BROOKINGS

Order from Chaos

More pain than gain: How the US-China trade war hurt America

Ryan Hass and Abraham Denmark Friday, August 7, 2020

Editor's Note:

The ultimate results of the phase one trade deal between China and the United States — and the trade war that preceded it — have significantly hurt the American economy without solving the underlying economic concerns that the trade war was meant to resolve, writes Ryan Hass and Abraham Denmark. The consequences that have followed in the wake of the economic clash have served to exacerbate bilateral relations. This piece originally appeared in SupChina.

As a candidate in 2016, Donald Trump built his argument for the presidency around his claimed acumen as a dealmaker. As the 2020 election draws nearer, President Trump and his surrogates are doubling down on that assertion, including by calling attention to what he has deemed "the biggest deal ever seen": the "phase one" trade deal with China. The agreement reportedly includes a Chinese commitment to purchase an additional $200 billion in American goods above 2017 levels by the end of 2021.

Six months after the deal was inked, the costs and benefits of this agreement are coming into clearer focus. Despite Trump's claim that "trade wars are good, and easy to win," the ultimate results of the phase one trade deal between China and the United States — and the trade war that preceded it — have significantly hurt the American economy without solving the underlying economic concerns that the trade war was meant to resolve. The effects of the trade war go beyond economics, though. Trump's prioritization on the trade deal and de-prioritization of all other dimensions of the relationship produced a more permissive environment for China to advance its interests abroad and oppress its own people at home, secure in the knowledge that American responses would be muted by a president who was reluctant to risk losing the deal.

Origins of the trade war

During the 2016 presidential campaign, a consistent refrain from then-candidate Trump was to point to U.S. trade with China, and the agreements that enabled it, as a primary cause of the loss of U.S. manufacturing jobs and intellectual property. He said China was responsible for "the greatest theft in the history of the world" and lambasted the U.S. trade deficit with China, which in 2016 stood at around $346 billion. He declared, "We can't continue to allow China to rape our country." Building on the image of Donald Trump as the ultimate dealmaker, his campaign released a strategy to reform the U.S.-China trade relationship, in which it pledged to "cut a better deal with China that helps American businesses and workers compete." Trump laid out a four-part plan to secure a better deal with China: declare China a currency manipulator; confront China on intellectual property and forced technology transfer concerns; end China's use of export subsidies and lax labor and environmental standards; and lower America's corporate tax rate to make U.S. manufacturing more competitive.

Upon entering office, Trump sought to engage Beijing directly to address structural concerns about China's economic policies. Just three months into his administration, he met with Chinese leader Xí Jìnpíng 习近平 at Mar-a-Largo, where they agreed to establish a 100-Day Action Plan to resolve trade differences. The next month, China agreed to open its economy (slightly) to U.S. firms and services in exchange for greater Chinese access on bilateral trade and U.S. recognition of China's Belt and Road Initiative. Yet follow-on negotiations fizzled as Washington pushed Beijing for more concessions and Beijing rebuffed American pressure. The 100 days concluded in July 2017 with no agreement, no press conference, and no joint statement out of the first meeting of the U.S.-China Comprehensive Economic Dialogue (which was declared dead by the Trump administration four months later).

President Trump launched the trade war to pressure Beijing to implement significant changes to aspects of its economic system that facilitate unfair Chinese trade practices, including forced technology transfer, limited market access, intellectual property theft, and subsidies to state-owned enterprises. Trump argued that unilateral tariffs would shrink the U.S. trade deficit with China and cause companies to bring manufacturing jobs back to the United States. Between July 2018 and August 2019, the United States announced plans to impose tariffs on more than $550 billion of Chinese products, and China retaliated with tariffs on more than $185 billion of U.S. goods.

Economic costs of the trade war

The trade war caused economic pain on both sides and led to diversion of trade flows away from both China and the United States. As described by Heather Long at the Washington Post, "U.S. economic growth slowed, business investment froze, and companies didn't hire as many people. Across the nation, a lot of farmers went bankrupt, and the manufacturing and freight transportation sectors have hit lows not seen since the last recession. Trump's actions amounted to one of the largest tax increases in years."

