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What can shipping containers tell Us about the US-china trade war?
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DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast, Dollar & Sense. Today my guest is Lori Ann Larocco, author of a new book, *"Trade War: Containers Don't Lie, Navigating the Bluster."* So we're going to talk about what we learned from Lori's book about the actual impact on the ground of President Trump's trade policies.

Welcome to the show, Lori.

LAROCCO: Thank you for having me.

DOLLAR: So your book deals a lot with ports and shipping. I really liked the reality on the ground, the details. So I'd like to start with a general question about the role of maritime transport in international trade.

LAROCCO: Sure.

DOLLAR: Some trade moves by trucks – say between the U.S. and Mexico. There's a little bit of air shipment. But maritime travel is really the key thing for international trade. So tell us a little about the patterns of that, what are some of the key U.S. ports, what's the role of maritime?

LAROCCO: Yeah, sure. Well, a lot of folks don't realize that around 90 percent of what is in your home arrives on a ship. And so shipping is really a forward-looking indicator of a country's economy, because it's based on consumption. Based on how folks are doing in a particular country, they can buy more product. There are what I like to call various pipe plumbings, right. If you want to look at the flow of trade, it's like plumbing. You've got various pipes, and one of the biggest pipes that goes between the United States and China is the trans-Pacific trade highway, if you will. And that's predominantly where you've got your West Coast ports. Where you have Los Angeles, Long Beach, Oakland, Seattle. That's where the majority of the Chinese products arrive into.

So what I did was I wanted to see based on the trade war, what is China buying and did they fulfill what they were doing. And, more importantly, not only were they buying from us, but what they were supposedly buying. So it was very easy to track. You can definitely track all this trade flow, if you will, through the various government data.

DOLLAR: One of the nice things in your book is there's a little excerpt about the role of containers. I think everybody takes this for granted in today's world, but they were invented I believe about 50 years ago and they really play a key role in this transport, right?

LAROCCO: Yeah. It's pretty amazing. And, you know, it's like one my journalist teachers said, a great story could be at the end of your nose. Well, when it comes to maritime, this one gentleman created a container, if you will, that would be ubiquitous – it can move on trains and it could also move via truck. Because back in – you can't even say the olden days – back like say 60 years ago, a lot of product was…instead of just being like all nice and neat where you see the stacks of containers, if you will, on the vessels, it was like a hodgepodge. You had boxes of toilet paper, you've got TVs, and things like that. And the gentleman realized that if you had one container where you could load it up at one country, put it on a vessel, and then send it to another country it was a lot quicker not only take the product out, but also to get where it needed to go. And also not to lose it. So it's a really great way of tracking the product.

DOLLAR: Right, you just pick the container up, you put it on a truck or you put it on a railbed, and you move it around. It never has to be opened. It's really a key feature of modern trade.

LAROCCO: Yeah. It's pretty neat.

DOLLAR: One of the interesting issues you take up in your book is what you call frontloading. It would be helpful for our listeners, I think, if you explain that a little bit. When the U.S. has imposed these various tariffs, there's a comment period, and I guess that's key to this frontloading issue. Is that right?

LAROCCO: Exactly. So what happened was when you were watching the trade flows, President Trump would announce that on this day we are going to set tariffs on whatever the product was. And then you have a comment period for X amount of time. Well, there are two different ways of getting your product over: either in a 10 to 14-day time period by ship, or by 20 to 30 days. And so, it's not like you can get something overnight via ship, it takes time. So what a lot of these companies had to do was frontload their product, and that meant to get as much volume of their product in that could be tariffed in before the tariff deadline. And what happened was that all these companies started just filling their containers, if you will, and sending them on ships to go to, say, the Port of Los Angeles. And what happened was you had this frontloading phenomenon where the flow of trade actually changed because you had so many ships trying to get in before that time because if you were one day late, your product was going to be tariffed. So you had these – not a split second decision – but you had decisions by some folks where say instead of going to the Port of Los Angeles, they couldn't wait any longer, they went and diverted their ships to say the Port of Houston, all in an effort to get their product in.

