The U.S.-China Phase One Trade Agreement: Implications for U.S. Forestry

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Introduction

On January 15, 2020, the U.S. and China signed a "Phase One" trade deal to address desired structural reforms and other changes to the Chinese economy affecting international trade and foreign investment. The U.S.-China Phase One Trade Agreement, which is the first agreement in what is expected to be a series of agreements, focuses on reforms in the Chinese economy in the areas of intellectual property, technology transfer, agriculture, financial services, and currency and foreign exchange. The agreement also includes commitments by China to purchase additional U.S. goods over the next two years, including significant purchases of U.S. agricultural, food, fish and forest products (USTR, 2020a).

Although the U.S. has agreed not to impose additional tariffs on imports from China, and China has agreed to reduce or eliminate certain tariffs imposed in retaliation, the Phase One Agreement does not specifically address the escalating tariffs between the two countries due to the ongoing trade dispute that started in 2018. However, the agreement signifies a decrease in tensions and a possible path to tariff reductions and eliminations in the future. This is particularly important for U.S. forest product exports, which suffered significant losses in 2018 and 2019 from Chinese retaliatory tariffs.

In this report, we provide the context and overview of the U.S.-China Phase One Trade Agreement and implications for U.S. forest product exports. Forest products are a major agricultural and agriculture-related export for the U.S. However, the negative impact of the trade dispute on the sector has received little attention compared to other agricultural commodities such as soybeans and cotton. Over the last decade, the sector has become increasingly reliant on China for sales and suffered considerable losses from the retaliatory tariffs that China imposed (Ward, 2019; Pryor, 2019). The U.S.-China Phase One Trade Agreement sets the stage for a decrease in tensions between the two countries and the eventual removal of Chinese

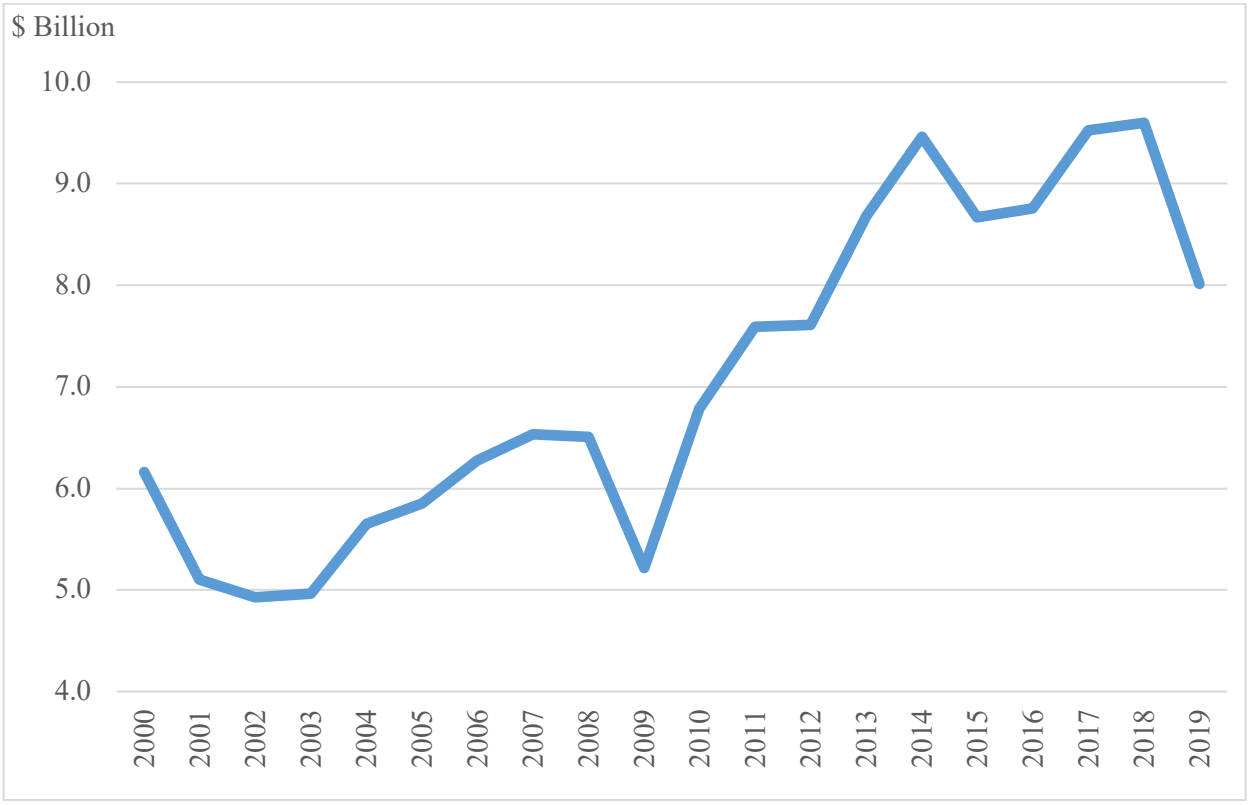
tariffs on U.S. products. This could result in considerable gains for the U.S. forest product sector moving forward.

