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The US–China trade deal and its impact on China's key trading partners

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- In manufacturing, Germany is likely to experience the greatest trade diversion effects in a number of industries such as vehicles (-1.28 bn USD), aircraft (-1.59 bn USD) and industrial machinery (-0.72 bn USD).
- Developing countries will also be hit if China redirects its imports towards US suppliers. Brazil could experience a reduction of 4.95 bn USD in soybeans exports to China in 2021 as a result of the ETA.

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OVERVIEW/ ÜBERBLICK

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Keywords: US–China trade relations, trade diversion, multilateralism

- Das Wirtschafts- und Handelsabkommen (ETA) zwischen den USA und China trat am 14. Februar 2020 in Kraft und eröffnete eine neue Phase in der schon langandauenden handels- und geopolitischen Rivalität zwischen beiden Ländern.
- Das ETA enthält spezifische Ziele für die Erhöhung der chinesischen Importe von US-Gütern und -Dienstleistungen in Höhe von 200 Mrd. US-Dollar für die Jahre 2020 und 2021. Diese Abnahmeverpflichtungen können erhebliche Handelsumlenkungseffekte und Marktanteilsverschiebungen für Chinas wichtigste Handelspartner zur Folge haben.
- Im Verarbeitenden Gewerbe dürfte Deutschland von den größten Handelsumlenkungseffekten in einer Reihe von Branchen wie Fahrzeuge (-1,28 Mrd. US-Dollar), Flugzeuge (-1,59 Mrd. US-Dollar) und Industriemaschinen (-0,72 Mrd. US-Dollar) betroffen sein.
- Ebenso werden Entwicklungsländer die Auswirkungen des ETA spüren, wenn China seine Importe auf US-Lieferanten umleitet. Alleine Brasilien könnte im Jahr 2021 infolge des ETA einen Rückgang der Sojabohnenexporte nach China um 4,95 Mrd. US-Dollar zu verkraften haben.

Schlüsselwörter: Beziehungen USA–China, Handelsumlenkung, Multilateralismus

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THE US–CHINA TRADE DEAL AND ITS IMPACT ON CHINA'S KEY TRADING PARTNERS

Sonali Chowdhry*, and Gabriel Felbermayr

1 CHANGING POLICY LANDSCAPE: THE US–CHINA TRADE DEAL ENTERS INTO FORCE

The US–China Economic and Trade Agreement (ETA) entered into force on 14th February 2020. It is a highly unusual agreement in several respects. Most notably, it commits China to purchase certain dollar values of US agrifood, manufacturing goods, energy products and services over 2020 and 2021, with a continuation till 2025 (Table 1). Precisely how these targets will be met—through public procurement, tariff reduction, import subsidies or a combination thereof—was not specified in the agreement. However, a recent announcement by China's Finance Ministry provides some clarity. Punitive tariffs imposed on 1,717 US goods such as soybeans and crude oil in September 2018 were halved by China on 14th February 2020. This is an important policy shift that signals China's commitment towards meeting the purchase targets even as it faces downward risks to its economy and disruptions in supply chains following the Coronavirus outbreak. In lockstep, the US also planned to halve tariffs on some Chinese goods on 14th February.

Table 1:
China's Purchase Commitments under the ETA, 2020–2021

Category	Additional Imports of China from the US, on top of 2017 baseline (bn USD)		
	2020	**2021**	**Two-year total**
Agriculture	12.5	19.5	32
Manufacturing	32.9	44.8	77.7
Energy	18.5	33.9	52.4
Services	12.8	25.1	37.9
Total	76.7	123.3	200

Source: **Text of the US–China ETA.**

Though these are welcome developments, trade policy uncertainty is likely to persist as these tariff reductions may be withdrawn if China's US imports fall below the required levels in 2020, an outcome that will be known only by March 2021 when official US trade statistics

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are released. Moreover, US tariffs under Section 301 will remain in place till a Phase II deal is agreed upon. A newly finalized rule on currencies also adds to the uncertainty as it permits the US Commerce Department to impose countervailing duties against alleged currency manipulators. Given the technical difficulties in determining the true value of a foreign currency and the fact that the Chinese renminbi is still on the US Treasury's currency Monitoring List (US Treasury, 2020), this rule adds to the possibility of trade tensions reescalating in the future.

Which countries would be most affected by the entry into force of this agreement? Table 2 below shows China's goods imports from its top trading partners in 2017, disaggregated by sector. Clearly, China sources some products heavily from these countries such as 20.67 bn USD of crude oil from Russia, 20.83 bn USD worth of industrial machinery from Germany and 20.32 bn USD in oilseeds from Brazil. Since these items are also covered under the ETA, there will likely be substantial reallocation of market shares as China shifts towards US suppliers over the coming years.

