Center for American Progress

1333 H Street, NW, 10th Floor
Washington, DC 20005
Tel: 202 682.1611 • Fax: 202 682.1867

www.americanprogress.org

Memorandum to Interested Parties
From: Center for American Progress
Date: January 16, 2020
Subject: The Phase One Trade Deal with China Accomplishes Little

Yesterday President Trump and Chinese Vice Premier Liu He signed a so-called "phase one" trade deal between the United States and China. Yet despite the two countries agreeing to some changes in their behavior, the trade war goes on and there is little reason to celebrate what has been negotiated thus far.

While all the details of the deal are not yet public, what is known so far suggests that having forced himself to undo a problem of his own making, Trump may be making the underlying problems worse with a weak deal. Trump will attempt to spin the outcome of these negotiations as a win, but the winners are not American workers or the American economy.

I. The Economic Costs of the Trade War So Far

The Trump trade war with China has a large set of goals, ranging from ending the bilateral trade deficit to preventing the theft of intellectual property to altering the organization of the Chinese economy through forced changes to its industrial policy. The administration has never explained how it prioritizes these goals, nor has it explained why imposing unilateral tariffs is an appropriate strategy for achieving any or all of them.

Nonetheless, the war initiated with tariffs on solar panels and washing machines, followed by tariffs on steel, and then expanded to cover a wide range of goods from China. Retaliatory tariffs on U.S. exports have been imposed by China as well as the European Union, Mexico and other countries affected by Trump administration tariffs. That retaliation has been directed at goods ranging from soybeans and pork to Harley Davidson motorcycles.

In total the Trump administration has levied tariffs on $505 billion worth of Chinese imports. In response, China has levied tariffs on $150 billion worth of American imports.

The domestic economic effects of the trade war have been negative in the aggregate, and include:

- *Increased costs to U.S. firms and consumers who purchase goods from China.* A recent paper by Amiti et al. (2020) concludes that American tariffs are almost entirely borne by U.S. consumers and firms. According to a detailed estimate by P. Fajegelbaum et al. (2019), the tariff escalation collectively raised consumer and producer costs by $51 billion in 2018.
- *Reduced real wages for workers in tradeable goods sectors.* Fajegelbaum et al. (2019) estimate that the average real wage in the tradeable sector was reduced by the combined

tariff effects by about 0.7 percent.

- *Reduced U.S. real income.* Real income in 2018 was reduced by about $7.8 billion for the year according to Fajegelbaum et al. (2019). This estimate of real output loss is very close to one derived by M. Amti et al. (2019).
- *Reduced U.S. employment.* A report from Moody's Analytics concludes that the trade war with China reduced employment by 300,000 through August of 2019. Another recent Federal Reserve study by Flaaen and Pierce (2019) concludes that the net effects of the U.S. tariffs and Chinese retaliatory tariffs were relative reductions in manufacturing employment and relative increases in producer prices.

On the U.S. side, the 25% tariffs on $250 billion worth of Chinese goods will remain in place under the "phase one" deal, along with tariffs of 7.5% on an another $110 billion in goods the United States imports from China. Trump claims he is keeping those tariffs in place to maintain leverage over the Chinese. The United States will definitely need leverage, because the deal is riddled with loopholes, so enforceability will be a major challenge. It is not the Chinese who bear the costs of these tariffs, it is Americans households and businesses.

II. Why This China Trade Deal Fails

The administration appears to be applying the same tactic with China that it has used on issues ranging from climate policy to tax policy: find short-term fixes that provide an immediate political pay-off for Trump, while ignoring the long-term damage that will undermine American prosperity for decades to come.

Signed on January 15, 2020, the "Phase One Economic and Trade Agreement Between the United States of America and The People's Republic of China" covers the following topics:

- *Intellectual Property (IP) and Technology Transfers* – Commits China to strengthen protections and enforcements of IP, bolster protections for trade secrets and enforcements against trade secret theft and prohibit the forced transfer of foreign technology to Chinese firms. However, many of these commitments echo promises China has made before, and many of the provisions are vague and weak. If past is prologue, American companies may soon find that enforcing these provisions within the Chinese system is easier said than done.
- *Agriculture* – Commits China to a number of deregulatory steps and other procedural changes to facilitate trade in food and agriculture products from the U.S., committing to purchasing $80 billion in agricultural products over the next two years. Notably, some of China's promises in the food and agriculture chapter are simply a re-statement of its existing WTO obligations.
- *Financial Services* – Commits China to expand the ability for U.S. financial services firms to do business in China, including by eliminating the foreign equity caps for securities companies and insurance providers and taking other steps to enable providers of electronic payment services, asset management services, banking services, and credit

and debt services to do business in China. Although a top priority for the Trump Treasury Department, some of these promises reflect internal Chinese priorities regarding reforming their own China's financial markets.

