

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

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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 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 and services over the next two years, including significant purchases of U.S. agricultural, food and fishery products (Office of the U.S. Trade Representative [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 direct retaliation to U.S. tariffs, 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 between the U.S. and China and a possible path to future tariff reductions and eliminations. These potential reductions are particularly important for U.S. agriculture, which has suffered considerable export losses in 2018 and 2019 from Chinese retaliatory tariffs. (See Muhammad and Smith, 2018; and Muhammad, Smith, and MacDonald, 2019, for a discussion of the trade dispute’s impact on Tennessee and U.S. soybeans and cotton.)

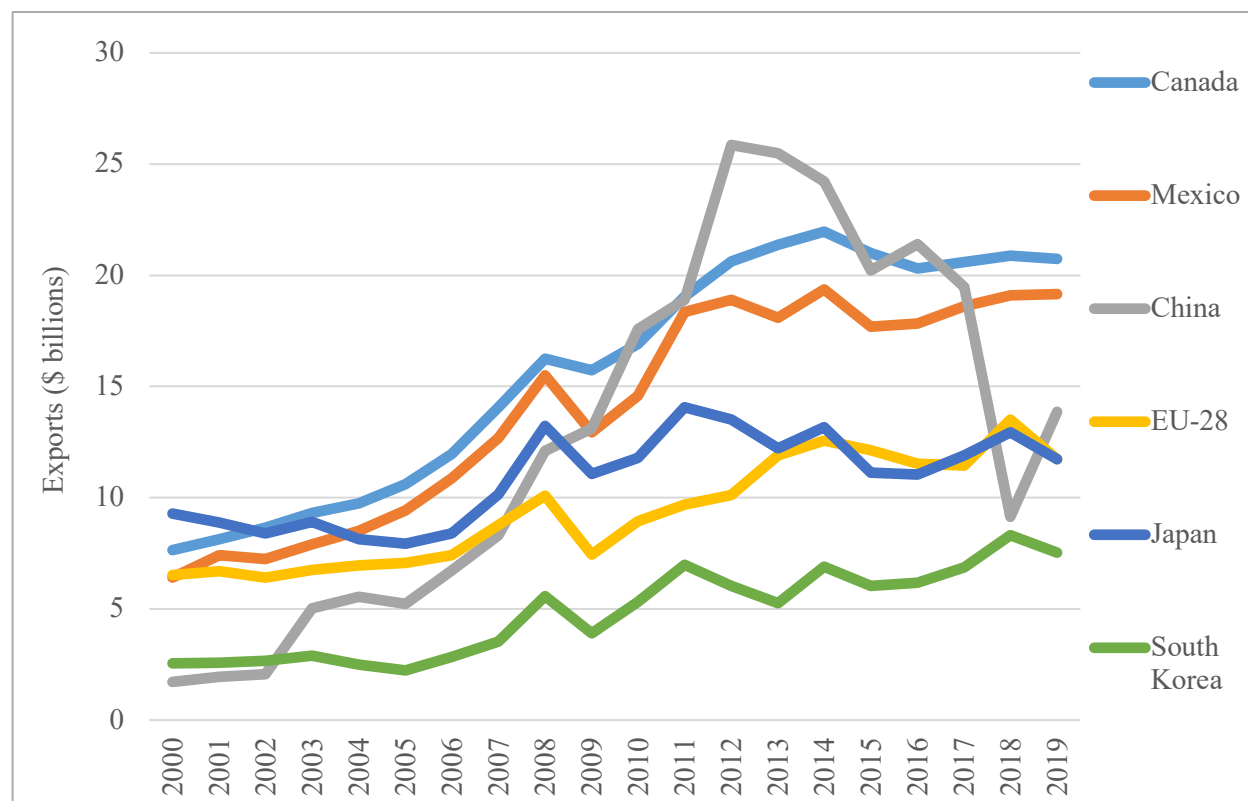
In this report, we provide both an overview and context for the U.S.-China Phase One Agreement and outlook for U.S. agricultural exports. We also discuss the potential price implications for major agricultural commodities. We close the report with a brief summary and discuss implications for U.S. and Tennessee agriculture.