Table 2:
Composition of China's goods imports, top trading partners, 2017

Category	China's imports in 2017, bn USD									
	World	AU	BR	DE	JP	KR	RU	US	VN	ZA
AGRICULTURE	120.06	8.65	23.22	1.89	0.56	1.03	1.78	21.33	2.80	0.56
Cereals	6.97	1.38	0.00	0.02	0.00	0.00	0.04	1.56	1.17	0.00
Cotton	2.14	0.35	0.13	0.00	0.00	0.00	0.00	0.98	0.04	0.00
Meat	9.22	1.02	1.79	0.57	0.00	0.00	0.00	0.57	0.00	0.01
Oilseeds	36.58	0.00	20.32	0.00	0.00	0.00	0.14	12.42	0.00	0.00
Other agricultural commodities	57.00	5.62	0.96	1.29	0.44	0.78	0.52	4.55	1.36	0.54
Seafood	8.15	0.28	0.01	0.01	0.11	0.24	1.09	1.25	0.23	0.02
MANUFACTURING	662.48	3.12	1.98	62.23	82.98	98.03	6.20	66.82	25.51	1.17
Aircraft (orders and deliveries)	24.16	0.00	0.42	4.22	0.00	0.00	0.12	13.35	0.00	0.00
Electrical equipment and machinery	124.81	0.33	0.08	12.22	21.39	19.32	0.59	6.26	16.83	0.03
Industrial machinery	143.05	0.23	0.43	20.83	31.03	16.23	1.50	15.03	1.16	0.02
Iron and steel	21.98	0.02	0.60	1.27	5.86	3.52	0.05	0.71	0.03	0.94
Optical and medical instruments	16.51	0.17	0.01	2.34	2.00	0.50	0.01	4.06	0.35	0.00
Other manufactured goods	265.68	1.73	0.43	4.32	15.53	58.22	3.81	12.97	7.14	0.14
Pharmaceutical products	19.81	0.63	0.02	3.15	0.77	0.20	0.00	3.38	0.00	0.03
Vehicles	46.48	0.00	0.00	13.87	6.40	0.05	0.12	11.05	0.00	0.00
ENERGY	190.56	15.22	7.37	0.00	0.02	0.11	22.50	6.99	0.97	0.42
Coal	17.06	8.87	0.00	0.00	0.00	0.00	1.77	0.40	0.01	0.00
Crude oil	147.65	0.53	7.37	0.00	0.00	0.00	20.67	4.09	0.95	0.42
LNG	14.34	5.72	0.00	0.00	0.00	0.00	0.04	0.47	0.00	0.00
Refined prods	11.51	0.11	0.00	0.00	0.02	0.10	0.02	2.03	0.00	0.00
Total	973.10	26.99	32.57	64.12	83.56	99.16	30.48	95.14	29.28	2.15

Source: **CEPII BACI trade data; own calculations.**

2 MAGNITUDE OF TRADE DIVERSION

The agreement has raised widespread concern amongst WTO members who expect significant trade diversion if China redirects its imports towards the US to fulfil purchase commitments. Given the systemic importance of China to the global economy and the international trading system, it is crucial to understand these trade diversion effects. We follow the methodology in Chowdhry and Felbermayr (2020) and calculate the magnitude of bilateral trade diversion for China's major trading partners by comparing two scenarios. We first define a counterfactual scenario for 2021 with no trade war and no ETA, whereby China's imports from a trade partner grow as per a simple gravity equation and depend on GDP forecasts (IMF, 2019). This counterfactual scenario is compared with a second scenario in which China's imports from the US in 2021 increase as per the ETA, with other countries bearing an equal burden of adjustment from the trade diversion. This analysis presumes that China's propensity to import does not change between the two scenarios, i.e., China's total imports from the world remain the same in 2021 with or without the ETA.

Table 3 below shows the trade diversion from the ETA. Each of the traditional US allies such as Australia, Germany, Japan and Korea are affected in key sectors. Japan would experience a reduction of 1.08 bn USD in industrial machinery and 0.60 bn in vehicles. This can undermine the recently signed US-Japan Phase I Deal, also highly asymmetric in its concessions, which entered into force on 1st January 2020 and allowed US exporters greater access to Japan's relatively protected agricultural markets.

In manufacturing, Germany is likely to experience the greatest trade diversion effects in a number of industries such as vehicles (-1.28 bn USD), aircraft (-1.59 bn USD) and industrial machinery (-0.72 bn USD). Amongst these top trading partners, Russia (-2.72 bn USD) and Australia (-1.82 bn USD) are likely to be most affected in energy products since they are important suppliers of crude oil and coal to China.

