

US-China Trade War: Implications, Impacts and Asia's Regional Cooperation

Masahiro KAWAI

**Economic Research Institute for Northeast Asia
and
Graduate School of Public Policy, U. of Tokyo**

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1. Introduction

- The “America first” policy of US President Trump has been damaging the liberal, rules-based international economic system
- Intensification of US-China trade war is posing significant challenges for China and other Asian countries that have been integrated into Asian supply chains
- The bilateral trade war has been forcing China to further shift its trade and investment relations away from the US towards BRI countries
- The role of regional cooperation is becoming increasingly important to respond to the US's unilateral approach and US-China trade war

The paper addresses several questions

- What is the impact of US-China trade war on trade (globally and for the US, China, Japan and other Asian countries) as well as growth prospects?
- What are the implications of the trade war for global and regional supply chains and Asia's trade and investment?
- What policy stance has Japan taken?
- What needs to be done to cope with the US-China trade war and help restore a rules-based international trade system?

2. US President Trump's unilateral "America-first" trade policy

President Trump views trade deficits as bad for the US. He wants to reduce deficits by forcing its trading partners to change their trade policies

- He imposed higher tariffs on steel and aluminum for "security" reasons based on its domestic trade act (Section 232 of the Trade Expansion Act of 1962). He even threatens to impose higher tariffs on automobiles, a challenge particularly for Japan and Germany
- He renegotiated the US-Korea FTA with ROK and NAFTA with Mexico and Canada and successfully revised them in the US's favor
- He persuaded the EU and Japan to negotiate trade agreements in a way to benefit US industries under the threat of automobile tariffs

US-China trade war

- President Trump has raised tariffs on imports from China in three rounds due to China's "unfair trade practices" based on another domestic trade act (Section 301 of the US Trade Act of 1974)
- As China retaliated the US by raising tariffs on its imports from the US and the US further retaliated China, the two countries went for a trade war
- The Trump Administration tightened its regulation on inward foreign investment, targeting China's investment in the US to deter technology outflows from the US
- The Administration has banned five high-tech companies, including Huawei Technology, from the US procurement market (since Aug. 13, 2019)
- The US government has decided to strictly limit US firms' exports to Huawei Technology
- The Administration has announced to introduce the fourth round of tariff increases starting on September 1
- The US Treasury has labeled China a "currency manipulator"



Factors behind the US's tough approach to China

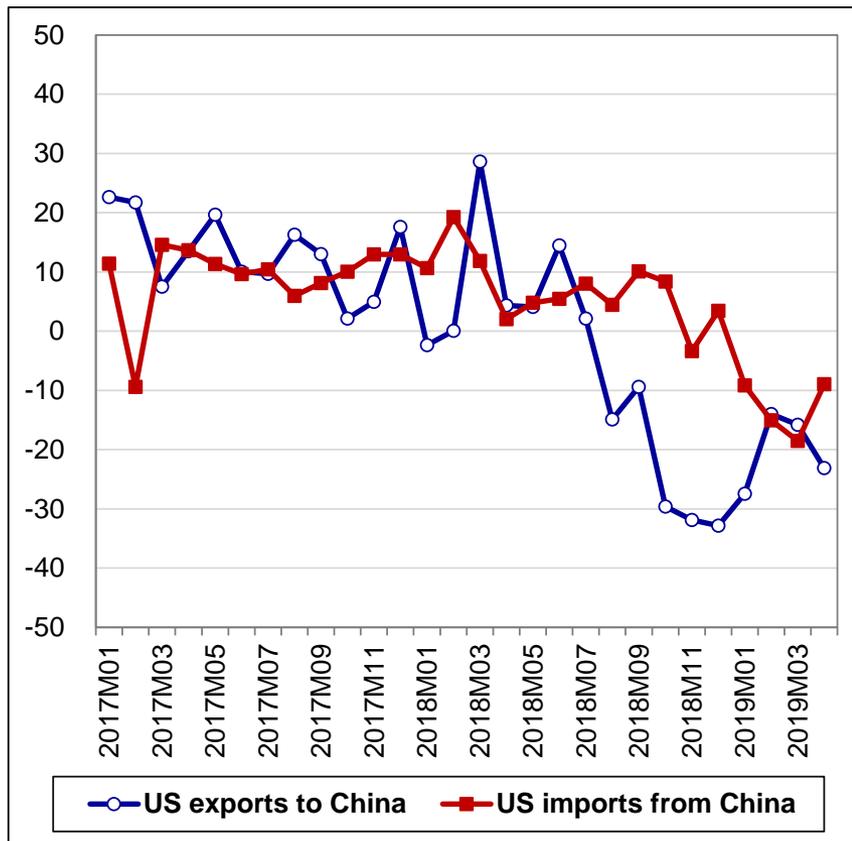
- The US runs the largest trade deficits vis-à-vis China, and Mr. Trump wants China to take action to reduce the deficits
- The US argues that China has adopted "unfair trade practices", such as forced technology transfers, IPR thefts, massive industrial subsidies for “Made in China 2025,” and trade-distortions created by state-owned enterprises (SOEs), and that China should stop them
- China is rapidly catching up with the US in the economic and technology arenas, which threatens the US supremacy in these areas as well as its national security
- The US may wish to decouple the Chinese economy from the US economy and global supply chains. This is particularly evident with its approach to Huawei Technology and the telecommunications industry (5G)

