KIEL POLICY BRIEF

Sonali Chowdhry, and Gabriel Felbermayr

The US–China Trade Deal: How the EU and WTO lose from managed trade

No. 132 January 2020

- The Economic and Trade Agreement (ETA) between China and the US, also referred to as the Phase-I Deal, was signed on January 15, 2020. It is a highly asymmetric treaty which commits China to open its markets and to purchase large quantities of US products in order for the US to refrain from imposing additional punitive tariffs.
- While the ETA contains provisions that will also benefit producers from third countries, it is highly discriminatory in the area of goods trade.
- The Phase-I Deal roughly requires Chinese imports of certain US goods to increase by about 95 bn USD in 2021 relative to the 2017 baseline. This amounts to a doubling of imports of these goods from the US.
- Compared to a 2021 benchmark without a US–China trade war and without the ETA, the EU is likely to lose about 11 bn USD in exports to China; this is about a sixth of the overall trade diversion caused by the ETA.
- The largest negative effects for the EU are expected in aircraft, vehicles, industrial machinery, optical and medical machinery, pharmaceuticals, and other agricultural goods.
- The country in the EU most strongly affected by the possible trade diversion effects is Germany.
- The ETA is very unlikely to be compatible with WTO law, because it violates the most-favored-nations principle and engages in managed trade. By signing up to this agreement, both parties seriously undermine the multilateral trading system.

Kiel Institute for the World Economy
ISSN 2195–7525

OVERVIEW/ ÜBERBLICK

- The Economic and Trade Agreement (ETA) between China and the US, also referred to as the Phase-I Deal, was signed on January 15, 2020. It is a highly asymmetric treaty which commits China to open its markets and to purchase large quantities of US products in order for the US to refrain from imposing additional punitive tariffs.
- While the ETA contains provisions that will also benefit producers from third countries, it is highly discriminatory in the area of goods trade.
- The Phase-I Deal roughly requires Chinese imports of certain US goods to increase by about 95 bn USD in 2021 relative to the 2017 baseline. This amounts to a doubling of imports of these goods from the US.
- Compared to a 2021 benchmark without a US–China trade war and without the ETA, the EU is likely to lose about 11 bn USD in exports to China; this is about a sixth of the overall trade diversion caused by the ETA.
- The largest negative effects for the EU are expected in aircraft, vehicles, industrial machinery, optical and medical machinery, pharmaceuticals, and other agricultural goods.
- The country in the EU most strongly affected by the possible trade diversion effects is Germany.
- The ETA is very unlikely to be compatible with WTO law, because it violates the most-favored-nations principle and engages in managed trade. By signing up to this agreement, both parties seriously undermine the multilateral trading system.

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

- Das Wirtschafts- und Handelsabkommen (ETA) zwischen China und den USA, auch als Phase-I-Deal bezeichnet, wurde am 15. Januar 2020 unterzeichnet. Es handelt sich um einen ausgesprochen asymmetrischen Vertrag, der China dazu verpflichtet, seine Märkte zu öffnen und große Mengen von US-Produkten zu kaufen, damit die USA auf zusätzliche Strafzölle verzichten.
- Während das ETA Bestimmungen enthält, die auch Herstellern aus Drittländern zugute kommen werden, ist es im Bereich des Warenhandels stark diskriminierend.
- Der Phase-I-Deal sieht vor, dass die chinesischen Importe bestimmter US-Waren im Jahr 2021 um etwa 95 Mrd. USD gegenüber dem Ausgangswert von 2017 steigen sollen. Dies entspricht einer Verdoppelung der Einfuhren dieser Waren aus den USA.
- Im Vergleich zu einem Referenzwert für 2021 ohne einen Handelskrieg zwischen den USA und China und ohne das ETA wird die EU wahrscheinlich rund 11 Mrd. USD an Exporten nach China verlieren; dies ist etwa ein Sechstel der gesamten Handelsumlenkung, die durch das ETA verursacht wird.
- Die größten negativen Auswirkungen für die EU werden bei Flugzeugen, Fahrzeugen, Industriemaschinen, optischen und medizinischen Geräten, Arzneimitteln und anderen landwirtschaftlichen Gütern erwartet.
- Das Land, das in der EU am stärksten von den möglichen Auswirkungen der Handelsumlenkung betroffen ist, ist Deutschland.
- Es ist sehr unwahrscheinlich, dass das ETA mit dem WTO-Recht vereinbar ist, da es gegen das Meistbegünstigungsprinzip verstößt und einen gelenkten Handel begünstigt. Mit der Unterzeichnung dieses Abkommens untergraben beide Parteien auf schwerwiegende Weise das multilaterale Handelssystem.