So that's what frontloading was. Frontloading literally is the action in which the companies brought a lot of their product and they just stored it in warehouses. But what happened was that type of frontloading, that surge of volume, if you will, not only moved the flow of trade from one port to the other, it actually created what looked like a trucking shortage because you didn't have enough trucks to move the containers. And you had not as much warehousing because if you can't fill a warehouse –not like your attic, right, where you just fill it to the brim – well, in a port you can't do that because you have to have some way of moving around the area to go get the product. So this frontloading really crippled the movement of containers as well as the availability of trucks.

DOLLAR: So I think that's a really fascinating insight into the reality of the trade war on the ground, that you've got this scrambling, trying to take advantage of the availability of ports and warehouses and filling them up at one moment and then they'll be relatively empty a couple of months later.

So from an economist's point of view, that's a kind of inefficiency in all of this.

LAROCCO: Exactly.

DOLLAR: As the Trump administration rolled out its tariffs, various members of the administration said that other countries would not dare retaliate against the U.S. because of the U.S.'s size and importance. In fact, what has happened with retaliation, which would affect what's happening in the U.S. exports as this trade war is prosecuted?

LAROCCO: Well, the biggest thing that we have seen is that there has been a decrease; particularly, like when you look at China, they're not buying. One of the biggest news hits that we had in 2019 was this joyous news that the U.S.-China deficit was smaller. Well, yes, it was, but it wasn't because the United States started exporting more and China had less. The fact was you had almost like an equal, if you will, of less Chinese products coming in and less U.S. products going out. You definitely have had retaliatory measures, even over at the EU. Whiskey, for example – U.S. whiskey I should say – is pretty much all gone. There is no market in the EU anymore.

So for countries to say that they're not going to retaliate, they definitely are. And when you're looking at the EU right now as it relates to the 100 percent tariff on wine that the president is currently threatening, they said that they're not going to pick up this matter until the end of the year. Well, what's going to happen in the fall – the U.S. election. So I think when it comes to what's going on for retaliatory measures, for other trade deals – we've even heard it with China – a lot of folks are waiting to see what happens with the 2020 election.

DOLLAR: This is one of the reasons why, economists in general, we don't expect these kind of trade measures to affect the trade balance. You might think that tariffs reduce imports so the trade balance has to move in a certain direction, but retaliation almost always occurs, so the U.S. exports less.

So if you look at the aggregate, the U.S. trade deficit has actually gotten a little bit worse during 2019 if you leave aside petroleum, which is kind of on its own track. So you do get his predictable result that we import less, but we also export less, not really had much happen to the overall trade balance.

Your book also has a nice section on who pays for the tariffs because there's been a lot of debate about that in the U.S. So what did you find about who pays for the tariffs?

LAROCCO: Well, I actually asked customs, because U.S. Customs are the agency that collect the tariff, and I asked them point blank “who pays for the tariff?” And, as you know, President Trump has said China pays the tariff. Well, that's in effect wrong. The U.S. Customs has explained in an email to me that it is the U.S. importer that pays for the tariff. The U.S. importer is the company. And so, when I had also spoken with CEOs that make their products in China, they have told me that a lot of times when their products get tariffed, particularly looking at the tariff back in September of 2019, the founder of Casabella cleaning products told me that his product, because the tariff was implemented so quickly, he had product being shipped that was going to be tariffed by the time it got in, and he tried to go to companies to try to renegotiate his product and they said “no way.” And so he had to eat that tariff. So in the end he told me that hurts innovation, that hurts job creation.

So in the end, the one that's paying the tariff is indeed the company.

DOLLAR: Right, that makes sense. And in some ways it was always a little inconsistent for the administration to argue that the Chinese were paying the tariff because the whole point of the tariff is to make the price more expensive in the United States. So if the Chinese just picked it up, if they absorbed it, then the prices would be same for the American consumer and people would keep importing. The whole point really is to raise prices. And, as you say, a lot of what we import from China are things that are used by manufacturing firms and they're going to eat those costs.

LAROCCO: Exactly. And here's a fact I didn't even realize. Going back to the Casabella CEO, they make brooms and cleaning products. He told me he cannot bristle a broom in the United States because there is no technology to do so. So the only place that he can bristle his brooms is China. And because of what's going on with the tariffs he is also looking to move out. He's not looking to move out and come back to the United States, he's looking to do what other countries have done: Either move to Southeast Asia or maybe possibly a European country like Italy because he's actually looking in his case at Italian manufacturers.

