TRADE talks

A podcast about the economics of trade & policy
with Chad P. Bown

Episode 181. US-China trade war fallout:

This is what decoupling looks like

[Episode webpage]

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Transcript

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Chad Bown: The US-China trade war began in March of 2018. The US government released a 200-page report calling out China for a number of ways it was being unfair. China was stealing American intellectual property. The Chinese government was forcing US companies to transfer their technology to local Chinese firms.

The first week of April, President Donald Trump threatened China with tariffs. Within hours, China said it would retaliate. The next day, Trump threatened more tariffs.

With the actions of those three days, the trade war was suddenly on.

The first round of tariffs would not officially be imposed until July. But March of 2018 is when the world began to change. The US-China tariff conflict became the biggest trade dispute since the end of the second world war. What started small concluded with the world's two largest economies suddenly putting tariffs on over $400 billion of international trade – more than half of their imports and exports with each other.

Five years later, and the trade war never really ended. A truce has now been in place for over three years. But almost all of those trade war tariffs never left.

The US and China are on a new path often referred to as "decoupling." At the same time, there is this emerging puzzle:

News clip (March 11, 2023): *Two-way trade between China and the U.S. showed resilience in 2022 despite ongoing frictions. Newly released data from the U.S. Commerce Department shows China-U.S. goods trade hit a record high of $690.6 billion last year.*

Chad Bown: Somehow US-China trade – both their imports and their exports – are now higher than ever. Even though there is this decoupling.

This episode reconciles these seeming contradictions. It tells the story of the trade war, and it explains what has happened to US-China trade in the five years since.

You are listening to an episode of *Trade Talks*, a podcast about the economics of trade and policy. I'm your host, Chad Bown, the Reginald Jones Senior Fellow at the Peterson Institute for International Economics in Washington.

PART 1. THE TRADE WAR (02:28)

Chad Bown: On the campaign trail in 2016, candidate Donald Trump promised a different approach to trade and especially to trade with China. Trump complained about China stealing American jobs. He was especially focused on the bilateral trade deficit – that China was selling more to the United States than it was buying.

Once elected, Trump followed through on many of his promises to act on trade. First, he forced the renegotiation of NAFTA – the trade agreement between the United States, Canada and Mexico. Then, he imposed controversial tariffs on imports of steel and aluminum under the name of protecting America's national security.

But Trump's biggest moves on trade involved the US relationship with China.

In August of 2017, less than one year into his administration, Trump's US Trade Representative, Robert Lighthizer, began the process. He announced the government was going to investigate China's unfair trade practices under Section 301 of the Trade Act of 1974.

This was weird. Not that the US had problems with China's policies – that was definitely not weird. Previous administrations had found the same thing, but they had chosen to tackle the problem differently, including by bringing China to formal dispute settlement at the WTO.

What was weird was that Trump was dusting off an old law. This Section 301 had been used a lot in the 1980s and 1990s, but since the start of the WTO in 1995, it had been pushed to the side. With Trump, something was truly different.

On March 22, 2018, the Trump administration released the findings of the Section 301 investigation to the public. Over 200 pages, the United States detailed its complaints. China was stealing American intellectual property. It was forcing the transfer of American technology to Chinese firms without paying them enough compensation. The report made lots and lots of detailed allegations.

But to President Trump, it was all about the trade deficit

President Donald Trump (March 22, 2018): *In particular with China, we're going to be doing a Section 301 trade action. It could be about $60 billion. But that's really just a fraction of what we're talking about. I've been speaking with the highest Chinese representative, including the President, and I've asked them to reduce the trade deficit immediately by $100 billion, that's a lot.*

Chad Bown: Ten days later, the first week in April, is when the trade war first started to spiral.

The Trump administration released a list of products it planned to hit with new 25 percent tariffs. That list covered $50 billion of imports from China – not the $60 billion that President Trump had stated earlier. This was the first of many confusing parts of the details of how US policy was changing during President Trump's trade war.

Within hours, the Chinese government had released its own list of $50 billion worth of US exports over which it promised to retaliate, including against American exports of soybeans and cars.

Upset, Trump escalated things further. The next day, he instructed the US Trade Representative to find an additional $100 billion of imported products from China for even more tariffs. Trump also told his Agriculture Secretary to come up with a plan to protect American farmers should China implement its retaliatory tariffs.

The trade war was suddenly on.

The first US and Chinese tariffs were imposed in July of 2018. Another round went on in August – combined, each side had imposed tariffs now covering $50 billion worth of trade.