Trade War and U.S. Forest Product Exports

Before considering the impact of the Phase One Agreement, it is important to provide some context as to how U.S. forest product exports have fared during the trade dispute. From 2002-2018, U.S. forest product exports increased from less than $5 billion to $9.6 billion, nearly a 100 percent increase. However, when the Chinese government imposed retaliatory tariffs, as high as 25 percent on major U.S. hardwoods, exports decreased by 20 percent to $8.0 billion in 2019 (**Figure 1**) (Pryor, 2019; Ward, 2019; GATS, 2020).

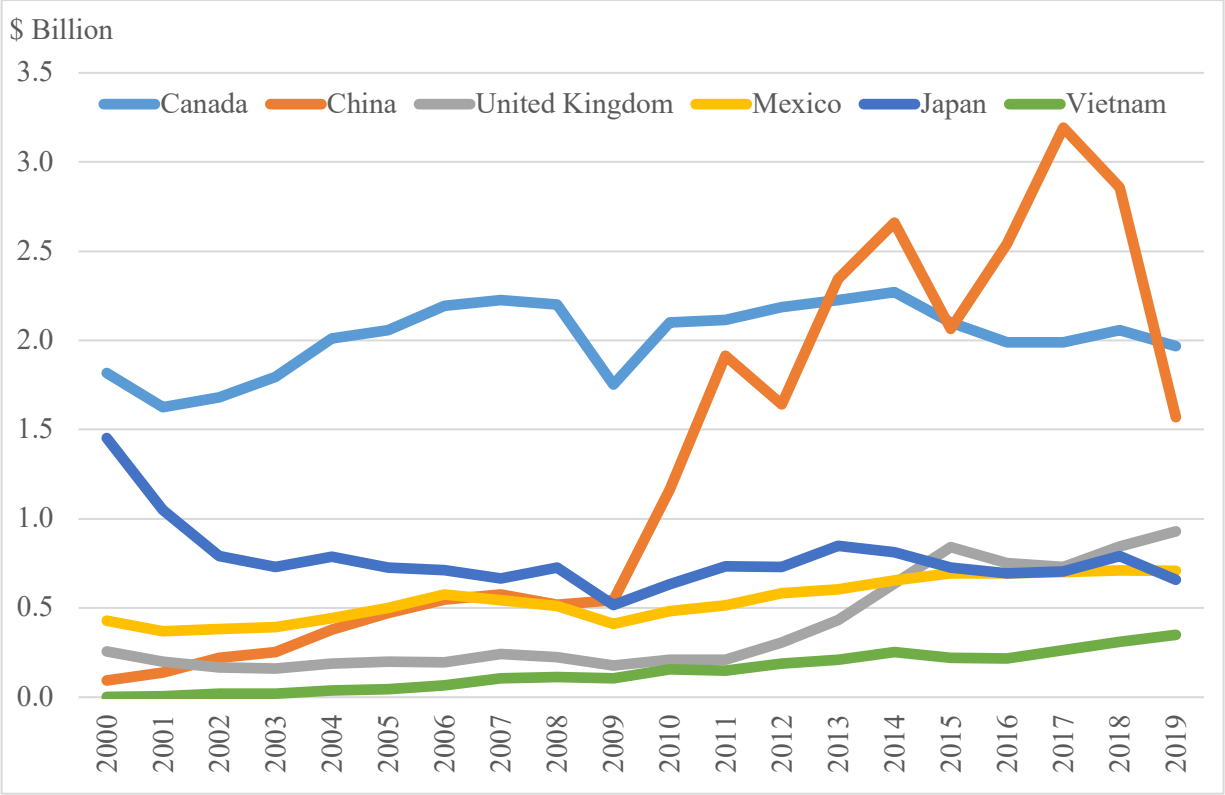
Similar to many agricultural commodities, the growth in exports over the last decade was due to increased demand in China. From 2009-2017, U.S. forest product exports to China increased from $500 million to $3.2 billion, an increase of about 500 percent, making China the leading market for U.S. forest product exports. Given the increasing reliance on China, the sector was particularly affected by the trade dispute. U.S. forest product exports to China have since declined by 50 percent to $1.6 billion (**Figure 2**). U.S. exports to China are primarily logs (HS 4403 *wood in the rough*) and lumber (HS 4407 *wood sawn or chipped*).[1] These two categories account for nearly 100 percent of U.S. forest products in China. In 2019, U.S. log exports to China were down 48 percent compared to 2017 ($1.4 billion to $714 million), and lumber exports were down 52 percent compared to 2017 ($1.7 billion to $835 million) (GATS, 2020).

