TRANSCRIPT
The Truth of the Matter

“U.S.-China Trade Deal: Phase One”

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BOB SCHIEFFER: I'm Bob Schieffer.

ANDREW SCHWARTZ And I'm Andrew Schwartz of the Center for Strategic and International Studies and this is the Truth of the Matter.

MR. SCHIEFFER: This is the podcast where we break down the policy issues of the day. Since the politicians are having their say, we will excuse them with respect and bring in the experts, many of them from CSIS, people who have been working these issues for years.

MR. SCHWARTZ No spin, no bombast, no finger pointing, just informed discussion.

MR. SCHIEFFER: To get to the truth of the matter on the US-China trade deal, we'll talk with CSIS's Trade Guys, Bill Reinsch and Scott Miller. Mr. Reinsch holds the Scholl Chair in International Business at CSIS and is a senior advisor at Kelley, Drye & Warren, LLP. Previously he served for 15 years as President of the National Foreign Trade Council where he led efforts in favor of open markets and supported the export-import bank and overseas private investment corporation. Mr. Miller is a senior advisor at CSIS, and from 2012 to 2017 held the Scholl Chair in International Business at CSIS, which focuses on key issues in the global economy, such as international trade, investment competitiveness, and innovation. From 1997 to 2012, Mr. Miller was Director for Global Trade Policy at Proctor and Gamble, a leading consumer products company. Gentlemen, welcome.

MR. SCHIEFFER: I'll go to you first, Bill. Who loves this deal and who hates it?

BILL REINSCH: I think the farmers love it. Farmers did very well, not only in the purchase commitments, which are substantial, pushing 40 billion over two years, above 2017 levels. So it's a significant net increase. But if you go through the agreement, there are pages and pages and pages of very specific market opening commitments by the Chinese in which they agree to eliminate certain very specific regulations, to adopt international standards with timeframes and deadlines for doing it—and not just on the soybeans and corn you've been reading about, about alfalfa, barley, avocados, blueberries, all kinds of products across the board. In the short run, that won't make huge amounts of difference in terms of dollars. In the long-term I think it's a major market opening concession on the part of the Chinese.

SCOTT MILLER: Yes. When it comes to agriculture, the acceptance of USDA foreign ag. service standards, which is woven into this agreement, will probably be the biggest long-term gain if it's actually implemented as the text says, because challenges based on non-scientific grounds have been a major headache for agricultural exporters in many markets, but China in particular. And so if that is one of the long-term effects of this, that's quite positive. There are a few other positive too. Financial services as an industry did very well in terms of genuine new market access and control over their business that they didn't have before. There's also, frankly, for anybody doing business from the United States into China, there is a sense of greater predictability
this year, because I think what we’ve achieved is with phase one established and agreed, and phase two off in the distance, that we’ll have relative stability in terms of trade in the conditions. And that stability and predictability, I think is overall a good thing.

MR. SCHIEFFER: So Scott, who doesn’t like it?

MR. MILLER: Well look, I would characterize it as a spaghetti western. We’ve talked about the good, the bad part is what it hasn’t done yet. There’s ugly too. The bad is that, one of the biggest problems in China is subsidies, and subsidies were not dealt with at all in this particular tranche of the agreement. So phase one did not deal with subsidies. It may or may not have dealt with technology transfer and we’ll find that out as we go along, but it’s an area of suspicion, at least for me. In my mind, the ugly part is the quantitative commitments of US purchases. My view is, most American exporters, most American firms, want to compete in a place where markets are contestable and we want to offer best value, best quality, best service and win the competitive battle rather than having it allocated to us by a government, whether it’s our government or somebody else’s government.

Now, that’s the part I’m sure the politicians will all talk about. They’ll quote the numbers and you can quote them down to the HS 10 digit line if you want to, if you want to get really into the details of the annexes. But practically speaking, I know why they did that. I wish they hadn’t, but overall there are some positive to this, but US-China relationships are complicated. There’s a lot more work to be done.

