Strategic Analysis Paper

Chinese Imports of US Farm Goods Remain Robust in the Face of Deteriorating Relations

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Key Points

- Chinese and American trade representatives reiterated their commitment to the US-China Phase One Trade Agreement last month. Under the terms of the agreement, which was reached in January this year, China committed to purchase US$32.1 billion of US agricultural goods in 2020.

- Despite significant increases in the volume of US agricultural goods imported by China, it is unlikely that it will be able to reach that target.

- Beijing has removed many of the structural barriers to US agricultural goods in the past six months, however, and US trade officials might be willing to show a higher degree of flexibility after the economic downturn caused by the Covid-19 pandemic.

- Food price inflation in China has increased to the highest point in more than a decade, mainly due to a steep decline in pork production and uncertainty about grain production after the worst floods in at least two decades. As a result, China is left with little option but to purchase US farm goods.

Summary

President Donald Trump took office with a promise to create a strong trade deal with Beijing, which would help to reduce the US trade deficit with China. A deal of sorts was reached in early 2020, under which China committed to increase its imports of American goods by US$200 billion above 2017 levels. Beijing agreed to import US$32.1 billion of American agricultural products this year, but disruptions to international trade during the Covid-19 pandemic means that it is unlikely to reach that target. It is uncertain whether there will be any consequences for China failing to meet that commitment, but US trade officials appear to

be open to some degree of flexibility, provided that China demonstrates at least some progress in trying to meet the targets. President Trump's strong commitment to achieve a deal early in his tenure also means that the deal is likely to survive until after the 2020 presidential election.

Analysis

The United States and China reaffirmed their commitment to the Phase One Trade Agreement in a biannual review in August. The agreement was signed on 15 January and came into effect a month later. The Phase One Trade Agreement commits China to increase the value of US imports by at least US$200 billion over the next two years, compared to 2017. Those imports are divided into four categories: manufactured goods, agriculture, energy and services. The minimum amount that China will need to purchase above the 2017 baseline in each of those categories is outlined in the following table.

ANNEX 6.1
INCREASES IN U.S. EXPORTS TO CHINA OVER 2 YEARS

Unit: USD Billion

Product Category		Additional U.S. Exports to China on Top of 2017 Baseline		
		Year 1	Year 2	2-Year Total
1. Manufactured Goods		**32.9**	**44.8**	**77.7**
1	Industrial machinery			
2	Electrical equipment and machinery			
3	Pharmaceutical products			
4	Aircraft (orders and deliveries)			
5	Vehicles			
6	Optical and medical instruments			
7	Iron and steel			
8	Other manufactured goods[a]			
2. Agriculture[b]		**12.5**	**19.5**	**32.0**
9	Oilseeds			
10	Meat			
11	Cereals			
12	Cotton			
13	Other agricultural commodities[c]			
14	Seafood[d]			
3. Energy		**18.5**	**33.9**	**52.4**
15	Liquefied natural gas			
16	Crude oil			
17	Refined products			
18	Coal[e]			
4. Services[f]		**12.8**	**25.1**	**37.9**
19	Charges for use of IP			
20	Business travel and tourism			
21	Financial services and insurance			
22	Other services			
23	Cloud and related services			
TOTAL		**76.7**	**123.3**	**200.0**

Source: Economic and Trade Agreement Between the Government of the United States of America and the Government of the People's Republic of China

Trade statistics from the end of July, about six months into the first year of the trade agreement, indicate that China has failed to lift imports sufficiently to meet the 2020 target in each category. China has purchased about 27 per cent of the agricultural goods target and it is unlikely that it will be able to buy enough American agricultural goods in the next six months to meet its commitment. Senior US trade officials involved in the agreement, however, have indicated that Washington could grant Beijing some flexibility in meeting the targets, noting that:

> There's going to continue to be a dialogue and discussion, and keep in mind this is a two-year commitment, so you are going to have to look at this over time. Everyone wants to measure month to month to month … At least from my perspective, we have to give this some time.

