Center for Strategic and International Studies

The Trade Guys Podcast

“U.S. Protectionism and the EU-Japan Trade Deal”

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SCOTT MILLER: I’m Scott.

WILLIAM ALAN REINSCH: I’m Bill.

MR. MILLER and MR. REINSCH: (Together.) And we’re The Trade Guys.

(Music plays.)

H. ANDREW SCHWARTZ: You’re listening to The Trade Guys, a podcast produced by CSIS where we talk about trade in terms that everyone can understand.

I’m H. Andrew Schwartz, and I’m here with Scott Miller and Bill Reinsch, the CSIS Trade Guys. In this episode, the Trump administration digs in. This week the United States filed separate complaints against China, the EU, Canada, Mexico, and Turkey. This was in response to previous World Trade Organization lawsuits that those countries had filed against President Trump’s steel and aluminum tariffs. Meanwhile, American producers continue to brace for what’s to come.

REPORTER: (From recording.) Mid Continent Steel and Wire in Poplar Bluff is the country’s largest producer of steel nails, and has already laid off 60 of its 500 workers due to increased costs.

MR. SCHWARTZ: But the Trump administration has resolved to continue their fight. At the Department of Commerce this week Vice President Pence issued a warning against China.

VICE PRESIDENT MIKE PENCE: (From recording.) If China refuses to level the playing field, and continues to retaliate against American manufacturers and American agriculture, their leaders should know America will not back down.

MR. SCHWARTZ: The administration says producers will suffer in the short term before things will get better, but for how long?

Plus, Japan and the EU sign a massive bilateral trade deal. At a news conference this week European Council President Donald Tusk said that the Japan-EU agreement sends a clear message.

EU COUNCIL PRESIDENT DONALD TUSK: (From recording.) This is an act of enormous strategic importance for the rules-based international order at a time when some are questioning this order.

MR. SCHWARTZ: Are America’s trade partners going their own way? Are they hedging against U.S. trade policies? Is the U.S. missing out? We put it to The Trade Guys.

Gentlemen, start your engines. Washington today, Washington this week, it’s an angry town. I think it’s an angry America. I think Helsinki threw everybody for a loop. But we’re not here to talk about that. We’re here to talk about trade.

Meantime, while the president’s been overseas, the U.S. launched a WTO – World Trade Organization – assault on retaliatory tariffs. Tell us about that, Bill.
MR. REINSCH: Well, I thought it was the height of irony. You know, we took actions of dubious legality when we imposed steel tariffs on everybody, and the –

MR. SCHWARTZ: Well, wait. Let’s back up. Time out. What does the World Trade Organization do?

MR. REINSCH: Well, it does – it does three things. It leads negotiations on trade liberalization.

MR. SCHWARTZ: Right.

MR. REINSCH: There’s not a lot of that going on right now, but that’s – it’s done that in the past. It has a dispute-settlement process, which is what this conversation is going to be about, where countries that feel somebody else has cheated them can go to the WTO and complain and have their complaint adjudicated by an independent panel of experts.

MR. SCHWARTZ: And it’s a civil process.

MR. REINSCH: It’s – yeah. Well, more or less.

MR. SCHWARTZ: Or a civilized process.

MR. MILLER: It can be.

MR. REINSCH: It’s a more or less – it’s a more or less civil process. (Laughter.)

MR. MILLER: It’s supposed to be.

MR. REINSCH: And the third thing they do, which is unsung but important, is they have a lot of committees that help countries develop normal and, you know, consistent standards and rules of behavior. So, for developing countries that have joined – and there’s 164 members of the WTO, so that’s most of the world –

MR. SCHWARTZ: Members or countries?

MR. REINSCH: Countries.

MR. SCHWARTZ: Yeah.

MR. REINSCH: Yeah, only countries are members.

MR. SCHWARTZ: The United States is a member.

MR. REINSCH: So far, yes. We were –

MR. SCHWARTZ: That’s what this is about.

MR. REINSCH: We’re one of the founding members. For developing countries who want to, say, set up a –
MR. SCHWARTZ: Just curious: Who else founded it?

MR. MILLER: The United Kingdom.

MR. REINSCH: Well, there were 23.

MR. MILLER: Twenty-three, actually –

MR. REINSCH: Europeans, mostly.

MR. MILLER: Mostly European countries, but indeed Cuba was one of the original signatories. In fact, the conference that launched the GATT was the Havana Conference.

MR. SCHWARTZ: General Agreement on Tariffs and Trade.

MR. MILLER: Tariffs and Trade. So, in fact – and Chiang Kai-shek’s China was a – was a founding member, as was India. So think of it as the allies who wound up on the winning side of World War II were the initial parties.

MR. SCHWARTZ: OK.