MR. SCHIEFFER: Bill, what do you see is the downside, if any?

MR. REINSCH: Well, I think there’s several. I mean, Scott made the ugly point. From the trade theory point of view this is managed trade. It is the Chinese making certain commitments that they’ll purchase certain quantities or dollar values of stuff. It is not the normal competition that we like to think is the way the system works. Ambassador Lighthizer is a longtime fan of managed trade. That’s what he did when he was in USTR in a different capacity during the Reagan administration. If you’re not deeply into the principle of the thing, you pass over that. To me the biggest thing that’s missing is the failure to address subsidies, Chinese state-owned enterprises, and essentially Chinese industrial policy. They wrote this monograph called “Made in China 2025,” which really was a roadmap to developing global champions in 10 different high-tech sectors.

And the point of it was to say, we’re going to put in a huge pile of money into these sectors, we’re going to develop global champions, and we’re going to outcompete you foreigners. That’s a challenge to the Americans because most of those sectors are areas where we have the lead. Fair competition is one thing. I think our companies are happy to take them on, but when the Chinese say we have $150 billion that we’re going to put into semiconductor
manufacturing plants, that's a resource bump that we can't really do much about.

MR. SCHWARTZ: Well, put it this way, if you have a 5% tariff, you can deal with that, but when your competitor's cost of capital is zero, that's a very different problem and that's the subsidies problem.

MR. REINSCH: And this is left for the next tranche for actually one very obvious reasons, which is the Chinese don't want to give that up, and I don't think that we'll be very successful in tranche two, but it limits the effectiveness of what we've done now. Clearly what we did do is, as Scott said, we restored some stability in the market, made the farmers happy. But to be fair about it, the purchase commitments are also in manufacturing, they're in energy. The oil and gas people, the LNG people in particular should be happy.

MR. MILLER: Well, they're in services.

MR. REINSCH: And services too. It's not just soybeans and corn.

MR. MILLER: Including IP royalties. So send enough Chinese to enough Disney movies and they fulfill their services obligation.

MR. SCHIEFFER: Andrew?

MR. SCHWARTZ: Bob, thanks for having me and the Trade Guys on. As you know, we have our Trade Guys podcast every week.

MR. SCHIEFFER: Yes, I know that.

MR. SCHWARTZ: So we're going to this more this week on our own podcast.

MR. REINSCH: With much more bombast this time.

MR. SCHWARTZ: With spin and bombast, of course.

MR. REINSCH: Yes, here it's just the facts.

MR. SCHWARTZ: Right. And Scott knows I'm going to do half of the podcast this week in Go Joe's voice. We're going to do Go Tigers, LSU. Anyway-

MR. REINSCH: And I'm going to roll my eyes every time you did it.

MR. SCHWARTZ: Bill will roll his eyes, we'll do our normal shtick. But what I wanted to really ask you guys is, until now, there's been bipartisan support pretty much for Trump signing this phase one with China. Until now. Because Chuck Schumer is saying that President Trump's phase one deal with China, on Tuesday said, that it's too weak. Why is he saying it's too weak now, and does this signal that this bipartisanship is coming to an end?
MR. REINSCH: It's because it's the only thing he can say.

MR. MILLER: Look, last I checked the calendar, we're having an election this year.

MR. SCHWARTZ: Oh yeah, that's true.

MR. MILLER: That's your first clue.

MR. SCHWARTZ: Right.

MR. REINSCH: You know they're going to be against it and the only thing the Democrats can say about it is, not good enough. And he's right. It isn't good enough. It isn't good enough in Trump's terms. It isn't everything he wanted.

MR. SCHWARTZ: Well, why isn't it good enough?

MR. REINSCH: Because of the stuff that's missing.

