THE BROOKINGS INSTITUTION
DOLLAR & SENSE
Tariffs on China are no substitute for a trade deal
Friday, May 10, 2019

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(MUSIC)

DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast, "Dollar & Sense." From time to time we do short episodes to update a topic that we have covered in earlier podcasts. Today I am going to look at the current developments in the US-China trade talks.

I would like to cover three things. First, where we stand in the U.S.-China talks. Second, some recent research on the impact of the tariffs that have been imposed so far. And third, the uncertainty going forward.

So first, where we stand. Both sides had put out positive messages in recent weeks leading up to the current negotiations. It seemed that we were close to a deal. Then on May 5 President Trump tweeted that the U.S. side felt that China was backing away from what had been negotiated. In particular, the US wants China to change various laws via its National People's Congress, whereas China wants to implement through government regulations. The president raised the U.S. tariffs that had been at 10 percent to 25 percent on May 10. The Chinese said that they would retaliate but did not specific exactly how.

Trump's escalation of tariffs surprised the Chinese and threatened the round of negotiations scheduled for exactly this time. But in the end the Chinese delegation came to Washington, headed by the chief negotiator, Liu He. The Chinese delegation brought what President Trump described as a "beautiful letter" from President Xi urging the two sides to reach an agreement. Still, President Trump's most recent tweet on the issue said that there is "no need to rush on a deal."

A second topic I want to discuss is some of the growing research on the impact of the tariffs that are in place. President Trump said this week that "tariffs are an excellent alternative to a trade deal," implying that escalating tariffs would be as good for the U.S. economy as a deal. Hopefully this is just a negotiating ploy, because it certainly is not true.

Tariffs are paid by the American firms that import from China, not by the Chinese exporters. In theory, there are cases where the exporter – China in this case – responds by lowering prices, which would be a gain for Americans. Recent studies find that this is NOT happening in this case – Chinese export prices have not gone down. And the full cost of tariffs is being passed on to American consumers.

Keep in mind that this is the objective of protection: to raise prices of goods so that producing in America becomes more profitable. A good recent study of the 25 percent tariff on washing machine shows how this works. The full cost of the tariffs was passed on to households who had to pay more for washing machines. This made U.S. producers more profitable and they added 1,800 jobs. However, the extra cost to consumers was 1.5 billion dollars – I'll do the math for you, that's more than 800,000 dollars per job. You may be surprised at the price tag, but economists are not. A study by Gary Hufbauer at the Peterson Institute looked at 26 previous cases of import tariffs and found that on average it costs 500,000 dollars per year to protect one job through protection. To come back to washing machine case: The extra $1.5 billion paid by consumers means that they cannot buy other things. They go to fewer restaurant meals, buy fewer automobiles, maybe cut back on healthcare – and so what happens is jobs are lost in other sectors of the economy. Careful research generally establishes that the jobs lost are many times greater than the jobs that are gained in protected sectors.

What all is this means is that the import tariffs are bad for the U.S. economy. The key question then is whether the tariffs are a means to a good trade deal with China. If there is no deal, and the tariffs stay in place, that is definitely a loss for Americans. The loss was modest when we taxed some of our imports from China at 10 percent. If we move to taxing all our imports from China at 25 percent then the losses will be much larger.

The third point I want to emphasize is an obvious one: We are going to be living with a lot of uncertainty concerning U.S.-China trade for the foreseeable future. The negotiations are going on – they are still going on. It seems unlikely that there would be a sudden agreement as each side has dug in their heels, but it's always possible there will be a sudden agreement. But probably, we're going to be living with the tariffs that are in place for a while, and President Trump has indicated that he's moving ahead with 25 percent tariffs on all the remained of our imports from China.

So it is possible that these negotiations will not succeed and that we'll be living with tariffs for a while. I call this new situation "ping pong diplomacy" because we're swiveling back and forth between encouraging news that there will be a deal and then negative news that the deal looks unlikely – and then back to positive and back to negative. So this is a new kind of ping pong diplomacy between China and the United States.

Aside from the tariff increase that's already in place as of May 10, President Trump has threatened 25 percent on the remaining imports from China. And China quickly indicted that it would retaliate. It did not specify the exact measures. China does not import as much from the United States as we import from China, so they can't match the protection dollar for dollar, but they could have a higher rate of tariff on some products, or they could go after American companies that do business in China. They've indicated they'll find some way to retaliate.

Now there is a chance that the two sides will surprise us with a deal in the near future – perhaps immediately, perhaps quite soon— but even then, I think the uncertainty will continue because there will be uncertainty about how long it will last. The issues they are negotiating over –market access, technology transfer, and intellectual property rights protection – these are all very complex issues. If you want more detail, look at the episode with Eswar Prasad. And there's also the issue with implementation: Look at the episode with Wendy Cutler. Basically, the only way for the U.S. to enforce this is the threat of reinstituting tariffs, so even if there is an agreement, probably the threat of tariffs will be hanging over U.S.-China trade for the foreseeable future.

So we are going to be living with uncertainty whether there is a deal or not. We'd be better off having a deal, but we'll be living with uncertainty either way.

This is David Dollar on the "Dollar & Sense" podcast. If and when there is a trade deal, I will be back talking to you with a short update. Hopefully I'll be back talking to you soon.

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