China has also completed 50 of the 57 structural changes that it agreed to make to improve access to its market for US exporters. As a result, US beef and poultry exports have increased markedly and dairy exports have risen by more than 20 per cent. The number of US facilities with approval to export agricultural products to China has also more than doubled to 3,500.

US President Donald Trump believes that an increase in agricultural exports to China will translate into greater support for him in rural electoral districts, especially in the Mid-West. According to John Bolton, the former US National Security Advisor, President Trump views the China-US trade relationship purely in economic, rather than strategic, terms. He notes that:

> Trump approached trade and trade deficits as if reading a corporate balance sheet: trade deficits meant we were losing, and trade surpluses meant we were winning. Tariffs would reduce imports and increase government revenues, which was better than the opposite … Still, trade deficits often indicated other problems, such as the enormous benefits China reaped from intellectual property theft, which in turn allowed it to compete more successfully against the very firms it had stolen the intellectual property from. Compounding the problem, Beijing subsidized its businesses to lower their prices internationally. Major decreases in US manufacturing jobs resulted from lower labor costs of production in China and other developing countries. It was therefore trade deficits as symptoms of other problems, not as problems in themselves, that warranted more attention.[1]

If that is the case, Trump might be willing to forego Beijing making meaningful structural changes if China purchases more American goods. According to Bolton, Trump is particularly keen for China to purchase more American agricultural goods, as he sees it as a means to build and maintain support with rural voters. During his meeting with Xi Jinping at the 2019 G20 Summit, President Trump allegedly voiced his belief that China has considerable sway over the 2020 presidential election. Bolton claims that Trump "pleaded" with Xi to ensure that he

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[1] John Bolton, *The Room Where it Happened: A White House Memoir*, (Simon & Schuster: New York, 2020), p. 290.

would win and 'stressed the importance of farmers, and increased Chinese purchases of soybeans and wheat in the electoral outcome.'[2]

For the most part, Trump has been supportive of the Phase One Trade Agreement. During the negotiations that led to its signing in early 2020, he indicated to his economic and national security advisors on multiple occasions that he'd be willing to use Chinese technology companies, such as Huawei and ZTE, as leverage in securing a trade deal favourable to the US (see, for instance, pages 290-294 and 305-309 of Bolton's book). If Bolton's version of events is correct, Trump views the trade deal as an end in itself, rather than as a means to alter Chinese trade and economic policy.

Since the signing of the agreement, however, Trump has become more strident in his criticism of China. It seems that his thinking around the trade agreement and the US trade deficit with China has evolved. His administration has: threatened to ban Chinese technology companies, such as [WeChat and TikTok](#), from operating in America; stopped US semi-conductor manufacturers from legally trading with [Huawei](#); stated that [Hong Kong is no longer sufficiently autonomous from China](#) to justify differential treatment, effectively suggesting that Beijing has violated the "one country, two systems" arrangement; shown signs of growing support for Taiwan (see [here](#) and [here](#)); closed the [Chinese consulate in Houston](#); imposed [sanctions on Chinese and Hong Kong officials](#), including the Chief Executive of Hong Kong, Carrie Lam; [imposed sanctions on a Chinese government entity](#) that is involved in the mass incarceration of Uighurs; and officially [declared](#) that Chinese activities in the South China Sea are inconsistent with international law. While some of those positions might be used to gain leverage in a future trade negotiation, many of them indicate a significant shift in the US-China relationship and are designed to encourage Beijing to implement structural reform.

The US Trade Representative, Robert Lighthizer, has [clearly articulated](#) the Trump Administration's rationale for its trade policy. He states that the administration seeks to find 'a balance among economic security, economic efficiency, and the needs of working people.' In his view, and that of the administration, US trade policy has prioritised economic efficiency at the expense of working people over the last few decades. He argues that most Americans want 'a trade policy that supports the kind of society they want to live in. To that end, the right policy is one that makes it possible for most citizens, including those without college educations, to access the middle class through stable, well-paying jobs.' That is a theme that is likely to continue into President Trump's second term in office, if he is re-elected in November, as his [second-term agenda](#) includes a goal to bring one million manufacturing jobs back to the US from China.

