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THE CURRENT: Will the new US-China trade deal end the trade war?

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PARTICIPANTS:

Host: Adrianna Pita – Office of Communications, The Brookings Institution

Guest: David Dollar – Senior Fellow, John L. Thornton China Center; Host, "Dollar and Sense" podcast, The Brookings Institution

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PITA: You're listening to the Brookings Podcast Network. This is Adrianna Pita and I'm here with David Dollar, host of "Dollar and Sense," and we're bringing you another joint episode of "The Current" and "Dollar and Sense." David, thanks for joining us.

DOLLAR: Great to be on the show.

PITA: On Wednesday, the U.S. and China signed what's being called "phase one" of a trade agreement intended to ratchet down tensions following nearly two years of escalating, retaliatory tariffs between the two countries. Can you tell us the highlights of what's included in this phase one deal?

DOLLAR: The administration's been trumpeting big commitments by China for increasing its purchases from the U.S., so the U.S. will export more to China. There's specific numerical targets – essentially $200 billion of additional US exports over the next two years. That's a very significant number. Starting from where we were in 2019, U.S. exports would have to increase by about 40% this year, and an additional 40% on top of that next year, so those are very large increases.

PITA: You're comparing that to what trade was in 2019, during the trade war – how do those numbers compare to what U.S. and China trade was before the trade war started? How much is that increase over that?

DOLLAR: So, 2019 was down about 20% over 2017, so the targets are relative to 2017, but I converted it to a percentage increase to 2019, because for an economist, that's more relevant. Compared to what we were doing last year, we now have to do 40% more, and then 40% more the following year. Those are fairly big increments; we don't normally see numbers rising at that kind of rate.

PITA: Yeah, that is a big jump. Can U.S. producers suddenly keep up with that? What does that involve – is that agriculture, is it manufacturing, what's built into that?

DOLLAR: So it's actually broken down into four categories: agriculture's gotten the most attention, but that's actually relatively small, a $32 billion increment. Energy is $53 billion. Services, we export a lot of services to China, that's supposed to go up by $35 billion. And manufacturing is supposed to go up by $80 billion. Now within that are a lot of specific products. Boeing has historically sold a lot of planes to China, and they could sell more; the Chinese air market is growing rapidly. But you take a production problem like the Boeing 737 Max – that's out of production right now. If that problem doesn't get solved, it's really hard to see how to get an increase in aircraft exports.

Or, energy: we've been maximum exporting $10 billion of energy to China, and now the target is $50 billion. And that's possible, but it will take new facilities, liquified natural gas terminals and pipelines. Someone will have to make a big investment, that's in North America, and they'll need a long-term contract. No one's going to do that without a long-term contract. If they think trade may be stopped in a year or two, then you're not going to build a new LNG terminal.

So, in each of these areas, these are pretty significant jumps that we're talking about, and a lot of things could interfere with meeting those targets.

PITA: What about some of the more big picture, structural issues that have really been at the heart of U.S.-China disputes, including things like intellectual property rights?

DOLLAR: So, the new agreement definitely covers some of the structural issues. For example, China's committing to improving intellectual property rights protection. It says it's not going to force foreign companies to do technology transfer to Chinese companies. These are mostly vague promises. In some cases, the Chinese have recently taken specific measures. So, they've strengthened their penalties for IPR violations. So I would say the agreement basically includes things that were already in the works, and/or things that were somewhat vague promises, and it remains to be seen if Chinese practices actually change.

PITA: Was there any mention of any sort of timelines or benchmarks for when some of these improvements might happen, or for the purchases, when they have to happen by?

DOLLAR: The benchmarks are definitely for the purchases. So the target, as I said, over $200 billion relative over 2017 levels. I think as you get to the end of this year, 2020, it'll be clear if you're remotely on target for that. So the two sides will meet and discuss that, and I think that's sort of the main target for those purchases.

PITA: And for enforcement, is that, the next time that they meet, is that basically there they'll decide if there's been sufficient progress or not and then decide on consequences after that, or is there some sort of mechanism built in?

DOLLAR: To me, the main enforcement mechanism is that if the U.S. is unhappy, it's going to ratchet up the tariffs even further. We're not withdrawing a lot of tariffs as a part of this agreement. We cancelled the December 15th round of tariffs, so we're not escalating. We've taken away about 10% of the tariffs that we implemented; that leaves 90% in place. So I think if China performs well, you can anticipate the U.S. rolling back more tariffs, and if the U.S. is unhappy, it's going to increase tariffs. That's really the main enforcement mechanism.

