The Brookings Institution
Dollar & Sense podcast
What do we know about the Biden administration's emerging trade policy?
February 16, 2021

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**DAVID DOLLAR:** Hi, I'm David, the host of the Brookings trade podcast "Dollar & Sense." Today, my guest is Mary Lovely, a professor of Economics at Syracuse University and a senior fellow at the Peterson Institute for International Economics. Immediately after the election, Mary wrote a memo to the Biden administration on promoting trade to maximize American prosperity and inclusion. We are about one month into the new administration, so this is a good time to take stock of the trade policy that's emerging and hopefully there is still time to make recommendations. So, thank you for joining me, Mary.

Let's start with a hot button issue: the resilience of supply chains. There is a lot of concern about the U.S. importing medical equipment or other things related to the COVID-19 pandemic. What should the U.S. be doing to build up resilience? I mean, is there a problem here?

**MARY LOVELY:** Yeah, it's a great question. You know, we did see that the unprecedented circumstances of COVID-19 did catch companies and governments off guard. Many countries didn't have the equipment and medicines they needed to respond. Even today, we are seeing that the U.S. has, in some areas, companies that have a surplus of N95 masks and there are still health care workers who claim they can't get access to them. So we have supplies in the wrong place, no supply, unmet demand.

This is not just a U.S. problem. The European Union has both been exporting and trying to control exports of now vaccines and vaccine supplies. Mexican hospitals are having trouble getting oxygen; people are dying without access to oxygen. So even today, almost a year into this, we are still having these problems. So the question is, you know, what do we do about it?

A lot of focus has been on so-called resilience. I think it's something that, you know, C-suites already took account of. Of course, one of the key things in supply chain management is to make sure that your supply chain is resilient. So we have to recognize that what we are experiencing is just very unusual and extreme. So it's not going to be perfect. We are testing the system.

Then, of course, the other question is to focus on governments. You know, are we witnessing sort of massive government failure? In a lot of ways I think we are. We realize that the government had let stockpiles deplete, had not been maintained. That they have tripped up in their plans to improve supply chains, as in the United States which has funded a lot of companies to turn to producing things like N95 masks and then not figured out how to get them where they need to go.

So I think there will be a lot of Monday morning quarterbacking, but really what we need to do is to take a hard look at what we need to do to be prepared for the next epidemic and take seriously what we hear from virologists and others about what is coming next. That means we have to recognize that it's going to be costly. [...] It's something that we can't afford not to spend on. For example, having stockpiles means that those stockpiles have to be maintained and replaced. So I think this is much more than about global supply chains—there has been a lot of focus on that—we really need to focus on the public aspect of it as well.

**DOLLAR:** One aspect of that whole debate is to what extent we should be making things in America versus importing things. So beyond the supply chain resilience issue, there is a more general question about "Buy America." President Biden has signed an executive order that, as I understand it, is really just kind of reviewing the situation. But we are talking about some very large stimulus spending, and probably more relevant we are hopefully—I hope we are going to get a large infrastructure bill. So there is a lot of potential government spending coming down the road that could be affected by Buy American provision. So, what are the pros and cons of these kind of provisions?

**LOVELY:** Yeah, I clearly see that one segues into the other and that I think we will see a move to Buy America on things like PPE and essential medical supplies. One big pro for Buy America provisions is that they are very popular with voters. It seems to make sense to voters that if they are spending money that it should go to American jobs. But, you know, there's some problems with that logic. I think one is that it kind of misunderstands how job creation happens. It fails to take account of the fact that macroeconomic conditions often dictate what's happening in terms of the total number of jobs.

You are very familiar with this, David, and I'm sure you have covered it on past podcasts. So, you save a job at one plant, or you keep a job at one point, but of course taxpayers have to spend more to get the supplies. So you lose a job someplace else because eventually someone has to pay for the extra amount that we use if we require American rolling stock, for example, to go back to infrastructure. So a big con, or a negative for Buy America, is this going to cost the taxpayers more, and state and local governments are going to have fewer options in terms of which products they can choose.