Schlüsselwörter: Beziehungen USA–China, gelenkter Handel, Handelsumlenkung, Multilateralismus

Sonali Chowdhry
Kiel Institute for the World Economy
Kiellinie 66
24105 Kiel / Germany
Phone: +49 431 8814 469
E-Mail: sonali.chowdhry@ifw-kiel.de

Gabriel Felbermayr
Kiel Institute for the World Economy
Kiellinie 66
24105 Kiel / Germany
Phone: +49 431 8814 236
E-Mail: gabriel.felbermayr@ifw-kiel.de

THE US–CHINA TRADE DEAL: HOW THE EU AND WTO LOSE FROM MANAGED TRADE

Sonali Chowdhry*, and Gabriel Felbermayr

1 THE US–CHINA ECONOMIC AND TRADE AGREEMENT (ETA): ASYMMETRIC, NOTHING ON TARIFFS

On January 15, 2020, US President Donald Trump and the Chinese Vice Premier Liu He signed an "Economic and Trade Agreement" (ETA),[1] usually referred to as the Phase-I Deal.

The agreement is highly asymmetric: it contains over 100 sentences with "China shall" or "China should" of the type: "China shall within 10 days of the date of entry into force of this Agreement, recognize the U.S. dairy-safety system as providing at least the same level of protection as China's dairy-safety system (Article 3.1, Annex 2.2b)." In contrast, the ETA contains only five sentences that commit the US. Those commitments are about control mechanisms, e.g., "China and the United States shall establish a joint working group" (Article 3.1, Annex 7.5).

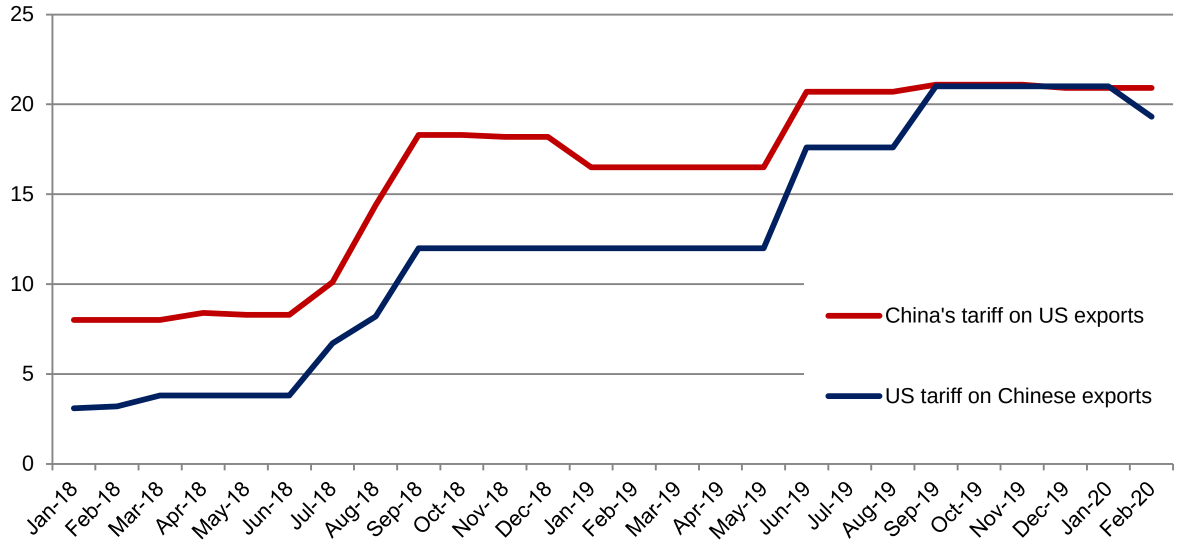
Tariffs between the US and China have increased in lockstep. The first escalation happened in the summer of 2018, where, according to data from Chad Bown at the Peterson Institute for International Economics in Washington, D.C., the average US import tariff on Chinese goods went up from about 3.8 to 12% and the Chinese import tariff on US goods went up from about 8.3 to 18.3%. The second phase of escalation took place in the summer of 2019, and saw US tariffs rise from an average of 12 to an average of 21% while Chinese tariffs, which had gone down to 16.5% in May 2019, also increased to 21%; see Figure 1.

The ETA does not mention tariffs at all. If, in exchange to Chinese concessions, the US president has committed to forego new tariffs and to halve punitive tariff rates on a subset of products from the current level of 15 to 7.5%, this can only be part of a different agreement or of an oral understanding. Similarly, the Chinese have made no tariff-rate commitments in the agreement. The agreement does, however, require substantial increases in Chinese imports; see below. This may or may not be achieved by lowering tariffs on US goods.

* The author acknowledges funding by the EU Trade and Investment Policy ITN (EUTIP) project under the European Union's Horizon 2020 research and innovation programme (Marie Skłodowska-Curie grant agreement No 721916).

[1] Text of the US–China ETA via Internet (January 20, 2020) <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/january/economic-and-trade-agreement-between-government-united-states-and-government-peoples-republic-china>.

Figure 1:
Average tariffs on US–China goods trade, 2018–2020



Source: **Data from Chad Bown via Internet (January 20, 2020) <https://www.piie.com/blogs/trade-investment-policy-watch/trump-trade-war-china-date-guide>; own illustration.**

Since it contains no material commitments for the US, the agreement does not require consent by Congress and can enter into force by February 15, 2020. Given this short timeline, its effect on trade flows is likely to be rapid. However, the agreement can also be dissolved very easily by the US president because Congress is not formally involved. Trade policy uncertainty, therefore, persists.