MR. MILLER: Well, yes. Because as Bill and I both talked, there are things that have not been done yet. But look at it this way, no one in Washington thinks about the US-China relationship the way many people did in 2015 or 2016. Political scientists talk about the Overton window, which is sort of the frame for where reasonable political discussion happens. No one in Washington, even the critics of the president, think China's a normal country anymore, that we ought to deal with them on normal terms with normal kinds of trade agreements, with normal kinds of international principles.

MR. SCHWARTZ: The window is broken.

MR. MILLER: That window has shifted dramatically. And it shifted by the president, and I think by and large the consensus, even from the president's critics, is China can't be treated like a normal country, won't behave like one, and needs the special attention that the president has put on it. Now, whether it's good enough or not, at that point he's changed the debate.

MR. REINSCH: I'd just add, it's not only the president that's changed the debate, it's the Chinese president.

MR. MILLER: That's true.

MR. REINSCH: Xi Jinping has changed China's policy. When they joined the WTO in 2001, the then-Chinese leaders, Jiang Zemin and Xuran Xi said we want to integrate China into the Western trading system. I think the sub text was we want to use our international obligations through the WTO to force our recalcitrant ministries into doing what they need to do to promote Chinese growth. It was a different message and I think they were telling the truth, then. They're gone. The new leadership is pursuing a much more state-centered economic policy and a policy that takes on the United States, not only economically, but in the South China sea and regionally, in a much more
aggressive way. And I think one of the reasons that opinion here is shifted, not the only reason, but one of the reasons opinion shifted, is Chinese policy has changed.

MR. SCHWARTZ: Do you think that by agreeing to this phase one deal, as Schumer suggested, we’ve seeded too much leverage to the Chinese?

MR. MILLER: Look, I think the Minority Leader Schumer was going to criticize this agreement no matter what happened. The fact that he started as criticism with currency manipulation was a tell that his arguments weren’t that strong, because most of us who followed this carefully realized that China was, according to the Treasury department’s own criteria, were never really manipulating their currency. They did intervene and they did have a large bilateral deficit with the United States, but their overall current account is in good shape. And so they don’t meet the qualification and yet that was the first point of criticism.

I don’t know how much of this is posturing. There is a lot of work to be done and the approach we’re taking is, the president seems to be doing it on his own. He’s been criticized for not getting cooperation from our allies and partners in this, and I think that’s a criticism that will resound to a much greater degree in the days ahead.

MR. SCHIEFFER: You know, let me just bring up one thing. On this podcast we try to not only just break the issues down to the bare facts, but also the jargon. When people read that we have accused the Chinese of being currency manipulators and then this week we declared they’re not currency manipulators, what are they talking about? What is currency manipulation?

MR. MILLER: Well, it turns out there is a definition in the statute and the Treasury department is the arbiter of this definition. Currency manipulation requires three factors. You basically have to intervene in currency markets on behalf of the value of your own currency as a sovereign. Second, there has to be a large bilateral account deficit, a trade deficit with the United States. So it’s unfavorable to us when you manage your currency. But the third criteria is, that you have to have a current account that also has a deficit. So in other words, you are already trying to export your way out of trouble by pushing down your currency.

MR. SCHIEFFER: And basically what are you doing?

MR. REINSCH: The issue is whether or not a country is artificially maintaining the value of its currency in order to-

MR. MILLER: Promote its exports.

MR. REINSCH: Promote its exports. If they want their currency to be artificially low-in-value compared, in our case, to the dollar, if they keep it low it makes their
exports cheaper and it makes our exports to them more expensive. So their surplus goes up, our deficit goes up.

MR. SCHIEFFER: So it really is something that is important.

MR. MILLER: Well, it does happen.

MR. REINSCH: It happens, yeah.