That sentiment appears to have bipartisan support. Joe Biden, the Democratic presidential nominee, also [proposes](#) to 'stand up to the Chinese government's abuses, insist on fair trade, and extend opportunity to all Americans.' He seeks to 'create millions of new manufacturing and innovation jobs throughout all of America.' His campaign also highlights the need to 'Bring back critical supply chains to America so we aren't dependent on China or any other country

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[2]*ibid*, p. 301.

for the production of critical goods in a crisis.' Regardless of who wins the presidential election in November, it is likely that the decoupling of the US and Chinese economies will continue.

US agricultural exports to China could be spared from any ill-effects of that decoupling, however, as China increases its purchases of American farm goods to comply with the agreement and strengthen deteriorating food security conditions. The value of American agricultural exports to China totalled US$19.6 billion in 2017. To comply with the agreement, China will need to import at least US$51.6 billion ($70.6 billion) worth of US farm goods in 2020-21. In 2017, the main agricultural commodities that the US exported to China included: soybeans (which alone accounted for 63 per cent of US agricultural exports to China), sorghum and cotton. Even after two challenging years in 2018 and 2019, China remains the third-largest market for US agricultural exports. Feed grains are the main US agricultural commodities exported to China, however, pork and beef exports have risen significantly in the past year. The US Department of Agriculture (USDA) forecasts that agricultural exports to China will reach US$18.5 billion in 2020, which is roughly equal to that of 2017, but far short of the US$32.1 billion required under the trade agreement.

Beijing attempted to weaponise the trade agreement in June, by threatening to halt the importation of US farm goods if Washington imposed sanctions on Chinese officials and businesses. A fear of deteriorating food security in China has limited Beijing's ability to follow through with that threat, however, and its purchases of US agricultural products have increased significantly despite increased US "meddling" in Chinese affairs.

Chinese food price inflation has increased to the highest point in more than a decade, due to a steep decline in pork production, lingering trade disruptions from the Covid-19 pandemic, severe floods in the Yangtze basin (parts of which are facing the worst conditions since at least the early 1980s) and warnings of a growing grain supply gap. Beijing abandoned a scheme that encouraged farmers to grow corn, as the country began to produce too much to stockpile. In the last four years, however, state stockpiles have dwindled to a point where agricultural analysts are predicting that China will experience a corn deficit of up to 30 million tonnes, equal to about ten per cent of its total corn crop. The Chinese agriculture ministry forecasts that the deficit will be closer to 17 million tonnes. Those fears are driving a considerable increase in the volume of feed grain imported into China.

According to USDA data, the volume of corn and sorghum exported to China is likely to reach its highest level since 2013/14. It is also possible that the volume of corn shipped to China will be so large that the tariff-rate quota will be reached for the first time since it was set by the World Trade Organization in 2001, meaning that US corn could be subjected to Chinese tariffs for the first time since Beijing joined the WTO. As there is no tariff-rate quota on US sorghum, however, Chinese importers could elect to increase their purchases of that feed grain later in the marketing year. Corn could also be substituted with other feed grains, such as barley or wheat, if prices continue to rise.