Following the Chinese tariffs on US agricultural exports like soybeans, the Trump administration said it would provide up to $12 billion of subsidies to support American farmers. Over the next two years, the Trump administration would pay out tens of billions of dollars of subsidies to those farmers. The other parts of the US economy hurt by the trade war – especially the manufacturing sector – did not receive any subsidies.

In September of 2018, Trump followed through with his second threat made during that fateful first week in April. He put tariffs on another $200 billion of imports from China. Again, this was confusing at it was not the same as Trump's original announcement. It was $200 billion, and not $100 billion. And it was also a tariff of 10 percent, as opposed to early indications of 25 percent.

But again, China immediately retaliated.

Over the next few months, things quieted down. No new tariff threats. But also, it was unclear what was going on.

Until finally, in December of 2018, President Trump and Chinese President Xi Jinping had a dinner meeting at the G20 in Buenos Aires. They called a temporary truce to their tariff escalation. They instructed their trade teams to start negotiating.

With the media and cameras clicking away, at the dinner, Trump sounded optimistic

President Donald Trump (December 1, 2018): *The relationship is very special, the relationship that I have with President Xi, and I think that is going to be a very primary reason why we will probably end up getting something that is good for China and good for the United States. So we very much appreciate it.*

Chad Bown: The US and China negotiated. It looked like they were closing in on a deal – the US administration leaked to the press what the agreement was expected to cover. The US side also signaled what the agreement was not going to cover. In particular, the deal would not remove all of those newly imposed tariffs. Nevertheless, it looked like there would be a deal.

Then, in early May, the key US negotiators – Lighthizer as well as Treasury Secretary Steven Mnuchin, took one last trip to Beijing to finalize the agreement. But then the talks collapsed.

On May 5, 2019, the trade war was suddenly back on. President Trump tweeted that the 10 percent tariffs he had imposed in September on $200 billion of Chinese imports – those tariffs would immediately increase to 25 percent. And Trump tweeted that the rest of US imports from China – another $300 billion or so of trade – would also be hit with 25 percent tariffs "shortly."

Now, once again, the details of Trump's tariffs didn't quite match the President's Tweet. But over the next few months, Trump did escalate things further by imposing tariffs on more than $100 billion of additional imports from China. Roughly two thirds of US imports from China would eventually be caught up in Trump's tariffs.

One interesting development – and important for what is happening today – took place in August of 2019. Trump decided to postpone putting tariffs on over $150 billion of imports of products like mobile phones, laptops, computer monitors, video game consoles, and toys.

Here is Trump standing under the Marine One helicopter explaining why he was delaying those tariffs

President Donald Trump (August 13, 2019): *We're doing this for Christmas season, just in case some of the tariffs would have an impact on US customers. So far, they have had virtually none. The only impact has been that we have collected almost $60 billion of tariffs from China, complements of China. But just in case they might have an impact on people we have delayed it so that they won't be relevant for the Christmas shopping season.*

Chad Bown: Trump initially delayed those tariffs because of the products they would hit. They were consumer goods. Most of his earlier rounds of tariffs had hit parts and components or inputs bought by companies.

Tariffs on phones and toys and computers might increase consumer prices quickly and noticeably, making him unpopular, right during the Christmas shopping season.

Of course, Trump was being inconsistent. His other claim was that the $60 billion of tariff revenue being collected by the US government was "complements of China." Economic research would refute, time and again, Trump's claims that China was paying for his tariffs. It was American buyers who were paying the costs of those tariffs. Anyway.

Before that last and final round of tariffs on consumer products was scheduled to go on, in December of 2019, the US and China announced they had reached a deal.

After more than a year and a half of tariff escalation, the trade war was finally over. Sort of.

PART 2. THE TRADE WAR TRUCE AND THE PHASE ONE AGREEMENT (12:12)

Chad Bown: In January 2020, President Trump put on a big event. The White House would host an elaborate signing ceremony for his new trade agreement with China. In attendance were a lot of VIPs. The ceremony was long. It was televised. It was awkward.

President Donald Trump (January 15, 2020): *Today, we take a momentous step — one that has never been taken before with China — toward a future of fair and reciprocal trade, as we sign "phase one" of the historic trade deal between the United States and China. Together, we are righting the wrongs of the past and delivering a future of economic justice and security for American workers, farmers, and families. I want to thank President Xi, who is watching as we speak — and I'll be going over to China in the not-too-distant future to reciprocate — but I want to thank President Xi, a very, very good friend of mine.*

Chad Bown: For trade nerds, what mattered were the legal details of that deal. What had China and the United States committed to in the text of this agreement?