3. Impact of US-China trade war

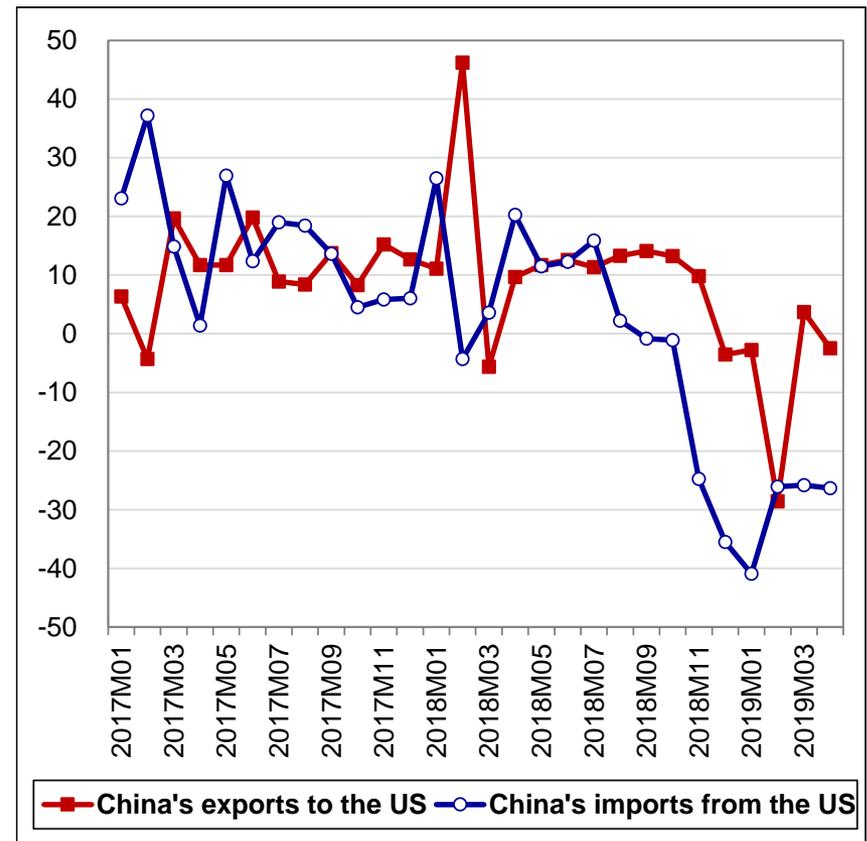
- The US-China trade war has likely induced the US's and China's trade as well as global trade to decline or slow down
- It did not help improve US trade deficits vis-à-vis China or the overall US trade deficit in 2018, but has finally started to improve the US bilateral trade balance vis-à-vis China in 2019
- This is due to the improvement of the US trade balance in capital goods (except automotive) and in consumer goods (except food and automotive), for which the US traditionally had large deficits against China

Growth rate of US-China bilateral trade (Jan. 2017 – Apr. 2019)

US (% , y-o-y)



China (% , y-o-y)



Source: Compiled by author from IMF, Direction of Trade Statistics

US trade balance by goods and partner (2017-18)

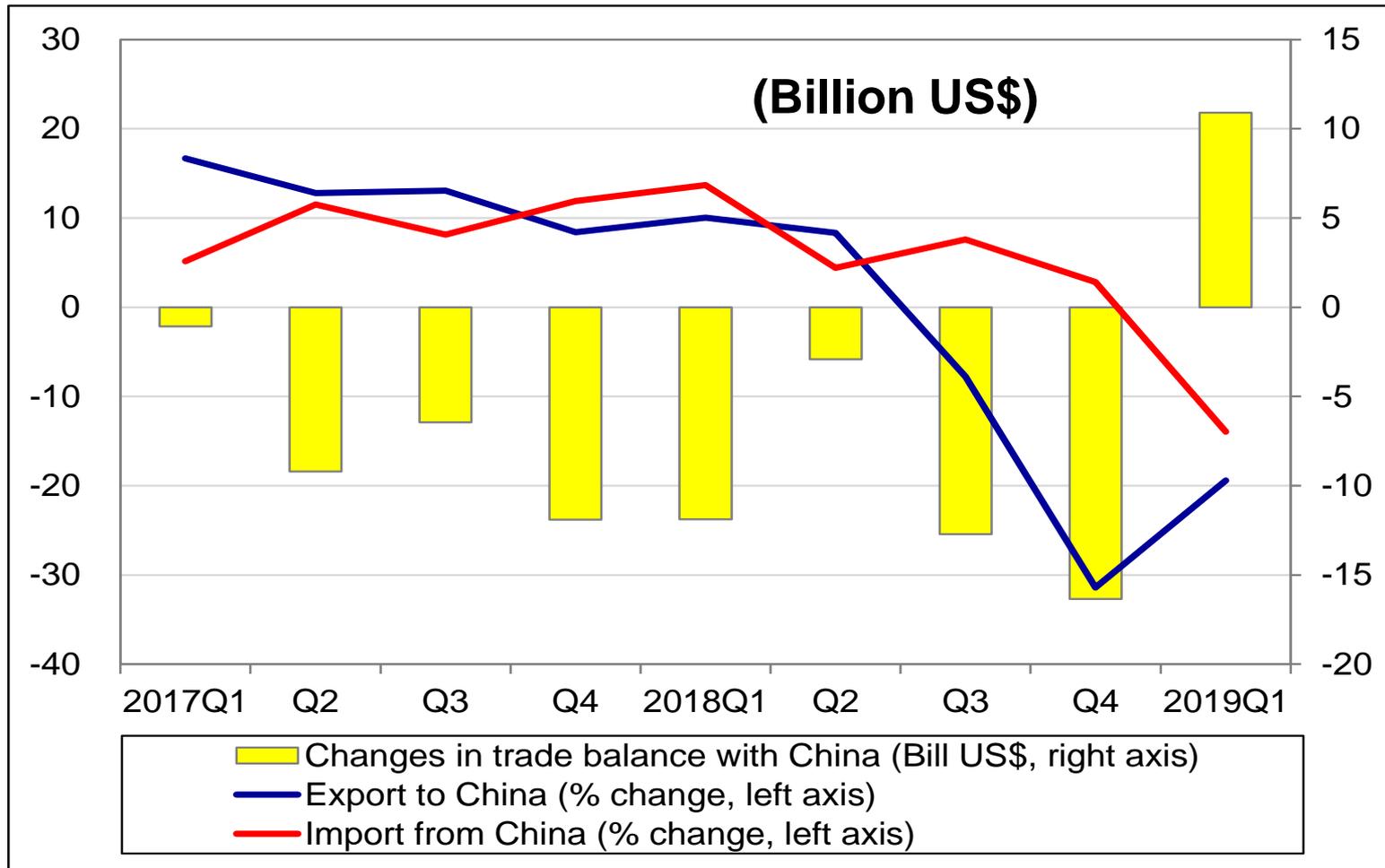
2017	WLD	CHN	EU	MEX	JPN	DEU	CAN	KOR
Total net exports	-807	-376	-153	-76	-70	-64	-23	-23
Foods, feeds, beverages	-6	12	-15	-10	12	0	-1	6
Industrial supplies, mats	-55	-6	1	55	4	-8	-68	3
Capital goods (ex. autos)	-110	-143	-16	-11	-29	-19	37	-2
Autos, parts, engines	-202	-6	-45	-83	-53	-22	-1	-21
Consumer goods (ex f&a)	-407	-229	-65	-24	-1	-12	21	-8
Other goods	-27	-4	-14	-4	-1	-4	-10	-0

2018	WLD	CHN	EU	MEX	JPN	DEU	CAN	KOR
Total net exports	-891	-419	-170	-87	-69	-69	-26	-18
Foods, feeds, beverages	-15	2	-15	-11	12	0	-2	7
Industrial supplies, mats	-52	-16	4	60	7	-9	-76	9
Capital goods (ex. autos)	-134	-148	-18	-17	-31	-21	39	-5
Autos, parts, engines	-215	-12	-45	-92	-54	-20	1	-20
Consumer goods (ex f&a)	-445	-241	-80	-24	-2	-14	20	-8
Other goods	-31	-5	-16	-4	-1	-4	-7	0