## Phase One Agreement and Agriculture

According to the Office of the U.S. Trade Representative (USTR, 2020a), the Agriculture Chapter in the U.S.-China Phase One Agreement addresses structural barriers that limit U.S. exports to China. These include nontariff barriers (mostly regulatory and technical barriers such as age limits on slaughtered animals) to U.S. agriculture and seafood products, including beef, poultry, seafood, rice, dairy, infant formula, horticultural products, feed and feed additives, pet food and biotechnology products. Although these reforms are important, what has received considerable attention is the Expanding Trade Chapter, which includes commitments by China to purchase U.S. goods and services in 2020 and 2021, in excess of 2017 trade, by no less than \$200 billion in four broad categories: agriculture, energy, manufacturing and services. Specifically for agriculture (which includes agricultural, food and fishery products), China has agreed to import at least \$80 billion in U.S. agricultural, food and fishery products over the next two years (2020 and 2021) (USTR, 2020a). In 2020, China has agreed to purchase no less than \$12.5 billion in additional imports above the 2017 baseline and in 2021, no less than \$19.5 billion above the 2017 baseline (USTR, 2020b). The 2017 baseline value is not explicitly stated in the agreement, but given the total committed purchases of agricultural, food and fishery products for the next two years (\$80 billion), and the committed additional purchases in 2020 (\$12.5 billion) and 2021 (\$19.5 billion), the implied 2017 baseline is \$24 billion.

Although the implied 2017 baseline from the agreement text is \$24 billion, the actual value of the agricultural, food and fishery products listed in the Expanding Trade Chapter of the agreement was less than \$24 billion in 2017. Based on U.S. Department of Agriculture trade data (Global Agricultural Trade System, 2020), the total value of U.S. exports to China in 2017 for all of the categories listed under Agriculture in the Expanding Trade Chapter was \$20.8 billion. Considering these product categories, if China imports \$80 billion in agricultural, food and fishery products over the next two years (\$40 billion each year, on average), this would represent a 92 percent annual increase when compared to 2017 and a 177 percent annual increase when compared to 2019 (\$14.5 billion). To put this in context, projected exports to China in 2020 and 2021 would far exceed U.S. exports to any country within recent history (**Figure 1**). In 2012, U.S. exports to China based on the agricultural, food and fishery products listed in the agreement peaked at around \$26 billion, but this was during a period of relatively high commodity prices. For the 2013 marketing year, the U.S. average farm price was \$6.89/bu for corn, 72.5 cents/lb for cotton, and \$14.40/bu for soybeans (USDA-National Agricultural Statistics Service [NASS], 2020). Current prices are substantially lower with the most recently completed marketing year (2019) prices, estimated at \$3.61 for corn – 47.6 percent lower; 70.3 cents/lb for cotton – 3 percent lower; and \$8.48/bu for soybeans – 41.1 percent lower (**Figure 2**) (USDA-NASS, 2020). As such, China would need to

