Event Transcript

Trade War with China: Costs, Opportunities, Challenges, and Benefits

Moderator: Steve Weisman, Peterson Institute for International Economics (PIIE)

Speakers:
Chad P. Bown (PIIE), Mary E. Lovely (PIIE) and Martin Chorzempa (PIIE)

September 25, 2018
Capitol Visitor's Center, Washington, DC

PIIE's leading experts on China briefed Senate and House of Representatives committee staff members on Capitol Hill on the escalating US-China trade war. Chad P. Bown reviewed the costs and economic effects of the latest tariffs imposed by Washington and the impact of China's retaliation. Mary E. Lovely assessed the impact on US-based multinationals. Martin Chorzempa answered questions about China's advances in financial technology. The meeting was planned as the beginning of a new drive by PIIE to expand its Congressional outreach.

Steve Weisman: Good afternoon, ladies and gentlemen. Thank you for being here. My name is Steve Weisman. I'm the vice president for publications and communications at the Peterson Institute for International Economics. Thank you all for coming out for a discussion about trade wars and trade policies with China.

I will just introduce my colleagues here briefly. To my left is Mary Lovely, who is a professor of economics at the Maxwell School at Syracuse University, who is visiting as a nonresident senior fellow at the Peterson Institute. And she's a specialist on manufacturing and the relationship to China exports and has written many articles. They are in the packet that is outside, which we welcome you to take with you after the session, if you haven't already picked one up.

Next to Mary is Chad Bown, who is a senior fellow at the Peterson Institute. Chad has been a top trade economist at the World Bank and at the Council of Economic Advisers at the White House. He's been a professor of economics at Brandeis University, and is also in the thick of the trade conflicts with China. He is also the cohost of a podcast that you can find on our website that is going strong, with more than 50 episodes, called Trade Talks, which he does with Soumaya Keynes, who is the chief US economics editor at *The Economist* magazine.

And further to my left, not ideologically but just directionally, is Martin Chorzempa. Martin will not make a presentation, but he's here to answer any questions you have on the innovations that China has made in financial technology, which is one of the areas where they're surging ahead of the United

States, and he has some papers outside on that and on CFIUS [Committee on Foreign Investment in the United States], which is a hot issue for China.

The Peterson Institute is a non-partisan policy research institute. We're proud of our name, Peterson. We're not the same as the Peterson Foundation, which you may be familiar with and their agenda on budget deficits. So we'll be talking today not about that but about China. And without further ado, we'll begin with Mary making a short presentation, followed by Chad. And the bulk of today will be taken up with the conversation and questions that you may have about this very important current issue.

Mary, take it away.

Mary Lovely: Thanks, Steve. And so great to see you all here on such an important topic. In response to an investigation into Chinese technology practices and intellectual property protection issues, this summer the United States placed 25 percent tariffs on $50 billion worth of American imports from China.

Yesterday, 10 percent tariffs were levied on another $200 billion of American imports from China, with the rate set to rise to 25 percent tariffs in the new year. In response to Chinese retaliation for these tariffs, which now cover more than two-thirds of US exports to China, President Trump has promised to tax the remaining $260 billion in imports from China. By early 2019, we are likely to see all trade between the United States and China subject to punitive taxation.

These barriers have occurred amid a general ratcheting up of American trade barriers. With the latest round of tariffs on China, President Trump has imposed new trade restrictions on 12 percent of US imports during 2018 alone. The combined trading partner retaliation stemming from Trump's 2018 tariff collection will cover over $125 billion, or 8 percent, of US exports.

And Chad Bown has done a lot of work documenting this and keeping a timeline, which people often use to keep track of all the tit-for-tat tariffs that are being levied. I want to make basically three points. These tariffs (A) make manufacturers operating in the United States and employing US workers less competitive and less able to compete abroad; (B) disproportionately harm US exporters, especially farmers and ranchers; and (C) punish American consumers, especially those with low incomes.

The new tariffs inflict damage on the United States while failing as a means to create manufacturing jobs in the United States or to challenge China's IP [intellectual property] practices.