MR. REINSCH: Yes.

MR. SCHWARTZ: OK. So this is an important institution in the world.

MR. REINSCH: We would say so. I think last week we talked about this. I thought Scott’s analogy was apt, which was – well, his comment was apt, that it’s one of these things where you’ll miss it when it’s gone because it really provides the foundation for the way the trading system works. And all the rules that countries are supposed to have and obey fall under their umbrella, and that’s what gets adjudicated in this dispute-settlement process.

MR. SCHWARTZ: OK. So what did we do?

MR. MILLER: We basically had this investigation under the premises of national security of the affect on United States national security of the imports of steel and aluminum.

MR. SCHWARTZ: All right. Why does – what does steel and aluminum have anything to do with U.S. national security?

MR. MILLER: Well, there is an argument to be made that it’s very useful in production of munitions and all sorts of military equipment. The broader notion – and I think what attracted the Trump administration to use this section of law, of a 1962 law –

MR. SCHWARTZ: Section 232.

MR. MILLER: – that’s the one – is the fact that national security or essential security is, according to WTO rules, a matter that is self-judging, that members cannot be challenged in their judgment with regard to what constitutes their own national security interests.
MR. SCHWARTZ: Right, that was my question. So if we say this is a national security issue for us, who’s to say it’s not?

MR. MILLER: Well, the Europeans and –

MR. REINSCH: Well, that’s what’s being – that’s what’s being debated. And, in fact, there’s a case going on right now at the WTO that doesn’t involve us, for once, that raises exactly this issue, and that’s Russia versus Ukraine, because Russia took some actions against Ukraine that Russia says is in their –

MR. SCHWARTZ: Russia’s taken a lot of actions against Ukraine.

MR. REINSCH: Well, yes, including some trade actions, tariffs and obstacles to Ukrainian exports. And Russia said these are in our national security interest. Ukraine disagreed. The United States filed a brief, a supporting brief. We took Russia’s side, which was that Russia gets to decide what’s in its national security interest and nobody gets to second guess.

MR. SCHWARTZ: We seem to be taking Russia’s side a lot these days.

MR. REINSCH: Well, this is not the first time. The EU took Ukraine’s side –

MR. SCHWARTZ: OK.

MR. REINSCH: – and said we do get to second guess. And that’s being litigated right now. There’s a dispute-settlement panel that’s reviewing that. That decision’s not due, I don’t think, until next year at the rate they’re going.

MR. MILLER: I think that’s right. And the U.S. dispute is a little more – it’s a little topspin on that, which is what the parties who are challenging the U.S. actions are saying is that this really isn’t an action about national security; this is a safeguard. Now, a safeguard is a provision of trade law, and it’s – basically, it’s a political safety valve.

MR. SCHWARTZ: So they’re saying we’re hiding behind national security to do what?

MR. MILLER: Yes. Well, to protect domestic industries which are injured from fairly-traded goods, the key word being “fairly.” Safeguards are a part of law. Think of it as a political tool more than an economic tool. When goods are unfairly traded, there are a whole set of remedies called – or trade remedy laws, and they’re well-known by the steel industry. They’re used by a lot of parties in the United States.

But safeguards cover fairly-traded goods, goods that are – that are imported. They do injure the industry, but there’s nothing unfair about the competition. And safeguards can be used temporarily and under some agreed-to conditions. But basically what our – what our trading partners are saying is you didn’t do steel and aluminum for national security; you did it to protect industries that are being – that claim to be hurt because of fairly-traded imports. That’s a safeguard. We’re going to challenge it as if it were a safeguard, which means we get to – we get to suspend concessions or retaliate immediately.
MR. REINSCH: That’s the key point. If you call it a safeguard, then you can retaliate immediately. You don’t have to go through a dispute-settlement process and have it adjudicated. You have the right under WTO rules to do an equivalent thing back at us. So the EU says it wasn’t national security, we’re – basically, it said we’re lying, we made it up, and what we’ve really done is –

MR. SCHWARTZ: Well, no one likes to be called a liar.

MR. REINSCH: Well –

MR. SCHWARTZ: Especially when you’re talking about –

MR. REINSCH: Certainly the president doesn’t like to be called a liar.

MR. SCHWARTZ: And especially when you’re talking about national security.

MR. REINSCH: Yes. And the EU position is it really is a safeguard measure in disguise, so we’re going to retaliate against you like it was. The U.S. position is essentially it may walk like a duck, it may quack like a duck, but it’s not a duck unless we say it’s a duck, and we say it’s not. We say it’s national security. So you can’t call it a safeguard. We get to decide what it is because it’s our measure.

And this is why I was referring to dubious legality. I can make a case – a national security case for steel and aluminum, probably a better one than Scott can make. I spent a lot of time working on the steel industry. But it’s complicated and it probably doesn’t cover all products, even though our action covers almost all products.