MR. MILLER: It does happen. The best example of it was about three years ago, the government of Switzerland came out and announced, the central bank of Switzerland announced that they were going to peg the Swiss franc to the euro and it was in order to support their exporters. I mean, it's like an open and shut case of precisely this tactic. And they couldn't afford it to sustain it very long, but they did it for a while to help their exporters. So it does happen. Whether China's doing it or not has always been quite contentious and most people who look at it carefully would indicate that China does not manipulate its currency.

MR. REINSCH: This was a huge issue, and you'll remember this because a huge issue in the 80s with Japan, where the Americans, including the president, accused the Japanese of maintaining the yen at an artificially low rate in order to promote their exports in the United States, beginning with automobiles and a whole bunch of electronic appliances. And that ended with the Plaza Accord in 1986 in which Japan agreed to maintain it at a certain exchange rate level and a lot of those problems then went away. So it does make a difference. It is an issue. People who've watched the Chinese will tell you that the Chinese were pretty clearly guilty of that for a long time up until about 10 years ago. And about 10 years ago they stopped being guilty of it and they let it float a little bit. And currently, if anything, far from driving their currency down, they're propping it up. And if they let the market operate normally, it would probably go down more than it has.

MR. MILLER: Yes, it would.

MR. REINSCH: In a bizarre way they're doing us a favor.

MR. MILLER: Yes.

MR. REINSCH: Despite what Senator Schumer says.

MR. MILLER: Their intervention in the market is to prop up the currency, not to drive it down.

MR. SCHWARTZ: So is what we did largely symbolic?

MR. MILLER: I would say so, given that the Treasury is required to evaluate these conditions every six months. And six months ago, they announced that China was manipulating. Six months later they're taking it off.
MR. SCHWARTZ: But is it important to the Chinese? I mean, symbolic is important to them.

MR. MILLER: Yes.

MR. REINSCH: I think they wanted to get out from under this. I mean, they believe, correctly, that they've been unjustly accused. I mean, if this were 2005-

MR. MILLER: It's a different story.

MR. REINSCH: The argument would be a different story. But in 2020 or 2019, they're innocent and they don't like being blamed. So this gets them off the hook. I mean, the reality of the U.S. law on the subject is it was never much more than symbolic anyway. Even if you decide that they are a manipulator of currency, the only thing that happened was you were supposed to go negotiate with them and get them to stop. I mean, there wasn't any built-in penalty, but it was like a black mark on your report card.

MR. SCHIEFFER: So we know the farmers are going to be happy with this.

MR. MILLER: We hope they will.

MR. SCHIEFFER: If what they say is going to happen, happens, they're going to get to sell to China.

MR. REINSCH: They should be, yes.

MR. SCHIEFFER: But in other parts of America, what will we see here? Are we going to feel this? Is something that to happen as a result of what happened today that we'll immediately notice or even notice down the line?

MR. REINSCH: Well there's a lot of people, Americans, who have been hurt by the tariffs the president put into place and by the Chinese retaliation. And this was particularly true in a lot of manufacturing, because by putting tariffs on Chinese parts and components, it made American products more expensive. And then the Chinese retaliated, so it made our sales to them more expensive because it bumped up our prices going there. So a lot of our manufacturers took a big hit. And most of those tariffs remain in place.

MR. MILLER: Yes. They haven't gone up, but they're still in place. And what you would assume is many of the supply chain managers whose lives have been miserable for a couple of years now, have at least figured out how to manage around this and how to accommodate it within their acquisition plans and their pricing plans. What we're not facing is a rapid escalation of tariffs on consumer goods. Remember, the last tranche of threatened tariffs on China was on electronics and toys. I mean, the president had positioned himself to-

MR. REINSCH: Phones and laptops were the two biggest items.
MR. MILLER: Phones. Yeah, he was going to be the Grinch that stole Christmas had those been implemented. But on December 15th, they were waived as a result of this reaching the phase one deal.

