Exporters' reactions to trade protectionism: Implications from the US-China trade conflict

Dr. Molly De-Luca*

Associate Professor at Lomonosov Moscow State University

Dr. Jeanmaric-Voskresensky

Professor at HSE University (National Research University Higher School of Economics

Abstract

This study of the US-China trade conflict in 2010 aims to determine how exports react to trade protection. We find that the start of the US's trade war against Chinese exports reduces China's overall exports to the US by an average of 26.87% for the period of January 2000 to May 2023. Further analysis reveals that the decline in exports is primarily attributable to a drop in quantity, with prices remaining largely unchanged. Negative trade shocks also drive exports in R&D-intensive, skilled labor-intensive, high- apital-income-share, and upstream industries to be routed even more to nearby nations with larger economies. Industries with a comparative advantage, rapid export growth, high export value, and high elasticity of substitution, according to heterogeneous analyses.

Keywords- Trade war, China, US and conflict

Introduction

Trade between the world's two biggest economies has ballooned in recent decades, bringing significant benefits but also frictions over China's state-led development and calls to rethink the relationship. U.S. trade with China has grown enormously in recent decades and is crucial for both countries. Today, the United States imports more from

China than from any other country, and China is one of the largest export markets for U.S. goods and services. This trade has helped the United States in the form of lower prices for consumers and higher profits for corporations, but it has also come with costs.

Though U.S. consumers benefited from the flood of cheaper goods from China, millions of Americans lost their jobs due to import competition. The United States has long accused China of pressuring American companies to hand over their technology, or pilfering it outright. The optimism that accompanied China's entry into the World Trade Organization (WTO) twenty years ago has vanished as Beijing has embraced state-led development, pouring subsidies into targeted industries to the detriment of U.S. and foreign companies. Meanwhile, investment by Chinese companies has increasingly raised national security concerns. As U.S. President Joe Biden embraces an increasingly aggressive approach, the future of the economic relationship is uncertain.

What is the history of the U.S.-China trade relationship?

For thirty years following the establishment of the People's Republic of China in 1949, there was virtually no trade between the two countries as Washington had severed ties with the communist government in Beijing. In 1979, the United States and China normalized relations, prompting an explosion of trade over the next four decades from a few billion dollars worth to hundreds of billions of dollars annually.

China also began a decades-long process of economic reform in the late 1970s under the leadership of Deng Xiaoping. His government loosened state control over the economy and allowed private industry to develop. Chinese policymakers aimed to boost trade and investment, and in 1986 Beijing applied to rejoin the General Agreement on Tariffs and Trade, the WTO's predecessor. After protracted negotiations with the United States and other WTO members, China joined the WTO in December 2001. As a condition of admission, Beijing committed to a sweeping set of economic reforms, including steep tariff cuts for imported goods, protections for intellectual property (IP), and transparency around its laws and regulations.

At the time, U.S. President Bill Clinton and his advisors contended that bringing China into the global trading system would not only benefit the United States, but also foster economic and ultimately democratic reform in China. Still, the move was opposed by U.S. labor unions and many congressional Democrats, who argued that China's weak worker and environmental protections would incentivize similar practices elsewhere and bring about a "race to the bottom."

Even before China joined the WTO, trade between the two countries was growing. But WTO membership ensured "permanent normal trade relations," thereby providing U.S. and foreign companies additional certainty that they could produce in China and export to the United States. Trade surged: the value of U.S. goods imports from China rose from about $100 billion in 2001 to $500 billion in 2021. This leap in imports is due in part to China's critical position in global supply chains; Chinese factories assemble products for export to the United States using components from all over the world.

U.S. consumers have benefited from lower prices, and U.S. companies have profited immensely from access to China's market. In a 2019 study, economists Xavier Jaravel and Erick Sager found that increased trade with China boosted the annual purchasing power of the average U.S. household by $1,500 between 2000 and 2007. China is now the third-largest export market for the United States, behind Canada and Mexico. A 2017 study [PDF] commissioned by the U.S.-China Business Council, an industry group, found that exports to China supported nearly two million jobs in the United States.

American companies earn hundreds of billions of dollars annually from sales in China—money they can then invest in their U.S. operations. Chinese companies have invested tens of billions of dollars in the United States, though this investment has dwindled in recent years amid heightened U.S. government scrutiny.

For China, the gains from trade with the United States and the rest of the world have been tremendous. Since 2001, China's economy has grown roughly five-fold, adjusted for inflation, and it is now the world's second largest, behind only the United States. (By some measures, it is the largest.) Hundreds of millions of people have escaped extreme poverty as a result of this growth.