Table 3:
Change in China's 2021 imports due to the ETA

Category	Trade diversion, difference between 2021 ETA and 2021 counterfactual (bn USD)								
	AU	BR	DE	JP	KR	RU	US	VN	ZA
AGRICULTURE	-0.65	-5.10	-0.08	-0.03	-0.06	-0.17	11.52	-0.35	-0.03
Cereals	-0.20	0.00	0.00	0.00	0.00	-0.01	0.84	-0.22	0.00
Cotton	-0.15	-0.05	0.00	0.00	0.00	0.00	0.53	-0.02	0.00
Meat	-0.03	-0.06	-0.02	0.00	0.00	0.00	0.31	0.00	0.00
Oilseeds	0.00	-4.95	0.00	0.00	0.00	-0.04	6.71	0.00	0.00
Other agricultural commodities	-0.24	-0.04	-0.06	-0.02	-0.03	-0.02	2.46	-0.08	-0.02
Seafood	-0.03	0.00	0.00	-0.01	-0.02	-0.10	0.68	-0.03	0.00
MANUFACTURING	-0.09	-0.16	-4.27	-2.55	-1.72	-0.17	19.81	-0.53	-0.01
Aircraft (orders and deliveries)	0.00	-0.14	-1.59	0.00	0.00	-0.04	3.96	0.00	0.00
Electrical equipment and machinery	0.00	0.00	-0.19	-0.34	-0.28	-0.01	1.86	-0.31	0.00
Industrial machinery	-0.01	-0.01	-0.72	-1.08	-0.52	-0.05	4.46	-0.05	0.00
Iron and steel	0.00	-0.01	-0.01	-0.06	-0.03	0.00	0.21	0.00	-0.01
Optical and medical instruments	-0.01	0.00	-0.23	-0.20	-0.04	0.00	1.20	-0.04	0.00
Other manufactured goods	-0.02	-0.01	-0.07	-0.24	-0.82	-0.06	3.85	-0.13	0.00
Pharmaceutical products	-0.04	0.00	-0.19	-0.05	-0.01	0.00	1.00	0.00	0.00
Vehicles	0.00	0.00	-1.28	-0.60	0.00	-0.01	3.28	0.00	0.00
ENERGY	-1.82	-0.82	0.00	-0.02	-0.09	-2.72	31.29	-0.15	-0.05
Coal	-0.88	0.00	0.00	0.00	0.00	-0.18	1.80	0.00	0.00
Crude oil	-0.06	-0.81	0.00	0.00	0.00	-2.51	18.30	-0.14	-0.05
LNG	-0.79	0.00	0.00	0.00	0.00	-0.01	2.09	0.00	0.00
Refined prods	-0.09	0.00	0.00	-0.02	-0.09	-0.02	9.10	0.00	0.00
Total	-2.56	-6.07	-4.36	-2.61	-1.87	-3.06	62.62	-1.02	-0.09

Source: **CEPII BACI trade data; own calculations. Counterfactual 2021 trade flows based on gravity equation and forecast GDPs from the IMF's World Economic Outlook.**

3 IMPACT ON DEVELOPING ECONOMIES

In the agricultural sector, Brazil will be most affected amongst China's top trade partners primarily due to lost exports in soybeans (-4.95 bn USD). Brazil is the biggest exporter of soybeans in the world and in 2017, nearly 80% of those exports were directed towards China. The country exports soybeans to other markets as well such as Thailand (2.4%), Spain (2.9%) and the Netherlands (2.2%), but it is highly unlikely that these markets provide enough of a buffer to withstand substantial loss of sales to China. However, Brazil is expected to reap a strong harvest of soybeans this year and the competitive pricing of its crop may lead China to continue importing from the country and allocate the mandated increase of 12.5 bn USD to other US agricultural products in 2020.

Besides Brazil, other developing countries such as Vietnam and South Africa are also affected from the US–China ETA. Vietnam exports electronic goods such as telephones, integrated circuits and broadcasting equipment to China which would reduce by 0.31 bn USD in 2021 under the ETA in comparison to the counterfactual. Although Vietnam has benefited from the US–China tariff escalation by acting as an alternative manufacturing base, its persistent vulnerability to the volatile nature of US–China trade relations is a cause for concern.

4 AT STAKE: THE MFN PRINCIPLE

In summary, the US–China ETA has substantial implications for third countries, including developing nations not directly involved in the tariff war. With the WTO's Appellate Body still in paralysis due to the blockage of new appointments, it is uncertain how a case could be effectively brought to challenge the ETA's managed trade provisions. Talks on developing a multi-party interim appeal arrangement as a contingency measure for dispute settlement have begun but so far they only include the EU, China and 15 other WTO members and crucially, not the US. It therefore remains to be seen whether and how the multilateral trading system will adapt to accommodate such new limited scope deals should they become the norm.

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