2 SCOPE OF THE ETA: EIGHT CHAPTERS IN 89 PAGES

Chapter 1 of the ETA relates to intellectual property and covers the pharmaceutical industry, patents, piracy and counterfeiting on e-commerce platforms, geographical indications as well as the manufacture and export of pirated and counterfeit goods. Most remarkably, it shifts the burden of proof to the accused party, which makes winning such cases for US companies much easier. Within 30 working days after the date of entry into force of the ETA, China is required to promulgate an Action Plan to strengthen its intellectual property protection. In addition to these provisions, Chapter 2 of the ETA prohibits forced technology transfer. Chapters 1 and 2 are likely to require nondiscriminatory legislative reforms in China that could benefit third country producers such as the EU.

Trade in food and agricultural products is addressed under Chapter 3 and rules out sanitary or phytosanitary measures which would constitute a disguised restriction on international trade. It sets out fairly detailed provisions for dairy, infant formula, poultry, beef, processed meat, aquatic products, rice, pet food and other areas. In particular, it appears that China is to allow hormone-treated beef onto its market (Annex 4.5).

Financial services in Chapter 4 constitute another important aspect of this agreement. Here, China makes relatively wide-ranging commitments, including eliminating foreign equity limits and allowing wholly US-owned services suppliers to participate in the securities, fund management, and futures sectors no later than April 1, 2020 (Art. 4.7(2)). However, there is nothing in the ETA that precludes China from opening up its financial market to not only US firms but also those from third parties. Chapter 5 of the ETA forbids exchange rate manipulations, but offers relatively little substance. To the extent that China modernizes its regulatory environment and increases transparency, the EU as well as other third parties may benefit as well from the bilateral deal. The central commitments under the ETA are provided under Chapter 6 titled 'Expanding Trade,' which includes specific targets for increased Chinese imports of US goods and services. It commits China to additional imports relative to the 2017 baseline for agriculture, manufacturing, energy and services amounting to about 77 bn USD for 2020 and 123 bn USD in 2021, with a continuation until 2025.

This chapter contains a list of 537 mostly 4-digit products, in which the mandated increases are to take place, without specifying more detail. It does not state whether the mandated additional imports are to be realized through higher quantities or higher prices or a combination of both. It only states that purchases will be made at market prices based on commercial considerations.

Chapter 7 contains provisions on dispute settlement. These are quite simplistic and do not involve third party arbitration. In short, the entire agreement can be suspended by either party if commitments are reneged. Finally, Chapter 8 specifies that the agreement is to enter into force by February 15, 2020. To summarize, this agreement is much narrower than usual free trade agreements. Most strikingly, it features no commitments on tariffs. It is also asymmetric. It does not include the usual definitions of key terms and appears vague in many areas. Crucially, it leaves open the negotiating timeline and content of a future Phase-II Deal. We note that the agreement contains multiple references to the World Trade Organization (WTO). However, by focusing on outcomes (specific increases in imports) rather than trade cost reductions, it is likely to violate Art. 1 GATT, which rules out discriminatory trade policy practices. The pressing concern is that such managed trade as expected under the ETA, may come at the expense of other countries.

3 NOT IN THE AGREEMENT: SUBSIDIES

One of the key issues that the US and other WTO members have repeatedly raised with China is the use of subsidies. In fact, the justification of Section 301 tariffs (Figure 1) is largely based on the accusation that China provides subsidies to unfairly promote its own companies, most notably state-owned enterprises, and to skew the level playing field. However, the words "state aid" or "subsidy" do not appear at all in the text of the agreement. Since the geostrategic rivalry between the US and China revolves around technology and innovation, the deal does little to restructure or alleviate this conflict by excluding state subsidies.