First, tariffs on China make US-based manufacturing less competitive. The tariffs levied so far largely cover the cost of inputs ... raise the cost of inputs for American manufacturers. As PIIE analysis of the goods subject to the new taxes shows, about half of the import taxes are levied on intermediate inputs, and another third are on capital goods. A very large share of this trade is between related parties, which means between American-based manufacturers and their affiliates in China, or on purchases for non-Chinese firms operating in China and selling to American firms, such as Foxconn selling to Apple.

Raising the costs of these components and machines hinders American-based firms' ability to be cost competitive against foreign-made goods sold here in the United States, and these cost increases come on top of burdens for higher prices for steel and aluminum, which I'm sure you're aware.

American exporters are doubly hurt by the current trade conflict. On the one hand, their production costs are higher thanks to higher tariffs imported inputs, and on the other hand, by the higher tariffs they face when they sell in overseas markets. So they're hurt on the cost side, and they're hurt when they try to sell.

In 2017, the United States exported $10 billion in finished automobiles to China, sales that are now surely lost by the retaliatory 40 percent tariffs now faced by US exporters into the Chinese market. As you well know, China lowered its auto tariffs on all other producers except the United States because of the trade war. Soybeans, fruits, nuts, all various agricultural growers, pork farmers, and ranchers are all facing higher barriers to foreign sales, losing access to customers who may never return to US suppliers.

Lastly, the new tariffs punish American consumers. While the first two waves of China tariffs targeted American manufacturers, the US consumer is increasingly feeling the effect directly at the cash register. The last wave of tariffs, if it comes, will include all remaining consumer goods imported from China, including children's clothing, toys, mobile phones, and household items, some of which are already subject to the second wave of tariffs. Retailers will be forced to raise prices, and they will let customers know why they are seeing these price hikes.

Ongoing work at PIIE tells us that few manufacturing jobs will come back to the United States as a result of these tariffs.

First, the goods we import from China have far lower value than goods that can be successfully sold in the United States while paying American wages. Secondly, many low-income countries are able to produce these goods, and it is there that producers are most likely to move or to source. In conclusion, these tariffs erode American competitiveness. They harm American consumers, and they're ineffective as a means to promoting American manufacturing.

I'm going to turn it over now to my colleague, Chad, who will discuss better ways to promote changes in Chinese practices.

Chad P. Bown: Thanks, Mary. Thanks everybody for the opportunity to be here. It's nice to chat with you. So, what I thought I would do is explain two things. The first is how did we get here in terms of what ultimately led the US administration to be acting in the way that they have, and then maybe how ultimately we're going to get out of this.

So how did we get here? I think even if President Trump hadn't won the election, this was going to be a moment in time in which there was going to be a challenging interaction between the United States and China on trade. China came into the World Trade Organization [WTO] in 2001. It undertook a tremendous number of reforms. It became much more open. It cut its own tariffs. It became much more market oriented. And yet, it hasn't completely transformed into a market-oriented economy that we're familiar with in the United States, or even in Europe or Japan or South Korea or all the other market-oriented economies of the world.

And there are challenges with that: the role of the Chinese state and economic activity, whether it's through state-owned enterprises, where they have a lot of really big companies with close ties to either the central government or the Communist Party; their policies on foreign investment and potentially discriminating against not only American-based companies but also European- or Japanese-based companies; the forced transfer of technology. All of these were critical issues that were going to have to be dealt with.

Earlier administrations chose a different approach. The approach of essentially the last two administrations was to kind of recognize that this was going to be a challenge, a problem, and the way to deal with it was to draft new kinds of trade agreements that would have new rules that China wouldn't be a part of. And so here I'm thinking about the Trans-Pacific Partnership [TPP] agreement that had specific rules on state-owned enterprises, concerns about labor and environment and competition—all of these things that the United States is concerned about China's behavior in. That agreement had rules to address all those issues.

China wasn't going to be a part of it, by design. But ultimately, at some point down the line, it would want to get in because there would be goodies. There would be benefits to actually being involved in this agreement. And being excluded from it meant that they would be discriminated against in the US market, the Japanese market, and other countries around the world.

So, that was the approach of earlier administrations. Obviously, President Trump has chosen to go in a different way through applying tariffs. Not offering up carrots for how China could actually be on better terms, how it could reform to be a better player within the rules-based system, but instead to just impose, as Mary indicated, hundreds of billions of dollars' worth of tariffs.