MR. SCHWARTZ: So we formally challenged tariffs that China, the EU, Canada, Mexico, and Turkey have imposed on more than $20 billion worth of U.S. exports in retaliation –

MR. REINSCH: Because they challenged tariffs that we’ve imposed.

MR. SCHWARTZ: Right.

MR. REINSCH: I mean, keep in mind that they’ve taken – they’ve retaliated. I mean, there’s no shortage of hypocrisy on all sides in this. At the same time the EU and these others called it a safeguard measure and retaliated, they’ve also made a complaint against us by arguing that we’ve misused the national security provision. So it is simultaneously being litigated and being retaliated against in advance. We have responded to that by saying we’re going to complain about you just like you’ve complained about us.

MR. SCHWARTZ: Yeah, but there’s a little more to it than that because what I’m reading is that the WTO could be forced to make an extremely high-stakes decision here about whether the U.S. misused the national security exemption – exception under the WTO rules, and if goes against the United States, what could happen?

MR. REINSCH: Well, go back a step, though. Yes, it may come to that, but they have to make the same decision for Russia and Ukraine first. That’s farther along in their pile.

MR. SCHWARTZ: So we just need to get in line here?
MR. REINSCH: We have to get in line. These things take time. And that one’s coming to them first.

MR. SCHWARTZ: How long do they take?

MR. REINSCH: It varies, but probably –

MR. SCHWARTZ: Are we talking about months or years?

MR. REINSCH: Less than a year in this case, probably.

MR. MILLER: Yes. The panel tends to take about a year. If you go to the appellate body, that adds another six to eight months. And then the terms of the retaliation are subject to negotiation. So it takes a while to play out. Think of it as if it were complex civil litigation in a U.S. court. These things take time to resolve themselves.

MR. SCHWARTZ: So what would provoke us to threaten to withdraw – I guess we’ve already threatened to withdraw from the WTO.

MR. MILLER: Yeah. There’s no news there. And the only thing that I would suggest is Bill’s right about the sequence. This decision of sort of how bulletproof the national security exemption is will be litigated by somebody else. But I would point out that while judges aren’t politicians, they read the newspapers. And it’s likely that the panel, as it considers the Russia-Ukraine situation, will be thinking about how this might play out with the really big members.

MR. SCHWARTZ: Well, judges also listen to The Trade Guys. And so what’s your prediction here about what’s going to happen?

MR. MILLER: I think the side with the national security argument.

MR. SCHWARTZ: Bill?

MR. REINSCH: Yeah, I think the U.S. wins. Whether we deserve to or not is a different question. But the whole history of this suggests that the way that the rules are structured countries get to decide for themselves what’s in their national security interests. So I think we win on that point.

MR. SCHWARTZ: OK. Well, meanwhile China’s lodged their own WTO complaint against the Trump administration – proposal on the 200 billion (dollars).

MR. REINSCH: Yeah. And that one I think we lose.

MR. MILLER: Probably.

MR. SCHWARTZ: So we win some, we lose some. What happens if we lose that $200 billion situation?

MR. REINSCH: Well, we – well, actually, it’s – the first one will be the 34 billion (dollars). I think we’re appealing that. They’re bringing a case against that one first. Well, if we lose – first of all,
like Scott just said, it takes a while. They are arguing that we have acted unilaterally, and we have. We used a statute, Section 301, which we’ve referred to before.

MR. SCHWARTZ: What’s 301?

MR. REINSCH: It’s a statute that says if the U.S. finds – what is the buzzword – finds a practice that is discriminatory or –

MR. MILLER: Unfair.

MR. REINSCH: Unfair or discriminatory, we are allowed to – the president has authority to take action against it.

MR. SCHWARTZ: This is Section 301 of the U.S. Trade Act of 1974.

MR. REINSCH: That’s correct.

MR. SCHWARTZ: OK.

MR. REINSCH: And we used this a good bit in the ’80s when the dispute settlement process of the WTO functioned in a different way. Before the WTO was created, and you just had the General Agreement on Tariffs and Trade, the GATT, the dispute settlement process was subject to consensus. That meant that a decision could only be adopted by the GATT if everybody agreed to it – that meant, including the loser had to agree to it. So oftentimes reports were never adopted because the loser wouldn’t agree. When the WTO was formed in 1994, they changed this process. So now it’s not – it doesn’t take consensus. So if you lose, you can’t block the report from being adopted. If you lose, you have to face the consequences. And if you lose, you have three choices – well, you may have more than three. One is, you comply. You stop doing the bad thing that they’ve determined that you are doing. Second, you keep doing the bad thing, but you pay. The other side is allowed to –

MR. SCHWARTZ: You pay a fine?