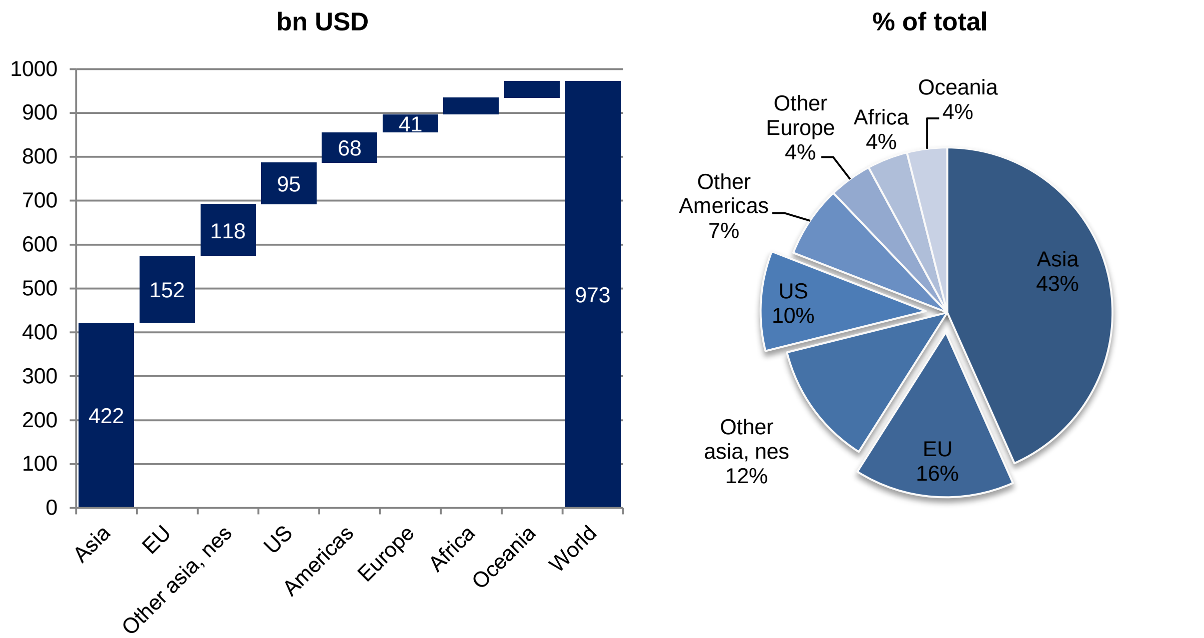
4 CRITICAL FOR THE EU: PROVISIONS ON TRADE EXPANSION

In the following analysis, we quantify how other countries may be affected by the entry into force of the ETA. We base our calculations on the BACI trade dataset which is built from the UN COMTRADE data and cleaned by the French research institute CEPII.

The ETA sets out 18 types of goods and five types of services where China's imports from the US are to increase by negotiated quantities. In total, 537 4-digit products (at places, more detailed product codes are given) are affected by the quantity targets of the ETA. In these products, according to the BACI data for the 2017 baseline, China was importing goods from the US amounting to a total of 95 billion USD. This is about 9.8% of total Chinese imports in the affected products, which totaled 973 bn USD in 2017.

The EPA specifies additional imports in the goods area of 63.9 bn USD in 2020 and 98.2 bn USD in 2021. These additional sales amount to an increase relative the baseline level of 2017 of 67% in 2020 and 103% in 2021, respectively.

Figure 2:
Chinese imports in products affected by the US–China ETA, bn USD, 2017 baseline

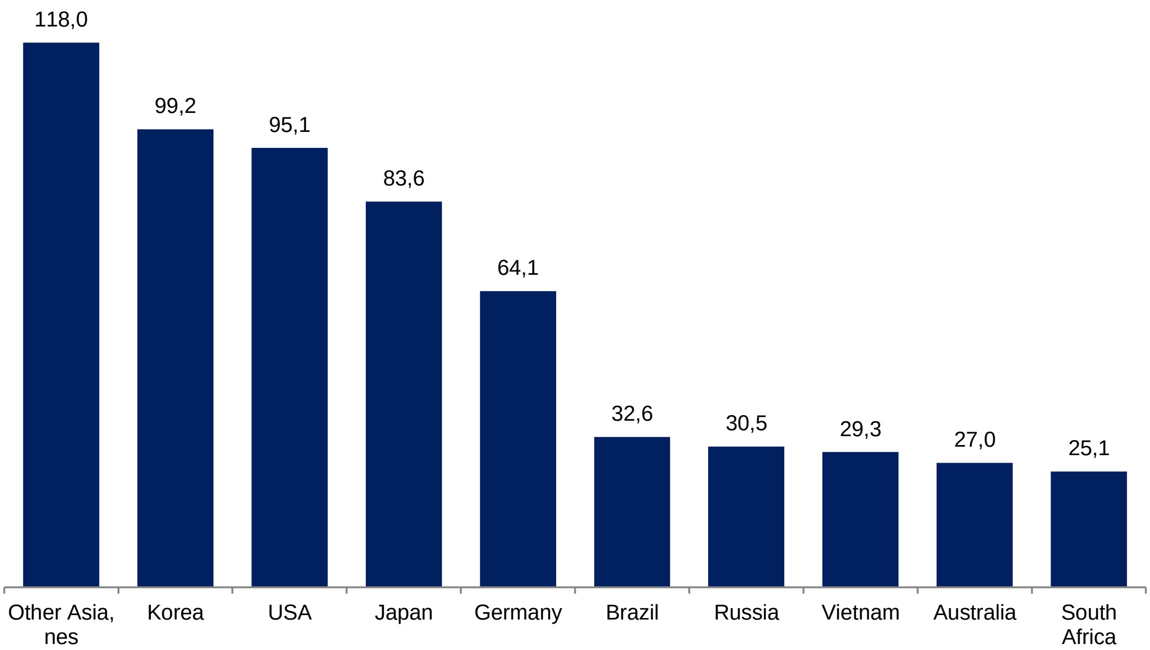


Source: **Text of the US–China ETA; CEPII BACI trade data; own calculations and illustration.**

The agreement contains targets based on the volume of US exports to China in 2017 amounting to about 95 bn USD. This is about 72% of the entire goods exports of the US to China, which stood at 132 bn USD in 2017. In other words, there are no targets for 28% of US exports to China. It is well possible that US exports in those products explicitly targeted by the ETA go up by the agreed amounts, but exports in the noncovered products remain constant or go down.