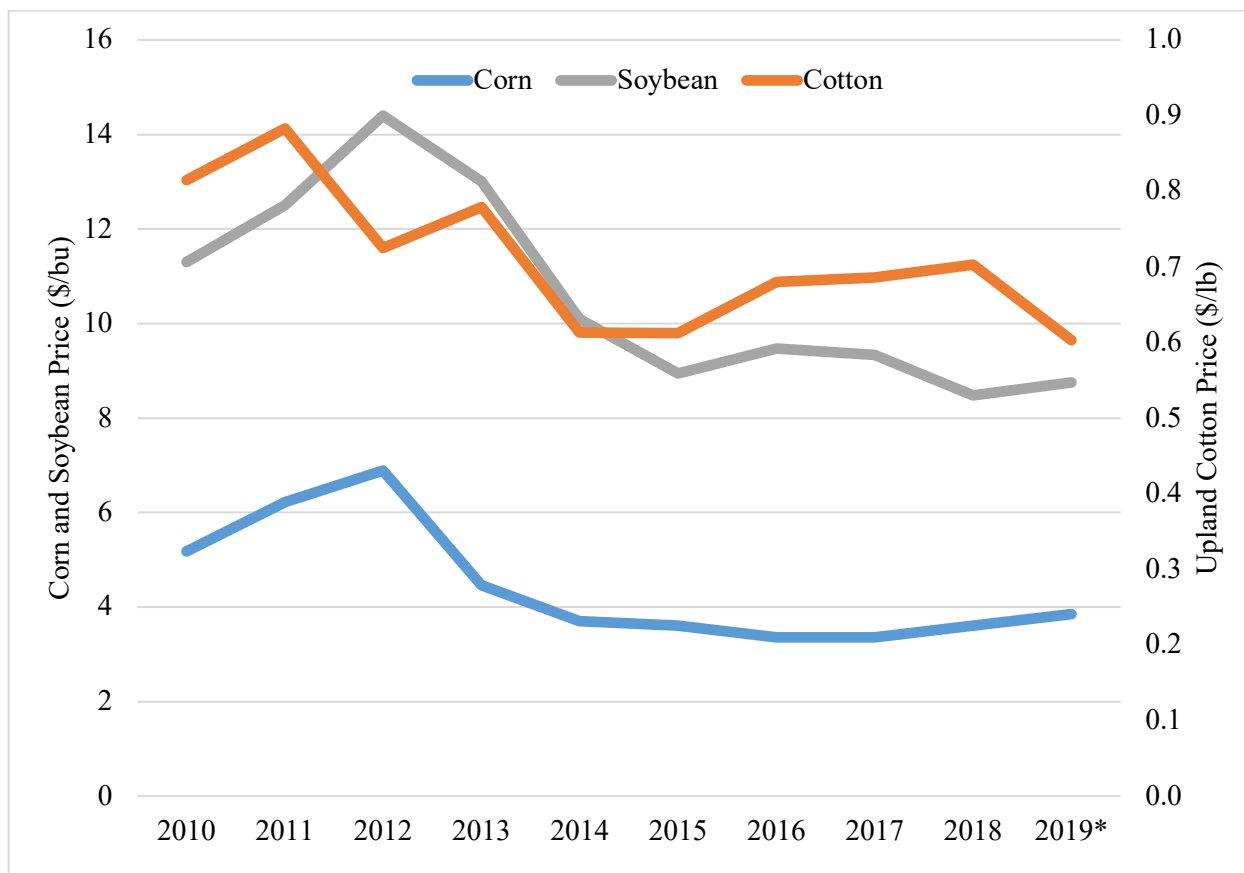
purchase substantially greater quantities of agricultural products, due to lower per unit prices, to achieve the targeted export value outlined in the Phase One Agreement.



Note: Agricultural exports in this figure exclude agriculture-related goods.

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

**Figure 1. U.S. Agricultural Exports by Top Destination Market: 2000-2019.**



Source: USDA-NASS, 2020.

**Figure 2. U.S. Marketing Year Average Price for Corn, Cotton and Soybeans, 2010-2019.**

### *Export Projections Based on the Phase One Agreement*

In the Expanding Trade Chapter, more than 200 agricultural and food product categories are listed at the Harmonized System (HS) 4-digit level, which includes major commodity exports like soybeans and cotton; commodities that were once banned in the Chinese market such as poultry and beef; and infrequently traded products such as cocoa butter, fat and oil. The agreement provides no specifics as to how China will fulfill its obligations. In principle (but highly unlikely), China could fulfill its obligations by purchasing \$40 billion in U.S. chocolate, pasta and beer each year.

**Table 1. U.S. Agricultural Exports to China Based on the Top 12 Product Categories in the Expanding Trade Chapter of the Phase One Agreement**

HS Code	Product	2017 (\$ mill.)	2017 (%)	2019 Projection		Change
				(\$ mill.)	(\$ mill.)*	(% )**
	Total*	\$20,840	100.0	\$14,453	\$40,000	176.8
1201	Soybeans	12,225	58.7	7,989	\$23,480	193.9
5201	Cotton (not carded)	973	4.7	707	1,880	166.1
4101	Raw hides (bovine)	877	4.2	400	1,680	319.9
1007	Grain Sorghum	840	4.0	191	1,600	736.4
0303	Frozen fish (whole), excluding fillets	822	3.9	590	1,560	164.5
1214	Hay, alfalfa, other/similar forage products	389	1.9	339	760	124.0
1001	Wheat	353	1.7	56	680	1,125.2
0206	Edible Offal (all), fresh, chilled or frozen	251	1.2	243	480	97.4
0404	Whey and products	246	1.2	115	480	316.3
0203	Pork, fresh, chilled or frozen	237	1.1	853	440	-48.4
0306	Crustaceans	231	1.1	111	440	296.8
0802	Nuts, fresh or dried, shelled or peeled	219	1.1	585	440	-24.7
N/A	<i>All Other Products</i>	<i>3,177</i>	<i>15.2</i>	<i>2,274</i>	<i>6,080</i>	