On the other hand, right now the U.S. government mainly buys stuff that is made in America. A lot of what they buy is services, like state and local governments [spend on] people to clean the snow off the streets. I'm up here in Syracuse; that's a big expense. Or health care spending; another big expense for the county. Those are not all outsourced; those are right here. The military is largely buying products that are made in America.

So, I don't think it's really that big a cost for the U.S. It's certainly something that we can absorb. However, when we get to the big infrastructure spending that you and I both share this view that it's very much needed and we hope it occurs, we can see an impact. So I think there we will see that perhaps this will be very costly. But again, you know, voters like it, and I don't think it's something that the costs are going to determine. I think the politics are going to determine it.

**DOLLAR:** You mentioned the macro aspect of that. The trade data from 2020 showed the largest manufacturing trade deficit in U.S. history for a variety of reasons. If we get these big spending bills—which, as I said, I favor—probably some of that is going to spill over into the trade deficit. It would be very surprising if our trade deficit didn't continue to go up. So I do worry a little bit that on the one hand you may get the Buy America instinct for the political reasons you talk about. That's just going to deflect the imports and other manufacturing categories, so it's probably not going to be a net creator of manufacturing jobs. There is a decent chance that it throws enough sand in the wheels that it's a negative as far as that goes.

**LOVELY:** Yeah, I don't think that is very well understood. And again, it's something that I guess we will learn as we move through it just as we learned about the U.S. and its market power regarding tariffs on China—by living through the last four years. So, I think that is something that we will learn.

I think that the focus on the manufacturing trade deficit is often used as sort of a cudgel to harp on other policies that people want for various reasons. It really has very little to do with actually thinking about job creation in the U.S., unfortunately. And I think exhibit A is the fact that the vast majority of Americans work in services, and we very rarely hear about service jobs. I do understand that people place a special quality on manufacturing jobs. They may be unionized—although increasingly they are not—but they pay on average somewhat higher wages, have benefit packages, and often steady work. That is believed up here in central New York where we still have manufacturing jobs. But it ignores the fact that so many people, and many of the younger people that are coming into the market, almost all of them will be in the service sector. And you don't hear "what about the service trade surplus we have? How do we keep that? How do we open up foreign markets for services?"

So, there is sort of this obsession with manufacturing and the manufacturing trade deficit that I think really leads us down a wrong path.

This clearly leads into the fact that we saw the Trump administration encouraging firms to leave China, in particular during the trade war. They saw that as a “twofer” policy. On the one hand, you can be tough on China and take on the alleged abuses of U.S. intellectual property and technology. And on the other hand, you could look like it was a labor market policy or a job creation policy. And clearly, I don't think that twofer existed.

**DOLLAR:** So do you actually see any reshoring going on? I mean, after four years of Trump policies, do we see American firms leaving China coming back to the United States?

**LOVELY:** Yeah, that's a really important question. I think that, by and large, the answer is no. We did see the tariffs have a significant impact on import volumes in the categories that were taxed. So, on average, the best academic studies suggest that if an item was taxed, the value of imports in that fell by about 30 percent. So that's a big hit. But by and large, those products were then procured or purchased from other countries like Mexico, Vietnam, Malaysia. So it only makes sense that if you were importing things that were not high tech, didn't require U.S. technology and U.S. labor, that you go to the next low cost place. That often was in Asia or next door in Mexico. And that was very sector specific, so Mexico would be the place you'd go for certain things, like certain auto parts. We already have a deep integration with Mexico. Many of sort of peripherals for computers moved to places like Malaysia or Vietnam where they were already making the white chords that you used to charge at your iPhone. So, you know, we just didn't see these jobs coming back.

I think some numbers might be useful here. China was providing about 15 percent of the world exports before the trade war, and they're still providing 15 percent of the world's exports.