The ETA foresees very large increases in China's imports from the US. In agriculture, imports are to increase by 12.5 bn USD in 2020 and by 19.5 bn USD in 2021; this is 59 and 91% of baseline trade, respectively. In the area of manufacturing, Chinese imports are to increase by 32.9 bn USD in 2020 and 44.8 bn USD in 2021; which amount to 49 and 67% of the baseline, respectively. And in the area of energy, China's imports from the US are to increase from 7.0 bn USD by 18.5 bn USD and 33.9 bn USD in 2020 and 2021, these are increases by 265 and 485%, respectively. Overall, by 2021, the ETA mandates a doubling of Chinese imports from the US in the affected areas relative to 2017.

Figure 3:
Chinese imports in products affected by the US–China ETA, top 10 origins, bn USD, 2017



Source: **Text of the US–China ETA; CEPII BACI trade data; own calculations and illustration.**

Table 1:
China's baseline imports from the US and the EU, and additional US exports according to the ETA

	Baseline (bn USD, 2017)			Additional US exports to China on top of 2017 baseline		Percentage increase in imports from US (wrt baseline)	
	China imports from world	China imports from US	China imports from EU	2020	2021	2020	2021
Agriculture	120.1	21.3	14.0	12.5	19.5	59%	91%
Manufacturing	662.5	66.8	137.2	32.9	44.8	49%	67%
Energy	190.6	7.0	3.9	18.5	33.9	265%	485%
Total	**973.1**	**95.1**	**155.1**	**63.9**	**98.2**	**67%**	**103%**

Source: **Text of the US–China ETA; CEPII BACI trade data; own calculations.**

5 SUBSTANTIAL TRADE DIVERSION

The ETA does not mandate any reductions in tariffs, neither on the US nor on the Chinese side. There are a number of reductions in Chinese nontariff barriers, in particular for agricultural goods. However, without tariff cuts by China, it is difficult to see how overall imports can increase beyond their normal rise due to the general expansion of economic activity. Hence, as a first approximation, one must assume that the import propensity of China in the goods mentioned in the ETA will not go up. This assumption, together with large mandated increases in imports from the US, implies that the additional exports by the US crowd out exports by other trade partners of China.

The EU, which accounts for about one fifth of Chinese manufacturing goods imports, is particularly vulnerable to trade diversion in this area. Table 2 shows the top 10 (4-digit) products imported by China from the EU. Those products account for about 45% of the entire Chinese imports in the products affected by the ETA. About 56% of Chinese imports in the category of motor vehicles comes from the EU, 41% of aircraft, 61% of medicaments, 60% of electric control boards and almost 70% of malt extract. All top 10 products fall in the area of manufacturing, in which US exports are to increase by about 45 bn USD compared to the 2017 baseline.

Table 2:
Top 10 EU exports products to China, 2017

		bn USD	% of China total
8703	Motor vehicles principally for the transport of persons	25.9	56.3
8802	Other aircraft	10.0	41.4
3004	Medicaments	8.4	61.0
8542	Electronic integrated circuits	5.6	3.1
2709	Petroleum oils	3.6	2.5
8479	Machines and mechanical appliances	3.4	29.4
8537	Electric control boards	3.3	59.5
1901	Malt extract	2.8	68.6
8481	Taps, valves, etc.	2.6	40.6
8411	Turbojets	2.6	32.9

Source: **Text of the US–China ETA; CEPII BACI trade data; own calculations.**

6 A FIRST QUANTIFICATION: EU TO LOSE ABOUT 11 BN USD IN EXPORTS TO CHINA BY 2021

How large could those trade diversion effects be? Table 3 shows Chinese imports from the world in 2017 for the product categories mapped out in the text of the US–China ETA, and decomposes that sum into flows from US, the EU, and the rest of the world (RoW).

It also shows predicted trade flows (in current US dollars) for the year of 2021 under the assumption of no trade war between the US and China and of no trade agreement between the two nations. The prediction is based on the gravity model, on the GDP data published (until 2018) and the forecast (2019-2021) by the IMF in the latest World Economic Outlook (October 2019). In this model, at unchanged trade costs, imports of China with any trade partner change approximately at a rate given by China's nominal GDP growth rate plus the trade partner's nominal GDP growth rate minus the world's nominal GDP growth rate. For 2021, relative to 2017, this yields a growth of nominal imports by, e.g., 37.4% for the US and by 30.3% for the EU. Given this prediction, China's overall imports in the goods targeted by the US–China ETA would go from about 973 bn USD in 2017 to 1300 bn USD in 2021. China's goods imports from the US would increase from 95 to 131 bn USD in 2021. Hence, the agreed increase in China's US goods imports amounts to 48% (comparing 131 bn USD under alternate 2021 baseline to the mandated purchases of 193.8 bn USD in 2021) instead of 103% (comparing the 95 bn USD in the 2017 baseline to the mandated purchases of 193.8 bn USD in 2021).