China said it would do a number of things. Chapters 1 and 2 contained promises to better protect American intellectual property and to stop forcing the transfer of foreign technology. Chapter 3 explained how it would get rid of nontariff barriers impacting American farm exports. Chapter 4 committed China to opening up its market for foreign financial services.

But the headline for President Trump was something else entirely. To reduce the bilateral trade deficit, Trump got China to commit to buy an additional $200 billion of American goods and services exports over 2020 and 2021.

President Donald Trump (January 15, 2020): *Phase one will also see China greatly expand imports to the United States…. what is, to me, very important. Number one, they're going to be spending much more than $200 billion over the next two years, including up to $50 billion just on agriculture alone.*

Chad Bown: That additional $200 billion of US exports over the next two years is super important – we will come back to that momentarily.

Equally important though is what was NOT in the deal. There was nothing about China's problematic nonmarket economy and its system of subsidies.

There was also nothing about China removing its trade war tariffs on tens of billions of dollars of US exports. China would later announce a government process whereby the government would decide which Chinese companies would not have to pay tariffs on US goods, but this was at odds with a separate American complaint about the centralized, state-run nature of the Chinese economic system.

Letting the Chinese government decide which companies would be exempt from the tariffs put more power into government hands, instead of the private sector, which seemed massively inconsistent with Washington's underlying concerns.

Finally, this weird US-China deal made the rest of the world nervous. Maybe Trump's $200 billion of purchase commitments would just come at their expense. Maybe China would buy more American stuff, but China would not increase its imports overall. So more US exports would mean less exports from Europe, Japan, Brazil and everyone else.

The world was watching.

On the US side, the United States did not commit to do anything differently. Again, here is President Trump at that signing ceremony,

President Donald Trump (January 15, 2020): *As soon as this kicks in, we'll be starting phase two. We're leaving tariffs on, which people are shocked, but it's great. But I will agree to take those tariffs off, if we are able to do phase two.*

Chad Bown: Almost all of the tariffs that Trump had imposed over the previous 18 months would remain in place. They are still in place today.

There was never a phase two in the US-China negotiations. In part, that is because the world suddenly changed.

COVID-19 emerged in China In late 2019. By January, the disease was already spreading globally. On March 11, the World Health Organization called the outbreak a global pandemic. Over the next three years, the world suffered tremendously. Tens of millions of people would die. Trillions of dollars of economic activity would be lost, because of lockdowns and other shocks to the global economy.

Weirdly though, some elements of the pandemic spurred more trade. We'll come back to that later in the story.

During this period though, China also showed signs of change. Its aggressive "wolf warrior" diplomacy signaled a more hostile foreign policy. China engaged in economic coercion, punishing countries like Canada, Australia, and Lithuania with trade restrictions when it did not like their government policies. In Hong Kong, China cracked down on democracy protests and implemented a national security law. China mounted new military exercises around the island of Taiwan, and there were concerns over a potential invasion.

President Xi Jinping promised a "no limits" partnership with Russian President Vladimir Putin. This put on the world on notice when Russia subsequently invaded Ukraine and started a brutal and deadly war.

In Washington, things were changing as well. At the same time that President Trump's trade deal wanted to expand US exports to China by an additional $200 billion, another part of his administration was limiting exports to China of things like semiconductors and equipment, due to emerging concerns over national security.

American policymakers also began to take action on human rights abuses in China, especially in the Xinjian region. The US Congress would eventually pass into law the Uyghur Forced Labor Prevention Act and ban imports of products from China made using forced labor.

Then, in November of 2020, a new US President was elected. President Trump was now out.

President Joe Biden would have different policy priorities than dealing with China on trade. He had to fight the pandemic. The Biden administration focused its policy efforts at home, with its "Build Back Better" legislation. It passed laws for new infrastructure as well as some industrial policy, including for semiconductor manufacturing, as well as clean energy products to tackle climate change.

On trade policy, the first two years of the Biden administration mostly ignored China. Where it needed to do anything at all on trade, it engaged directly with countries aside from China. With its allies in Europe, it created the Trade and Technology Council. With Japan, South Korea, Australia, and other countries in Asia, it began to negotiate IPEF, the Indo-Pacific Economic Framework.

With the trade war no longer in the day-to-day headlines, the big question was, whatever happened to US-China trade?