MR. REINSCH: Now, if you talk about winners and losers, there’s another winner in this scenario. And the other winner I think is Vietnam. Well, this was even before the tariffs, companies were beginning to move out of China to go somewhere else, largely because labor costs in China had been going up. The tariffs have accelerated that. If your business model was, to make things in China and then ship them back to the United States, that’s suddenly got much more expensive. And if your business was one that wasn’t very capital-intensive, say you were making t-shirts, it’s not that hard to say I’m going to shut my factory in Wu Han, I’m going to move to Bangladesh or I’m going to move to Vietnam and open one there, because then there wouldn’t be any tariffs. Or beyond the normal ones.

Now, if you just built a $2 billion automobile plant in China, you’re not going to move next week. But overall Vietnam has been a big winner as companies move out and you can see it in their trade deficit, or our trade deficit with Vietnam, which has gone from the mid-$20 billions to over $50 last year. So China is going down a little bit, but others have gone up in a major way.

MR. SCHIEFFER: And how will the Japanese view this?

MR. REINSCH: That’s a good question.

MR. MILLER: Thus far they've been surprisingly and astonishingly quiet throughout the process. Some of this is, I think a credit to Prime Minister Abe, who manages his personal relationship with the president very well and has managed commercial relations with the United States quite professionally at a very high-level since President Trump entered office. So they've stayed out of fights that they don’t have to get into.

MR. SCHWARTZ: I mean, just yesterday, his defense minister, Abe’s defense minister was here at CSIS, here in town visiting. His counterpart, Secretary Esper, not a word.

MR. MILLER: Now, they are working with the United States on a WTO-approach to subsidies, which if U.S. and Japan and Europe could actually agree, it would put some pressure on Chinese subsidies. We’re nowhere close to agreement, mostly because Europe can’t figure out how to discipline Chinese standard industries and not their own. So we’ve got a ways to go, but Japan has been quite cooperative on that. So they’ve been quiet. I think they’re not really harmed by the fight.

MR. REINSCH: There’s one area where they’re very nervous, and they’ve talked to us here at CSIS about this at considerable length over the last couple of years. The Chinese are doing the same thing to Japan that they’re doing to the United States. They are trying to acquire technology through investment and they’re buying Japanese companies that make critical technology, just as
they’re trying to buy American companies. The Japanese have set up the same process we have, to screen those investments and prevent the ones that the government doesn’t like. But their government is very nervous about this because they see an outflow of technology that will work to their disadvantage and they’ve been trying to encourage the Americans to work with them to make sure that we have a united front.

MR. MILLER: Bill raises high technology, and this was part of a speech that former Secretary, Hank Paulson, gave at CSIS last year where he called this the technology cold war between the United States and China, which is ongoing, which was not settled by phase one and probably won’t be settled by phase two, and will continue to fester as time goes on.

MR. SCHWARTZ: Okay guys, so administration is saying, as soon as phase one is signed, it was today, phase two begins. So what begins now?

MR. REINSCH: Well, I think they have the remaining agenda, which we’ve talked about: what’s missing. That’s what they’re going to talk about. I think they’ll talk about it for a long time. The debate we’ve been having internally here is not when it will start, which will be soon, but whether it will ever finish.

MR. SCHWARTZ: Right.

MR. REINSCH: Because I think that it’s unlikely the Chinese will do what we want. My sense has been that in the end the president will have a choice. In a way, the same choices he had with phase one, to accept something that is less than he wants and say it’s great, or to take some kind of further retaliatory action. Or he’s hinted at this, to kick the can until after the election.

MR. SCHWARTZ: Right. And you think he’s not doing anything on phase two until after if he gets re-elected?

MR. REINSCH: Well, no. I think his first choice would be to get an agreement that he can brag about before the election. So if in October he can get something that he can say addresses these problems, whether it does or not isn’t the point. If he’s got an agreement that he can sell as addressing these problems, I think he takes it. At the same time, I think he’s increasingly aware that that’s a long shot, and so rather than get to October and have to say, well, I failed, he’s setting the stage now so he can pull the plug in October and say, well, they won’t give me a good deal now because they think that my opponent is going to win and they’re waiting for the next guy. But once I win and they know I’m here for four more years, then they’ll give me a better deal. So I’m going to wait till then. That’s what he’ll say in October if he can’t get a good one.