Though the trade relationship has undoubtedly brought benefits, it has also presented the United States and other countries with a host of problems.

Manufacturing job losses. Research led by economists David Autor, David Dorn, and Gordon Hanson found that the costs of boosting trade with China, the so-called China Shock, were more pronounced than those from increased trade with other countries, such as Japan. This was due to the speed at which imports rose, the vast size of China's low-wage workforce, and the range of affected industries. Their research shows that political polarization also increased in the areas of the country most harmed by competition with China, which some analysts say helped to spur the rise of Donald Trump and populist political forces. CFR's Edward Alden and other experts say the United States lacks effective policies for managing these economic disruptions.

National security. U.S. policymakers are increasingly worried about Chinese efforts to acquire sensitive U.S. technology to achieve Beijing's industrial policy goals and bolster China's military. U.S. officials have repeatedly accused Beijing of stealing IP and requiring American companies to share their technologies as a condition of doing business in China, known as forced technology transfer. Wary of espionage, Washington has also raised concerns that U.S. companies that use Chinese technology could put U.S. national security at risk.

Subsidization and state-owned enterprises. To achieve its economic goals, the Chinese government has poured subsidies into a range of industries with the aim of creating "national champion" companies. Some experts argue that these subsidies are wasteful, but they can be disruptive to other countries whose companies cannot compete against such levels of state support. The United States argues that many Chinese state-owned enterprises are effectively arms of the government and, unlike their private competitors, do not make decisions based on market forces.

Currency manipulation. Many economists say China kept the value of its currency, the renminbi, artificially low in the decade after it joined the WTO by accumulating U.S. dollar reserves. A weaker currency makes Chinese imports cheaper and U.S. exports more expensive, thereby contributing to the trade deficit.

Labor and human rights violations. The United States has long been critical of China on human rights issues, and U.S. labor groups have persistently complained about poor working conditions in China. These concerns have resurfaced on the trade agenda in recent years with reports of forced labor in Xinjiang, where China is repressing millions of Uyghurs.

The United States has attempted to address its trade concerns with China through a mixture of negotiation, disputes at the WTO, heightened investment scrutiny, tariffs, and its own industrial policy. The relationship has grown more combative over the past decade as U.S. policymakers have charted a progressively more assertive course.

As part of China's entry into the WTO, U.S. negotiators demanded a temporary safeguard that could be used to limit imports from China, but this was hardly used before it expired twelve years later. Blustein writes that the George W. Bush administration was worried about cascading calls from U.S. companies for better protection and needed Beijing's support for other foreign policy objectives, including the global war on terrorism. The Bush administration imposed some tariffs on a range of Chinese goods that were subsidized or "dumped" (i.e., sold at an abnormally low price). It also launched high-level dialogues with China to address trade issues.

These dialogues continued under President Barack Obama, whose administration cracked down on Beijing. Obama used the special safeguard to impose tariffs on imported tires, and his administration won a number of WTO disputes against China. Scrutiny of Chinese investment also increased, with Obama taking the rare step of blocking two Chinese acquisitions on the recommendation of the Committee on Foreign Investment in the United States (CFIUS), an interagency body that screens investments on national security grounds. His administration also concluded negotiations for the Trans-Pacific Partnership (TPP), a mega-regional trade agreement that it billed as a way to confront China on trade.

President Donald Trump took an even more assertive approach, withdrawing from the TPP and imposing tariffs on hundreds of billions of dollars worth of Chinese goods. The two countries eventually negotiated what they called a "Phase One" agreement, which many experts have criticized as punting on core U.S. concerns in exchange for a commitment by China to purchase an additional $200 billion worth of U.S. goods—which it has failed to live up to. Trump also designated China as a currency manipulator for the first time in decades and maintained the Obama administration's block on new appointments to the WTO's Appellate Body, incapacitating the organization's dispute settlement system. Meanwhile, the U.S. Congress—responding mainly to fears over Chinese acquisition of U.S. technology—passed legislation expanding the role of CFIUS and tightening controls over high-tech exports.

Under President Biden, Washington has taken the most serious steps yet toward weakening China's play for economic dominance. In addition to retaining some $360 billion worth of tariffs imposed under Trump, Biden has sanctioned Chinese individuals associated with human rights abuses in Xinjiang and Hong Kong, threatened to remove Chinese companies collectively worth an estimated $2.4 trillion from U.S. stock exchanges, and introduced unprecedented export controls that restrict Beijing's ability to obtain advanced technology.