On the other hand, countries do continue to see the need to reduce their dependency on China. The motivation is partly that they would like to have the jobs themselves, but I think for countries like Japan, South Korea and other places, what you see is a need to reduce the risk of having all the eggs in one basket. There is a big push for diversification as opposed to job creation at home. And I think the risk of being too dependent on China has been illustrated by China itself and its retaliation against Australia on Australia's call for an open investigation into the origins of COVID-19. It's a bit of a walking caution for other countries who certainly have not missed the lesson.

These countries are taking steps, and Japan, South Korea, they have reassuring funds and the reassuring funds are actually placing some real money on the table. I think Japan's approach is the most interesting, not only because they have actually already issued money but because they really understand the theory of comparative advantage, which, of course, is near and dear to the heart of any trade professor.

They basically have said there are these products that we know are not going to be made competitively in Japan, and we are going to pay for Japanese companies to move some of their facilities out of China but to other parts of Asia, lower cost countries within Asia. So they are actually paying for Japanese companies to move operations to other parts of Asia, not back home. Then there are things that they think they can do competitively—higher tech stuff—and there, they are offering grants for to reduce the fixed costs of companies reshoring back to Japan.

So they acknowledge it is not this "oh, we are going to bring everything back to the U.S." Under the Trump administration, there was really no acknowledgment that these things were not appropriately made in the U.S. in the sense of the costs are just prohibitive. No company could remain afloat by doing it, whereas the Japanese are. So I think they are quite serious. The reason is really to diversify and to reduce risk, not really because they see it as a large job creation.

**DOLLAR:** So those statistics you added to our discussion are quite interesting. I saw kind of a case study of the Christmas lights market, which is a very small, very specialized market. America imports almost all the Christmas lights we put up every year. We used to import them almost completely from China, but in 2020 that was one of the items taxed at 25 percent, so we imported almost all our Christmas lights from Cambodia in 2020.

**LOVELY:** I imagine that means that I'm still going to get them up and one light won't work and half of the strand will be blinking, which always seems to happen to me no matter where they come from.

**DOLLAR:** I think all of those problems will persist. But you also mentioned that statistic that China's share of world trade is pretty stable. If anything, it went up a little bit in 2020. That's partly because China is exporting more to those ASEAN countries. ASEAN moved into first place as China's largest trading partner in 2020.

So, you know, China is sending equipment and components to places like Cambodia and Vietnam. And then there's final assembly and then the products come to the United States. So it's an adjustment in the value chain, but as you say, it's not bringing jobs necessarily back to Japan or the United States.

Now what you were describing about Japan's attitude, Australia, I think that is quite interesting. They have their worries about China's rise, but they were also part of this most recent trade agreement, the Regional Comprehensive Economic Partnership, which involves the 10 ASEAN countries plus China, Japan, South Korea, Australia, New Zealand. So do you think that kind of trade—this particular trade agreement—is going to have much effect on patterns of trade in value chains?

**LOVELY:** Yes, and I think you are raising a lot of interesting issues that really have to do with the fact that supply chains have been on the move for a long time—it didn't start with the Trump trade war—and they are changing quite rapidly within Asia itself.

When you are talking about the adjustment that we are seeing in Christmas lights—that's just a great example of how labor-intensive things are moving away from China because, you know, China's wages have been rising 10 percent or more in real terms for 20 years. That has to change your comparative advantage. Environmental costs are rising. The Chinese no longer preference this type of FDI, so we have to acknowledge the role that foreign invested enterprises play in China. 60 percent of U.S. imports from China are sourced from foreign invested enterprises operating in China, so they are very important actors in this trade. They have been—they and Chinese companies themselves—have been agents of change. One of the funny, ironic, things with the trade war is that we saw some activities move quite quickly, say to Vietnam, and those factories were actually Chinese-owned. So, we are importing from Vietnam instead of China, but we are still basically importing Chinese products made with Vietnamese labor in this case.

