TRANSCRIPT
The Trade Guys Podcast

“Chips, Engines, and India”

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Transcript by Rev.com
Scott Miller: I’m Scott.

Bill Reinsch: I’m Bill.

Both: And we’re the Trade Guys.

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.

Jack Caporal: I’m Jack Caporal filling in for Andrew Schwartz. This week on the Trade Guys, we’ll break down the debate over high technology exports to China, plus we’ll predict what’s likely out of President Trump’s trip to India next week. And we’ll take on the debate over whether developing countries should embrace protectionism to grow. Stay tuned for a brand new episode of the Trade Guys.

Jack Caporal: All right, so we’re back with a new episode of the Trade Guys and let’s start with a story that’s kind of been bubbling up over the past month, but I think also throughout the entirety of the Trump administration really, which is how the United States and the administration wants to deal with exports of high tech products to China. And the debate really centers around what’s known as export controls and Bill, this is an area that you’re deeply familiar with. So maybe you want to give us a little primer on what export controls are, why they matter, and why you know so much about such an archaic topic.

Bill Reinsch: Well, it’s past sins is the reason why I know about it. This is an interesting episode right now because it’s exactly the same battle that they had 10 years ago, 20 years ago, and 30 years ago, the issues never really change. I thought when I was running The Civilian Export Control Program in the ’90s in the Clinton administration that we had solved some of these issues, but the same old battles are back. It’s an interesting dilemma if you’re in that business because there’s a lot at stake, you’re trying to keep important stuff, critical technology out of the hands of the bad guys. And what we’ve learned over the years is if your controls are too lax, the bad guys get stuff you don’t want them to have. On the other hand, if your controls are too tight, other bad things happen. One, you give the bad guys an incentive to develop the same stuff on their own, which you don’t particularly want.

Bill Reinsch: Second, as we’re hearing right now, you undercut the revenue streams of your own technology companies by preventing them from selling stuff that allows them to be profitable. I’ll get back to that in a minute. And the third thing you do is you make it difficult for the United States or US companies to play a role in global standard setting. So when people sit down at the table internationally to create, for example, 5G standards, if Americans are not allowed to provide information about what they’re doing because Huawei is in the room, which is the issue, the result is most likely going to be a
standard that accommodates Huawei, and not a standard that accommodates US companies. So there's a cost to being too tight just as there's a cost to being too loose; it's a fine line.

Bill Reinsch: What happened in the '90s thanks largely to Bill Perry, who was first Under Secretary, and then Secretary of Defense, who's my hero, who really understood this stuff. He was one of the early people to realize the difficulty of trying to develop a defense establishment based entirely on stuff specially designed for the military. One of his assistants once told me, not joking, that one of their problems, particularly on software, was the lifecycle of what they were buying was shorter than the procurement process. The answer that Perry realized was, let's go with commercial off the shelf. COTS. Scott Miller: Commercial off the shelf is a category today. Bill Reinsch: And commercial off the shelf is a category today.

Bill Reinsch: COTS is in the procurement laws. Scott Miller: COTS is in the procurement laws. Bill Reinsch: But if you do that, it starts a logical chain that ends up turning export control philosophy on its head because if you think about that, what that means is going to commercial off the shelf is that you become Cisco, HP, Intel, whoever's customer you're the Pentagon, but you're never going to be a very big customer for them; compared to their civilian market. So then, when you think about that from the defense standpoint, you think, what is it we really want? What we really want is American high-tech companies being strong, healthy, and innovating, staying ahead of everybody else, so they can provide us with the stuff that we need. And by the way, so they can do classified work for us over on the side because they can afford to do that. And then you ask the next question, which is, so how do you do that? How do you make them strong and healthy? And when you look at their balance sheets, you realize that the way you make them strong and healthy is you let them export, because if you make them strong and healthy, you let them export, because that's the way you make them strong and healthy, is you let them export, because that's the way you make them strong and healthy, is you let them export, because you realize that if you're going to be able to get what it needs and get a vibrant, critical technology sector in this country continuing to innovate, it has to be able to continue to innovate. And that's what today's argument is about, the Commerce department was considering essentially tightening up the controls on the export of semiconductors and some other things to China, specifically to Huawei, it wasn't broader than that.
Bill Reinsch: And the semiconductors came in and pointed out, this is a lot of money for us, this is one of our best customers. The stuff you're letting us sell is not cutting edge, it's older technology. If you cut that off, you're going to take a significant chunk out of our revenue and it's going to compromise our ability to move forward. And because of the uncertainty of what you're doing, it makes it difficult for us to go to these international standard setting meetings and know what we're allowed to say and what we're not allowed to say.