Source: Compiled by author from Bureau of Economic Analysis, US Department of Commerce

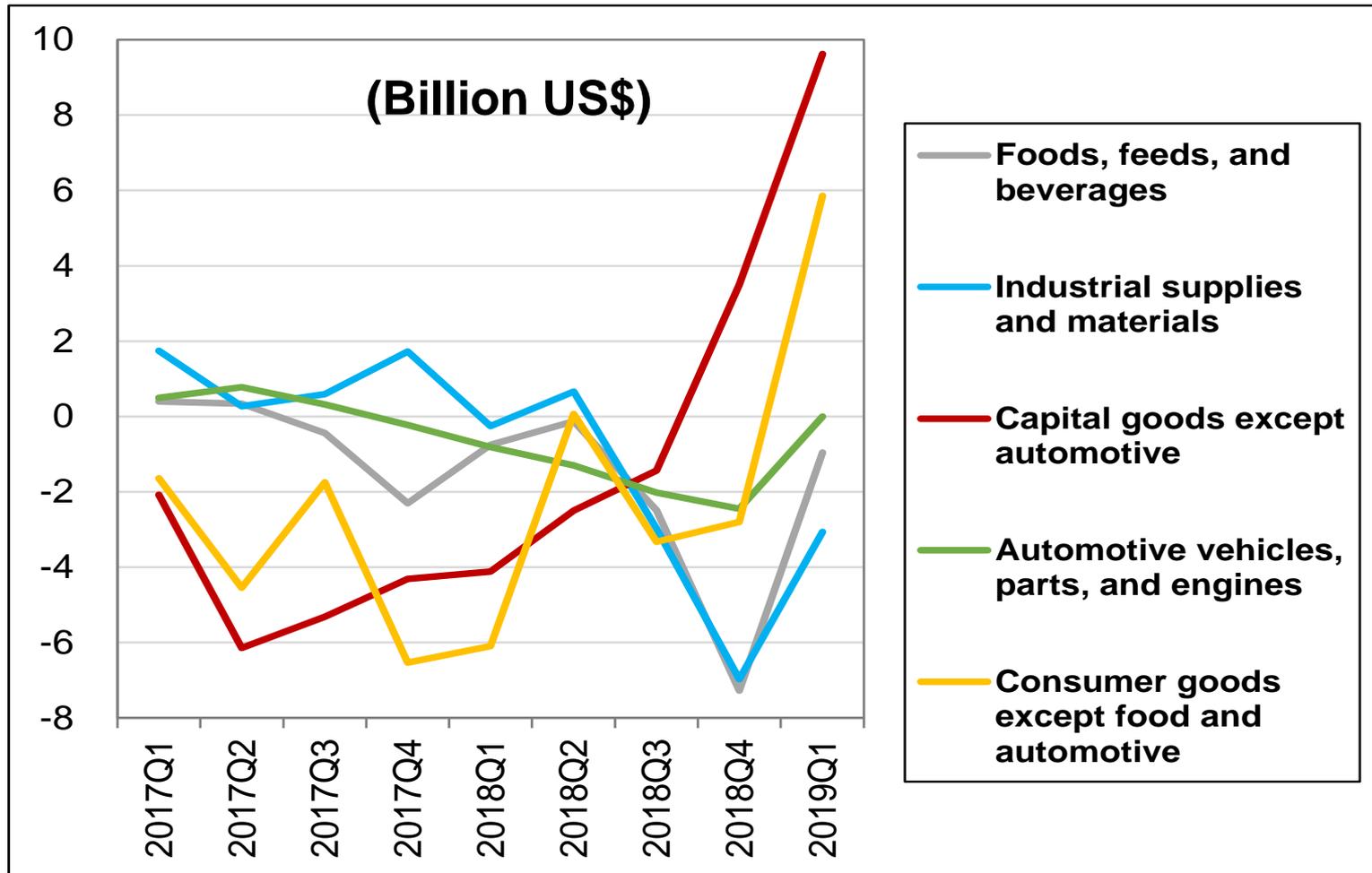
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Changes in the US trade balance vs. China (y-o-y, 2017Q1 – 2019Q1)



Source: Compiled by author from Bureau of Economic Analysis, US Department of Commerce
<https://www.bea.gov/iTable/iTable.cfm?reqid=62&step=1&isuri=1#reqid=62&step=2&isuri=1&6210=1>

Changes in the US trade balance vs. China by goods (2017Q1 - 2019Q1)



Source: Compiled by author from Bureau of Economic Analysis, US Department of Commerce

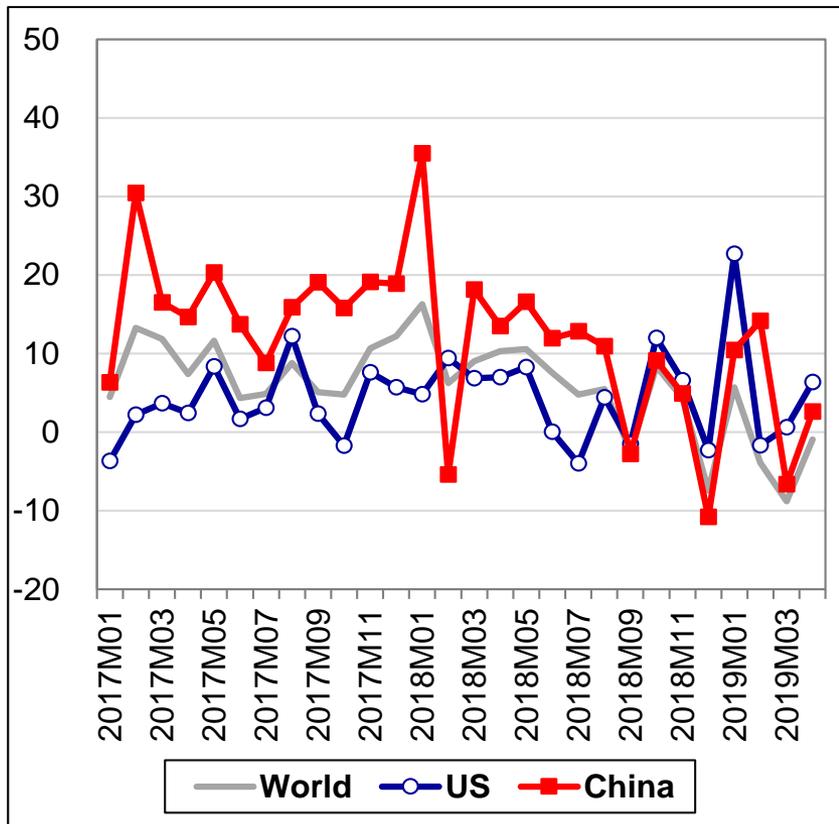
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Impact on Asian economies