So, that leads us to where we are today. And the question is, now that we're here, if we do continue to see the complete ratcheting up of tariffs that cover all US-China trade, which we could potentially see next year—and I think a lot of us are anticipating that's the direction in which things are going—how do we get out of this?

Is this a goal, in and of itself? Or is there some longer-term purpose here? And I'm not going to profess to know the strategy of the administration, and they have, I think, held what their potential strategy might be very close to the vest. But I think it is important to note that behind the scenes, there are other players who are actively engaging on these issues. They're trying to figure out how to get us out of this mess.

And so, in particular, the European Union, Japan, and potentially the US Trade Representative (USTR) as well, are right now working together to negotiate new rules. So this is the trilateral process that's been going on over the last 10 months or so, basically since the WTO administerial meeting last December in Buenos Aires, to try to write down new rules that would be potentially embedded in the World Trade Organization to address these big concerns that we have with China.

And it's not just American concerns with China. These are concerns that basically all of the market-oriented economies have on China's failure to transform and become more market oriented...its state industrial subsidies, on its forced technology transfer, and mistreatment in foreign investment. These are the big issues.

So they're writing new rules now, largely behind the scenes. But at some point in time, they will have drafted these rules, and the question will then be “Is there going to be an offer put on the table?” Is there going to be an offer to China that says, "Would you be willing to sign up to these new rules if we put them into a trade agreement, something like the WTO, that might make them enforceable?" Meaning that, China, if you don't live up to these things, then you could still be subject to the kinds of tariffs that you're facing today, but it would be internationally sanctioned. It would be in a rules-based system, which is what the WTO framework ultimately provides. Greater certainty, greater due process, and things like that. Unlike the world in which we're living right now.

So that's potentially a way out of this. I think the other major economies in the world trading system have recognized that this is a critical moment, and they're actively working to kind of draft new rules and to think about how to make them enforceable in ways that would entice China to join but also get America back to the table as well. And I think this is important because we don't know what a world without a fully functioning rules-based trading system ultimately looks like. The World Trade Organization that is now in a bit of disarray, this is a system that the United States developed over 70 years. It largely mirrors what America wants in terms of the rule of law and having dispute settlement provisions that are enforceable.

This is a system, despite what some politicians might say, this is a system that Americans designed, and it's worked extraordinarily well. It faces challenges now that we have to think about dealing with this China issue especially. But if that can be worked out, there are a lot of reasons to try to save or salvage or build from the system that's already out there.

Okay, so with that I think I'll stop. There's a lot to talk about with China, with these tariffs, with the way the relations are going, and I think—I know I am, but also Mary, and even though Martin is sitting over here quietly, he's an expert in a lot of other things beyond even the financial things that Steve talked about, certainly on the investment and CFIUS side too—we'll be happy to take your questions.

Steve Weisman: I should emphasize again that a lot of the background material is available in the packets outside, so you don't have to write everything down and take notes. It's there for background and of course Chad and Mary and all our folks are available for questions. First question over here, sir.

Question 1: How do you explain, even after the US imposing tariffs on China, that it seems like the stock market isn't doing quite so bad yet? Do you foresee that happening in the future, or is it going to take time to price in, or how do you explain that?

Chad P. Bown: We're trade people, not forecasters, so don't put any money on what we're about to say. I think one thing that's important to note is as important as even I think international trade and trade policy is, the United States is such a large economy that trade is only a fraction of what the United States does. And right now, the tariffs that we have put on, as Mary indicated, I think we're now up to... what did I say... 12 percent of US imports and 8 percent with US exports. You know, that is only a fraction of overall US GDP. It means costs are going up. Prices are going to go up in those segments of the economy. But the rest of the economy is doing relatively well.

The economy is doing relatively well, and so I don't think, certainly not amongst the experts we talk to, there is any sense that [with] what's happened so far that we should expect the United States to fall into a recession immediately. I guess that's not really what we're talking about here. It's more the question of what happens to America's competitiveness when these kinds of policies go in place, and, as Mary indicated, when you raise the cost of a lot of your inputs—whether it's steel or aluminum or all of these parts and components that now have 25 percent extra taxes on them coming in from China—that makes American companies that have to pay these taxes much, much less competitive than companies in Europe and Japan that don't have to pay these taxes.