MR. REINSCH: Well, you pay the plaintiff. He’s allowed to retaliate against you. So he can – you pay with higher tariffs or you pay with something. There’s some bizarre cases.

MR. SCHWARTZ: One way or another, you –

MR. REINSCH: One way or another, you pay. One of the most bizarre ones, just to digress for a minute, is we lost a case with Brazil on cotton subsidies. The Brazilians claimed we were subsidizing our cotton exports. They won. We lost. We – and this was not this administration. This was –

MR. SCHWARTZ: And we don’t want to lose anything to Brazil, especially – I mean, unless it’s soccer. We could deal with that, I guess. (Laughter.)

MR. REINSCH: Well, it gets worse. Because we lost, and then we declined to fix the problem, because there’s a lot of politics in the U.S. cotton program. And the administration at the time, which I think was first Bush and then Obama –

MR. MILLER: Correct.
MR. REINSCH: – were not about to irritate all these Southern cotton farmers by getting rid of a program that gave them lots of money. What we ended up doing, believe it or not, is we now – well, we may have stopped – we now pay Brazilian cotton farmers.

MR. MILLER: Yes, we pay their farmers and our farmers, just to make it equal.

MR. SCHWARTZ: Really?

MR. MILLER: Yes. OK, but Brazil threatened to basically withdraw protection for U.S. intellectual property. And so there were lots of threats and counter-threats along the way.

MR. SCHWARTZ: All right. So along these lines, we’re headed down this path again. This is why European Council President Donald Tusk this week called on China, the U.S. and Russia to work together to reform the WTO to avoid what we called conflict and chaos. This all certainly sounds like we’re headed – we’re already in conflict and chaos.

MR. REINSCH: But it’s actually – I take some heart from that. It’s a good – the fact that the Chinese agreed with that – although they didn’t spell out what reform meant – we are for reform. The EU is for reform. The Chinese say they’re for reform.

MR. SCHWARTZ: So have we agreed – have we agreed to work with China and Russia, like you said?

MR. REINSCH: Not yet.

MR. MILLER: Well, nobody’s agreed. But there is an agenda for reform. If you think about it, Bill described the old days of the GATT, where you never really resolved a dispute. But one of the – one of the charms and, frankly, beneficial parts of the old GATT is it was a tool for negotiation. And there was a role for ambiguity in the old system. In the WTO, we’ve moved away from ambiguity and toward sort of lawyerly, textual rulemaking. And that’s what happens when you get things like freestanding panelists judging trade disputes. And many in the United States at the time thought that would be an improvement. A lot of members of Congress were frustrated with these old ambiguous agreements that you couldn’t enforce.

MR. REINSCH: Certainly, the lawyers thought it would be a good thing.

MR. MILLER: The lawyers thought it would be a boon to be able to enforce the agreements. Now that have – we have sort of rule by lawyers in the dispute settlement understanding, it’s frustrating. And some of the objections that Ambassador Lighthizer and other people have to the system as it is now. So, yeah, we need to adapt. We need to adapt this. It’s been in place now for 20-some years. And we ought to revisit way that we can make it better. This is a difficult time to do it, but it’s – the goal have merit.

MR. SCHWARTZ: Well, in the meantime, up on Capitol Hill, Congress is getting antsy. And ways and means chairman, Texas Republican Kevin Brady, is saying that we need to have a clear timetable for resolving issues with China. The Commerce Department needs to fix the broken exclusion process. What’s going on up on the Hill?
MR. MILLER: Well, clearly—look the House is the body that is closest to the voters—stand for election every two years, they listen to constituents.

MR. SCHWARTZ: Yeah. Let me read you one quote from Brady this week. He said: We’re free traders. He’s meaning Republicans, I think. I’m all for fixing it, but I’m not for going to war over it. I hope there’s a plan or an endgame. Trade wars are not good for business.

MR. MILLER: Right. And that’s what they’re hearing from their constituents. So what I thought was constructive about Chairman Brady’s statement is he’s really asking for clarity from the administration—this clear timetable. Which means, the administration has got to figure out what it is we want. Usually it’s having an objective is sort of important if you intend to achieve it.

MR. SCHWARTZ: He’s suggesting that—one of the things he’s suggesting is we need a clear timetable for our negotiations with China, correct?

MR. MILLER: Right. This has got to fit some—we need to know what to expect, you know, in terms of how this plays out. But he’s also pointing to the fact that when the steel and aluminum tariffs were put in place, there was an exclusion mechanism for products that were not available anywhere else. The criteria were a little fuzzy. This process is not working in the minds of many people who have tried to use it. He further went on to say that there ought to be ways to exclude economies or trading partners from this. And he—I think he—

MR. SCHWARTZ: Meaning, our allies.