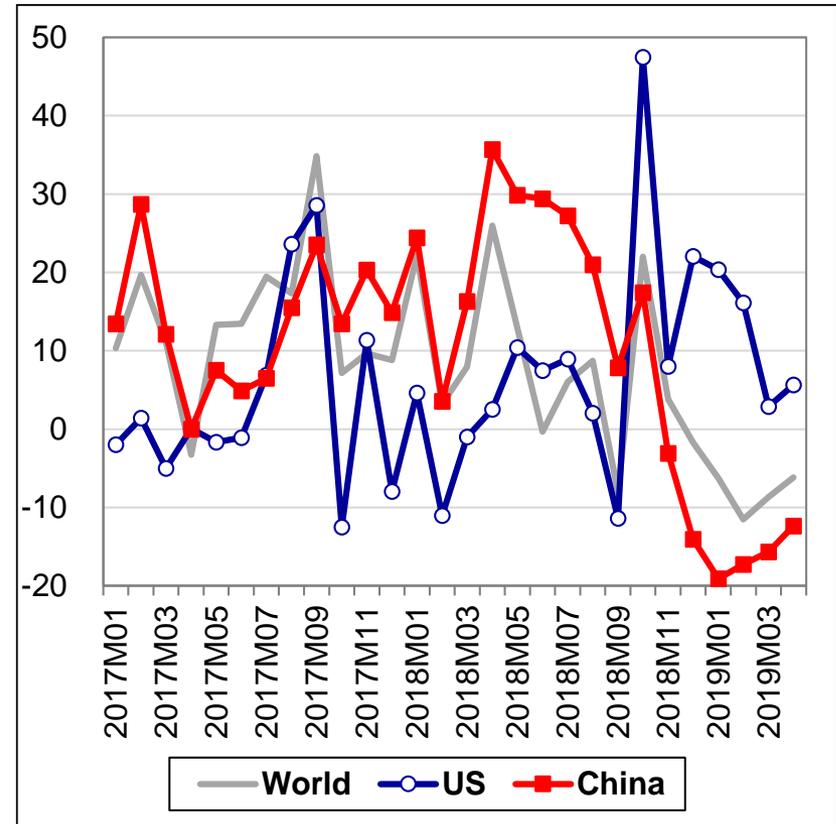
- Several emerging economies in Asia (notably Vietnam) have partly replaced the role of China as exporter to the US
- As a result, China's role of the "world factory" has been diminishing, and the longer the trade war persists the more likely this will be a long-term trend
- Even though emerging economies other than China may have increased exports and trade surpluses to the US, this may not be sustained as the US may apply pressure on them to reduce their bilateral trade surpluses

Growth rate of change in Japan's and ROK's trade with the US and China (Jan. 2017 – Apr. 2019)

Japan (% , y-o-y)



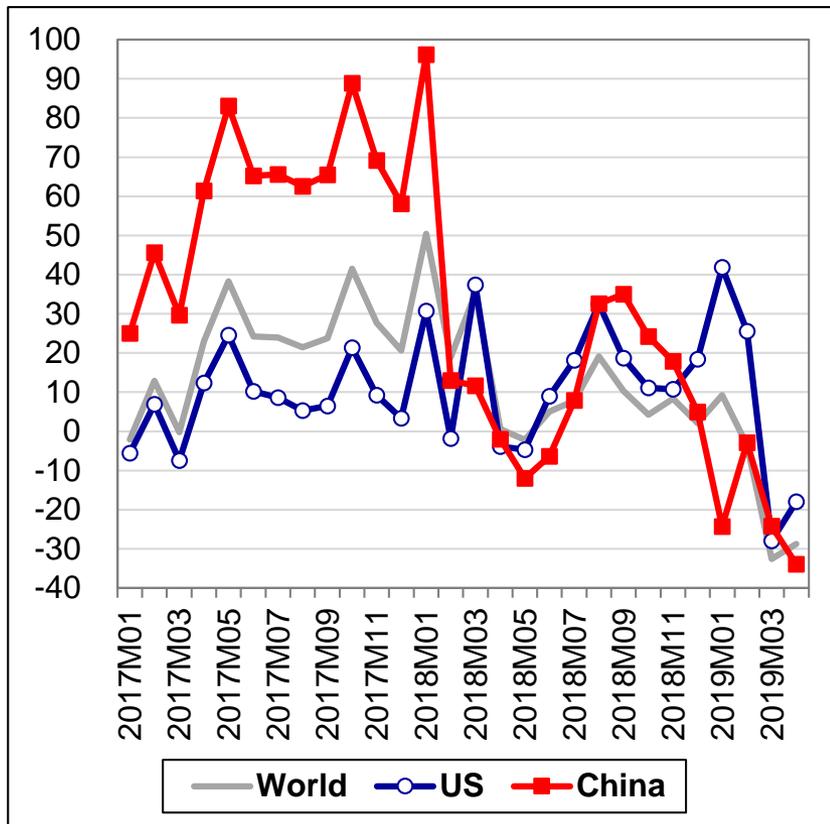
ROK (% , y-o-y)



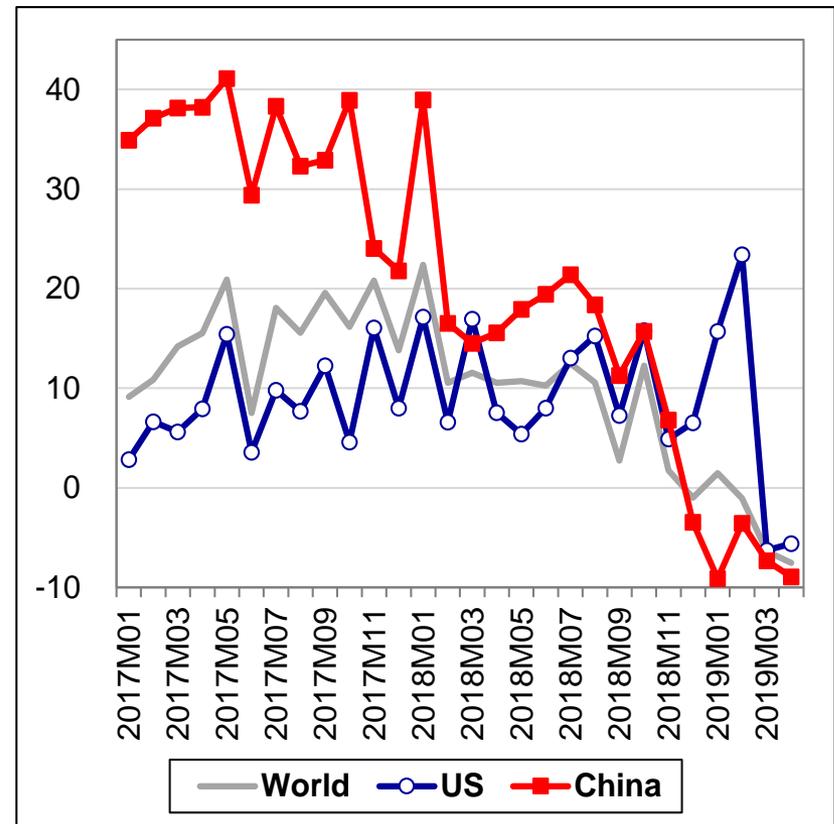
Source: Compiled by author from IMF, *Direction of Trade Statistics*