So when our companies trying make things here in the United States to compete in Asia or Latin America or in Europe with all those other companies out there in the world, they are finding it much more difficult and challenging. It may not show up through stock prices, but it is ultimately going to affect both their sales and then sometimes their decisions about where they choose to build a new facility to produce something. If it's no longer competitive to produce it in the United States because of these higher taxes, they'll build that next plant in South America or Asia or Europe and not provide the jobs here. I think that's kind of a bigger worry.

Mary Lovely: Yeah, I think that is the big worry that what was necessarily good for the American corporations might not always be good for American workers, so, for example, with Harley Davidson, they're saying they are going to produce in Europe as opposed to here, so the company may be okay. We already hear from a lot of firms that are adjusting their supply chains. That is different than what is in the best interest of American workers, so I think that's a distinction. If you look at forecasts from the IMF [International Monetary Fund] or from Wall Street firms, you see that among large risks on the horizon. Trade conflict, trade tensions are number one right now, so this is the big unknown for people. How far will this go?

And the dynamic effects are surely going to be bigger than the short-run effects, particularly because [of] this idea of Fortress America. We know countries that [are in the] CPTPP [Comprehensive and Progressive Agreement for Trans-Pacific Partnership], which is the follow-up to TPP-11, they're going to lower the tariff barriers against each other. Companies from Canada, from Mexico will have access to markets where we will face discriminatory tariffs. Discriminatory by our choice of not joining. So I think that we're increasingly going to see American businesses perhaps building outside of the United States for export into these markets.

Question 2: So the president really won on this issue, on trade and also immigration. And there is a lot of feeling, especially in the heartland, that trade, especially for steel mills, and I don't know if that would be USTR, used to represent US Steel—they think it was the only way to really get the heartland back on its feet. What do you say about the politics of this? I know that you are not a politician per se, but the politics have been pretty effective for the president. What do you say about that and trying to have these trade arguments and how they play?

Mary Lovely: I would argue as to whether the president won on this one. The president is using presidential executive power. Under the China tariffs, which are Section 301 which gives him almost unilateral ability to undertake this, so I'm not sure who he has convinced. It's certainly true that there are some plants and some workers who are benefiting, as you mention—steel, miners on the iron range up in Minnesota, for example. Outside of that we see a lot of losers. I just came back from the George W. Bush Center in Dallas, and there are a lot of farmers and ranchers in Texas who are very concerned about being closed out of markets. They're also deeply concerned about what's happening with NAFTA. They do a ton of business with Mexico, so I don't think we are seeing winning everywhere, and I don't think we're seeing support everywhere. I think we're seeing lots more places that are going to be hurt by this than are going to gain.

Chad P. Bown: I think that's right. It is a bit of a puzzle though. Despite the fact that you're starting to see some of the cost of these policies actually show up in terms of—

if you're talking about the Midwest or Iowa and soybean farmers, they're hurting, and yet we don't see a major revolt in turning necessarily on the president. I don't know. You ask them why that is, and they think, on the one hand, that he's going to get a deal, and they're just holding out hope that they see him as a deal maker and a businessman. But I'm not sure, at least with respect to the China issues, that there is going to be a deal that's coming. It looks like it's just a lot of tariffs. But the politics of this are very strange. I'll grant that. It's a challenging one to figure out.

Mary Lovely: Also, don't forget the second wave—the big wave just hit this week—so it hasn't had enough time really to trickle through.

Steve Weisman: I was going to say, for those of us who remember a long, long time ago in the 2016 election, there was a lot of talk that a president can't do these things unilaterally, because Congress ratified these trade agreements, so how can the president just unilaterally abrogate them, and it turns out there's a lot he can do unilaterally. I suppose that a lot of you know more about what the role of Congress is going to be than we do. But maybe Chad and Mary can address how Trump really circumvents Congress by invoking statutes that do exist but stretching their application beyond what anyone has ever done before. That might be of interest to some of you here.

Chad P. Bown: I think that's important. Historically the tariffs that President Trump has imposed on steel and aluminum, in and of themselves, let alone the Section 301 tariffs on China, we have never seen anything like this. Section 232 has been around since 1962, Section 301 since 1974. These laws have never been used on this scale before and, arguably, weren't designed to do this kind of thing. Are imports of steel a threat to national security? You can understand the argument—that the industry is injured and suffering and may require some assistance—but is it *national* security that is the legitimate argument there?