PITA: President Trump particularly will be counting on elements like these agricultural purchases as his big win that he's walking away with. If the tariffs that are going to be rolled back are more modest, let's say, what is China taking home to their people as a win out of this?

DOLLAR: So, the main thing China's getting is no further escalation. These tariffs have come in waves and it's definitely upset the Chinese, worried the Chinese. So the non-escalation is probably the main thing the Chinese are getting. They're happy there's a small rollback of U.S. tariffs; they wish it were more, but I think they're accepting of the small rollback. And then I'd say on the structural side, they're doing things they've already been planning for a while, so these are things that are going to be good for the Chinese economy. Strengthening intellectual property rights, not doing forced technology transfers, I think the Chinese are pretty committed to these structural measures. So, they're telling their people these are things they were already planning to do. And on the purchase side, mostly these are things China needs. China certainly needs energy, needs agricultural products. They'd love to buy more and more high-tech stuff from the United States if we're willing to sell it. So I think they'll present it to their people as a good compromise that prevents escalation into a much more serious trade war.

PITA: The pork purchases, those were included, those'll be especially important to them, they've had a big pork flu, I understand?

DOLLAR: Right, they've had a terrible crisis. the price of pork, at least until recently, was up by 50% over the year before. It's a very popular meat in China. We're heading into their main holiday season, the spring festival, the so-called Chinese New Year. People love pork dumplings and other types of dishes. I think that's been a real problem for them. It makes sense for them to import a lot of our pork. And then as they get their herds back into healthy shape, they're going to need to import a lot of soybeans to feed their herds.

PITA: One of the other elements that was included in the agreement was the U.S. agreed to lift their designation of China as a currency manipulator. The last time you and I talked, you mainly talked about how this was primarily a symbolic designation. Is lifting this designation also just a symbolic, giving China a little bit of a win, or was there anything of substance on monetary issues addressed?

DOLLAR: I would say the basic answer to your question is yes, this is symbolic. As we've discussed before, it was odd for the U.S. to label China a currency manipulator last summer because they haven't been manipulating their currency, not for 7 or 8 years. And they have a commitment within the G-20 group of countries not to manipulate their currency and they've been sticking to that. So I would say the recent U.S. move is just recognizing reality, plus the agreement does have a chapter in which the Chinese affirm that commitment that they're not going to manipulate their currency, so it'd be odd for the U.S. to sign the agreement and then keep calling China a currency manipulator. It'd be inconsistent. So I think dropping that designation, that's just righting a previous wrong.

PITA: So if this was phase 1, has there been any talk about when phase 2 begins, or what might be included, or anything like that? Or is everybody stepping back and taking a bit of a breather, now that they've hit phase 1?

DOLLAR: I argued that some structural measures are included in this phase 1, but they were things that China was already planning to move on. Things that are not included are things that China is not planning to move on. So this does not really say anything about the role of state enterprises in the economy, doesn't say anything about cyber-theft, doesn't say anything about industrial policy or subsidies to build up industries. All of the really tough stuff has been left for a somewhat mythical phase 2, but I think both sides have been pretty clear there are no concrete plans to move to those phase 2 negotiations. The negotiations may start during 2020, but I don't think it's in either side's interest to try and conclude that. In practice, if you want to make an agreement with China on those issues, the US is going to have to be willing to compromise, to take less than a maximalist position. Hard to see in 2020 that the US would be willing to compromise, so I think it's better politics to say you got a win in phase 1, someday there'll be a phase 2, but that's been kicked down the road.

PITA: Actually on that – for trying to achieve some of those bigger aims, even as big and as important as the U.S. and China economies are to each other, is that something – regardless of whether it's in 2020 or something that you aim to do in 5 years or 7 years – is that something the US can achieve on its own, or is that going to need a broader coalition of China's trading partners to get together and try to negotiate together on?

DOLLAR: Great question. I think it requires the broader coalition. China is on track to be the biggest economy in the world, the biggest trading nation. When we talk about what China's getting out of this, it's definitely buying a year of trade peace. I think we can anticipate this agreement will hold in 2020. Meanwhile, China is reorienting away from the United States. They're increasing their trade with Europe, with Southeast Asia, with Africa. The U.S. is a declining share of the world economy. Part of the Chinese strategy is to wait this out to some extent, and if the U.S. really wants to firmly deal with all those structural issues, we need to be working with Europe and Japan and other countries whom together make up most of the world economy. Then we have a reasonable chance of negotiating with China. If it's just the United States bilaterally, I think we're going to be getting this kind of agreement where China agrees to things it was largely planning to do, plus some politically palatable purchases, but not really any significant change in their system.

PITA: All right. David, thanks for explaining this to us today.

DOLLAR: Great to be with you.