Scott Miller: This is the consequence of actually what Secretary Paulson said at CSIS almost exactly a year ago. We had a trade conference here, Secretary Paulson was the speaker, and he characterized the pivotal issue in US, China trade policy will be the technology cold war. And we're seeing it in full flower here.

Bill Reinsch: And to make it more complicated, for a long time the US policy, which I think I had a small hand in it, but I think it was brilliant, which was not to deny the bad guys everything. The sanction countries, North Korea sure, but not to deny China everything, but to keep them one or two generations behind us. That did two things, it made sure they were behind, but it also kept them dependent on our products.

Scott Miller: They didn't create the business on their own.

Bill Reinsch: They didn't need to go off and do it on their own. That worked very well for about 30 years, you can make the case now and this is going on inside the government, you can make the case that that policy has run out of gas because the Chinese have made the decision for autarky. They've made the decision that they're going to develop their own technologies, their own national standards, and they've got the money to do it and they've got the scientists and engineers to do it.

Bill Reinsch: So in that case, maybe the policy we've been pursuing very successfully doesn't work. On the other hand, the people that want to crack down are only going to compromise our ability to further innovate and further compromise. This was heading for a very odd battle in the government because the Commerce department wanted to crack down, and the Defense department didn't. Because the Defense department was listening to it's suppliers. And it's suppliers were coming in and saying, if you do this, it's going to make it much more difficult for us to meet your needs. This is the reverse of what usually happens. It's usually the Commerce department that wants to loosen things up, until this week it looked like the hawks, if you will, we're going to win. And then the President produces a tweet that says, wait a minute, we want to sell stuff to China.

Jack Caporal: He said, they're using, "A fake term of national security to justify restrictions," "I think people are getting carried away with it, I mean there are things put on my desk that have nothing to do with national security including chip makers and various others, so we're going to give it up and
what will happen? They'll make those chips in a different country or they'll make them in China or someplace else.” And so I understand the logic from the President, surprisingly enough and I-

Bill Reinsch: It pains me to admit that he did something right.

Jack Caporal: But I guess I want to add two questions to this on the back of what the President said. Which is, one, why was he forced to weigh in in this debate in such a manner? Why has it gotten so complicated to hash out our relationship with China particularly when it comes to high tech items. And then second, is there not some middle ground? It seems like the issue is being portrayed in a pretty black and white way here. Either we sell them the chips, or we don’t tell them the chips, or we sell them the jet engine, or we don’t sell them the jet engine. But what’s the middle ground? Or is there one particularly because we’re dealing with a rival that some would call?

Bill Reinsch: The middle ground I think is still what we’ve been doing, which is to sell them the old stuff and not the newest.

Scott Miller: And that may well work in many product categories, jet engines for instance, you can reverse engineer jet engines, but why would you? And selling jet engines, whether they’re Boeing or whether GE or Pratt and Whitney or whoever’s making them. You can use the old processes as Bill described to protect your technology and not create a rival, but that doesn’t necessarily apply to everything. And I think the big concern, overwhelming concern right now is the network technology, where there is not a United States consolidator like Huawei. There are a lot of US suppliers to Huawei and others, but it’s a commitment because it’s a commitment to the backbone of the network, it has greater security implications at large. So I’m not sure there’s a one size fit all here.

Bill Reinsch: I agree with Scott, and I think the President got into it precisely because of the example he cited, the engines. And the irony’s there. We had that same debate about the same engines, an earlier model 30 years ago. People didn’t want to sell them, planes going to China then, they don’t seem to want to do it now. I think the President figured out this is technology that, it’s been 30 years. Maybe they’ve reversed engineering, but they’re not making their own engine, they’re still buying GE or Rolls Royce engines. This is an important market, it’s important for GE. They’re going into civilian aircraft, so it’s not exactly, we’re selling them weapons. And I think the President realized that, particularly if your focus is on reducing the deficit which is his, these things are a significant part of our trade balance.

Scott Miller: And the president just got a little bit of good news a week or two ago on the trade deficit, which had shrunk much to many surprise. A little bit, but enough to take credit for it, and I think he’d like to continue that just as a way to help the narrative between now and the election.
Bill Reinsch: He probably tweeted because he saw something on television and it caught his fancy, but the reality is this would have come to him eventually. This is an issue that people have been divided on for a long time and the agency players had unusual positions. I mean Defense and Commerce were sort of reversed, but the bottom line is still the same. There was division between his advisors over what to do. It’s natural for that to come up to the top. So I think it would have gotten there sooner or later.