So it's not a done deal that if you're going to make it unpleasant, if you will, when it comes to the tariff and increases in the prices, it's not a done deal that companies are going to move back because not all of them have.

DOLLAR: Lori Ann, your book has some chapters that go into individual products that are important. One that's gotten a lot of attention is soy beans, really key crop for American farmers and probably the biggest item that China has been buying from the U.S. for a long time. So can you tell us a little bit about what has happened to soy bean trade during the trade war?

LAROCCO: Definitely. Before the U.S. trade war with China, the United States was the top producer of soy beans for China. When we had the 232 tariff on steel and aluminum, that's what really started heating up and that's when soy beans got into the crosshairs, if you will. The price of soy beans, the tariff that they put on – "they" meaning China – put on soy beans made them so expensive that they had to go to other countries like Brazil in order to fulfill their needs. And so what we've seen over the course of two years is that our competitors – Brazil, Argentina, even Russia – they have increased their soy bean production. An interesting note, we have heard countless times the quality of the soy bean, how great the U.S. soy bean is. Well, in 2018 the Chinese started purchasing more beans, not from North Dakota, they started buying the beans up in Canada. It's the same exact bean, it grows in the same ground. The only difference is that it's literally across the imaginary border. In fact, the soy bean sales went up 60 percent in 2018 for Canada. This just shows you that China was able to eliminate the U.S. market and they, throughout the two years, have been expanding their trade relationships. And if you keep a close ear to the rhetoric that Chinese are making with phase one, they're saying that they are going to honor their other trade commitments with their trading partners. So when it comes to how much soy bean they're going to buy, we'll have to see.

DOLLAR: Now, a completely different product would be the metals: Steel and aluminum. And that's not so much about our China trade. Mostly we've been importing those metals from countries like Canada, Mexico, South Korea, Japan, Germany, and then we slapped on these 232 tariffs for alleged national security concerns. You've got a lot of nice material about what happened then to the metals trade. So can you tell us a little bit about that?

LAROCCO: Absolutely. When you're looking at steel and aluminum, which is actually two industries, if you will, that the president's base are employed through, he wanted to make sure that that industry would be alive again. And because of subsidies, which are monies that governments give to companies, they either – for example, for China's instance –they will pay for the electricity bills of the aluminum makers. Well, one of the number one costs to an aluminum maker is electricity. So you have all of these different headwinds, if you will, that make U.S. steel and U.S. aluminum too expensive and not competitive.

And with the 232 on steel and aluminum, it actually enabled the U.S. to be on even ground because what happened was the U.S. steel and aluminum rose to price against our competitors up so much. And because of that the U.S. steel could increase their steel prices up, but just under the tariff price. So they were not only able to try to take back some market share, they were able to make a little profit off of it. But, unfortunately, what we've seen is what's called a "boomerang effect." And what that means is that it's an unintended consequence. And what I'm getting to is the tariffs, if you will, on soy beans. And, ironically, because, for example, the farmers got hurt, right? What do the farmers buy? They buy John Deere. In the third quarter of 2019 they came out during their earnings call saying that they were going to pull back, if you will, on the building of John Deere tractors. Why? The farmers weren't buying them. And what are John Deere tractors made out of? Metal.

So in some ways, while they have had an opportunity, these companies, to raise their prices – which they haven't been able to in a very long time – the industries that use their material are not making things because there are certain pockets of the economy that are not buying.

DOLLAR: Right. So that's a great example of unintended consequences. The net result is there's been a small number of additional jobs created in metals, but then because metals are more expensive for the firms that use them – the John Deeres that you mentioned, used in construction of cars and auto – you end up net losing a lot of jobs. That's what has happened as a result of these metals tariffs is basically you create a few jobs in one sector, but you end up losing a lot of jobs in other sectors.

LAROCCO: Well, and you've also seen companies like U.S. Steel where they're closing plans. And, like you pointed out, that's jobs. And those are jobs that are gone. So it's kind of ironic to see how that is all playing out right now. So you really have to wonder, is that really a win?