Growth rate of change in emerging Asia's trade with the US and China (Jan. 2017 – Apr. 2019)

Vietnam (% , y-o-y)



Emerging Asia (% , y-o-y)



Note: Emerging Asia excludes China

Source: Compiled by author from IMF, *Direction of Trade Statistics*

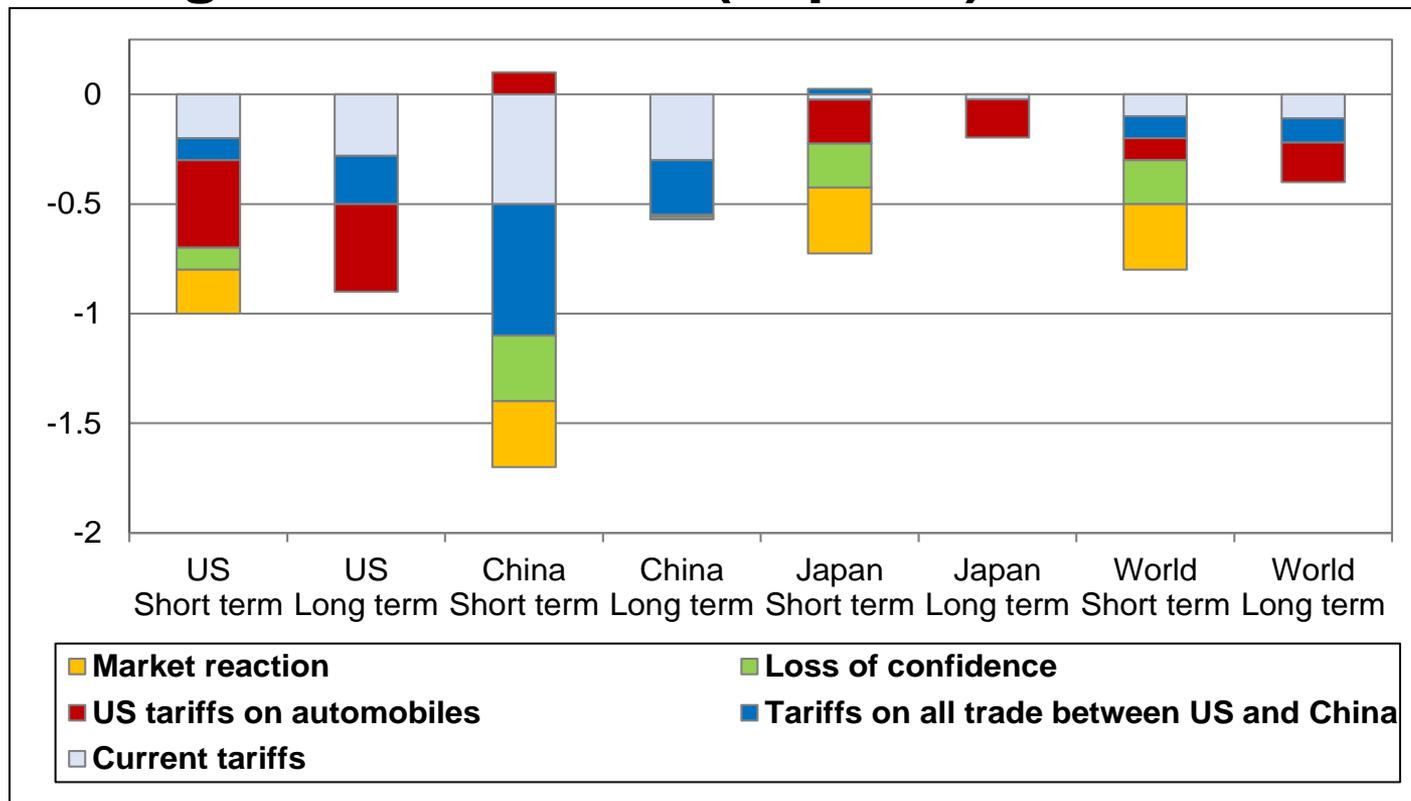
4. Implications of US-China trade war

Growth slowdown

- Economic impacts of US-China trade war have been analyzed by IMF and OECD among others
- They show that negative impacts on GDP are larger for China (about 1.5% point decline) than for the US (about 1% point decline)
- World GDP will likely decline by about 0.5% point and world trade by close to 2% points

Economic impact of US-China trade war and auto tariff increases (analysis by IMF)

Change from baseline (% point)