MR. MILLER: Right. And I think what he’s trying to do is get the administration to focus on a manageable agenda, versus the one they have now which is not only vague and hard to understand, but it’s—we have fights with everybody.

MR. SCHWARTZ: OK. So why isn’t this taking? I mean, Kevin Brady’s an affable guy. A lot of people like him on both sides of the aisle. The administration seems to like him. Why aren’t they listening to him?

MR. REINSCH: Well, we’ve talked about the politics of this before. The president’s—

MR. SCHWARTZ: And we will talk about them again.

MR. REINSCH: Because nothing’s going to get solved. The president is pretty immovable on trade issues.

MR. SCHWARTZ: This is optimistic trade guy Bill we’re hearing from. (Laughter.)

MR. REINSCH: Yeah. The president is immovable on—he’s the immovable object on trade issues. The Republicans have discovered that his base is their base. And you’ve got all these people saying: Well, I’m nervous. I mean, listen to what Blake Hurst said at our last one.

MR. SCHWARTZ: Yeah, Blake Hurst, the president of the Missouri—or “Missour-ah” depending on how you say it—Farm Bureau sat in here in studio with the trade guys, and here’s what he had to say.
BLAKE HURST: You know, as I visit with legislators or people in the administration, I think that patience has a limit. And I think –

MR. SCHWARTZ: Patience has a limit?

MR. HURST: Yeah. Yeah. I mean, I think that if I was in the administration I’d be very concerned about how much time they have without showing some kind of progress, I mean, because what we see is no at least public negotiations going on, no endgame in sight, no – and what we hear from the administration is pretty much that this is going to last a while.

MR. REINSCH: I think we’re all waiting – I mean, I bet Mr. Brady is sort of in the same boat. They’re all afraid. They’re afraid to challenge the president because they’re afraid of his voters. And I think, frankly, some of them are afraid of him personally. He’s – I’ve said this before – he’s a vindictive guy. He goes after individuals that say things he doesn’t like. It’s kind of a high bar if you want to challenge him. And if you are not confident that your own voters are going to back you up, you know, the path of least resistance is to – is to, you know, you whine about it, but not actually do anything.

MR. MILLER: Right. So nobody’s threatening to take action, but they are asking for, you know, what’s some scope? What are the parameters here? What are we doing?

MR. SCHWARTZ: Well, and in the meantime you have Vice President Pence out there saying, quote, “Our resolve will never break, and we’ll keep taking strong action to protect American workers until China changes course.”

MR. REINSCH: Which, of course, isn’t protecting American workers, because we’re starting to see layoffs because of the tariffs.

MR. SCHWARTZ: And it’s not protecting American farmers either.

MR. REINSCH: It’s not protecting the farmers. And I think even with Congressman Brady’s suggestion, he needs to be a little careful about what he wishes for. If you start to put timelines or deadlines on negotiations, I think with this president you’re asking for trouble. So you say –

MR. SCHWARTZ: Why is that?

MR. REINSCH: Well, if Brady says to the president: You need to say, you know, we’re going to settle this by Labor Day, so what happens if we don’t? So then what does the president do – 200 billion (dollars) more tariffs?

MR. MILLER: Right. And keep in mind, this is –

MR. SCHWARTZ: (Laughs.) Yeah.
MR. MILLER: One of the characteristics of our president is he never shows his hand. He always pushes. He prods. He makes extreme demands. He loves chaos. But he never tells you what his bottom line is.

MR. SCHWARTZ: Yeah. Pence also acknowledged that the tariffs are part of a negotiating process, and said, quote: “With this president, everything is a negotiation.” So I guess we need to listen to those words. But Brady’s trying to put some parameters around it, like let it – tell us what the negotiation is.

MR. REINSCH: He is. But he’s trying – but he’s trying to avoid the central issue, which is growing pressure – which is not yet significant – but growing pressure to pull back the authority that Congress has delegated to the president and give Congress more of a say on tariffs. This is the legislation that Senator Corker was pursuing several weeks ago. There’s now a House bill that would do the same thing. There are – there’s another Senate bill that would do the same thing.

This is still, you know, on the fringe. This is single-digit people that are unhappy. But it’s growing. And the speaker, I think, has said something about this. And if it continues to grow. There may actually be a movement, even amongst Republicans, to say we need to take some of this authority back, which would go back, rewrite the last 70 years of history.

MR. SCHWARTZ: Well, the tension’s certainly building, and the data is backing that up. The IMF this week put a price tag on – put a price tag on the trade war. It said that if escalating trade tensions and current protectionist leanings are on track to derail global economic growth and could reduce global output by around 0.5 percent, or about $400 billion by 2020.

MR. REINSCH: That’s real money.