A September 2019 study by Moody's Analytics found that the trade war had already cost the U.S. economy nearly 300,000 jobs and an estimated 0.3% of real GDP. Other studies put the cost to U.S. GDP at about 0.7%. A 2019 report from Bloomberg Economics estimated that the trade war would cost the U.S. economy $316 billion by the end of 2020, while more recent research from the Federal Reserve Bank of New York and Columbia University found that U.S. companies lost at least $1.7 trillion in the price of their stocks as a result of U.S. tariffs imposed on imports from China.

Numerous studies have found that U.S. companies primarily paid for U.S. tariffs, with the cost estimated at nearly $46 billion. The tariffs forced American companies to accept lower profit margins, cut wages and jobs for U.S. workers, defer potential wage hikes or expansions, and raise prices for American consumers or companies. A spokesperson for the American Farm Bureau stated that "farmers have lost the vast majority of what was once a $24 billion market in China" as a result of Chinese retaliatory actions.

Meanwhile, the U.S. goods trade deficit with China continued to grow, reaching a record $419.2 billion in 2018. By 2019, the trade deficit had shrunk to $345 billion, roughly the same level as 2016, largely as a result of reduced trade flows. It should be noted that, while the U.S. deficit with China decreased, its overall trade deficit did not. Trump's unilateral tariffs on China diverted trade flows from China, causing the U.S. trade deficit with Europe, Mexico, Japan, South Korea, and Taiwan to increase as a result.

China also felt economic pain as a result of the trade war, though apparently not enough to capitulate to the Trump administration's core demands for major structural reform. Indeed, as the trade war dragged on, Beijing lowered its tariffs for its other trading partners as it reduced its reliance on U.S. markets. The final deal that both sides announced on January 15, 2020, largely resembled the offer Beijing had put on the table from the start — increased goods purchases plus commitments on improved intellectual property protection, currency, and forced technology transfer.

Missing from the deal was any forward movement on subsidies, state-owned enterprises, and China's uses of industrial policy to advantage its own firms over foreign competitors. Progress on market access also proved underwhelming outside of the financial sector. These and other challenges were put off for a phase two negotiation, which Trump recently said is not under consideration.

A more permissive environment for Chinese aggression and suppression

Throughout this period, President Trump made efforts to develop a smooth and positive relationship with China — and especially with Xi Jinping — and explained his efforts as serving the purpose of advancing trade negotiations. Trump lauded Xi's strength and leadership publicly while shying away from points of sharp bilateral friction in private engagements. Instead, Trump reportedly used his private exchanges with Xi to urge him to act on his personal priorities, most of which related to the trade negotiations, and, for a time, North Korea.

In June 2019, Trump reportedly promised Xi Jinping in a private phone call that the United States would refrain from criticizing China over Hong Kong while trade negotiations were ongoing. The following month, Trump said he believed that Xi Jinping had acted "very responsibly" with the protests in Hong Kong, adding, "We're working on trade deals right now. We'll see what happens." He expressed similar sentiments publicly in November when he shied away from criticizing Xi about Hong Kong and linked the issue to trade negotiations, saying, "We have to stand with Hong Kong, but I'm also standing with President Xi." He further said that Xi is "a friend of mine, he's an incredible guy," and described the Hong Kong protests as a "complicating factor" in trade talks. On January 10, 2020, when Laura Ingraham on Fox News asked Trump about "the human rights issue in China" and referenced "a million people in reeducation camps, internment camps," he replied, "Well, I'm riding a fine line, because we're making…great trade deals."

