

G20: New Trade Threats and New Cans Kicked Down the Road

- The tariff truce reportedly agreed between Presidents Trump and Xi is a fresh sign that the White House wants to kick the imposition of further tariffs down the road and find an off-ramp from its trade dispute with Beijing.
- We don't expect President Trump to make good on his threat to withdraw from NAFTA in order to speed up US Congressional ratification of the new USMCA. But if he does go ahead, a variety of 'zombie NAFTA' scenarios could temporarily unfold while the USMCA ratification process moves to conclusion.

US-CHINA TRUCE KICKS THE TARIFF CAN DOWN THE ROAD

Presidents Trump and Xi are reported to have reached an understanding at the G20 summit over the weekend on a 90-day détente regarding the imposition of further tariffs on Sino-US trade. For the moment, the truce delays an increase in US tariffs from 10% to 25% on USD 200 bn in Chinese imports, a move that was programmed for January 1, 2019. Despite President Trump's proclamation on social media that China would lower its tariffs on US auto imports, no formal announcement has yet been made by either party. According to a White House statement, China has agreed to increase its purchases of US goods—namely agricultural products—to work toward closing the trade deficit between the two countries.

Under the guise of opening China's market to US exporters, the tariff cease-fire allows President Trump to claim a putative win for his trade agenda. Prior to the imposition of a first round of 25% duties on USD 50 bn of US imports from China, the Chinese tariff on incoming US automobiles had been brought down to 15% and was set to fall further. In retaliation to the US tariffs, Beijing raised its own charge on US autos to 40%. It's not yet clear whether President Trump thinks the Chinese tariff on US autos is coming back down to 15% or going lower.

Regardless of how much lower the Chinese move their tariff on imports of US autos, the real winners will be European automakers who account for over two-thirds of US-assembled vehicle sales in China (chart 1). American workers and the US economy will almost certainly be the real losers over the medium term: European auto manufacturers will likely move to supply the Chinese market wholly from plants inside China or from other countries whose trade policies are expected to be more stable than those of the US. Similarly, the US agricultural sector has likely seen permanent erosion in its market share in China even after one discounts for the seasonal bump in Chinese imports from Brazil (chart 2)

The 90-day tariff truce—temporarily bumped up to 120 days today by Presidential advisor Larry Kudlow, but since walked back by the White House—also provides President Trump with an opportunity to delay, and possibly completely avoid, raising duties in the new year on the second

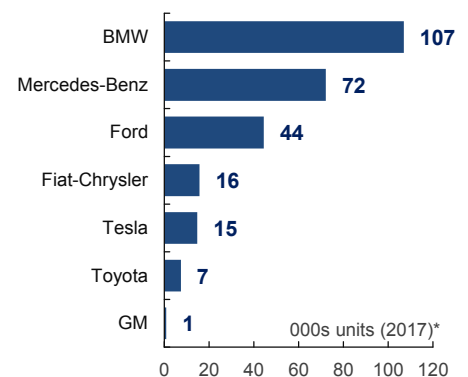
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Chart 1

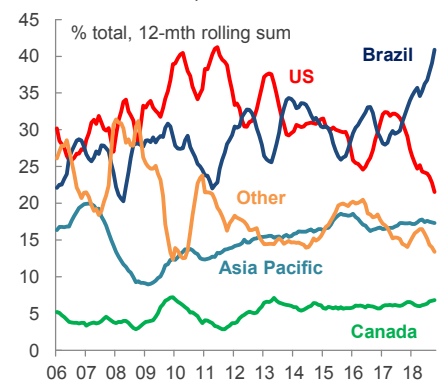
Sales of US-Assembled Vehicles in China



Sources: Scotiabank Economics, LMC Automotive.
*Amount to 263k units out of 267k total US-assembled unit sales in China.

Chart 2

Chinese Imports of Vegetable Products: Vegetables, Fruits, Cereals, Seeds, and Beans



Sources: Scotiabank Economics, China Customs.

tranche of USD 200 bn of US imports of Chinese goods. An additional 15 percentage points (ppts) of duties on this slice of imports from China would inflict substantial additional pain on households: around a quarter of the goods in this tranche of trade is made up of consumer goods (chart 3). While the recent depreciation in the Chinese yuan (CNY) has neutralized most of the impact of these tariffs, a further fifteen ppts increase on this second tranche of goods would directly hit average Americans' pocketbooks.