It is clear to me that this is not what Congress intended these laws to be used for, but they're written in a way that is sufficiently vague that the president has been able to use them for basically whatever purpose he's wanted, and that's not even talking yet about the really big case that's [coming] down [the] pike, which is automobiles, $350 billion worth of US imports. Apparently cars can be a threat to American national security. President Trump is obviously exercising authority under these laws in ways that we haven't seen before but probably not what Congress had originally intended.

Question 3: Can I ask a little bit about financial technology? Because I'm fascinated by the future, and I think one of the reasons some people want to have this trade war with China right now is because they are worried about the future. We had a guy on our podcast last week talking about robotics [inaudible] ahead of them. That's a real problem. But fintech seems to be a real issue for future global stability.

Martin Chorzempa: Yeah. China seems to have taken the lead in this, partially because their financial system was heavily underdeveloped before. If you would have asked somebody in the early 2000s if any Chinese firm would be leading in the world in finance or technology, they probably would have laughed you out of the room because everything was so far behind, but they've taken that to leap frog and now do everything on mobile phones where we still [use] plastic cards, which you shouldn't really need anymore. You should be able to just use your phone.

The United States is concerned that these Chinese firms are going to expand abroad and take over market share and also that it's unfair because American payments firms, for example Visa and AMEX, have been blocked from entering the Chinese market, and meanwhile their firms are out expanding [and] being used for payments in Europe and the United States. So that's one issue. The other is the national security side, that these firms use a lot of data and they also have a close relationship with the government. So recently the Committee on Foreign Investment in the United States [CFIUS] blocked a deal where China's most powerful financial technology player, Ant Financial, affiliated with Alibaba, wanted to buy MoneyGram. And it seems to be [that] the rationale for blocking that was that this Chinese firm would get access to a lot of data on American individuals, and that that would be potentially a privacy concern, including for members of the military who use MoneyGram to send money to friends and family. A lot of concerns in this area.

Question 4: So, to go back: You were talking about the cost of inputs and overseeing the rise for US businesses. As we see another wave coming, what sector do you—I know you're probably still gathering data on this—but what sector do you think will get hit hardest? We've got tech and finance, and we have auto and transportation. Do you have a sense yet of what might get hit hardest?

Mary Lovely: Well, the sectors that are already getting hammered are electronics, machinery, autos are starting to get covered, chemicals. We are already seeing chemical manufacturers saying that they're having trouble with the price of inputs, so I think those. The first round [of tariffs] actually was targeted toward what the United States considers intellectual property and intensive industries, industries that do a lot of patenting. The second, and obviously the third round, are just like everything. Those industries have been hit. What the Trump administration did was they didn't hit your final goods, but they were hitting the inputs into all these industries, which, of course, are going to trickle through to the final consumer, because if the semiconductors and hoses and cords and everything inside my electronic device is more expensive, it's going to affect me. They're the ones that are going to get really hit.

Chad P. Bown: Will you talk a little bit about your research on the multinationals too?

Mary Lovely: The interesting thing about US-China trade that I think is not very well appreciated is that 60 percent of it is between US companies and non-Chinese enterprises operating in China. These are firms from Taiwan, Korea, Japan, Macau, Hong Kong as well, although we can separate that out in the data. These firms are part of global supply chain trade. They're producing, like I said, hoses, all kinds of motors, LED lights, things that go into products that our companies or our plants then further process and finish for delivery to the American market. That's primarily what we're hitting, so what you're seeing here is really kind of a war on global supply chains.

Now while that may appeal to a lot of people, because they say we shouldn't have those, everything should be produced in the United States, it's simply not going to happen. The last 30 years have seen a transformation in manufacturing, and without access to global supply chains, American companies simply cannot compete. So we will have either them being unable to compete in the United States, so we have elevator manufacturers who are paying extra on the inputs that they import to create elevators—they're facing elevators that are coming from Europe that are not facing tariffs. So then the only way that we're going to be able to support our own manufacturers is then putting tariffs on everybody.

So you see how this heads toward so-called Fortress America and, when we do that, then our producers will be closed out of the European market in retaliation. It quickly becomes a situation where American corporations already are beginning to be heard. They will be heard even more. I think they're waiting now. There is, I think, a general sense that there was a deal that was going to be made. The longer this goes on and the more their consumers or their customers find alternative suppliers, I think the deeper the reality of what is actually happening will sink into the American business community.