If trade costs and hence relative prices do not change, the additional Chinese imports from the US must come at the expense of third countries. Table 3 shows the imports from the United States as mandated by the ETA (e.g., for agriculture this is the 2017 baseline of 21.3 bn USD plus the mandated increase by 2021 of 19.5 bn USD, a total of 40.8 bn USD), and allocates the remaining imports to other countries according to the spending shares implied by GDP growth rates. Because the additional imports required by the treaty exceed the "normal" growth of trade, other countries' exports to China must fall below the undistorted 2021 level. For example, in agriculture, EU exports would be 18.3 bn USD in 2021; with the ETA, they amount to 17.6 bn USD. Within each of the broad sectors (agriculture, manufacturing and energy), Chinese imports of US goods are assumed to experience the same adjustment.

Table 3:
Chinese imports in 2017 and 2021, bn USD

	2017				2021							
					without ETA				*with ETA*			
	US	EU	RoW	World	US	EU	RoW	World	US	EU	RoW	World
AGRICULTURE	21.3	14.0	84.7	120.1	29.3	18.3	112.8	160.4	40.8	17.6	102.0	160.4
Cereals	1.6	0.1	5.3	7.0	2.1	0.2	7.0	9.3	3.0	0.1	6.2	9.3
Cotton	1.0	0.0	1.1	2.1	1.3	0.0	1.5	2.9	1.9	0.0	1.0	2.9
Meat	0.6	2.5	6.2	9.2	0.8	3.2	8.3	12.3	1.1	3.1	8.1	12.3
Oilseeds	12.4	0.0	24.2	36.6	17.1	0.0	31.8	48.9	23.8	0.0	25.1	48.9
Other agricultural commodities	4.6	10.8	41.6	57.0	6.3	14.1	55.8	76.2	8.7	13.6	53.9	76.2
Seafood	1.3	0.6	6.3	8.2	1.7	0.8	8.3	10.9	2.4	0.8	7.7	10.9
MANUFACTURING	66.8	137.2	458.5	662.5	91.8	178.7	614.8	885.3	111.6	169.4	604.3	885.3
Aircraft (orders and deliveries)	13.4	10.0	0.8	24.2	18.3	13.0	0.9	32.3	22.3	9.3	0.7	32.3
Electrical equipment and machinery	6.3	21.9	96.6	124.8	8.6	28.5	129.7	166.8	10.5	28.2	128.1	166.8
Industrial machinery	15.0	41.2	86.8	143.1	20.6	53.7	116.8	191.2	25.1	52.3	113.8	191.2
Iron and steel	0.7	3.3	17.9	22.0	1.0	4.3	24.1	29.4	1.2	4.3	23.9	29.4
Optical and medical instruments	4.1	5.1	7.3	16.5	5.6	6.7	9.8	22.1	6.8	6.2	9.1	22.1
Other manufactured goods	13.0	18.1	234.6	265.7	17.8	23.6	313.7	355.0	21.7	23.3	310.1	355.0
Pharmaceutical products	3.4	11.3	5.1	19.8	4.6	14.7	7.1	26.5	5.7	14.0	6.8	26.5
Vehicles	11.0	26.2	9.2	46.5	15.2	34.2	12.8	62.1	18.5	31.8	11.9	62.1
ENERGY	7.0	3.9	179.7	190.6	9.6	5.0	240.0	254.7	40.9	4.4	209.3	254.7
Coal	0.4	0.0	16.7	17.1	0.6	0.0	22.2	22.8	2.3	0.0	20.5	22.8
Crude oil	4.1	3.6	139.9	147.6	5.6	4.7	187.0	197.3	23.9	4.3	169.1	197.3
LNG	0.5	0.1	13.8	14.3	0.6	0.1	18.4	19.2	2.7	0.1	16.3	19.2
Refined prods	2.0	0.1	9.4	11.5	2.8	0.2	12.4	15.4	11.9	0.0	3.4	15.4
Total	95.1	155.1	722.9	973.1	130.7	202.0	967.7	1300.4	193.3	191.2	915.9	1300.4

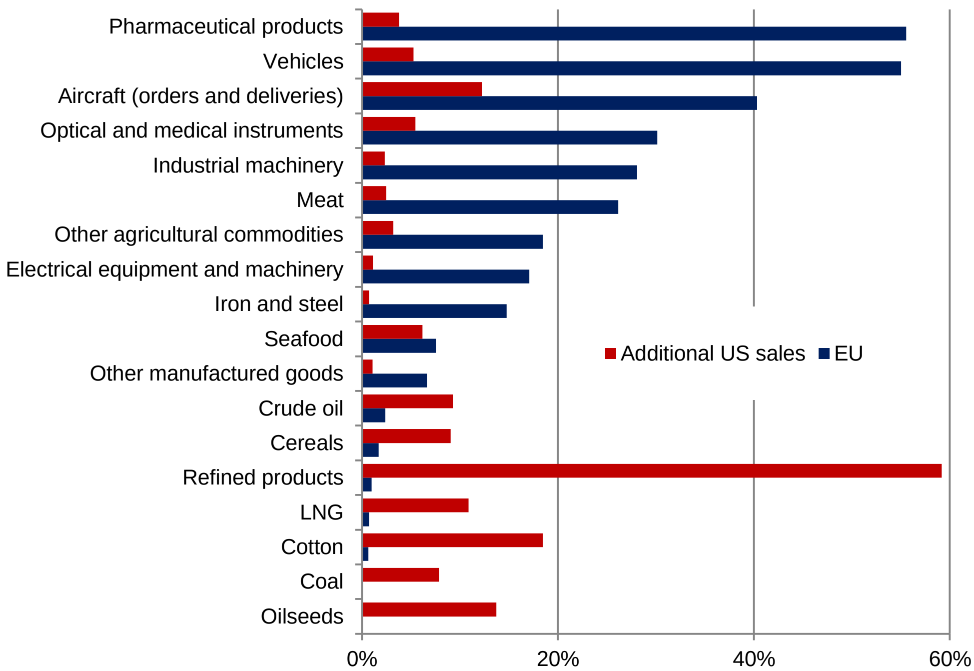
Source: **Text of the US–China ETA; CEPII BACI trade data; own calculations; Predicted 2021 trade flows based on gravity equation and forecast GDPs from the IMF's World Economic Outlook.**