\*Projections are based on 2017 percentages of total agricultural trade.

\*\*Percent changes are trade deal projections compared to 2019 trade.

Note: The table includes the top 12 categories based on 2017 exports to China. Smaller categories are not listed. The categories in the table accounted for 85 percent of total exports to China.

Source: Foreign Agricultural Service, Global Agricultural Trade System (GATS) and author's calculations.

In **Table 1**, we report the results of a straightforward analysis where we consider the top 12 agricultural, food and fishery product categories (based on 2017 U.S. exports to China) listed under the Agriculture in the Expanding Trade Chapter of the agreement. In 2017, these categories accounted for 85 percent of total U.S. agricultural, food and fishery product exports to China. We derive export projections assuming total commitments for Agriculture in the Expanding Trade Chapter of the agreement (\$40 billion per year, on average) and no change in the category export shares from 2017. For example, soybeans (\$12.2 billion) accounted for nearly 59 percent of total U.S. agricultural, food and fishery product exports to China in 2017. At this percent, soybean exports to China would be, on average, \$23.5 billion each year under the Phase One Agreement (Projection, **Table 1**). To put this in context, this would exceed U.S. soybean exports to all countries in 2017 and would represent a 194 percent increase when compared to exports to China in 2019. This would also be more than half of all soybeans imported by China before the trade dispute (UN Comtrade, 2020). From 2013 to 2019, Brazil, Argentina, Paraguay and Uruguay

together were responsible for 54 percent to 62 percent of global soybean exports (USDA-FAS, 2020). Over the same period, the U.S. share of global soybean exports ranged from 32 percent to 40 percent. Overall, the four South American countries and the U.S. controlled more than 90 percent of all global soybean exports, with China being the primary destination (around 60 percent of global soybean trade). China's total imports of soybeans for the 2020 marketing year are currently projected at 3.2 billion bushels or \$30.7 billion (assuming an average price of \$9.50/bu) (USDA-OCE, 2020; March 2020, USDA-World Agricultural Supply and Demand Estimates report). To achieve \$23.5 billion in soybean export sales to China, the U.S. would need to capture 77 percent of the Chinese import market, pushing out a substantial amount of South American soybeans. Displaced South American soybeans would increase available supplies to other importing countries.

Other noted increases (relative to 2019) include cotton at 166 percent (\$707 million to \$1.9 billion); hides and skins at 320 percent (\$400 million to \$1.7 billion); sorghum at 736 percent (\$191 million to \$1.6 billion); and wheat at 1,125 percent (\$56 million to \$680 million).

There is no evidence to suggest that China will allocate their committed purchases in the same proportion as 2017 trade, and it may not be possible in many circumstances. However, this analysis shows how substantial the required increase in purchases could be and why concerns have been raised about China satisfying its commitments. A limitation of simply assuming 2017 export shares by category is that we do not account for other factors that could affect U.S. exports to China in 2020 and 2021. For instance, the Chinese government recently lifted a ban on U.S. poultry in 2019. Consequently, U.S. poultry exports to China in 2017 may not be an adequate representation of U.S. poultry exports under the agreement. In 2017, U.S. poultry exports to China was only \$36 million but was \$300-\$400 million prior to the ban in 2015 and has been as high as \$700 million in the previous decade. The same could be said of distillers grain exports to China, valued at only \$62 million in 2017 but exceeded \$1.5 billion in 2015 (GATS, 2020). Pork is the only exception in our analysis since exports in 2019 were over three times exports in 2017. Given the reduction in China's swine herd due to African swine fever, it is likely that U.S. pork exports to China in 2020 and 2021 could exceed 2019 but could limit China's ability to fulfill the implied increase in soybean and other feed imports.