[1] The Harmonized System (HS) is an international nomenclature for the classification of products. It allows countries to classify traded goods on a common basis for customs purposes.



Source: Foreign Agricultural Service, Global Agricultural Trade System (GATS).

Figure 1. Total U.S. Forest Product Exports: 2000-2019.



Source: Foreign Agricultural Service, Global Agricultural Trade System (GATS).

Figure 2. U.S. Forest Product Exports by Major Destination: 2000-2019.

Phase One Trade Agreement and Forest Product Exports

The U.S.-China Phase One Trade Agreement addresses structural barriers that limit U.S. exports to China. These include nontariff barriers (mostly regulatory and technical) that primarily affect U.S. agricultural products. Although these reforms are important, what has received considerable attention is the Expanding Trade Chapter, which includes commitments by China to import U.S. goods and services over the next two years, in excess of imports in 2017, by no less than $200 billion (USTR, 2020a).

USDA categorizes U.S. forest products as an agriculture-related export along with fish products, ethanol and biodiesel, and distilled spirits (GATS, 2020). While fish and seafood products are listed under agriculture in the Expanding Trade Chapter of the agreement, which implies that U.S. fish and seafood could count toward China's committed agricultural purchases, forest products are listed under manufacturing (USTR, 2020b). This indicates that purchase of forest products would count as part of China's manufacturing commitments.

According to the agreement, China will import U.S. manufactured goods no less than $120.0 billion in 2020 and $131.9 billion in 2021 (USTR, 2020a). In 2020, China has agreed to import no less than $32.9 billion above the corresponding 2017 baseline, which is implied from the text to be $87.1 billion, and in 2021, no less than $44.8 billion above the corresponding 2017 baseline (USTR, 2020b). This represents a 45 percent increase each year (on average) compared to the 2017 baseline. Although less in percentage terms when compared to the expected increase in agricultural purchases, this could still represent a significant gain for the forestry sector.

For agriculture, China has agreed to import at least $80 billion in U.S. food and agriculture commodities and products over the next two years (USTR, 2020a). Forest products would have featured more prominently in the agreement as part of agriculture. The reason being, U.S. forest product exports account for a significant share of total U.S agricultural and agriculture-related exports, as well as exports to China. In 2017, U.S. forest product exports were valued at $9.5 billion, second only to soybean exports ($21.5 billion). Specific to China, U.S. forest product exports ($3.2 billion in 2017) accounted for more than 13 percent of all U.S. agricultural and agriculture-related exports, second only to soybeans ($12.2 billion) (GATS, 2020).

Since major agricultural exports such as soybeans and cotton are explicitly highlighted among the agricultural products in the Expanding Trade Chapter of the agreement, it is likely that forest products would have been similarly featured as an agricultural product. Relative to total U.S. manufacturing exports to China (approximately $90 billion in 2017), forest product exports are a comparatively smaller share (Census, 2020; USTR 2020a; USTR 2020b). Consequently, forest products are listed under the broad designation “Other manufactured goods” (USTR, 2020b).

Export Projections based on the Phase One Agreement

The Expanding Trade Chapter lists more than 300 manufacturing product categories at the Harmonized System (HS) 4-digit level, including several wood and forest product categories. The agreement provides no specifics as to how China will fulfill its obligations, and there is no guarantee that additional manufacturing purchases will include forest products.

