessarily a bad thing. You just defined it very clearly. So if you think about...if you're importing more than your exporting then you're have to be borrowing from the rest of the world to cover the difference. So what I look at is how much you're borrowing, and what are you using it for.

Before the global financial crisis back in 2006, the broadest measure of our trade deficit, called the current account, had gotten to 6 percent of GDP. That's a pretty big number. You sustain that over time and you become pretty seriously indebted. And also, we used that to fund the housing boom. And it's always easy to see this exposed, but we built a lot of unnecessary housing in places like Nevada and Florida. We had this speculative boom then it all came crashing down. A lot of that housing is never going to be used by people. So we borrowed money to build unnecessary housing stock and we had this crash. So I think post that was all not particularly clever.

Since the global crisis our deficit has come down to about 2 percent of GDP. It's ticked up a little bit in the last year to 2.4 percent of GDP. That's not a scary number for economists, so I'm not worried about the level. On the other hand, if you ask why is it ticking up, it's mostly because of the tax cut. So I don't think borrowing from abroad to finance a tax cut is particularly smart. I would prefer to borrow from abroad to finance infrastructure, for example. So if I were retooling our macro policy, I might raise taxes to get more revenue, but then I would spend it on infrastructure, maybe education. I wouldn't necessarily run to close down a pretty small trade deficit.

PITA: Can you talk a little bit more about some of the Trump administration's policies and what impact they have had on the trade deficit – and how that interacts?

DOLLAR: Right. So the trade deficit is mostly a macroeconomic phenomenon. So the most important thing is the tax cut is leading to a larger fiscal deficit and that's tending to keep interest rates higher than they would be otherwise. And that's bringing money into the U.S. and that's increasing the trade deficit. So the trade deficit has been increasing under President Trump.

Now trade policy, protectionist measures, generally are not going to affect the trade balance. This is one of these very counterintuitive theorems of economics. And what happens is you put these tariffs – in this case we've got this trade war with China so we are importing less from China, which is the objective of this. We've made Chinese stuff more expensive for American firms and households so they're buying less of it. On the other hand, we're buying more from places like Vietnam and Mexico. So some of the value chains are just reorganizing themselves. And China is still producing a lot of content, it's just now they're doing the medium part of the value chain and then it goes to Vietnam or Mexico for final assembly and comes into the United States duty free because it's not coming from China. So we're importing a lot from these other places.

And then this kind of trade war tends to reduce your exports. Most obvious thing is the Chinese retaliation has hit our firms and farmers that export to China. So our exports to China are down significantly, but our exports to the whole world are also down. That's a little bit harder to explain. I think the best way I could put it is that when you impose this kind of trade war the aggressive country – in this case the U.S. – your currency tends to appreciate. And this is particularly true if you're America, because not only are we fighting a trade war, but we're creating a lot of uncertainty in the world and whenever people get scared they go into dollars. So the dollar has appreciated during this trade war, not just against the Chinese currency, but against almost all major currencies and that's making it hard for our firms to export, so our overall exports are down. And there are a lot of other things going on. I don't want to oversimplify. But as a rule, a trade war is going to reduce your imports, but it's also going to reduce your exports, and historically there's no tendency for your trade balance to move in one particular direction or the other. In our case our trade deficits getting bigger, but I think that's for the macro reasons I mentioned.

PITA: So we've also recently been witnessing some tensions between South Korea and Japan, particularly over trade practices as well some other issues. Does the U.S. have a role in trying to mediate between these two allies of ours and how does this affect U.S. trade regionally?

DOLLAR: So normally the U.S. would play an important role in mediating this kind of conflict because Japan and South Korea are two key allies in Northeast Asia. What's going on here – it's very complicated because the underlying issue is historical tension relating to Japanese colonization of Korea before and during World War II. There are a lot of serious issues here and I don't think we have time to get into the details of that. The point I want to make for our trade podcast is the underlying issue has nothing to do with international trade [and] it has nothing to do with national security. But what's happened in this "historical conflict" we can call it is Japan has basically used an important trade measure. They've removed South Korea from their trusted trade partner list and Japan is almost the only producer of a few key chemicals used in the production of semiconductors and screens for smartphones laptops etc. Korea is the biggest producer and so Japan has made it much harder for its firms to export to Korea. It's now going to take 90 days to get a decision. Once again, it's that bureaucracy entrepreneurs now have to go to the bureaucracy to get permission to trade. So it's a pretty serious trade impediment, but it wasn't an underlying trade issue and it's not really an underlying national security issue.