- *Macroeconomic Policy* – Commits both parties to adhere to the International Monetary Fund exchange rate standards, which prohibit countries from manipulating exchange rates, and to provide quarterly monetary and financial metrics to the other party. China is a member of the IMF, and has manipulated its currency in the past while committed to IMF rules.
- *Purchases* – Commits China to buy an additional $200 billion worth of American goods over the next two years, including $77.7 billion of manufactured goods, $32 billion of agricultural goods, $54.2 billion in energy, and $37.9 billion in services. At the signing ceremony, Chinese Vice Premier Liu suggested those purchases are conditional—based on Chinese market demand—rather than set in stone. It is not yet clear whether those purchases are conditional on any U.S. actions, but the text released thus far suggests that may be the case.

At a macro level, three aspects of the deal are particularly concerning:

First, the administration's approach does nothing to level the playing field for American workers and may even put American companies even more on the line.

The Trump administration is taking the same approach to China the United States has pursued for decades: trying to get China to buy more U.S. goods and make it easier for U.S. businesses to locate in and sell to China. The problem is that China has no intention of playing fair. The Trump administration is seeking to increase Sino-American economic integration on an uneven playing field. China will use this integration to mine U.S. technical know-how and drive American companies out of business, leaving the United States worse off. The Trump approach also ignores the broader problems facing American workers and consumers. It does nothing to counter the global race to the bottom on wages, raise environmental standards, or reduce the power of companies to lock in high drug prices that hurt families or high seed prices that harm farmers.

Moreover, while it attempts to make China an easier environment for businesses operating there – by including provisions designed to protect intellectual property, prevent coerced technology transfer, and make it easier for financial services firms to do business – it is unclear just how enforceable any of these provisions are. The text released thus far suggest enforceability will be a major challenge.

The United States does not stand alone on China: many other nations have the same complaints about China's trade practices. Yet, instead of joining forces to form a united front on China, the Trump administration takes a mano-a-mano approach. That is a mistake. One reason: once the deal is struck, the United States bears sole responsibility to monitor Chinese behavior and enforce the deal. That responsibility, at a very practical level, falls most heavily on American companies. American companies who sell goods to China and do business in China are the canaries in the coal mine. It will be up to them to report back whether China is truly making meaningful change on issues such as market access and forced technology transfer. The problem: they know if they do complain, Beijing will retaliate in ways that hit their bottom line—such as holding up purchases and delaying business licenses—potentially forcing them to shed jobs. They will be between a rock and a hard place: even if things are bad in China, they will know that a return to a tariff war might be worse, so reporting China's failure to follow through on its promises may not be in their interests. Many will stay silent, allowing China to continue undermining U.S. prosperity and security.

Ultimately, even if effective, the principal beneficiaries of deal are large financial services firms, large agribusiness firms, and large technology or technology-dependent firms. With no provisions to secure worker rights, environmental protections, or raise other consumer protections, the deal will benefit the monopolistic position of the largest U.S. companies, while undermining the economic outcomes of working families in both the U.S. and China.

Second, Trump is touting the $200 billion China purchase agreement as the deal's big win, but the signing ceremony made clear that "agreement" is murkier than the administration would like to admit.

The supposed crown jewel of the new trade deal is a purchase agreement. The problem is, it is not at all clear what China is really agreeing to or what conditions the United States must meet for those purchases to go forward. During the signing ceremony, President Trump claimed the Chinese will buy an additional $50 billion in agricultural products from the United States. When Vice Premier Liu He stepped up to the podium, he corrected President Trump, stating that China has agreed to purchase around $40 billion per year total, and that total amount will be contingent on market demand.

As of the signing ceremony, even the leaders were not sure what they were actually signing. Yet, at that ceremony, President Trump called on American farmers to go out and invest in more tractors in order to ramp up production and boost U.S. agriculture exports to China to $50 billion per year, an amount his Chinese counterpart quickly shot down. It would be dangerous for American farmers—who have already been pushed to the breaking point by this administration's failed trade and antitrust policies—to take the President at his word and sink hard-earned capital into equipment and crops that only make sense if China is going on a buying spree. The USTR text states that China will purchase an additional $32 billion in agricultural goods above 2017 levels over two years. That number pales when compared to the losses American farmers have suffered due to tariffs. In fact, it is less than the $38 billion in taxpayer-funded bailouts the Trump administration has provided to American farmers to offset their losses from the Trump trade war. When lost sales from the past two years are taken into account, there is no net gain in agricultural sales from the deal. There is also no roadmap for what happens after the two-year mark, raising the likelihood that even if China does go on a buying spree, it will be a short-lived one. That does not provide American farmers the security they need.