References

Aguiar A., Narayanan B. & McDougall R. (2016). An overview of the gtap 9 data base. Journal of

Global Economic Analysis, 1 (1), 181–208.

Amiti M., Redding S.J. & Weinstein, D. (2019). The impact of the 2018 trade war on U.S. prices

and welfare. CEPR Discussion Paper no. 13564, 1–37.

Armington P.S. (1969). A theory of demand for products distinguished by place of production.

IMF Staff Papers, 16 (1), 159–178.

Balistreri, E.J., Böhringer, C. & Rutherford, T.F. (2018). Quantifying disruptive trade policies.

CESifo Working Papers no. 7382, 1–53.

Bollen, J. & Rojas-Romagosa, H. (2018). Trade wars: Economic impacts of US tariff increases

and retaliations - An international perspective. CPB Background Document, 1–43.

Bown C.P., Jung E. & Lu Z. (2018). Trump and China Formalize Tariffs on $260 Billion of

Imports and Look Ahead to Next Phase. Washington, DC: PIIE Trade & Investment Policy

Watch.

Busse M., Köninger J. & Nunnenkamp P. (2010). FDI promotion through bilateral investment

treaties: More than a bit? Review of World Economics, 146 (1), 147–177.

(https://onlinelibrary.wiley.com/terms-and-conditions) on Wiley Online Library for rules of use; OA articles are governed by the applicable Creative Commons License

Devarajan, S., Go, D.S., Lakatos, C., Robinson, S. & Thierfelder, K. (2018). Traders' Dilemma -

Developing Countries' Response to Trade Disputes. The World Bank Policy Research Working Paper no. 8640, 1–18.

Harrison W.J. & Pearson K.R. (1996). Computing solutions for large general equilibrium modeling using GEMPACK. Computational Economics, 9 (2), 83–127.

Hertel T.W. (ed.) (1997). Global Trade Analysis: Modeling and Applications. New York: Cambridge University Press.

Ianchovichina, E. & McDougall, R. (2001). Theoretical structure of dynamic GTAP. GTAP Technical Paper no. 17, Purdue University.

Ianchovichina E. & Walmsley T. (eds.) (2012). Dynamic Modeling and Applications for Global

Economic Analysis. New York: Cambridge University Press.

International Monetary Fund (2018). World Economic Outlook Database. Washington, DC: IMF.

International Monetary Fund. (2019). Chapter 4: The drivers of bilateral trade and the spillovers from tariffs. In: World Economic Outlook. Washington, DC: IMF, 103–129.

Itakura K. (2019). Chapter 3: Economic effects of east Asian integration on Southeast Asia. In:

Ing L.Y., Richardson M. & Urata S. (eds.), East Asian Integration: Goods, Services and Investment. New York: Routledge, 25–46.

Itakura K. & Oyamada K. (2015). Chapter 12: Extending GTAP data base and a CGE model with

global input-output linkage. In: Otsubo S. (ed.), Globalization and Development: Leading Issues in Development with Globalization. New York, NY: Routledge, 344–363.

Krugman P. (1980). Scale economies, product differentiation, and the pattern of trade. American

Economic Review, 70, 950–959.

Li, M. (2018). CARD trade war tariffs database. Accessed 27 December 2018. Available from

URL: https://www.card.iastate.edu/china/trade-war-data/

McDougall, R. (2003). A new regional household demand system for GTAP. GTAP Technical

Paper no. 20, Purdue University, 1–57.

Noland M. (2018). US trade policy in the Trump administration. Asian Economic Policy Review,

13 (2), 262–278.

Organization for Economic Co-operation and Development (2018). Inter-Country Input-Output

(ICIO) Tables. Paris: OECD.

Tsutsumi, M. (2018). The economic consequences of the 2018 US-China trade conflict: A CGE

simulation analysis. CIS Discussion Paper Series no. 676, Institute of Economic Research,

Hitotsubashi University, 1–25.

United Nations (2017). World Population Prospects: The 2017 Revision. New York: U.N.

Urata, S. (2015). Impacts of FTAs and BITs on the locational choice of foreign direct investment:

The case of Japanese firms. RIETI Discussion Paper Series no. 15-E-066, 1–28.

Walmsley, T. & Minor, P. (2018). Estimated impacts of US sections 232 and 301 trade actions on

the US and global economies: A supply chain prospective 2018-2030. ImpactEcon Report, 1–73.