The supply chains have been on the move before, and RCEP is going to play a role, and I think it was negotiated to play a role. RCEP had been under negotiation for quite some time. You know, people call RCEP a low-quality agreement or soft-standards agreement because it doesn't have higher expectations for labor standards, environmental standards, that we built into the Trans-Pacific Partnership, but it does have something important, which is very generous rules of origin. This means that once a good clears—I haven't seen the final text; I don't think it's out yet, I might be corrected on that—but once a product has 40 percent of regional content, it just, you know, can flow from country to country. It could have imported inputs added after that so long as the total value of those doesn't exceed 60 percent.

So it's going to be very beneficial to build in Asia. With demand in Asia increasing more rapidly than in other parts of the world, at least in the advanced economies which naturally grow slower, we are going to see continued expansion of East Asia within the RCEP. So I think five, ten years from now, if you and I are lucky enough to be around, we are going to look back and say, "oh, RCEP looks like it was a success." It is built for business in that sense.

**DOLLAR:** I think the point you are making about rules of origin is very important. I generally favor these plurilateral trade agreements that we are seeing, but I worry about this proliferation of different rules. When you actually get down to the company level deciding do you want to follow the rules that would put you within the USMCA framework, for example, the Mexico-Canada-U.S. agreement? Or is it not worth the trouble? Do you want to just trade under basic WTO tariffs? You know, it's a lot of administrative trouble.

**LOVELY:** Well, yeah, and we see lots of companies that don't take advantage of preferences that they might because of those reasons; it's just too much trouble. Unfortunately, with the USMCA, I think the U.S. government, the Trump administration, insisted on going the other way, which is making the rules of origin even more opaque and more difficult to meet with a whole variety of restrictions on value added in the automobile industry. So that led the administration to worry that automakers would just give up and import the very low MFN rates that the U.S. has on auto. So, it does put pressure on. They may make themselves irrelevant by making it so complex, I guess.

I think that China and other members, ASEAN countries, are aware of that within the RCEP. So they still have a lot of bilateral and multilateral agreements within the RCEP that determine bilateral tariff rates. So still underlying this is the Jagdish Bhagwati spaghetti bowl of agreements. The idea is supposed to be that those would eventually be made consistent with each other over time. Whether or not we are going to see that remains something we will have to watch for.

To the extent that RCEP and the generous rules of origin actually take off you might see it because then companies would be incentivized to lobby their governments to rationalize these differences. I'm creating, I'm finishing, I'm assembling a car or auto part in Thailand and I want to import it to these two countries and they have different tariff rates and different rules and, you know, this is a headache for me. So that would provide some pressure for those things to be changed. That often is—in the past, at least in the U.S., we saw that companies' commerce was a key driver of having the U.S. interested in creating trade agreements with other countries. So that operates outside the U.S. as well—that political dynamic.

**DOLLAR:** So we have two big Asian trade agreements which the U.S. is not party to: The RCEP we were just discussing and you mentioned the Trans-Pacific Partnership. President Trump pulled out of [the Trans-Pacific Partnership]. Do you think there's any realistic chance that the Biden administration would want to get in, particularly into the CPTPP which is the actual implementation of the 11 countries that remained after the U.S. pulled out?

**LOVELY:** Yeah, this is a really important question a lot of people are asking. I think, like many other people do, that there is a short-run and medium-run answer to this. In the short run, the answer is no. The Biden team has very consistently—and even again last week following up on the calls that were made between the United States and China at the highest levels of the two governments—the U.S., President Biden and his team, reaffirmed the need for America to be strong in their in their terms before taking on China, but also in terms of taking on anything like the TPP. So while the U.S. economy is trying to deal with the pandemic, get it under control and get the economy revived, we are not going to see anything like this. There's no appetite for it.

On the other hand, the team has also promised a comprehensive review and strategy for Asia, and many analysts have long urged them to think about China within the context of the larger Asian region. That was one of the key motivations behind the Obama administration's interest in negotiating the Trans-Pacific Partnership, and I think that they will return to commerce as a key part of an Asia strategy. It can't just be military, can't just be aid. It has to be commerce. Commerce has to be part of that.