Other commitments are just as concerning. With respect to the Chinese promise to increase purchase of manufactured goods by $77.7 billion, it is reasonable to ask whether China's commitment hinges on U.S. relaxation of export controls, or limits on what Huawei can buy from the U.S. Moreover, although $200 billion seems like a big number, purchases of this scale would not necessarily eliminate the trade deficit with China, an issue on which the administration has been fixated. The goods and services trade deficit with stood at $337 billion in 2017 and $380 billion in 2018.

Finally, Chinese industrial policy is the real problem, but the so-called "phase one" deal punts those and other hard issues for a "phase two" that is unlikely to ever come to pass.

Setting aside the above concerns, the agreement does nearly nothing to tackle China's industrial policies that are squelching U.S. exports to China and giving unfair advantage to Chinese companies in third markets. President Trump has declared that the cumulative damage the United States has suffered from those policies should be considered one of the "greatest thefts in the history of the world." Yet, now President Trump is essentially giving Beijing a free pass.

China maintains a range of governmental policies designed to privilege Chinese firms over their foreign competitors, distort trade and investment flows, and grow national champions—such as Huawei—that can distort or even dominate global supply chains. While currency manipulation has long been a highly visible policy—the impacts of which this deal fails to remedy—the most prominent policies today focus on state funding for Chinese firms seeking to gain market share in sectors Beijing wants them to dominate (such as the $160 billion Beijing is funneling to the nation's semiconductor firms). Beijing is not shy about these goals. The Made in China 2025 technology roadmap sets forth market-domination targets across a range of sectors. For example, in mobile telecommunication equipment—including 5G network equipment—the roadmap calls for Chinese firms to supply 80 percent of the domestic market and 40 percent of the global market by 2025.

The "phase one" deal is basically punting these problems, claiming they will be addressed in "phase two." There is little reason to believe that will ever happen.

The "phase one" deal does include terms to limit IP theft and limit Chinese policies that leverage China's domestic market to strip technology from U.S. firms (i.e., requiring foreign firms to form a joint venture with a Chinese partner, hand over privileged information to gain a business license in China, or needlessly incorporate Chinese components into their products). But it is unclear whether this will be any more effective than similar commitments made in the past.

III. A Better Approach

The Trump administration's approach to the China trade challenge is fundamentally flawed. It fails to address the competitive challenge posed by China, and yet ties the U.S. economy even more closely to China. It also forces the United States to combat the China problem alone. There is another way. The U.S. should be making critical investments at home to put the United States in a strong position regardless of what China does. We should be joining forces with our allies and partners to meet not only the China challenge but also the broader challenges globalization poses for our workers and for democratic legitimacy. In particular, the United States should:

- **Launch a National Economic Competitiveness Initiative.** Invest in education, workforce development, public infrastructure, and moonshot research and development, and deploy antitrust enforcement to protect America's innovative capacity and broad distribution of economic and political power.
- **Fight back on unfair trade practices in partnership with allies.** Rally other nations to file a nullification and impairment case against China at the World Trade Organization, support enhanced subsidies and currency disclosures and enforcement, build a U.S.-EU special relationship to boost labor rights and tackle corporate monopolies globally, and negotiate a digital trade agreement with allies and partners that protects national security while also leaving robust space for democratic protections such as in the area of privacy and antitrust.
- **Ensure workers can secure the benefits of trade and reduce the trend for trade agreements to increase corporate market power.** Raise labor and environmental standards in key trading relationships and reject the use of trade agreements to constrain socially important domestic regulation, e.g. by mandating excessive exclusivity periods that benefit pharmaceutical manufacturers but raise costs for households.
- **Launch a next-generation digital infrastructure initiative.** Lead an effort among democracies to adopt common governance principles for artificial intelligence and next-generation digital infrastructure; make digital infrastructure financing a high-priority focus for overseas aid; and secure U.S. consumers and companies from digital and cybersecurity risks.

For more detail, see:

- Limit, Leverage, and Compete: A New Strategy on China, by Melanie Hart and Kelly Magsamen, Center for American Progress, April 2019
- Trump's Trade Deal and the Road Not Taken: How to Evaluate the Renegotiated NAFTA, by Marc Jarsulic, Andy Green, and Daniella Zessoules, Center for American Progress, February 2019