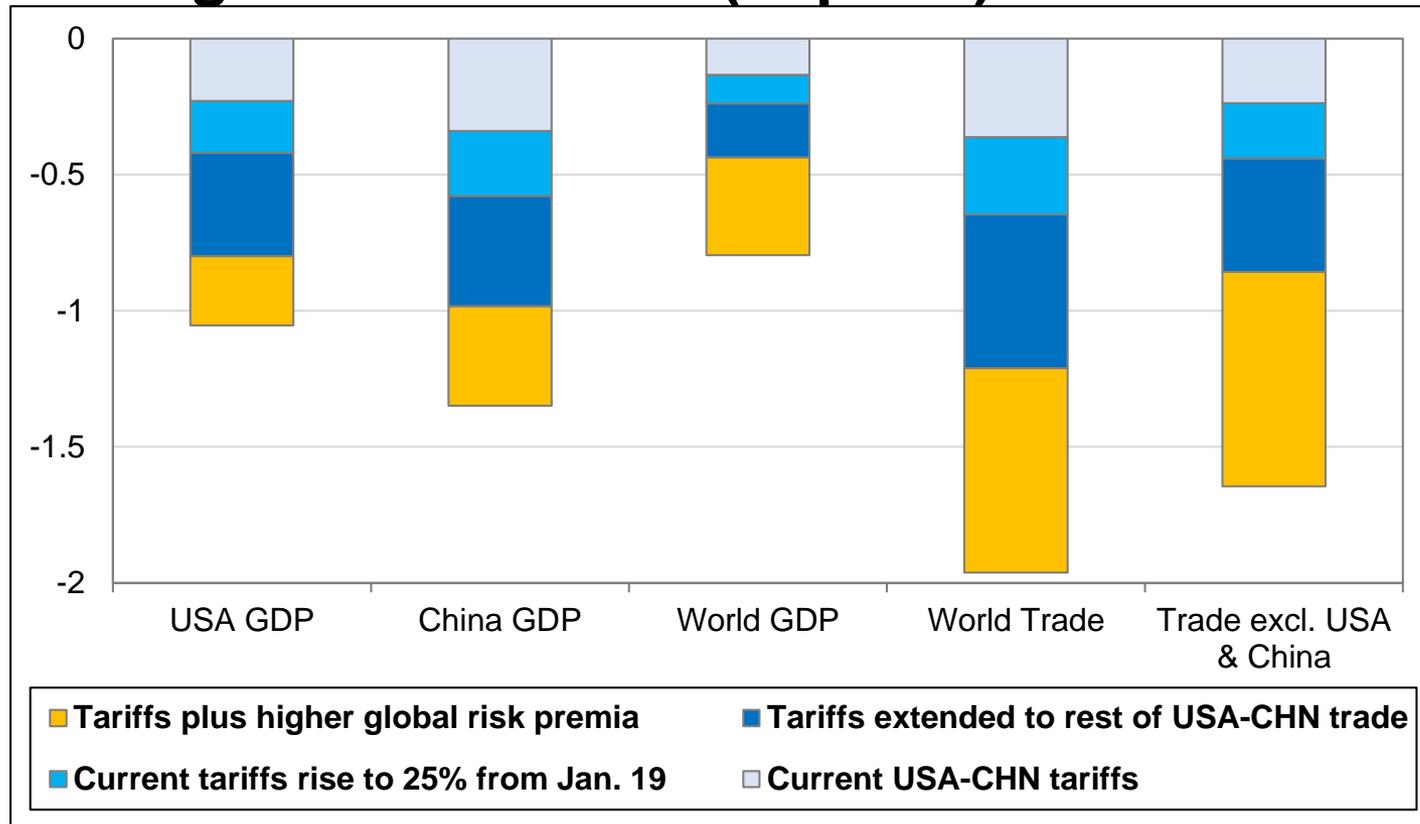


Note: Short-term effects are for 2020 (2019 for China), and long-term effects are for 2014 and beyond.

Source: Compiled by author from IMF, *World Economic Outlook*, October 2018.

Economic impact of US-China trade war (analysis by OECD)

Change from baseline (% point)



Note: Current US-CHN tariffs = Tariffs imposed during Jul.-Sep. 2018; Current tariffs rise to 25% from Jan. 19 = Raising tariffs on the 3rd round from 10% to 25% in Jan. 2019; Tariffs extended to rest of USA-CHN trade = Tariffs of 25% imposed on all remaining trade in Jul. 2019; Tariffs plus higher global risk premia = Global rise of 50 basis points in investment risk premia for 3 years.
 Source: Compiled by author from OECD, *Economic Outlook*, Volume 2018, Issue 2 (Nov. 2018).

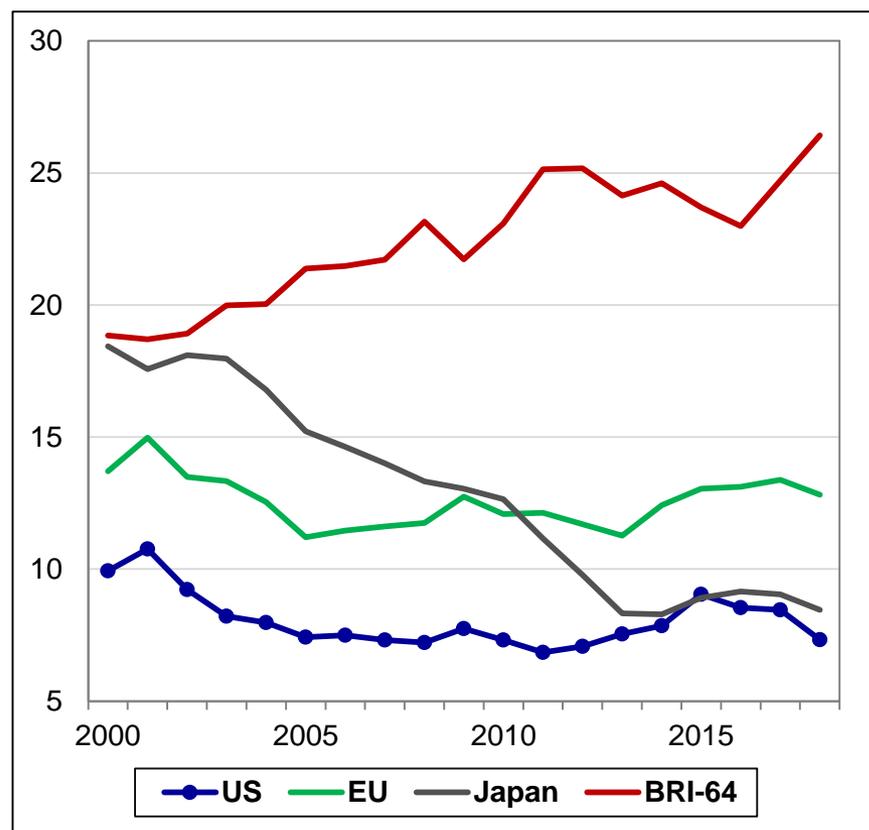
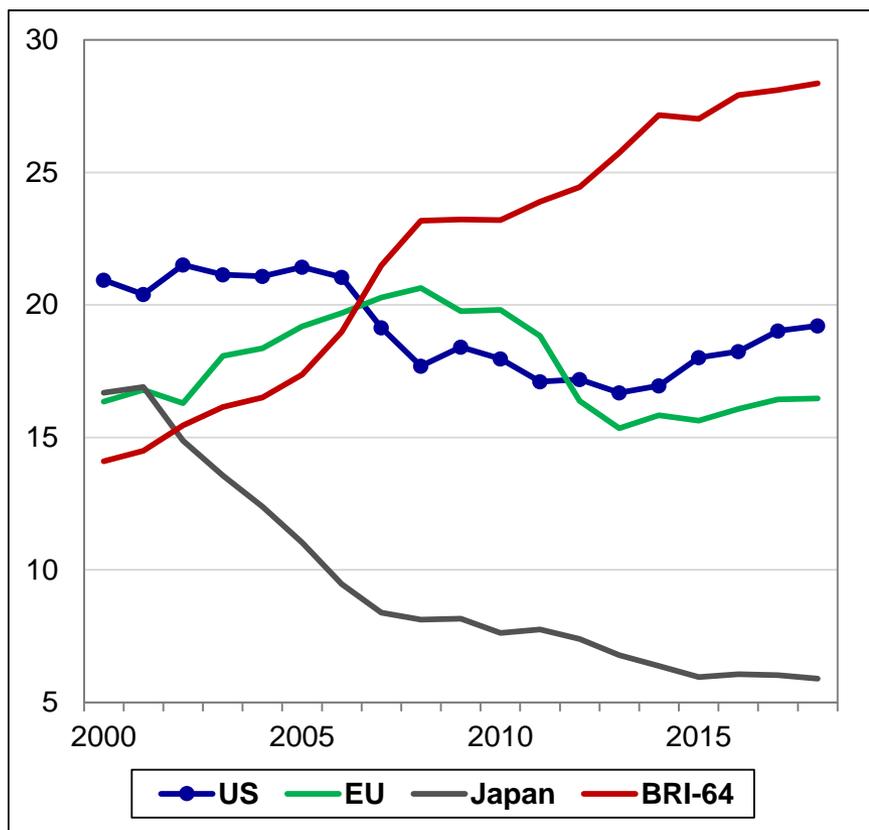
Implications for Asia