President Trump's threat to slap tariffs of up to 25% on the remaining USD 267 bn of US imports from China is also put on hold as the two countries engage in trade talks. Consumer products—notably smart phones and other consumer electronic staples—make up about 36% of the goods that would be affected by this final wave of duties.

We estimate that tariffs on the full suite of US imports from China would shave 0.2 ppts off US growth. Retaliatory trade barriers from other countries and related chilling effects on business and consumer confidence could reduce US growth by another 0.5 ppts. IMF research has generated similar estimates.

We've never found it entirely credible that the White House would proceed with such a direct hit to voters' wallets heading into the 2020 election season. As a result, it's not surprising to see this weekend's dampening of China-US trade tensions in Buenos Aires. Although we still lack details on possible next steps for trade negotiations between the two countries, and we have no information on the specific products and amounts of them that China has supposedly agreed to purchase from the US, the new China-US tariff truce relieves some of the immediate tensions between the two countries. It is also a clear sign that the White House likely doesn't want to follow through on some of its toughest anti-China trade rhetoric—but would rather kick this tariff can down the road.

THREAT TO TERMINATE NAFTA: THE SPECTRE OF 'ZOMBIE NAFTA' RETURNS

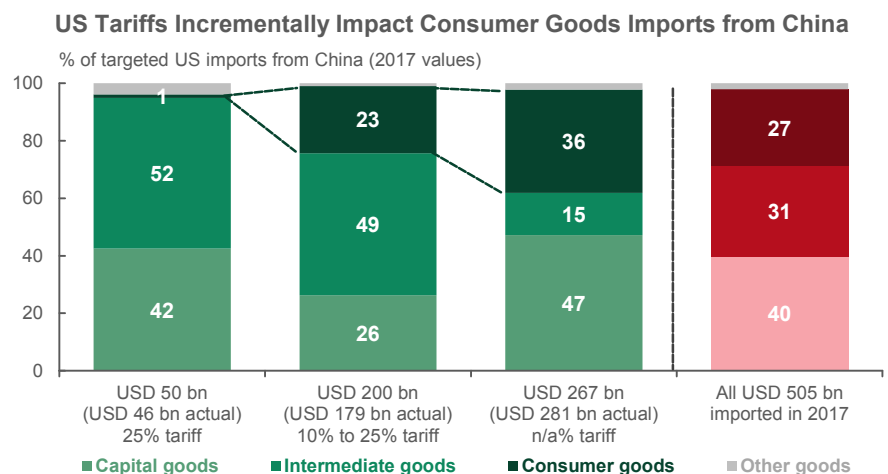
Aside from China-US trade relations, the President has also indicated that he intends to issue a notice of US withdrawal from NAFTA in order to pressure the US Congress into ratifying the recently-signed US-Canada-Mexico Agreement (USMCA in the US, CUSMA in Canada) with greater haste than the 180 days or more usually required by the US Congress (figure 1, which we repeat from previous publications, is an evergreen reference point for the US ratification process).

Under NAFTA's Article 2205 withdrawal procedures, a party must notify the accord's other members of its intention to exit the deal six months ahead of doing so. At the end of this six-month notice period, a member country has the option to withdraw at any time, but it is not bound to follow through on the notice it has provided.

At the end of the six-month withdrawal notice period, several different versions of 'zombie NAFTA' could obtain:

- **No further action is taken.** The US could complete its notice period and retain the right to withdraw from NAFTA at any time, which imposes a chilling effect on the US Congress, and on Canada and Mexico, but in de jure terms, nothing has changed.
- **A domestic US political tussle ensues over who has the right to effect a withdrawal.** Legal opinion is divided on whether the US President has the right to withdraw from NAFTA without the endorsement of Congress. Although Congress is given purview over taxes and tariffs by the US constitution, the President is given broad powers over foreign affairs. NAFTA sits in a grey zone between these

Chart 3



Sources: Scotiabank Economics, US ITC, International Trade Centre, USTR.

powers, in part because it does not have the status of an international treaty under US law. Moves by President Trump to give notice and to effect withdrawal are likely to be challenged in the US courts, which could see an extended period in which a Presidential withdrawal notice has been issued, the future status of the US in NAFTA is unclear, but the agreement's provisions remain wholly in place.