MR. SCHIEFFER: Does this in any way—I mean, there’s no question the Chinese have been trying to steal our technology. We’ve had the problems with the international copyrights and all that. Does this so far do anything to improve that situation?
MR. MILLER: Well, they have some serious commitments.

MR. REINSCH: On paper it does.

MR. MILLER: On paper. And that’s for me what I’m going to be watching over the next few months. Phase one, particularly in technology transfer and intellectual property is not an ice cream cone that licks itself. Okay? Somebody’s going to have to implement these provisions. All right? And they’re going to have to make them work. And if you read the language, they’re quite robust. China commits to provide transparency, fairness and due process in proceedings on tech transfer and to make sure things happen on market terms. I mean, this is a step change away from Chinese practices that are deeply embedded, not just at the federal level but at the provincial level in China.

MR. REINSCH: But they’ve made these promises before.

MR. MILLER: And they've made the promises before and not delivered them. So somebody has got to make sure they deliver them. They've got to implement the systems that are required. Some of these things, like trade secret theft, are going to be very difficult to root out.

MR. REINSCH: One of the new things in this agreement that a lot of people will be focusing on, because of exactly what Scott just said, is, there is a dispute settlement article. And it's very interesting because it's different from any other dispute settlement system that we've seen in that it's very unilateral. It sets up, like all of them do, levels of discussion. So there's a working level, there's a deputies level, there's a ministerial level. If you've got a grievance, you take it to the lowest level and if they don't solve it, it works its way up. But at the end of the day, if the ministers, which in this case would be the U.S. trade representative and his counterpart who’s not named, it would probably be Liu He, the guy who signed the paper.

If they can't agree, then it's very interesting phrasing, the complaining party, which will probably be us, can take unilateral action and the Chinese then have a choice. They can decide that we've acted in good faith, in which case they can't retaliate, the agreement prohibits that. The only alternative they have is if they want to argue that we’ve not acted in good faith, they can withdraw from the whole agreement. That's a pretty high bar. And if somebody brings in a complaint that says, well, they've got this agriculture thing that they haven't done, I don't see them torpedoing the entire agreement because of one problem.

MR. MILLER: Because of one inspection system. Yeah, right.

MR. REINSCH: And this is what Lighthizer wanted. He wanted a system in which the United States could do whatever it wanted and they wouldn’t be able to do anything about it. And this actually goes significant steps in that direction.
MR. MILLER: And it’s different than the times in the past where China’s promised and not delivered. So that’s a new ingredient, and given the brilliance and toughness that Lighthizer has shown in various negotiations, this one may work, who knows?

MR. REINSCH: But the answer will be down the road.

MR. MILLER: What’s the heaviest lift for phase two?

MR. REINSCH: Phase two? Yeah, the heaviest lift will be subsidies. Getting rid of subsidies. Because if they get rid of subsidies then they can’t do their industrial policy, simple as that. It would force them back into being a normal market economy. I mean, the irony of all this is that that would actually be good for them. You know? It would be good for economic growth. Their economists are no doubt telling Xi Jinping these are not bad ideas. They would, however, undermine the party’s control of the state. And what we were talking about Xi Jinping being different before, he has equated economic control with political control and his predecessors were prepared to give up some economic control in the interest of more growth as long as they maintain political control. This guy is tightening economic control, which is why he’s not going to agree to our demands. That’s the heavy lift.

MR. SCHIEFFER: Gentlemen, thank you for joining us and helping us get to the truth of the matter on this very important issue. We’ll be back next week. I’m Bob Schieffer.

MR. SCHWARTZ: And I’m Andrew Schwartz.

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