Then you have the TPP. you have important allies of the United States, like Japan, who would like the U.S. in TPP. So there will be forces that are pushing them in that direction. And I think, depending on the politics of the next few years, we could see the Biden administration in the second half of the term talking about TPP.

**DOLLAR:** Last question for you, Mary, is about U.S.-China trade policy. The Biden administration is reviewing the Phase One trade deal and larger U.S.-China economic relations. What would you recommend to them in terms of China policy? Because, frankly, what we have been doing has not really led to any significant change in practices, so it's hard to argue that there's any kind of success. It's also not an easy issue, obviously. What do you think Biden will do and what would you encourage the administration to do?

**LOVELY:** That's a tough question. I think it's an important question. On the one hand, yes, the Phase One deal did very little. It created these unrealistic purchasing targets. We know that the president was given a number and he said "double it." So, to some extent, they were pulled out of the air. My colleague at Peterson, Chad Bown, has quite completely and fully covered this in terms of the ramifications of not only why China failed to meet the purchasing agreements, but what this means for us.

You know, mandated trade was never going to be a long-term strategy for the U.S. We can buy something, but what happens in the long run? There was no market opening. In fact, tariffs remain on U.S. exports that are trying to make their way into the Chinese market. So, in some sense, we are in a worse situation than we were before.

The Biden administration clearly knows this. In their campaign literature, they were quite pointed in criticizing the Trump tariffs on China. They noted the academic research showing that it was American businesses and consumers who were bearing the burden of the tariffs; that it was hurting American companies. So they know that these are not good for us economically.

On the other hand, you cannot look weak on China. So how are they going to remove something that they think is bad for the United States while still looking tough on China? I think that is the problem.

Here, I think there's two possible routes that they could go. One is to just increase or liberalize the exclusion process. So the exclusion process is the way that U.S. firms can come forward and provide evidence that they are being hurt by the tariffs and the government will grant relief. Interestingly enough, members of the incoming administration have pointed to the exclusion process and said that President Biden wants to make it more transparent and fairer. And I think that's really important. Every American should have the right to petition its government equally. But that may also signal that they are going to use that in a way to reduce the costs for American manufacturers.

The other option is to negotiate some of these tariffs away. Here, my priority would be to increase American exporters’ access to the Chinese market. We have to remember that the original Section 301 case, which was the legal basis for the Trump administration to go forward with its tariffs, was about how American corporations, how their foreign affiliates in China were treated by the Chinese government. There were many other aspects, cybersecurity issues, et cetera. But the main claims were that by forcing American companies into joint ventures, American technology could be stolen or transferred under force. So, that's about U.S. corporations abroad. The Biden administration wants to focus on jobs here at home. Then they should be talking about exports, access to foreign markets. And I think it could be a winner for them to trade some of these tariffs for market access.

This is a problem that's going to continue, I think. What China has learned from the Trump administration's policy is that it needs to be self-sufficient, especially in technology. But they have practiced forms of import substitution even as they have liberalized, and I think that has kept some products that America is very competitive producer of out of the market. We need to find where we can best open up those markets and let American exports in. I think that would be worthwhile. So there's two routes: exclusions and negotiating some of the tariffs away.

**DOLLAR:** I'm David Dollar and I've been talking to Mary Lovely about the emerging trade policy of the Biden administration. I think it's fair to say that trade policy is not a first-headline issue as the Biden administration faces domestic and international crises, but we have just run through a set of issues, pretty important contemporary issues, and trade policy finds its way into just about all of them. So thank you very much, Mary, for your wisdom and for your recommendations.

**LOVELY:** You're welcome. It's my pleasure.

**DOLLAR:** Thank you all for listening. We’ll be releasing new episodes of Dollar & Sense every other week, so if you haven’t already, please subscribe wherever you get your podcasts and stay tuned.

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