DOLLAR: So last topic I wanted to take up with you, Lori Ann, is this phase one trade deal with China, which you mentioned. It includes a number of things. Probably most important, the U.S. has got China to agree to make larger purchases in different areas. They're supposed to by an extra $32 billion of Ag products, more than $50 billion of energy, plus manufacturers and services. This is all over the next two years.

So I'm interested – we can probably break it into two parts. First, you general reaction to the trade deal. And then, more specifically, I'll be interested in what you will be looking at as this phase one deal is implemented. But maybe start with your general reaction.

LAROCCO: Well, my general reaction to the deal is that you really have to see exactly what they're going to buy. When you're looking at the flow of trade and you look at their past trading patterns, looking at China, the soy beans, if they buy, it's going to be in the fall because there's a seasonality purchase when it comes to the soy bean. I think when it comes to the Ag purchases, I expect more of the timber and lumber to be purchased because they need that when it comes to building their infrastructure. And lumber is part of Ag purchases. So for a lot of people that think that it's going to be corn and a bunch of soy beans, I think they're going to be sorely disappointed.

I think we also have to see what happens with the technology. Being a journalist and following the last two years with this trade war and how China has fallen short of making their commitments, I'm kind of skeptical. And then now, of course, you've got the coronavirus, which essentially has shut down the country. And I'm going to be looking for – starting in February, that's when they normally purchase the Brazilian soy bean based on seasonality. So we have to see how much they purchase. And also, in terms of poultry, there's reports that their livestock is not getting their grain. There are a lot of unknowns when it comes to that.

But the one thing that I have been watching, and even traders that I've spoken with are not thrilled, is pork. And so starting back on December 13 I started keeping a keen eye on the sales of hogs because Lunar New Year is traditionally a very large protein consuming week for the holiday. And so they need pork because 60 percent of their pig population was culled because of African Swine Fever. And so they needed pork. And so I started looking: Were they going to make these large good will purchases? They did not, and they never did.

So, again, I'm kind of skeptical saying, "okay, are they now waiting until February 14?" But now we have to look because of what's going on with the coronavirus. And, you know, you've already started seeing the tea leaves. You already have Secretary Perdue talking about phase one and the impact the coronavirus can have on the Ag purchases.

So it's very, very fluid, but based on initial trade, they're buying things, but nothing of spectacular value that the trading community was expecting.

DOLLAR: I think you're right that there was a lot of skepticism right from the beginning of this agreement on phase one that China could actually meet these big commitments. And then, as you say, the coronavirus really complicates things. The Chinese economy is certainly going to slow down dramatically for at least a while. If we're lucky, it will be relatively short, but it's certainly going to affect 2020's result. If you think about these Chinese airlines drastically reducing their flights, that's going to affect their purchases of aircraft and their planning over the next couple of years. So it just gets a lot more complicated trying to meet these targets now in this new environment.

LAROCCO: Well, and also the human factor just because you do have a lot of people sick. And I go online – there's this great website if anyone is like a maritime-wonk it's called Marine Traffic. And you can go on there and you could see all those ships going everywhere around the world and you can drill down based on the ports. And based on the flow of the amount of ships going in and out of, say, the Port of Wuhan, it's drastically down – drastically. And a lot of it is because of the coronavirus, because of the manpower, if you will, and also the ships waiting to go in, and if they are going in, because of the virus. So you could literally see it in real time if you wanted to – the impact.

DOLLAR: I'm David Dollar and I've been talking to Lori Ann Larocco about her book, *"Trade War: Containers Don't Lie, Navigating the Bluster."* You can buy it on Amazon and I'm sure you can find it elsewhere. It's got a lot of great detail about maritime shipping, the reality of trade in terms of ships and containers, and it gives you a different perspective on this trade war that the U.S. has been waging, and now the trade peace that seems to have come about. So, thank you very much for joining us, Lori Ann.

LAROCCO: Thank you for having me.

DOLLAR: Thank you all for listening. We'll be releasing new episodes of Dollar & Sense every other week. If you haven't already, make sure to subscribe on Apple Podcasts, or wherever else you get your podcasts, and stay tuned.

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