Chad P. Bown: I think, in case people have a hard time grasping their head around this, I think it's critical. The issue is, a lot of the stuff that we are importing from China that we're hitting with tariffs is actually being made, assembled in China by American companies or the subsidiaries of American companies, of European companies, of Japanese companies in China, so you're not hitting Chinese companies. You're hitting Western companies with these tariffs, and those companies have bought a lot of American inputs—stuff that we sold to China originally for then additional assembly to come back to the United States. So we're kind of getting hit twice, because now we're not going to export as much of that stuff—the design and the ideas of most products in the first place—to China to have it actually come back to us. This is just the nature of how supply chains work, but it's how the world is going to unravel unfortunately.

Steve Weisman: Let me address a question that's been implicit in the comments of all three of you that I think is on the minds of Congress—unless I'm misreading it. There's this sense that China is embarked on a crusade to achieve advances in technology with their Made In China program, and part of that program has involved forcing American companies to hand over their technology. You hear from President Trump and the White House and his trade team constantly that that's their main concern with China. So, we've raised these tariffs in order to get them to change that policy, and you evidently think that's a counterproductive approach. What's the right approach? Some of this you addressed, Chad, in the new WTO rules that are emerging. But what are the chances of getting China to back off on this nationalistic economic crusade of its own other than through confrontation on trade? What are the chances of doing that? All three of you could answer that.

Chad P. Bown: I can start. I'll steal the easy ones, then leave the hard ones for you guys to have to come up with.

Mary Lovely: Martin's getting the hardest.

Chad P. Bown: I would say, first of all, the narrative about China and an economic crusade, I don't think we want to overplay it too much. The Made In China 2025, there is a bit of a debate about whether or not this was some grand master plan for China to rule the world, or if this is just an aspirational strategy for what they are trying to achieve. It's not quite a perfect analogy, but I was in the White House during the time of the National Export Initiative, I think it was called, where the goal was to double exports within five years. Okay, we didn't actually have a plan to double exports in five years. It's not as though we went and told all the companies in the United States, "this is your export target, you need to meet it or you're going to be..."—it was just an aspirational goal. There's some sense in which some of that may be the case in China.

Now, I'll grant you, China has access to other policies and ways of incentivizing behavior that we don't in the United States, which makes the context a little bit different, but I don't think we want to overdramatize the concern, at least in all sectors. There are some sectors that may be more sensitive than others, if we're talking about ones that have access to data and privacy concerns or artificial intelligence, which may actually have legitimate national security concerns. But not everything fits into that bucket, is I guess where I would start.

Some of the ways in which we've started to deal with that already, I think, is what Congress has done through the reform on the CFIUS procedures, and mandating enhanced, at some level, export controls for some of this more sensitive technology. Now, we're still going to see how the regulations ultimately get implemented for this process, starting this fall. And Martin can explain more about this, since he's been following it very closely for us.

But I think that's one area in which we can have positive development. The US government telling companies that you're not allowed to transfer certain technologies, and American companies being able to rely on that as an excuse when they're asked by a counterpart in China to share their technology, saying "I'm not allowed to, because the US government says that I can't, and there will be penalties if I do so"—that's publicly a positive thing, provided it doesn't go too far.

But then I think the last one is cooperation with allies and trading partners, who are also facing these same kind of concerns, and whether that's through the WTO or something like that, I think that's critical. Now, it's hard, though, because at the same that we do have all these big concerns going on with China, unfortunately the administration has made it increasingly challenging for other countries to be willing to work with us when we impose $6 billion, $7 billion worth of tariffs on steel from Europe, or $12 billion worth of tariffs on steel and aluminum from Canada, similarly with Japan. It makes it challenging for those countries politically to be able to trust the United States, even if they have the same underlying concerns with China.

And why this is important is, if we don't get these countries on our side on these issues, it becomes doubly hard for us, because then China, what it can do, is it can offer incentives for companies coming out of Europe or Japan or where have you, to get extra special access to their market. Mary gave me one really great example of what's happened with automobiles: In retaliation for President Trump's tariffs, Chinese tariffs on US cars—cars made in the United States, shipped to China—are now at 40 percent. At the same time, they cut their tariffs to 15 percent for cars coming in from Europe or Japan.