MR. SCHWARTZ: That is real money.

MR. MILLER: Yes. And we’re not seeing it in markets yet, but the fear is definitely there. Our friends at Bloomberg helpfully track when companies make earnings teleconference calls. And they sort of talk about their prospects for the coming quarter or year. Bloomberg helpfully tracks the words that are used. And they’ve tracked tariffs and how often that word comes up in company earnings conference calls. It’s at a six-month high.

MR. SCHWARTZ: I bet.

MR. MILLER: So companies are talking about this might affect our outlook.

MR. SCHWARTZ: Well, and the IMF also said that the U.S. – if this continues, the United States will be especially vulnerable to a slowdown because the focus of – because the U.S. will be the focus of a global retaliation.

MR. REINSCH: Yes, which is already happening thanks to the steel tariffs. And I said before, I still think that the breaking point here will be if he does the same thing on cars. Because that will be – that’s not the whole world. There aren’t that many countries that make cars. But it’s enormous part of the economy. And there will be a huge, direct consumer impact if he does that.
MR. SCHWARTZ: Well, I’m glad you brought that up, though, because the manufacturing guys – Scott Paul, who’s the president of the Alliance for American Manufacturing said this week on Twitter that China sets record daily steel output for a third month in a row. Time to get smart. If some get their way and the steel tariffs stop, the Chinese steel floods the global and U.S. markets. Tariffs have to stay on until we see real change.

MR. REINSCH: Well, I like Scott. Scott’s sort of a friend. But he’s got it – he’s got it backwards here.

MR. SCHWARTZ: Well, let’s bring him on Trade Guys.

MR. REINSCH: We can bring him on Trade Guys. What I’d say to him is: Look, you know, we’ve got the tariffs. The tariffs are in effect. And what’s happened because of the tariffs? Chinese steel production is going up. So the tariffs are working? I don’t think so.

MR. MILLER: And domestic steel prices are up, by the way. And so –

MR. REINSCH: Forty percent or more.

MR. MILLER: Lots of pain, not much gain.

MR. SCHWARTZ: And the end result, as you guys have been pointing out, is that we’re going to have some really expensive cars.

MR. REINSCH: Seven thousand dollars more.

MR. MILLER: If it comes to that, 7,000 (dollars) is the average price increase, roughly speaking.

MR. SCHWARTZ: If I have to pay $7,000 for my next car, my wife’s going to kill me.

MR. MILLER: Yes, that’s the increment, $7,000.

MR. SCHWARTZ: Because I’m not driving a smaller car.

MR. MILLER: Yeah, you’re probably going to stick with what you have.

MR. REINSCH: Well, if you –

MR. SCHWARTZ: I mean, don’t tell her I said that, but like, you know –

MR. REINSCH: I don’t want to do a commercial, but Toyota announced that the Camry – which they make in Kentucky, so it’s a U.S. car – even that will go up $1,800. So there you go.

MR. MILLER: Because of parts.

MR. REINSCH: It’s not 7,000 (dollars), but – because the parts will go up.

MR. SCHWARTZ: I’m not driving a Camry.
MR. MILLER: Yeah, that’s OK.

MR. REINSCH: You’re not driving a Camry? What are you, anti-Japanese, Andrew?

MR. SCHWARTZ: No, no, no, I have no problem with the Japanese. I just, you know – I want to aim a little higher.

MR. MILLER: Well, look, there will be – there will be a way to get the sense of where the industry is because this week the Commerce Department is holding public hearings. And there will be a full day of public hearings, lots of testimony. So far we can’t really find any constituent who supports the idea of tariffs on autos. It’s a global industry. People want to be globally competitive. You know, look, Ford has had operations in Europe since Henry Ford ran the place. They made Model-Ts in – they had big operations in Germany, France, and the United Kingdom before – well before World War II. The U.S. – GM has had a global footprint also for about that long. All the car companies operate globally on global supply chains. Nobody’s really interested in this except the president. So we’ll find out what they – whether they take the advice and how the Commerce Department makes its recommendation.

MR. REINSCH: Ironically, two of our biggest auto exporters – the president likes exporters. Our biggest exporters in automobiles right now are BMW and Daimler. And one their biggest –

MR. SCHWARTZ: So it’s BMW and Mercedes?

MR. REINSCH: Yes. And one of their biggest destinations for cars coming from America is China.

MR. SCHWARTZ: Sure.

MR. REINSCH: So if we put on – if he puts on car tariffs, the Chinese are going to respond, and you’re going to have a bunch of laid-off workers in South Carolina and Alabama.

MR. SCHWARTZ: That doesn’t sound good at all. And speaking of which, you know, a lot of people are saying that China will have a higher pain threshold than the U.S. in a trade war, both economically and politically. What do you all think about that?