Accumulated Exports - CHINA, PEOPLES REPUBLIC OF

Corn
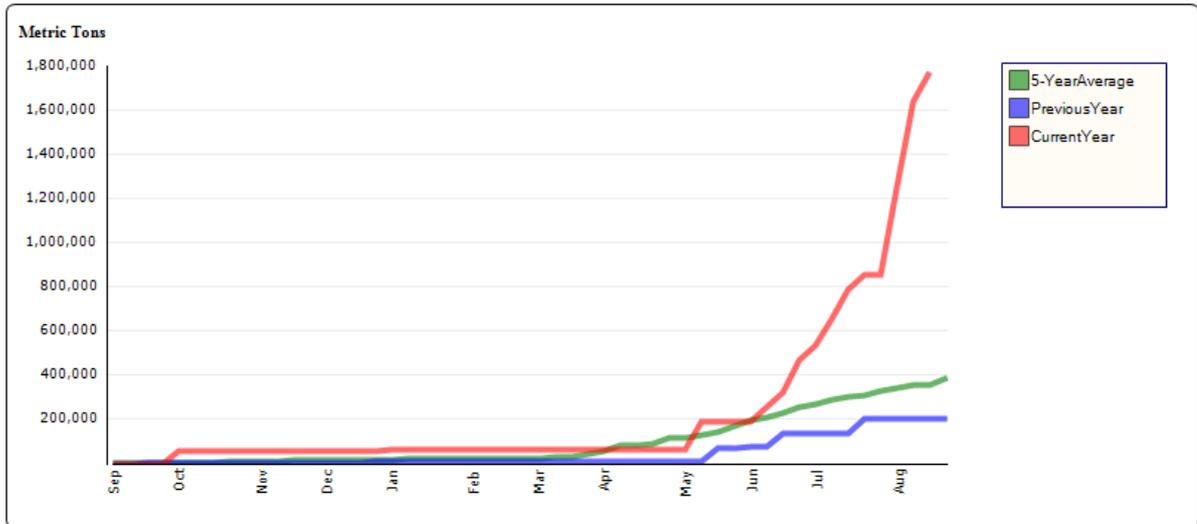
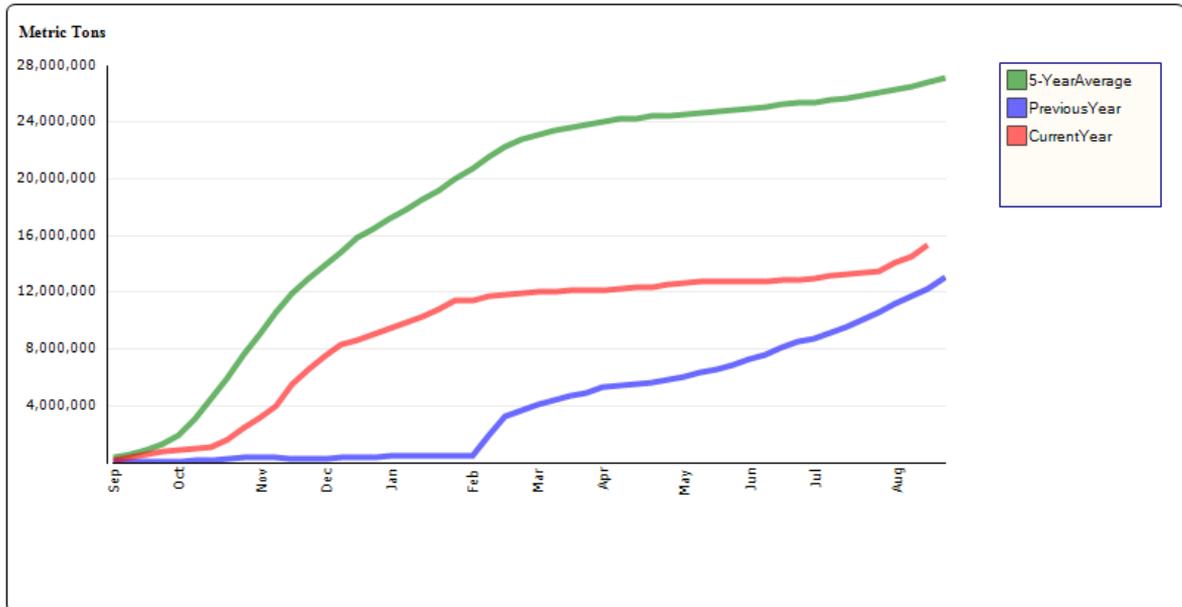Source: USDA/FAS/Export Sales Reporting