Jack Caporal: So let me just put my China Hawk hat on really quick. If you view China as a national security threat, they have a wholly different economic and political system that is at odds with the United States, we just fought—are still fighting a huge trade war with them, and they’re a chief security concern, voiced by our defense officials. Why should we be selling them anything that approaches sensitive technology to begin with? Why can’t we just say go, build your own jet engines and, we think Huawei is a national security threat, so you can’t have our chips and good luck?

Bill Reinsch: Because it compromises our ability to innovate. There are classic cases of this too. The example that I used a lot when I was doing this in the government was in night vision equipment, the goggles you use to see people at night. And the Pentagon wanted the United States Army to have them-

Scott Miller: And nobody else.

Bill Reinsch: And nobody else.

Jack Caporal: Small market.

Bill Reinsch: If you think about the marketing of this though, this is a capitalist economy, people that make these things want to grow. And I think somebody figured out that once everybody in the army has one, that’s it. If you can’t sell them to anybody else until you make the next model, and then you do it again. So they did what good capitalists do everywhere, they thought of civilian uses for these items.

Scott Miller: Hunters.

Bill Reinsch: Hunters, miners, night fishing, firemen. Firemen was a big one because you go into smoke filled rooms, if you want to see the bodies, use these things.

Scott Miller: You can’t actually find them without this.

Bill Reinsch: And the Pentagon still tried to block, one of the oddest cases as I recall was, somebody wanted to sell them to the Spanish army and the Pentagon’s position was, no you can’t do that. We pointed out they’re NATO ally. But apparently that didn’t matter, the consequence of that now is that there are three or four other countries that make these things. We don’t have a lock on all these technologies. I’ve said this before on this podcast and I say it in my
speeches. When you’re having a race, you either flip the other guy or you run faster.

Bill Reinsch: The answer to your question to what do we do is, we run faster, we stay a generation or two ahead of them. Now part of that is, what do we do to run faster? And one thing we do to run faster is make sure that our companies have enough money to do it.

Scott Miller: The same thing basically, the story repeated itself in unmanned aerial devices --drones-- where one of the leading centers of innovation is now Israel, and they make them for the commercial market and all sorts of things. So there’s innovation, there’s a lot of innovation that goes on outside the United States, and outside the United States government. And that’s what you’ve got to protect, you’ve got to protect the innovation pathway as you think carefully about who you sell, what to.

Bill Reinsch: We used to have this argument endlessly because people on the defense side would say, our technology is better than everybody else’s, and all the other stuff that’s going to get invented is inferior. So we should keep ours, don’t let anybody else have it and we’ll be better off. That’s just nonsense.

Scott Miller: It actually wasn’t true.

Bill Reinsch: It turned out not to be true, other people are capable of having good ideas and coming up, and developing, and inventing stuff that works. And so the key is out-innovating them, not simply trying to... In a way it’s the same issue as protectionist trade theory, if you wall your country off from trade it slows down basically, and other people move faster and go beyond and that’s what’s happening here. The problem is, if you’re not careful, you do end up selling them stuff that will enhance their military capabilities which you don’t want to do.

Scott Miller: Bill mentioned protection, so it’s a good thing to talk about India.

Jack Caporal: Yes. Yes, that’s the other country in the news alongside China. The President is heading there early next week to meet with Prime Minister Modi, and one item that’s been rumored to be on the agenda is some sort of mini trade agreement, but it seems like we talk about some trade outcome with India every six months.

Bill Reinsch: Should we start a pool on whether they’ll actually sign anything or not.

Jack Caporal: Yeah, I would put my money on no.

Bill Reinsch: My pick is somewhere between, not now and not ever.

Scott Miller: Yeah, I want the under on that one, whatever the over, under is.
Jack Caporal: So we’re all betting on the same thing, we’re all pessimistic and I guess the question is why? We do this dance every six months, what are they going to agree to? It’s the same gripes, it’s the same concerns. So why do we keep going in circles?

Scott Miller: Well look, India is a multi-party democracy and they operate that way. They also have a sense of the world that is first and foremost about India, they think of themselves as sufficient in many ways. They’re becoming more prosperous in a lot of ways, but there are a lot of old habits that they are not all that unhappy with.

Jack Caporal: Like what?

Scott Miller: Like what they call the permit Raj and the very bureaucratic way of getting anything done. Americans go to India and see the buildings are only five stories tall because there’s not enough reliable electric power to be able to count on an elevator, and they think this is a problem, but the Indians don’t think it’s a problem. So there’s a lot of things that go on there, which they’re happy with, and keep in mind it’s also a multi-party democracy, and of a billion plus people. And so to succeed at anything, you’ve got to put together roughly 300 to 400 million votes, which is not an easy task. So there’s I think a fair amount of resistance, we call resistance to change, but I don’t get the sense India thinks it needs to change all that much.