In **Table 1**, we report the results of a straightforward analysis where we apply the expected increase in manufacturing purchases to the top forest product exports to China, all of which qualify as manufacturing under the agreement. Note that a 45 percent increase in purchases of U.S. forest products would require exports to China to increase to over $4.6 billion, which is an increase of 195 percent when compared to 2019 ($1.6 billion) and would be a record year (GATS, 2020). Red oak lumber ($599 million) accounted for about 19 percent of the total in 2017. At this percent,

red oak lumber exports to China would be on average $869 million each year under the Phase One Agreement, an increase of 225 percent when compared to 2019. Other noted increases (relative to 2019) include ash lumber at 297 percent ($96 million to $294 million), red oak logs at 328 percent ($66 million to $283 million) and white oak lumber at 216 percent ($85 million to $268 million). Note that for many categories, exports fell to negligible levels in 2019. Thus, projected changes would represent an immeasurable increase in percentage terms.

Table 1. U.S. Forest Product Exports to China Based on the Top Categories in the Phase One Agreement: 2017, 2019 and Trade Deal Projections

HS Code	Product	2017 ($ mill.)	2017 (%)	2019 ($ mill.)	Projected ($ mill.)*	Change (%)**
	Total	$ 3,193	100.0	$ 1,569	$ 4,630	195.1
4407.91.0022	Lumber, Red Oak	599	18.8	267	869	225.3
4407.95.0000	Lumber, Ash	203	6.4	96	294	206.6
4403.91.0020	Logs, Red Oak	195	6.1	66	283	328.4
4407.91.0063	Lumber, White Oak	185	5.8	85	268	215.6
4403.20.0050	Logs, Western Hemlock	168	5.3	0	244	-
4407.94.0000	Lumber, Cherry	123	3.9	83	178	114.9
4407.99.0161	Lumber, Walnut	119	3.7	0	173	-
4407.99.0172	Lumber, Yellow Pop.	113	3.5	0	164	-
4403.20.0040	Logs, Doug-Fir	107	3.4	0	155	-
4403.99.0070	Logs, Walnut	102	3.2	0	148	-
4403.20.0020	Logs, S. Yellow Pine	101	3.2	0	146	-
4403.20.0060	Logs, Other Coniferous	100	3.1	0	145	-
4403.99.0040	Logs, Ash	98	3.1	0	142	-
4407.10.0147	Lumber, S. Yellow Pine	84	2.6	0	122	-
4403.20.0025	Logs, Ponderosa Pine	79	2.5	0	115	-

*Projections are based on the expected growth (45 percent) from the agreement.
**Percent change – trade agreement projections compared to 2019 trade.
Table includes the top 15 categories based on 2017 exports. These categories accounted for 75 percent of total exports in 2017.
Source: Foreign Agricultural Service, Global Agricultural Trade System (GATS) and author's calculations.

Implications and Discussion

What are the implications of the Phase One Trade Agreement for the Tennessee forestry sector? According to the USDA (GATS, 2020), Tennessee ranks high among states that export forest products (seventh based on 2017 exports). Tennessee forest product exports to China in 2017 were $143 million. Assuming the percentages from this report, this could increase to $207 million under the Phase One Trade Agreement, which is more than a 440 percent increase when compared to exports in 2019 ($38 million).

Overall, the Phase One Trade Agreement could benefit U.S. and Tennessee forestry because it further opens the largest market for U.S. exports. Although China has committed to increase purchases of U.S. exports overall, specific purchases have not been determined. Thus, the outlook for U.S. forest product exports under the Phase One Trade Agreement is uncertain. Assuming 2017 trade and increases in manufacturing purchases comparatively distributed across products, there are clear benefits for U.S. forest products and the potential for record exports. Only time will reveal if U.S. forest products would have been better off being listed under agriculture as opposed to being on the more extensive list of manufacturing goods.

More important than the purchase commitments under the agreement are the tariffs that China imposed on U.S. forest products. Fortunately, effective March 2020, the Chinese government will grant tariff exclusions for major U.S. forest products (Inouye, 2020). If the tariffs no longer apply, U.S. forest product exports to China could recover and conceivably reach pre-trade war levels.

Lastly, the spread of the coronavirus (COVID-19) has complicated the implementation of the Phase One Trade Agreement. Logistical disruptions and reduced economic activity will provide substantial head winds for China attempting to meet the purchases required under the agreement. Purchases could be delayed until the scope of the pandemic subsides and trade normalizes.

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