Accumulated Exports - CHINA, PEOPLES REPUBLIC OF

Sorghum
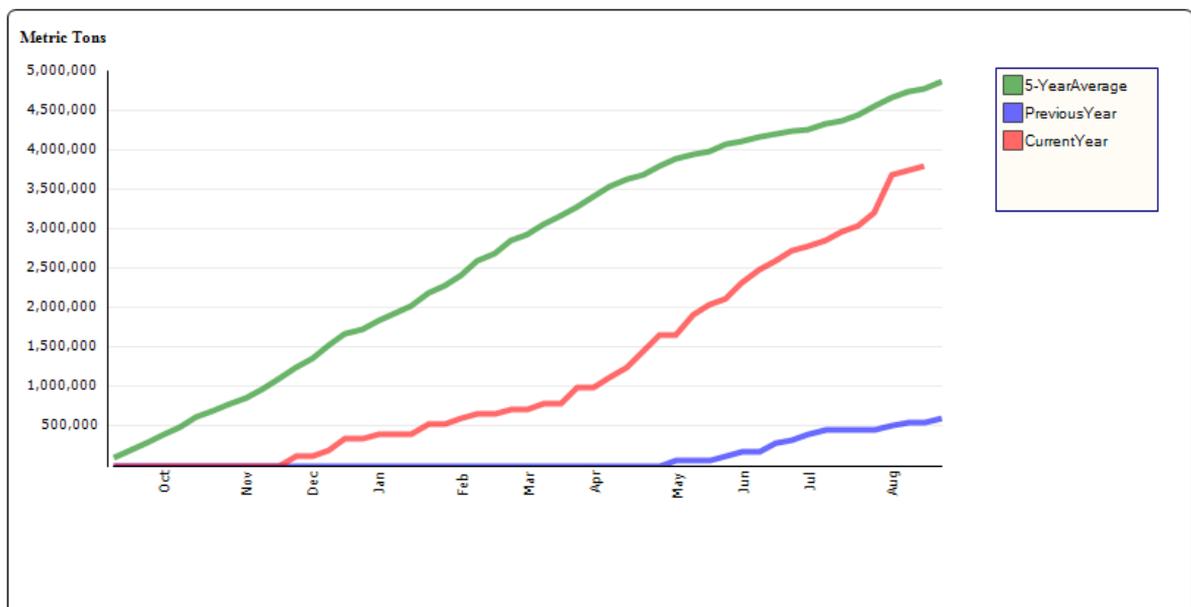
Source: USDA/FAS/Export Sales Reporting

US soybean exports to China are also expected to increase significantly in 2020. Agricultural trade analysts suggest that China is likely to buy a record 40 million tonnes, about 25 per cent more than in 2017 and ten per cent more than the current record set in 2016. While exports are currently trending below the five-year average, China usually purchases the majority of its soybeans from the US in the last quarter of the year.
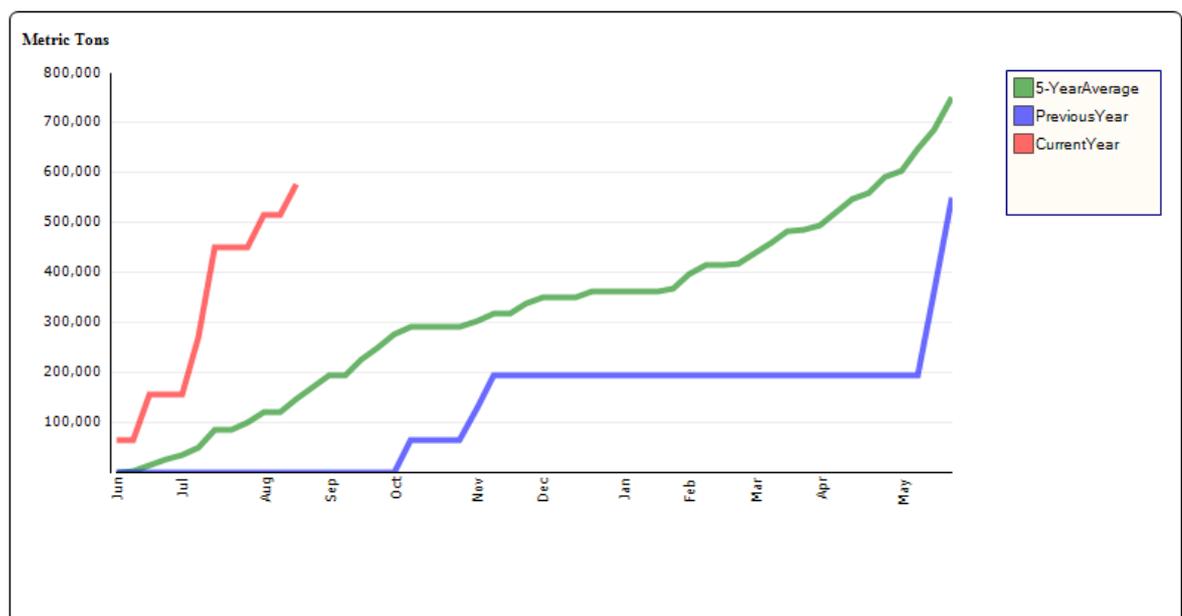
Accumulated Exports - CHINA, PEOPLES REPUBLIC OF