To see where trade diversion effects for the EU are strongest, it is useful to compare the EU share of Chinese imports in broad categories of goods (under the undistorted 2021 scenario) with the share of extra US sales (mandated minus undistorted sales in 2021) in Chinese imports.

Figure 4 shows that the EU has very high shares in Chinese imports of pharmaceutical products, vehicles, aircraft or medical instruments. Additional US sales are substantial in these areas, so that it is very likely that the EU will have to cede some market share. In the area of agricultural products or energy, the EU has very small shares in Chinese imports, so that the additional sales foreseen by the ETA, even if, in some cases, they may be as high as almost 60% of the overall imports, harmful trade diversion for the EU is small.

Table 4 shows the predicted differences in China's imports in 2021 between i) a situation where trade would evolve normally from 2017 to 2021; and ii) a situation with a US–China trade war and the ETA. Overall, the US would export additional goods worth about 62.6 bn USD; the EU would export 10.8 bn USD less, and the rest of the world (RoW) exports would also decrease by 51.8 bn USD. In percentage terms, the US would see its exports to China go up by about 48% relative to the undistorted 2021 benchmark, while the EU and other countries would, on average, lose 5%.

Figure 4:
China's imports from EU in undistorted 2021 scenario and additional US sales, as shares of China's world imports in 2021



Source: **Text of the US–China ETA; CEPII BACI trade data; own calculations. Predicted 2021 trade flows based on gravity equation and forecast GDPs from the IMF's World Economic Outlook. Share of China's world imports in 2021.**

Table 4:
Change in Chinese 2021 imports brought about by the ETA

	bn. USD			in %		
	US	EU	RoW	US	EU	RoW
AGRICULTURE	**11.5**	**-0.7**	**-10.9**	**39%**	**-4%**	**-10%**
Cereals	0.8	0.0	-0.8	39%	-12%	-12%
Cotton	0.5	0.0	-0.5	39%	-35%	-35%
Meat	0.3	-0.1	-0.2	39%	-3%	-3%
Oilseeds	6.7	0.0	-6.7	39%	-21%	-21%
Other agricultural commodities	2.5	-0.5	-2.0	39%	-4%	-4%
Seafood	0.7	-0.1	-0.6	39%	-7%	-7%
MANUFACTURING	**19.8**	**-9.3**	**-10.5**	**22%**	**-5%**	**-2%**
Aircraft (orders and deliveries)	4.0	-3.7	-0.3	22%	-28%	-28%
Electrical equipment and machinery	1.9	-0.3	-1.5	22%	-1%	-1%
Industrial machinery	4.5	-1.4	-3.1	22%	-3%	-3%
Iron and steel	0.2	0.0	-0.2	22%	-1%	-1%
Optical and medical instruments	1.2	-0.5	-0.7	22%	-7%	-7%
Other manufactured goods	3.8	-0.3	-3.6	22%	-1%	-1%
Pharmaceutical products	1.0	-0.7	-0.3	22%	-5%	-5%
Vehicles	3.3	-2.4	-0.9	22%	-7%	-7%
ENERGY	**31.3**	**-0.6**	**-30.7**	**326%**	**-12%**	**-13%**
Coal	1.8	0.0	-1.8	326%	-8%	-8%
Crude oil	18.3	-0.5	-17.9	326%	-10%	-10%
LNG	2.1	0.0	-2.1	326%	-11%	-11%
Refined prods	9.1	-0.1	-9.0	326%	-72%	-72%
Total	**62.6**	**-10.8**	**-51.8**	**48%**	**-5%**	**-5%**

Source: **Text of the US–China ETA; CEPII BACI trade data; own calculations. Predicted 2021 trade flows based on gravity equation and forecast GDPs from the IMF's World Economic Outlook.**

For the EU, the biggest absolute losses would be in aircraft (–3.7 bn USD), vehicles (–2.4 bn USD), and industrial machinery (–1.4 bn USD). By far the largest share of this loss will have to be borne by EU member states Germany and France. In terms of percentage changes, the largest relative losses would again be in the aircraft sector (–28%), vehicles (–7%), and pharmaceutical products (–5%).