MR. MILLER: We’ll find out. It is sort of a staring contest, as we’ve talked on previous episodes. China has had a pretty effective experience in sort of waiting out its trading partners. And in my view they have a lot of tools other than just tariffs. You know, for instance, I saw today on – it was on some reporter’s Twitter feed, a photo from a restaurant in Beijing. And the restaurant said: To our American visitors, we will add 25 percent to your bill at the end of –

MR. SCHWARTZ: No, really?

MR. MILLER: – yes – at the end of the meal just to keep you aware of the treatment of China by the United States.

MR. SCHWARTZ: That’s unbelievable.
MR. MILLER: Yes. So this is –

MR. REINSCH: Well, that’s likely to catch on. Things in China – small things in China become big things very quickly.

MR. SCHWARTZ: Yeah. Well –

MR. REINSCH: And the Chinese government – don’t forget, the Chinese government has an advantage over us in this respect. They don’t have elections.

MR. SCHWARTZ: Right. Well, that’s what I was saying. They have more – you know, they have a higher threshold. They don’t have to worry about politics.

MR. REINSCH: Not in the same way. They pay a lot of attention to public opinion.

MR. SCHWARTZ: Yeah.

MR. REINSCH: But it’s –

MR. MILLER: It’s different.

MR. REINSCH: It plays out differently.

MR. SCHWARTZ: All right. Well, let me ask you this. China runs a sizeable trade surplus against the United States. The U.S. also runs a surplus, as you guys have pointed out, in services with China of about 40 (billion dollars) to $50 billion. For years China’s been the largest buyer of U.S. Treasurys. It holds more than 1 trillion (dollars) of those Treasurys, which has allowed us to do a lot of things, right? So China’s selling us real goods and then they’re also buying American paper in return. Isn’t that a good deal?

MR. REINSCH: Well, it has been for American consumers. One of the things that happens when you run a trade deficit is you are able to consume what you don’t produce. So, from a consumer standpoint, it’s quite good.

Second, the point you make here – and it’s a really important one – is that trade deficits are only one side of the ledger. And, in fact, national accounts are always balanced. The current account, which includes the trade balance, is always equal to the capital account, and a trade deficit translates dollar for dollar to an investment surplus.

Now, yes, China does hold Treasurys, as do most economies outside the United States. The dollar is the reserve currency. China makes use of the dollars they hold principally to manage the value of their currency. In other words, they trade – they trade in dollars to support or deflate their own currency, to manage it, which is exactly how the Japanese use the dollars they hold in Treasury bills. So it’s not like they would – they would suddenly have an incentive to sell all their Treasurys because that would – that would just hurt their own currency value. It would make their imports more expensive, so there’s not much incentive to do that. But that’s the reason they hold dollars. It was the same reason people held gold a hundred years ago.
MR. SCHWARTZ: Yeah. Well, I mean, one thing that keeps occurring to me, too, is that, you know, our companies are really going to have a problem. So Apple sales in China, for instance, amount to about 45 billion (dollars), which is about 20 percent of their total. China produces 60 percent of the world’s rare earth minerals. And if there’s a disruption in that, that could really be devastating to the U.S. and China. And I’m thinking about, you know, young people. Young people are really brand loyal to Apple iPhones. If an iPhone all of a sudden costs a lot of money –

MR. REINSCH: Two hundred dollars more.

MR. SCHWARTZ: Yeah, or maybe more than that even. You know, that can’t be good for politics either, for whichever party presides over that. So why would – why would this administration want to get into that?

MR. REINSCH: I think the president believes – erroneously, but I think he believes these are short-term actions, that these are tactics you use to bludgeon the other side into submission. Once they cave, we get what we want, and then you can remove all the tariffs. Now, my column this week talked about this because the president seems to think this is like a light switch; you know, you put them on, you put them off, and everything goes back to the way it was before. And it doesn’t happen that way.

MR. MILLER: Right.

MR. REINSCH: Because what companies do is they – if the tariffs go on, they begin to alter their supply chains because if suddenly parts and components have become more expensive, they have to adjust their supply chains in a different way. The most obvious example is not even a supply chain example: soybeans. And we talked about this when Blake was here. The Chinese have started to buy Brazilian soybeans. And –

MR. SCHWARTZ: Right. Blake’s a soybean farmer and he’s really being affected.

MR. REINSCH: Yeah. And as he pointed out, a lot of – particularly in Asia, a lot of this is relationship-based. Buyers want to know the sellers. They want to know they can trust the sellers. So what you’re getting – what Trump is doing here, he’s getting a lot of buyers – he’s forcing a lot of buyers to change relationships and have new sellers.