Soybeans

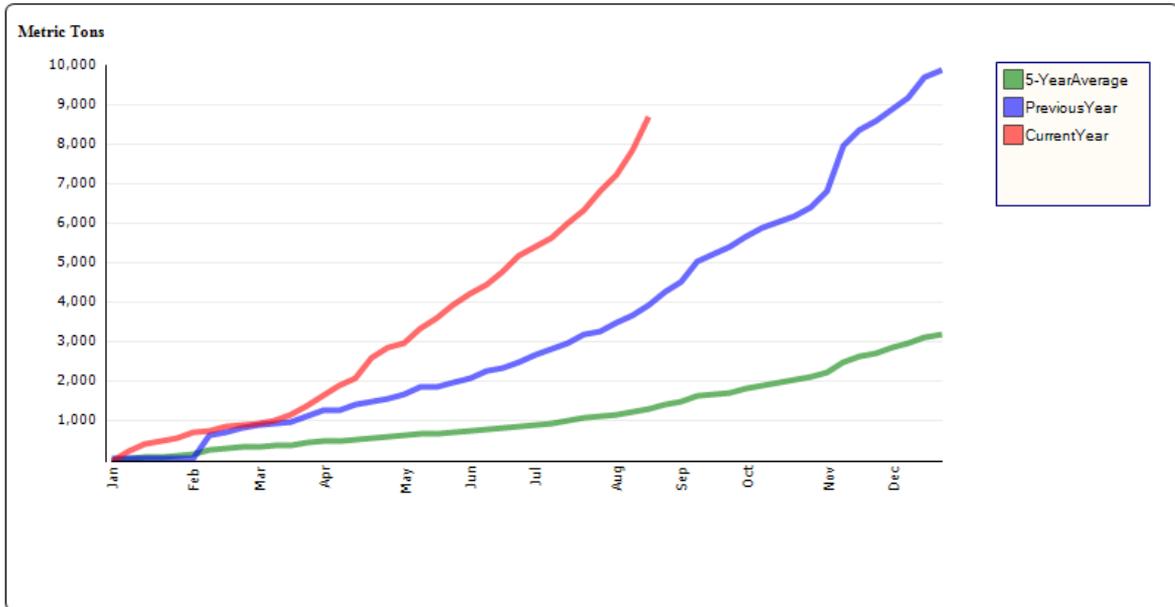Source: USDA/FAS/Export Sales Reporting

Chinese wheat imports have also more than doubled in the first seven months of 2020, due to increased demand for high-quality wheat. Chinese farmers have begun hoarding the grain in anticipation of higher prices. The US wheat marketing year runs from June to May and, as the following graph indicates, exports to China are about five times higher than the five-year average.