So now American automobile producers are being extra discriminated against. They can do the same as well, potentially on investment issues or on technology issues. So, I think it's important for us to think through what our long-term strategy is in working with allies, I think, on these types of issues.

Martin Chorzempa: I would say we have to consider the possibility that the administration doesn't actually want a deal with China. They don't actually want China to change its practices. They instead want to push you, as firms, to disengage from China, to move their supply chains out of China, not transfer any more technology there, because they've potentially considered China to be a long-term security threat, and that allowing China to develop its technology to a greater level will allow it to have better military competitiveness with the United States. And they believe that they can stop that by blocking some of these acquisitions in the United States, blocking exports there and moving American firms out. And if you believe that, then the best deal for them is not to come up with any sort of negotiated agreement, but instead to keep the Chinese guessing and keep imposing these barriers so that they move away.

But the risk of this strategy is that the Chinese have already become much better at innovating themselves, and they've shown that if they're not able to pay American firms for technology, they can go in, hack it, and get it for free. And if they're not able to buy it in any other way, then they're going to start investing a lot of money in developing alternatives to American technology instead of buying it. One of my colleagues has done some research showing that the amount of money the Chinese pay to the United States, to license technology, has been increasing enormously in the past years. That might go down and harm the competitiveness of the American companies going forward.

And if you consider that China's the threat and try to cut [it] off, you might actually make China a self-fulfilling prophecy. You could make that true, even if it doesn't necessarily have to happen, and that could lead to conflict that goes far beyond a trade war.

Mary Lovely: I just think that we don't know enough about China and US trade. For example, one of the main complaints or subjects of the investigation in the Section 301 report is forced tech transfer through joint ventures. Eighty percent of the foreign investors going into China today are going in as wholly-owned enterprises—that means they don't have a foreign partner. I think that would surprise a lot of people, because all we hear about is that they're being forced to have these partners, but that changed radically after they joined the WTO and made reforms.

We've looked, we've deep dived into so-called high-tech exports from China that will include almost anything in your computer, so we don't want to think that this is advanced robotics, although there's some of that in there. Most of the exporting is being done by foreign enterprises, and most of that is being done by wholly-owned foreign subsidiaries of Japanese firms, American firms, German firms. So they're still very, very dependent, in terms of their exporting, on the presence of foreign firms, and those exports include a great deal of imported content as well. So it is also a source of our exports to them. So I think we just don't really know exactly which industries are doing it.

There's a lot of carrots, as opposed to sticks, being used. So if you go to China, you will see fresh science and technology parks, you can go to places where they say we modeled this on Palo Alto, because we know you want the highest guild talent here, access to university graduates from Tsinghua or other engineering schools.

These are the kinds of sweeteners that are being offered; those are not yet illegal, there's nothing that they've done wrong. I think the question we really need to think about is, where are the practices that we object to? Have they promised not to do it? If they haven't promised not to do it, and we still object to it, then how do we deal with this? So we're still way behind, I think, in knowing exactly what the issues are, unfortunately.

Steve Weisman: I wonder if I could throw it out to this very well informed group here to ask whether China is in a class by itself, in terms of trade. There seems to be bipartisan consensus that China is some kind of a threat that needs to be confronted, whereas on issues with Europe and Mexico, there's more division on both sides of the aisle. But, I wonder, if someone wants to ask a question here that relates to your area of expertise on whether or not you think that these policies on China are of real mounting concern in a Congress that obviously is facing an election and is preoccupied with other issues going on in Washington. But these are your issues, so I wonder if you have any thoughts that you could pose in the form of a question.

Question 4: What can you say about, once you impose tariffs, tariffs can be sticky sometimes, and they're going to be industries that are going to be used to the tariffs that are imposed, then how can that change the dynamic of the economy here in the United States? And also to the point of CFIUS, there are some venture capitalists, in Silicon Valley and elsewhere, that point to Chinese investment and how much they need Chinese investment to develop new technology.

Mary Lovely: So, you're absolutely right, once the tariffs are imposed, and companies get used to that, we see companies either stay in business or enter the business because of the higher price. But it makes it more difficult to remove the tariff. It goes back to the old chicken tax story and why we have such high tariffs on imported trucks, goes back to the fight with the European Union in the 1960s. And of course, behind that tariff wall, the industry has built a very successful sub-business.