Bill Reinsch: The other example that’s been fought out lately without result is the retail issue. It’s a country of small shopkeepers and the big boxes, and Walmart being a good example, has made a concerted attempt over the years to get in there and build what they do in the United States. And there has been ferocious political resistance from all the small guys who are afraid that they’re going to get put, not entirely without reason, that they’re going to get put out of business. But that’s where the political power is.

Jack Caporal: India is a huge market, obviously. Do you expect that the President will set his target on India the same way he put China in the crosshair awhile back? Or do you think that the dynamic is different? So India comes out of this unscathed, even if there isn’t some trade agreement that the President can go tout?

Scott Miller: I’m expecting a completely different picture than China. China was characterized as the problem, as inconsistent with everything we valued, and an unfair trader. The relationship with India is very different. First of all, there’s not much of a trade relationship, partly because of distance, partly because of India’s own practices. Second, there has been an embrace by India and the Indian American community of the President. Go back and watch some of the rally that took place in Houston, Texas.

Jack Caporal: Yeah, Howdy Modi.
Scott Miller: Yes, it was pretty impressive. And I think the President is about to find himself in even larger, more adoring crowds when he gets to India.

Jack Caporal: Yes. There are supposed to be millions of people at the airport for him.

Scott Miller: And that’s a fascinating dynamic, but it’s a political dynamic entirely unlike US-China politics, which have been tense for a long time and for all the reasons we’ve discussed before. So I think it’s a very different situation. Also, I don’t think the President needs much in this election year in terms of deliverables, but he would like a favorable reception. And I think the President, look, the President was in the travel services business before he became president, and he knows that while China has five times as many millennials as the United States, India has six times as many millennials, and it’s going to be a huge consumer market. And believe it or not, Indian millennials want the same thing that American millennials do. They want experiences, they want travel, they want new adventures.

Scott Miller: And so as a market, not necessarily for stuff, for cars, and steel, and things the President talks about at home, but for the things the American economy is a leading producer of at all ends of the market. I think he senses the opportunity there in a way to make peace and advance things with a country that is likely to be a better friend than China ever could.

Bill Reinsch: We’re also in a situation where the Indians wants something from us. The President removed them from our Generalized System of Preferences Program, which is the duty free program we have for developing countries, and they badly want to get back into it, it’s hundreds of millions of dollars of potential trade that’s been lost.

Scott Miller: Most of their exports to the US had been covered by GSP.

Jack Caporal: So they’ve gone from duty free to having to face tariffs.

Bill Reinsch: And I think what Ambassador Lighthizer is saying, if you want to get that back, you have to make trade concessions that are equivalent. And they’ve been searching for products that are not so politically sensitive that the Indians can do it, they’ve also been looking... this I thought was creative. They’ve been looking for products where India has right now been buying them from China, where they could buy them from the United States. And from the United States point of view that serves two purposes.

Scott Miller: That’s a win, win.

Bill Reinsch: That’s win, win. If they can alter the source of that stuff. The signs last week when Ambassador Lighthizer ended up not going to India, despite predictions that he would, is that this is not yet ready for signature.

Scott Miller: It’s not ripe.
Jack Caporal: So ultimate prediction out of the trip next week, no deal? Small deal? Or big deal?

Scott Miller: Promise of a magnificent luxurious deal.

Jack Caporal: Okay, so that’s par for the course.

Scott Miller: But no substance.

Bill Reinsch: And probably after the election, is what the promise will be. Because like China phase two, I think the president would love it before the election, I don’t think that he’s going to get it-

Scott Miller: Nor does he need it.

Bill Reinsch: I don’t think I agree with you on that, I think he thinks he needs it.

Scott Miller: Okay good point because he’s making a trip.

Bill Reinsch: He wants to have all the agreements that he can to brag about. But what is guaranteed is that if he’s not going to get one, he’s going to pull the plug preemptively and say, we’re going to do this after the election. And he’s not going to fail before the election.

Jack Caporal: He’s already kind of previewed that saying, this might take some time, so stay tuned.

Bill Reinsch: Which is a sign that it’s not likely to happen and this is going to drag on for months.

Jack Caporal: So we have a listener question that maybe takes us from the specific to the theoretical on this issue. It’s from Henryk Mota, apologies if I’ve mispronounced your name. He says, “Hi, I’ve been reading Ha-Joon Chang’s book, Kicking Away the Ladder where he explains how nowadays developed countries got to this level using protectionist tariffs, and heavy state involvement. Do you think that in a modern economy this would be possible since everything is more connected?”