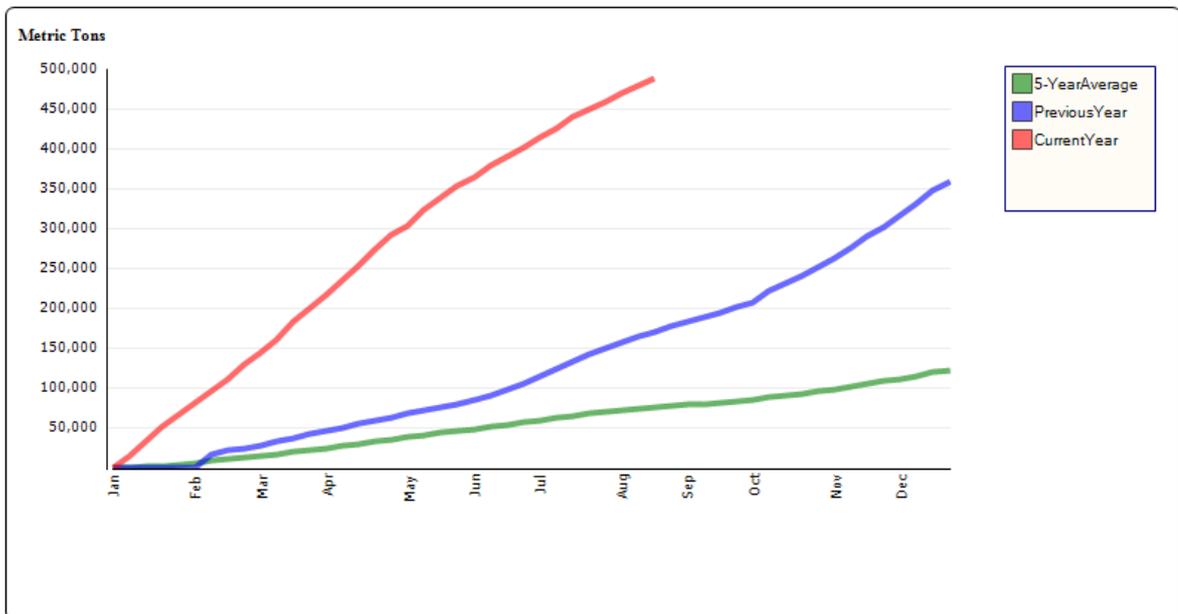**Accumulated Exports - CHINA, PEOPLES REPUBLIC OF**

All Wheat

Source: USDA/FAS/Export Sales Reporting

Accumulated Exports - CHINA, PEOPLES REPUBLIC OF

Fresh, Chilled, or Frozen Muscle Cuts of Beef

Source: USDA/FAS/Export Sales Reporting

Accumulated Exports - CHINA, PEOPLES REPUBLIC OF

Fresh, Chilled, or Frozen Muscle Cuts of Pork

Source: USDA/FAS/Export Sales Reporting

Chinese demand for US meat products has increased dramatically in the last two years as the country grapples with a decline in pork production, due to the loss of hundreds of millions of pigs that were infected with African Swine Fever. Beef imports also increased dramatically over the past decade, but US exports were largely banned from entering the market due to

mad cow disease-related restrictions and the use of synthetic growth hormones. Imports have increased dramatically after Beijing removed those non-tariff barriers.

It is unlikely that China will reach the import targets that it committed to in the Phase One Trade Agreement. It has significantly increased its purchases of US farm goods and that trend that is likely to continue as China faces mounting food security concerns and there are relatively few other countries from which it can assuredly import large quantities of grain. President Trump's earlier commitment to reaching a trade deal with China also means that the agreement is likely to survive until after the November presidential election. While the agreement failed to reduce the US trade deficit with China in any meaningful way, it has helped to foster bipartisan support for a tougher US approach to Beijing. Regardless of which candidate wins the 2020 presidential election, it is likely that US trade policy towards China has been permanently altered.

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