John Bolton, then national security adviser, claims that the reasons behind President Trump's prioritization of a trade deal above other considerations with China were made clear in a private meeting with Xi Jinping at the June 2019 G-20 summit in Japan. According to Bolton, Trump told Xi to go ahead with building camps to detain 1 million or more Uyghur Muslims in Xinjiang, saying it was exactly the right thing to do, and asked Xi Jinping to help him win the upcoming presidential election by increasing purchases of soybeans and wheat. Trump later challenged Bolton's characterization of events, tweeting that Bolton's book "is a compilation of lies and made up stories"; Trump specifically denied Bolton's claims about Xinjiang. Yet at a campaign rally in Manchester, New Hampshire, on February 10, 2020, Trump declared, "Last month, we signed a groundbreaking trade agreement with China that will defeat so many of our opponents."

Although other members of the Trump administration, including Vice President Mike Pence and Secretary of State Mike Pompeo, have been outspoken in their criticism of China's repression at home and aggression abroad, their statements have not been seen in Beijing as a substitute for presidential opprobrium. During this period, the Trump administration did take a wide range of actions against China, including tightening export controls, enhancing investment screening, challenging Chinese technology companies, and blunting the Belt and Road Initiative. In Beijing's top-down Leninist system, though, the signals that other leaders send to Xi Jinping, and Xi's responses to those messages, carry significant weight. Neither the United States nor any other country gets to have two foreign policies with China. There only is one. Beijing's antennae are tuned to the signals that other leaders send.

To be clear, the Chinese leadership owns full responsibility for its recklessly nationalistic actions along its periphery and its brutal suppression at home. Beijing's decisions to move in its current direction were made simpler, though, by its confidence in Trump's tight focus on trade and his interest in not allowing other issues to obstruct completion of a deal or derail the deal's implementation.

Even in the weeks following the signing of the phase one trade deal, President Trump remained focused on reassuring Xi of his support. For weeks, Trump repeatedly praised Xi's response to the rapid spread of COVID-19 in China. Trump's tone would not change until the virus took its toll on the United States.

Was the trade war worth it?

The two sides declared a truce in the trade war at an ornate signing ceremony at the White House involving President Trump and Chinese Vice Premier Liú Hè 刘鹤, the 11th ranked member in the Chinese leadership. Although the full text of the agreement has not been made public, reports say the agreement commits China to purchasing an extra $200 billion in American products over two years above 2017 levels. The text of the agreement that has been made public shows China committing to protect American intellectual property, halt coercive technology transfers, and refrain from using currency devaluation as a trade weapon. It also included an enforcement mechanism that would allow for the imposition of import tariffs if disputes are not resolved.

In the six months since the deal was signed, the prospects of China meeting its purchasing targets have dimmed considerably. According to Bloomberg calculations based on Chinese Customs Administration data, China in the first half of 2020 had purchased only 23% of the total purchase target for the year. While part of this is attributable to trade flow disruptions caused by COVID-19, much of the gap owes to the impracticality of the agreement from the start. In the phase one deal, as described by Brad W. Setser and Dylan Yalbir at the Council on Foreign Relations, China committed to purchasing roughly $60 billion more in U.S. goods than it had in 2017 — roughly $180 billion in U.S. goods this year. Yet U.S. goods exports to China currently are *significantly below* what they were in 2017.

In other words, Beijing essentially paid for the deal with a promise of a windfall in purchases of American goods. It appears that President Trump accepted an IOU as a declaration of victory.

Time will tell if the innovations in the agreement on enforcement will succeed where others have failed, and much will depend on China's willingness to translate agreements into law and, crucially, enforce them. Yet the key question for the United States — especially today, as the U.S. economy is in its worst state since the Great Depression as a result of the COVID-19 pandemic — is if the economic costs it paid for those enforcement agreements were worth the billions of dollars lost in value, the hundreds of thousands of jobs lost, the stagnation of U.S. manufacturing, and the devastating effects of the trade war on American farmers.

Ultimately, the phase one agreement disappointed because it, along with the trade war, severely damaged the U.S. economy while failing to make significant progress in fundamentally resolving the structural imbalances of the U.S.-China trade relationship.

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