Scott Miller: It’s actually a great question because it is a question about how has the world really changed in the last 25 years. 25 years ago, the most popular theory of development economics was something called import substitution industrialization or ISI. Import substitution industrialization was a recognition that if you weren’t industrialized, you had to do something to get there, you couldn’t just catch up on your own. And so the theory was that you lowered barriers for parts and components, you raise the tariff barriers on finished goods, and you then created the incentives for producers to produce in your market. It was practiced in many places, South Africa is still does to some extent. All their autos basically are assembled in South Africa, otherwise they face a prohibitive tariff. Brazil has long practiced this, India
practices in certain sectors, so it was a very popular theory. What caused the theory to fail though was the globalization 2.0 which we've talked about here, is cheap data and the ability to control precisely all these tasks at a distance.

Scott Miller: And really so since the mid '90s the better economic strategy for a country that is not an industrial economy, is to become part of some other industrial economies supply chain, rather than force the localization through import substitution. There's actually a great test case of this in automobiles, in the ASEAN, and it is Malaysia and Thailand. So it's a textbook study of this because Malaysia for a long time, even back to the 1970s had put a great premium on having their own car company. They wanted-

Bill Reinsch: Proton right?

Scott Miller: Proton is the brand name. They wanted their own national automobile like every other nation as they saw it. And they went to great lengths to create the Proton. They maintained it, they started it in the 1980s with a partnership with, I believe Mitsubishi. And they sourced, basically Mitsubishi’s old technology and built a car locally as any good import substitutor would. Now, Thailand never had any of those kinds of ambitions, but when Japan and Japanese nameplate auto makers were looking to build supply networks, Thailand created policies that made them a really terrific supplier to all the Japanese name plate automobiles. Now, the long story of Malaysia is that they failed miserably to produce a competitive automobile. Protons are like, think of the Hugo, or some other classic examples of Trabant, of Hungarian engineering or something like that. It was never a good car, never a car that actually could be sold in any market outside of Malaysia.

Scott Miller: And they struggled along for a while, they kept using old technologies, they tried everything. They bought technology, they bought Lotus, the British company, which was an engineering company. They bought a Spanish company, MV Agusta and nothing could make that car competitive because they were always behind in technology. Meanwhile, Thailand very cooperatively winds up with something like three times the automobile employment as Malaysia.

Jack Caporal: Organically.

Scott Miller: Well, by lowering barriers and becoming part of the Japanese name plate automakers supply chains. So what you had was import substitution was not a terrible alternative back before global value chains. In the world of global value chains, participating in somebody else's chain is much more probable that it would lead to success. And the classic case study was, you wound up with something like three or four times the auto workers in Thailand, which never had a national champion and the poor national champion Malaysian company, now owned by China by the way, Geely of China bought the Proton. So I wish them all the luck in the world.
Scott Miller: But that’s the story. So basically, to answer, the listener’s question which is a great one, you can do this, you can follow import substitution. To do so, you have to force your citizens to pay more for poor products, that’s the tax that is imposed by that. If you ever go to India, look at a Royal Enfield motorcycle and it’s a 1960s British maker’s motorcycle, just as lousy as they were in Britain in the 1960s, still made an India. You’ll never find a Honda though because the barriers keep the Honda’s out despite much globally competitive product, probably at a lower price.

Bill Reinsch: Philosophically, this was a big thing in Latin America in the ’50s and ’60s. And the other thing that happened was, for the most part, it didn’t succeed. They pursued import substitution policies, it simply did not produce the growth that they wanted.

Scott Miller: And in a world of value chains, you can wind up, by bad policy, being on the outside looking in. I mean once you’ve decided to have these barriers in place, the incumbents who benefit from the barriers will want to keep them there. And you have to liberalize to become part of value chains, now sometimes you’re just too far. South Africa’s problem is it was just too far from any other markets to be able to join a value chain realistically. But it does keep you on the outside of the way jobs get created today, so it’s an important lesson that policy maybe forever, but technology changes all the time.

Jack Caporal: Fantastic answer. If our listeners have questions, you can find our email question box at tradeguys.csis.org. I think with that, we’ll wrap it up and be back next week with a brand new episode.

Andrew 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. We’ll also now on Spotify so you can find us there when you’re listening to The Rolling Stones or you’re listening to Tom Petty or whatever you’re listening to. Thank you Trade Guys.

Scott Miller: Thank you.

Bill Reinsch: Thank you.

Andrew Schwartz: You’ve been listening the Trade Guys, a CSIS podcast.