Table 5 illustrates the massive market share reallocation that the ETA between China and the US entails. The US share in Chinese imports would go up from 10% to about 15%; the EU share would fall from 16 to 15%; and the share of the rest of the world would collapse from 74 to 70%.

The largest market share shifts would occur in the energy sector where US imports compared to the undistorted 2021 benchmark increase by 326%. Here, the US market share is bound to quadruple from about 4 to 16%. Also, in the agricultural area, its share is to climb from 18 to 25%. Market share reallocations are smaller in manufacturing, where the EU tends to have the strongest position.

Table 5:
Shares in aggregate Chinese imports—2017 versus 2021 with ETA

	2017			2021 with ETA		
	US	EU	RoW	US	EU	RoW
AGRICULTURE	**18%**	**12%**	**71%**	**25%**	**11%**	**64%**
Cereals	22%	2%	76%	32%	2%	66%
Cotton	46%	1%	54%	65%	0%	34%
Meat	6%	27%	67%	9%	25%	66%
Oilseeds	34%	0%	66%	49%	0%	51%
Other agricultural commodities	8%	19%	73%	11%	18%	71%
Seafood	15%	8%	77%	22%	7%	71%
MANUFACTURING	**10%**	**21%**	**69%**	**13%**	**19%**	**68%**
Aircraft (orders and deliveries)	55%	41%	3%	69%	29%	2%
Electrical equipment and machinery	5%	18%	77%	6%	17%	77%
Industrial machinery	11%	29%	61%	13%	27%	60%
Iron and steel	3%	15%	82%	4%	15%	81%
Optical and medical instruments	25%	31%	44%	31%	28%	41%
Other manufactured goods	5%	7%	88%	6%	7%	87%
Pharmaceutical products	17%	57%	26%	21%	53%	26%
Vehicles	24%	56%	20%	30%	51%	19%
ENERGY	**4%**	**2%**	**94%**	**16%**	**2%**	**82%**
Coal	2%	0%	98%	10%	0%	90%
Crude oil	3%	2%	95%	12%	2%	86%
LNG	3%	1%	96%	14%	1%	85%
Refined prods	18%	1%	81%	77%	0%	22%
Total	**10%**	**16%**	**74%**	**15%**	**15%**	**70%**

Source: **Text of the US–China ETA; CEPII BACI trade data; own calculations. Predicted 2021 trade flows based on gravity equation and forecast GDPs from the IMF's World Economic Outlook.**

7 SERVICES: A WIDENING US–CHINA TRADE SURPLUS

The US had a services trade surplus of an estimated $41 billion with China in 2018, up 0.8% from 2017. The ETA is likely to widen this surplus, as it mandates an increase in China's imports of US services by 12.8 bn USD in 2020 and 25.1 bn USD in 2021. These increases will be achieved by stepping up purchases under 5 potential categories: i) charges for the use of IP; ii) business travel and tourism; iii) financial services and insurance; iv) cloud services and; v) other services including maintenance, repair and transportation. Of these, travel services account for the largest category of US services exports to China (approximately 62% in 2016). The impact of these purchases for the EU may be limited given that China accounted for only 5% of EU's total services exports in 2017, in comparison to the US (26%) and Switzerland (13%). Furthermore, if the ETA is successful in inducing China to undertake regulatory reforms in financial services and IPR, it would benefit all trade partners and not just the US.

8 COLLATERAL DAMAGE: THE MFN PRINCIPLE AND WTO

The Phase-I Deal can be considered a success for the trade policy approach adopted by the Trump Administration. By withdrawing concessions enshrined in the WTO treaties, the US has pressured China into accepting a very one-sided agreement that is likely to be inconsistent with the fundamental values of nondiscrimination that underpin the multilateral trading system. By stipulating large and swift increases in purchases from the US, the agreement almost certainly discriminates against other trade partners. It forces China, which has repeatedly insisted on the values of the multilateral system, to violate the core principles of the WTO.

IMPRESSUM

DR. KLAUS SCHRADER
Leiter Bereich Schwerpunktanalysen
Head of Area Special Topics

> klaus.schrader@ifw-kiel.de

Publisher:
Kiel Institute for the World Economy
Kiellinie 66, 24105 Kiel, Germany
Phone +49 (431) 8814-1
Fax +49 (431) 8814-500

Editorial Team:
Dr. Klaus Schrader,
Ilse Büxenstein-Gaspar, M.A.,
Margitta Führmann.
The Kiel Institute for the World Economy is a foundation under public law of the State of Schleswig-Holstein, having legal capacity.

Value Added Tax Id.-Number:
DE 251899169

Authorized Representative:
Prof. Gabriel Felbermayr, Ph.D. (President)

Cover Foto:
© Creativa Images - stock.adobe.com

Responsible Supervisory Authority:
Ministry of Education, Science and Cultural Affairs of the Land Schleswig-Holstein

https://www.ifw-kiel.de/de/publikationen/kiel-policy-briefs/