But it also means that we really don't export any trucks anywhere else in the world, we build them just for North America. So, that's that Fortress North America. You can imagine, though, on the kinds of things that we're importing from China, we're really not going to be producing them here. If we look at things that we do produce in common, like semiconductors, you look at Chinese semiconductors versus those from the United States or Korea or Japan, we have done a deep dive on some of these products, and it in analyses on our website, you see that they're what I call "cheap chips," they're cheap chips. These are commodity chips, these are not the kind of chips that the US and Japan export. And so those are not going to come, they're going to go to Malaysia or other big electronic exporters.

So there is this worry about tariffs staying around forever, but there's a lot of this that's just going to raise costs with no benefit at all.

Martin Chorzempa: On the VC [venture capital] and technology investment side, I think Congress did a really excellent job of trying to thread the needle on this one and being balanced so that they don't put too many restrictions that would stop all Chinese investment.

For example, it's only going to be in the most sensitive sectors, hopefully, and it's also only when the investment allows them to get access to the underlying technology, material non-public information, or how that technology will be used on board seats. And a lot of this investment is in passive form, in terms of disinvestment and a fund. So, the firms will still be able to get access to Chinese technology.

But there is a worry that if we impose these kinds of restrictions, then American VCs won't be able to invest in Chinese Internet companies, and a lot of people don't know that many of China's most successful Internet companies got a lot of American VC money up front, and those Americans made a lot of money on those deals. And getting locked out of China's Internet market, which is growing at just an enormous pace, would be a big loss for American investors.

Question 5: You talked about whether China is actually being hurt by this tariff.

Steve Weisman: The question was, is China being hurt by the tariffs?

Martin Chorzempa: The best estimate I've seen is about 1.5 percentage points of GDP growth reduction, if all of them are imposed. If not only the initial 50 [billion dollars], but then the next 200, then the threatened 267 are imposed, then that would hit 1.5 [percent]. But, they're going to be able to adjust to other markets as well.

So, I think that people in the administration overestimate the US's leverage on China, on these issues, and think that China's economy is much weaker than it actually is, and that therefore it will cave. I don't think it's looking like it will cave anytime soon, and they think they can buckle down and survive the trade war.

Steve Weisman: I was going to add that one of our leading experts on the Chinese economy, Nicholas Lardy, has produced, in the last couple of weeks, three blog posts challenging the conventional wisdom from a lot in Washington that Martin just addressed, which is that the Chinese economy is tanking somehow. This has been a prediction over the last several years, especially when the stock market was fluctuating a couple years ago. And our scholar Nick Lardy has said that a lot of those predictions and that analysis is based on flawed data. His pieces are also on our website. I didn't mean to interrupt, but Mary or Chad, why don't you answer that as well.

Mary Lovely: I will just add one quick statistic, which might be handy-dandy to have, is we look at, when we buy from China, we think of it as enormous. But again, China is an extremely large economy, as is our own, and we talked about how trade is just a small part of the overall picture for US economic health.

We've calculated, it's very easy to do, but if you take trade, China's exports to the United States and divide it by the total output of their manufacturing sector, it's only 3 percent. We're 3 percent of the gross of their manufacturing. So you lose 3 percent, basically, of your sales. And all of that is not Chinese input, because in your iPhone that's an export from China, it's got the screen from Korea and the chip from Japan.

So basically, I think it's easy for us to overemphasize how important we are, and how much we can produce for them. But the reality is, that's really not what we're talking about. We're really talking about competitiveness, growth, having access to growing markets in the future for American-based firms.

Chad P. Bown: Only thing I would add is, while we're pretty great, we're only 300 million people, 325 million people, and the world is 7.5 billion people. There's a lot of mother markets out there, aside from the United States, that China wants access to, we want access to, and thinking that we are great, but thinking that we're greater than we are, and more powerful than we are, in the trade sense, I don't think is particularly helpful.

Steve Weisman: I'll conclude by thanking my colleagues Mary, Chad, and Martin, for coming up to Capitol Hill, and thanking all of you for taking time out from your lunch to come and listen, and again, we're available to help you, and answer questions.