Concerns about China satisfying its purchasing commitments may be why commodity markets did not respond positively (increased futures prices). The signing of the Phase One Agreement did not positively affect futures prices for many commodities (**Table 2**). For example, on the day of the signing, the nearby soybean futures contract dropped 13 ½ cents (1.4 percent), from \$9.42 to \$9.28 ¾. Two weeks later, on January 29<sup>t</sup>, soybean futures closed at \$8.93, down almost 50 cents (5.2

percent) compared to the opening price the day of the signing. It is important to note that market reaction to the Phase One Agreement did not happen in a vacuum, so caution should be taken when tying price changes to a single event. Other factors such as record Brazilian soybean production, the spread of African swine fever, and the initial onset of the COVID-19 pandemic were influencing markets over the time period presented in **Table 2**. However, a signing of this importance to agricultural trade should have had a positive effect on agricultural commodity markets.

**Table 2. CBOT Nearby Futures Prices for Select Commodities on the Day of the Signing of the Phase One Agreement and Two Weeks Later**

	<u>March Futures Contract Price CBOT</u>				
	Open January 15, 2020	Close January 15, 2020	Daily Change	Close January 29, 2020	2-Week Change
Soybean	\$9.42	\$9.29	-1.4%	\$8.93	-5.2%
Cotton	71.38	70.32	-1.5%	70.06	-1.8%
Corn	\$3.89	\$3.88	-0.3%	\$3.84	-1.2%
Wheat	\$5.69	\$5.73	0.7%	\$5.62	-1.2%

Data Source: Barchart, 2020.

## Discussion and Implications

The Phase One Trade Agreement could benefit U.S. agriculture because it further opens the largest market for agricultural commodities and products. However, increasing the U.S. share of China's imports may or may not provide substantial price increases for U.S. agricultural producers in 2020 and 2021. It is important to consider potential purchases by China in a global context. Purchases of U.S. products have the potential to divert commodities and products from competing countries, such as Brazil. Thus, the Phase One Trade Agreement does not necessarily represent an increase in total global demand; it may just reroute trade between countries. There could be global demand changes if China implements/expands its commodity stockpiling program. However, building stocks can create short-term demand at the expense of long-term demand for many bulk commodities.

China has 1.4 billion people (18.1 percent of the global population), so their demand for agricultural commodities and products is substantial. Additionally, global stocks of major grains and oilseeds are near all-time highs. For example, USDA projects 2020 global (U.S.) corn, soybean, wheat and cotton stocks at 11.69 billion bushels (1.892 billion bushels), 3.63 billion bushels (0.425 billion bushels), 10.58 billion bushels (0.94 billion bushels) and 82.1 million bales (5.1 million bales) (USDA-FAS, 2020). Although China will not likely purchase all of the projected stocks of corn, soybeans,

wheat and cotton in the U.S., the large availability of U.S. and global stocks and China's history of stockpiling commodities suggest that China may be able to satisfy a significant share of the agreement's agricultural commitment with bulk commodity purchases from the U.S. However, this will likely displace Chinese purchases from other exporting countries, thus keeping global supplies high and prices low.

What are the implications of the Phase One Trade Agreement for Tennessee? According to the USDA (GATS, 2020), Tennessee ranks high among states that export cotton to China (fourth based on 2017 export data). Tennessee cotton exports to China were \$77.5 million in 2017. Under the Phase One Trade Agreement, this could increase to \$149 million, assuming the percentages from this report. The \$149 million would be an increase of over 370 percent when compared to the 2019 value. Tennessee soybean exports are more difficult to examine since the majority of state exports are consolidated with shipments from other states and attributed to the final state of exit. The Economic Research Service, USDA, estimated Tennessee's soybean exports at \$396 million in 2017 (State Export Data, 2020). Assuming that half of these exports go to China and percentages based on the Phase One Trade Agreement, Tennessee soybean exports could increase to almost \$580 million. It must be noted that these are projections based on past exports and the total commitment in the agreement. No information has been released about committed purchases of specific commodities.

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 global trade is back to normal.

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