MR. SCHWARTZ: Well, China imports about 12 –

MR. REINSCH: And it’s not going to go back to the status quo ante just because he gets rid of the tariffs. They’re going to stick with the Brazilians.

MR. SCHWARTZ: And China imports right now about $12 billion worth of U.S. soybeans, which is about 50 percent of the U.S. crop. So the stakes are really, really high here.

MR. MILLER: Oh yes. And this substitution effect is happening all through industrial supply chains as well. And keep in mind there, while relationships also matter, qualifying a new supplier is actually quite burdensome for most manufacturers who are buying intermediates. Whether it’s a chemical or a product or a component, getting a supplier to do it the way you want to do it precisely is a lot of work. If your supplier’s prices are suddenly a lot higher because of a tariff and you find an alternative supplier, there is energy and effort required to qualify the supplier. Once you qualify the new supplier, it’s not clear supplier A gets the business back when the tariffs go back to normal.
MR. SCHWARTZ: And this is what Bill was talking about, turning the switch back on and off.

MR. REINSCH: Exactly.

MR. MILLER: Precisely, right.

MR. REINSCH: Yeah. I mean, what we’re doing – I don’t think they realize it, but we’re doing permanent damage to our economy. As people change their supply chains in other ways, they’re going to be going to a less-efficient, more-expensive alternative, and then they’re going to be stuck with it. But it’s going to be even more expensive to go back to the way it was before.

MR. SCHWARTZ: I want to end on one other major issue that we didn’t talk about yet. Our allies, Japan and the EU, signed a massive bilateral trade deal this week. What does that say to us?

MR. MILLER: Well, Speaker Ryan was right. He said the world is not waiting for the United States to make – to take action in their own economic interest. The United States is on the sidelines. In fact, we’re going backwards in commercial integration. The rest of the world seems to get the – get the joke that commercial integration is actually beneficial, and these agreements benefit their firms and their consumers – voters – and they’re moving forward with these agreements.

MR. REINSCH: And what it will do, too, is it will reduce – downstream – this does not happen immediately – but if you’re an American company thinking, OK, now we’re going to have much freer access between the EU and Japan, I’m having trouble getting into the Japanese market –

MR. MILLER: Right.

MR. REINSCH: – so why don’t I move to Europe? Because then I’m going to be part of a free trade agreement and I can get access to Japan that way?

MR. SCHWARTZ: That’s really something.

MR. REINSCH: And so what you’re going to see is the opposite of what Trump wants. I mean, he wants to bring companies back here – we’ve talked about this before – which I think is not likely to happen. There was an event upstairs today –

MR. SCHWARTZ: Upstairs at CSIS.

MR. REINSCH: Upstairs at CSIS today with a senior administration official –

MR. SCHWARTZ: Trade Guys Studio is in the basement of CSIS.

MR. REINSCH: We are in the – yes. We belong in the basement. (Laughter.) The enlightened discussion goes on in the boardroom. And we had a –

MR. SCHWARTZ: Trade Guys are in the boardroom too sometimes.

MR. REINSCH: I was actually invited to this. I was not crashing. And we had a senior administration official who shall remain anonymous. But he was asked: What do you want to do while
you’re in office? You know, and he says, well, I have a list. And he did. It was a cool list. One of his lists was we want to stop offshoring.

MR. SCHWARTZ: What does – what did he mean by that?

MR. REINSCH: We want to stop our companies from leaving.

MR. SCHWARTZ: Right.

MR. REINSCH: We want them to stay here. And he went on to say, you know, we’re not making it illegal. We’re trying to deregulate. We’re trying to create incentives to stay here. But the point was very clear: We want American companies to manufacture and produce in America.

And going back to this EU-Japan thing, if I were an American company right now thinking about how can I sell more in Japan, knowing that they have a lot of barriers to access, knowing that we pulled out of TPP so we’re no longer going to benefit from that, I would think seriously about going to Europe and essentially going to Japan through the backdoor.

MR. MILLER: So great bumper sticker, lousy execution, because the administration is actually doing things on the trade front that are incentivizing offshoring. They did it with Harley Davidson motorcycles sold in Europe, which are now made elsewhere. This is happening in hundreds of places, most of it below the radar. They’ll never notice till it’s gone. But the fact is, no matter how much they want that, they’re acting in a way that is forcing decisions to be made to move production out of the United States. And it’s bizarre.

(Music plays.)

MR. SCHWARTZ: To our listeners, if you have a question for The Trade Guys, write us at tradeguys@csis.org. That’s tradeguys@csis.org. We’ll read some of your emails and have The Trade Guys react to it.

Thank you, Trade Guys.

MR. REINSCH: Thanks, Andrew.

MR. MILLER: Thank you.

MR. SCHWARTZ: You’ve been listening to The Trade Guys, a CSIS podcast.

(END)