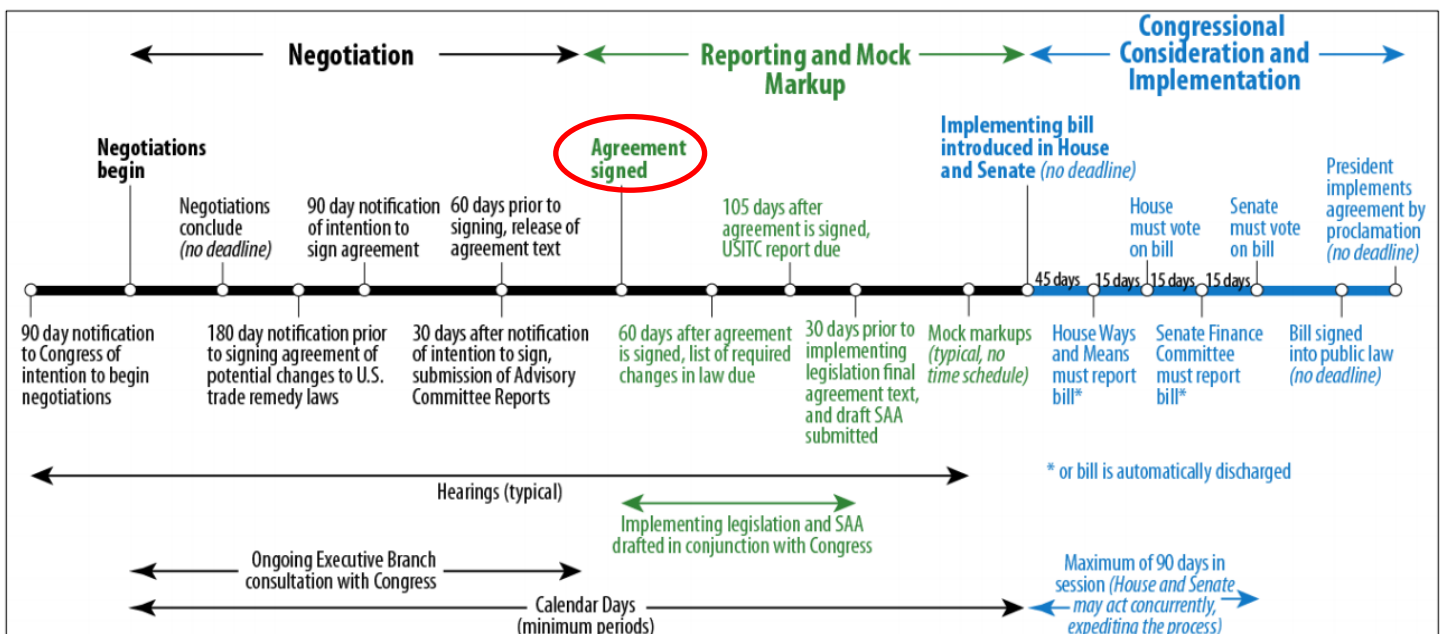
- US withdraws, but the US Congress doesn't change its NAFTA tariff rates.** With or without a legal fight, the US could withdraw from NAFTA prior to the ratification of the new USMCA. This would vapourize NAFTA's dispute settlement mechanisms, cooperative councils, regulatory arrangements, and possibly other features, but it may not automatically terminate its bilateral agreements on agriculture or its side letters on the environment and labour. NAFTA visas would remain in place, though they would be subject to change at any time. More importantly, Congress would still have to legislate to change the US tariff rates that apply to Canada and Mexico. The US Congress could refuse to pass such legislation, leaving trade in North America continuing broadly on NAFTA terms, but without NAFTA's formal superstructure, until USMCA is ratified.

President Trump's rhetoric clearly implies that he thinks the US Congress can be bullied into ratifying the USMCA text. Although many Democrats represent districts dependent on trade with Canada and Mexico, and they have an incentive to ensure this trade continues flowing freely, they have little incentive to hand the White House an easy win on the USMCA—a win that President Trump needs on one of his signature issues. Moreover, many Congress people continue to have conflicted views on free trade, and need to make at least a nod to these views in the USMCA ratification process.

Knowing all this, and in view of his step back in his conflict with China, we continue to expect that the US President will not make good on his threat to withdraw from NAFTA. Instead, the ratification process will likely proceed with difficult headlines at each step of the process outlined in figure 1. Congress will likely make some demands, on issues such as labour rights, which can be dealt with in side letters or in the USMCA's enabling legislation. Both sides would be able to claim to have notched up a win.

Like much of its content, USMCA's ratification would then look a lot like the process that brought NAFTA into being in the early-1990s.

Figure 1



Source: CRS.

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