So I look at this and I think this is a negative spillover from what the U.S. has started. I began by mentioning the steel and aluminum tariffs they were put in place over national security reasons, but no serious person thinks there's international security issue there that we're getting steel from Canada, for example. Or from Germany. And so we've used this national security excuse to pursue a different objective. In this case, the underlying issue is historical, but Japan is now using this national security rationale to impose a trade measure that starts interfering. If this all continues it's going to interfere with the value chain for producing all kinds of electronic products because the semiconductors are used in so many different things and the screens obviously are used in different products.

PITA: Is South Korea producing like the screens and the semiconductors for a really wide range of manufacturers then? So it's not just Apple or Samsung or...

DOLLAR: They actually produce 90 percent of the world's semiconductors, so if you just think about that number. We have these complicated value chains. So a lot of that's going to China, and then there's additional value added, and now because of these tariffs some of that's then moving on to Vietnam for final assembly before it comes to the United States. So we have these complicated value chains and we're throwing all this sand in the wheels of commerce and it's clearly slowing down the world economy.

PITA: Lastly, there's been a lot of attention on how artificial intelligence and automation are both already reshaping the way people work and connect and also how it will continue to do so going forward. How do you foresee how these technologies are going to start affecting or will continue to affect global trade?

DOLLAR: So I think the developments in AI and automation interact with international trade in a way that's particularly important for advanced countries like the United States. So if you look at the United States [and] the effective of trade, trade does not affect the total number of jobs in the economy. I think that's a common misunderstanding you'll hear on trade eliminated so many jobs. What trade does is it changes the composition of jobs, and our U.S. trade with China has definitely eliminated medium skilled jobs in manufacturing. On the other hand, it's created high skilled jobs. We are a technology exporter -- we export advanced stuff. Or one good example, we've got hundreds of thousands of foreign college students in the U.S.. That's a kind of export. So we're creating jobs for all these college professors.

Trade is creating demand for people with advanced skills. It's eliminating jobs for people with medium skills. And when I think of low skills, I'm thinking about hospital orderly or simple construction work, not the craft workers. In general they're not that directly impacted by trade. So you've got this kind of hollowing out of the occupational spectrum.

Now automation and I are having pretty much the same effect. They're not really eliminating jobs for brain surgeons and it's actually not economic to use automation to replace hospital orderlies or basic construction work, but automation is definitely affecting those medium skilled jobs in manufacturing but also in offices a lot of the things that used to be done by secretaries essentially has been taken over by automation and by AI.

So I think the combination really creates a big challenge for a country like the United States. People are being pushed either up the occupational scale -- you have to get more skills, you have to get retraining, you have to become qualified for the high-skilled jobs – or you're losing that great job in manufacturin with benefits, health care, etc. and now you're pushed down to compete for some of those low-skilled jobs which pay very little money in the United States.

Now for listeners, if you haven't heard the episode with Jay Shambaugh a few weeks ago on how to help left-behind communities and workers, I would encourage you to listen to that. Because it's tempting...It's always been this temptation to slow down technological change or to stop international trade, and that's basically a losing strategy for dealing with this. But it's a serious issue making sure people have the skills they need. Also, probably young people are going to do multiple jobs in their lifetime and require different skills. So you need a safety net as you go from job to job. Be nice to have better portability of health insurance. Pensions, of course. Retraining. And then sometimes you get a whole community hit by one of these changes – by either technological innovation or by trade – and I think from my point of view doesn't matter which of these things hits your community. If there's a big decrease in the number of jobs then we need to have some kind of community safety net to deal with that.

PITA: Just on the number of jobs question: the number of higher-skilled jobs some of these things create usually doesn't match the number of those middle-skilled jobs so there is still kind of that gap there. Or is that taken up then by the number of lower-skill jobs is easier to raise up?

DOLLAR: I think what's happening is some people are being pushed down to lower-skill jobs. We're fighting over whether to raise the minimum wage to 15 dollars an hour nationally. That's a ridiculously small amount of money -- just do the math that's like about 30,000 dollars a year. That's not something that you can live comfortably on with a family. So we've definitely got a lot of low-skill jobs, and we've got lots of high-skill jobs, and we're losing that middle. And I don't think there's any simple answer to that but it's one reason why international trade is so complicated, or controversial I should say. But I do think automation is an equally important part of the story and we're not going to stop automation.

PITA: Well David, thank you for answering all of our questions today. As always, we recommend our listeners go back and check out past episodes including one with Jay Shambaugh to dive into any one of these issues more deeply, and you can follow us on Twitter @policypodcasts. And David, who are you on Twitter?

DOLLAR: @davidrdollar.

PITA: Wonderful.

DOLLAR: Thanks so much.

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