- Disruption of global and regional supply chains by forcing a move of final-stage production processes away from China to its neighboring emerging economies in Asia, such as Vietnam
 - ▣ This will likely end China's role as the "global factory" and accelerate the country's transformation into a high-value-added industrial and services-oriented economy
- Expansion of China's trade and investment with Belt and Road Initiative (BRI) countries, and its economic relations with these countries
- Incentives for Asian economies to increase regional trade and investment and re-establish new supply chains
 - ▣ This will require Asian economic cooperation to increase demand and create an Asia-wide free trade zone

China's trade share by partner (2000 – 2018)

China's export (% share)

China's import (% share)

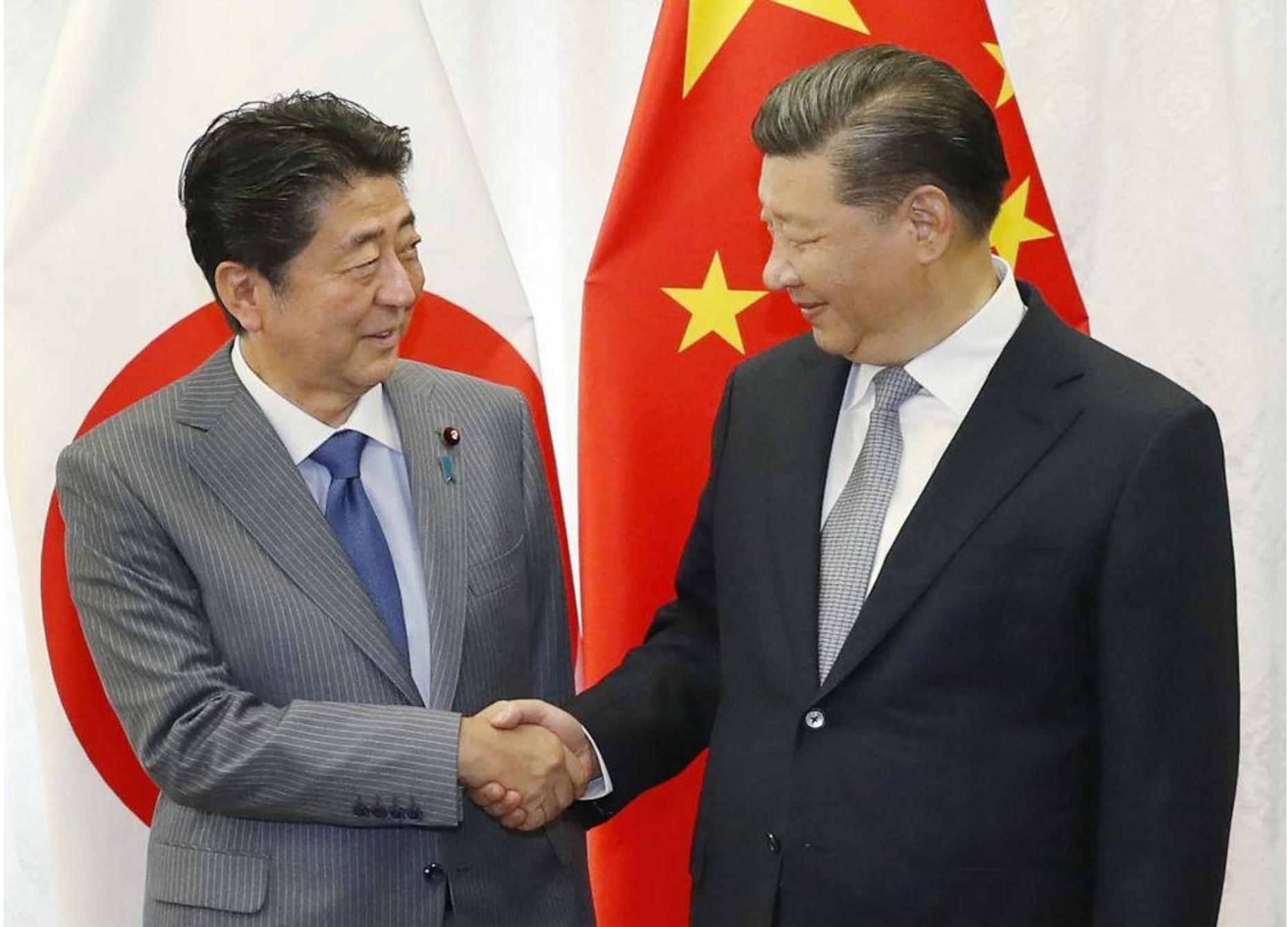


Source: Compiled by author from IMF, *Direction of Trade Statistics*

5. Japan's approach

- Japan is an active promoter of globalization and multilateralism because the country has benefited enormously from the rules-based liberal international order
- Despite being one of the closest US allies in terms of security, Japan has been critical of the US departure from rules-based multilateralism
- It has taken leadership in negotiating, concluding and implementing CPTPP (or TPP-11)
- It has worked closely with the EU to negotiate, conclude and implement an Economic Partnership Agreement (Japan-EU EPA).
- At the same time, it shares the same concerns as the US's and EU's on China's trade practices (IPR protection, state subsidies for industrial policy, SOEs)
- Japan is now negotiating with the US on a bilateral trade deal (under the threat of an automobile tariff hike)





Japan's balancing act

- Japan relies on the US for national security but avoids a confrontational approach to China
- Japan has been balancing risks and opportunities posed by the rapid rise of China by working with China in several economic cooperation areas
- Japan has been actively negotiating the Regional Comprehensive Economic Partnership (RCEP) with 15 other Asian economies including China and India
- Japan has agreed with China to have their firms collaborate with each other on joint projects in third countries, which is understood to help China's BRI
 - ▣ Japan has argued that four principles be observed for such joint projects, i.e., economic feasibility, openness, transparency, and debt sustainability of borrowing countries
 - ▣ Such Japanese engagement is expected to improve the “quality” of BRI projects and reduce the concern that the BRI is an instrument of China's “debt diplomacy”

6. Policy recommendations

Actions to be taken by the US and China

1. The US must return to multilateralism & global cooperation
 - The US should return to multilateralism and global cooperation
 - If the US wishes to reduce its trade deficits, it should attempt to improve the income-spending (or savings-investment) balance
 - The US should invest more in social safety nets to ensure that losers from globalization and technological progress be compensated
2. China must transform itself into a true "market economy"
 - Redefine the role of state in a way consistent with a market economy
 - Substantially open up the domestic markets for goods and services and foreign investment
 - Substantially reduce state subsidies for high-tech industries, particularly "Made in China 2025" programs
 - Aggressively reform SOEs and state-owned commercial banks
3. The US and China must manage their bilateral conflict
 - Establish a permanent bilateral "economic structural consultation" process, much like the US-Japan "structural impediments initiative", to identify and address structural issues in the respective economies

WTO reform

4. Members must substantially overhaul the WTO to regain its central role as the primary promoter and arbiter of 21st century international trade and trade-related rules

- Recovery of a fully operational Appellate Body for dispute settlement
- Enforcement of stricter compliance with notification obligations for policy transparency
- Stronger protection of IPR
- Greater disciplines on industrial subsidies and SOEs within the WTO framework
- Introduction of an objective definition of a “developing country” which can enjoy "special and differentiated treatment" and a graduation policy for developing countries

Asia's regional economic cooperation

5. Asian economies are encouraged to intensify their regional economic cooperation to cope with the negative impact of US-China trade war
- Promotion of intra-regional trade and investment through the completion of RCEP negotiations and the expansion of TPP-11 membership
 - Greater support for much-needed infrastructure investment, including in the CAREC region
 - Stronger economic ties with countries outside Asia, such as those in Europe, Latin America and Africa
 - Greater financial cooperation to promote financial stability against the background that external shocks (Trump shocks, non-deal Brexit, geopolitical risks) could destabilize emerging Asia's financial markets

Progress on RCEP (i.e., ASEAN+6 FTA)

RCEP negotiations among 16 countries (ASEAN+6)

- Agreements reached on 10 areas out of 19 areas:
 - SMEs, economic and technical cooperation, customs procedures and trade facilitation, government procurement, institutional provisions, SPS measures, and Standards, Technical Regulations and Conformity Assessment Procedures [STRACAP], financial services, telecommunications services, professional services
- Difficult areas
 - Trade in goods (market access)
 - Intellectual property rights
 - E-commerce
- India reluctant to accept liberal market opening due to the fear of being exposed to highly competitive Chinese products
 - India could be treated like CLMV in the sense of being given a longer time to achieve trade and investment liberalization and adopt high quality trade-investment rules

Significance of TPP-11

- TPP-11 can be a model for the 21st century trade and investment rules in the Asia-Pacific region, even though more than 20 provisions and rules (mostly related to IPR, ISDS) are suspended until the US returns
- The US can come back to TPP without new negotiations and all the suspended provisions and rules would be restored
- There are economic benefits to TPP-11, though smaller than TPP due to the absence of the US
- TPP-11 countries may acquire a certain degree of negotiating power against the US if the US proposes bilateral FTAs
- The challenge is its membership expansion to include: Thailand, Taiwan, Colombia, UK (after Brexit), Philippines, Indonesia, ROK, and possibly China

Multilateral infrastructure financing cooperation in Northeast & Central Asia

Membership of MDBs and GTI in NEA & CA

	China	Japan	ROK	DPRK	Mongolia	Russia	Other CAREC members
World Bank	✓	✓	✓	--	✓	✓	✓
ADB	✓	✓	✓	--	✓	--	✓
EBRD	✓	✓	✓	--	✓	✓	(✓) ⁽¹⁾
AIIB	✓	--	✓	--	✓	✓	(✓) ⁽¹⁾
GTI⁽²⁾	✓	✓	✓	---	✓	✓	--
CAREC	✓	--	--	--	✓	--	✓

ADB = Asian Development Bank; AIIB = Asian Infrastructure Investment Bank; CAREC = Central Asia Regional Economic Cooperation; EBRD = European Bank for Reconstruction and Development; GTI = Greater Tumen Initiative

Note: (1) Among CAREC members, Afghanistan and Pakistan are not members of EBRD, and Turkmenistan is not a member of AIIB.

(2) Though GTI is not a financing cooperation arrangement, it hosts the Northeast Asia EXIM Banks Association, including the EXIM Bank of China, Development Bank of Mongolia, EXIM Bank of Korea, and Bank for Development and Foreign Economic Affairs of Russia

Cooperation in financial stability

- China, Japan and ROK can support vulnerable Asian economies through IMF, CMIM and bilateral efforts
- They have been working together on CMIM and AMRO within ASEAN+3 financial cooperation
- Outside the ASEAN+3 framework, they are supporting Mongolia in its IMF program with a total package of \$5.5 billion
 - ▣ IMF provides \$440 million
 - ▣ World Bank, ADB, Japan and ROK provide up to \$3 billion in budget and project support for Mongolia
 - ▣ People's Bank of China has extended its CNY15 billion swap line with the Bank of Mongolia for at least another three years to enable Mongolia to save foreign exchange reserves for trade settlement

7. Conclusion

- Global trading system faces a crisis today due to the US's departure from multilateralism & global cooperation, and its use of unilateral action
- US-China trade war is disrupting global & regional supply chains, forcing China to accelerate a shift towards BRI countries, and demanding Asian regional economic cooperation
- Reinvigorating global rules and norms will require a US return to multilateralism and China's further domestic economic reform and opening, coupled with an overhaul of the WTO by its members
- Asian countries are encouraged to intensify their regional cooperation to cope with the negative impact of the US-China trade war in the areas of trade & investment, infrastructure, and finance

Thank you

For more information:

Masahiro KAWAI, PhD

**Representative Director and Director-General,
Economic Research Institute for Northeast Asia
and**

**Professor Emeritus and Specially Appointed
Professor, Graduate School of Public Policy,
University of Tokyo**

kawai.masahiro.21@erina.or.jp

mkawai@pp.u-tokyo.ac.jp