PART 3. US EXPORTS TO CHINA (19:45)

Chad Bown: To understand what has happened to US exports to China, it is useful to view them within the context of President Trump's own "phase one" agreement. Here he was in January of 2020 in Davos, at the World Economic Forum, less than a week after his White House signing ceremony:

President Donald Trump (January 21, 2020): *Additionally, China will spend an additional $200 billion over two years on American services, agriculture, and energy, and manufactured goods. So we'll be taking in an excess of $200 billion; could be closer to $300 billion when it finishes.*

Chad Bown: We collected the data and added up the numbers. By the time those two years had finished, China had purchased exactly none of the additional $200 billion of US exports Trump promised it would buy.

Not $100 billion, not $200 billion, and certainly not $300 billion. None.

In 2022, US exports to China did not get much better. Exports last year did go up slightly, so in value terms, technically, US exports to China have set new records. That media headline has generated some confusion. But that record-level headline is a pretty meaningless. Even if export volumes never went up, with any amount of inflation, price increases would mean exports reached record levels every year.

A better comparison is how high US exports would be today were it not for the trade war. Suppose that since 2018, US exports to China had simply grown at the same rate as China's imports from the world. No more, no less, just the average. By the end of 2022, US exports to China were now 23 percent *lower* than that benchmark.

To help me dig into the reasons why China seems to be "decoupling" from its buying of US exports, I will be joined by Yilin Wang. Yilin is my colleague here at the Peterson Institute.

Chad Bown: Hi, Yilin.

Yilin Wang: Hi, Chad.

Chad Bown: OK. As President Trump said, there are basically four sets of US exports we want to look at: manufacturing, services, energy, and agriculture. Let's start with manufacturing.

Yilin Wang: Manufacturing is important because it was the biggest part of US exports to China before the trade war. The US used to export a lot of cars, airplanes, semiconductor equipment and chips to China.

In 2022, US manufacturing exports to China were still lower than pre-trade war levels. They were also 23 percent lower than that benchmark projection – i.e., if we imagine that President Trump had not started a trade war.

Chad Bown: Going back to the trade war, in July 2018, President Trump put tariffs on car parts and China put tariffs on finished cars. With tariffs on its inputs and its output, Tesla said it was no longer profitable to ship electric vehicles to China from its American plants. It expedited construction of its factory in China, and Tesla now sells to Chinese consumers and it exports to the world from its Gigafactory in Shanghai. American auto exports to China have never come back.

Other problems for manufacturing have little to do with the tariffs. Boeing's 737 MAX suffered two crashes. China, the United States, and lots of countries grounded the model for months, to figure out what went wrong. Then, the pandemic reduced demand for new planes, as people stopped traveling, especially into and out of China. But in 2022, China had started buying planes again. Boeing's main competitor – Airbus from Europe – announced major new orders from Chinese airlines. For Boeing, there have not been similar announcements of airplane orders from China. US exports of aircraft to China fell off and remain tiny.

Finally, take semiconductors and equipment. US exports of these products were booming during the trade war as well as the pandemic. In part China needed this stuff because of high demand for goods that used semiconductors – like computers and video games – when everyone was stuck at home during COVID-19. The sudden threat of US export controls led to hoarding by Chinese buyers beginning in 2019. But in 2022, all of that global demand for consumer electronics finally dropped off. Semiconductor sector exports to China declined in 2022. With a major new US export control policy announced in October, US sales to China may never come back.

Next up is Services. Prior to the trade war, services were the second biggest part of US exports to China.

Yilin Wang: US services exports to China fell dramatically in 2020. In 2022, they remained 25 percent lower than their peak.

Chad Bown: During the trade war of 2018-19, US services exports to China actually did OK. Tariffs aren't really a big thing for services trade.

What really hurt services was the COVID-19 pandemic. We don't yet have the reasons why things have not improved in 2022 – that detailed data won't be available until July. At this point all we know is that, at an aggregate level, services exports to China are not getting any better.

But we do now know why things were so bad in 2020 and 2021. One big category of US services exports to China involved travel.

Yilin Wang: These are things like Chinese tourists coming to the United States, Chinese businesspeople traveling here to make deals or to go to trade fairs, or Chinese students coming to study at American universities.

With the pandemic and travel restrictions, all of these US services exports fell by a lot.

Chad Bown: For services, a second important example involved the other legal chapters of the "phase one" agreement. In Chapter 1, China promised to improve its protection of foreign intellectual property. The Chinese government also agreed to stop forcing the transfer of technology in Chapter 2. If those commitments are kicking in, Chinese companies should be paying bigger royalties – or fees – for their use of American technology.

Yilin Wang: The evidence we have so far is that there has been no big increase in the total fees that Chinese firms pay for using American intellectual property.

Chad Bown: A last example involves financial services like banking, insurance, credit rating, financial payments, and securities. In Chapter 4 of the "phase one" agreement, China had also agreed to open up its market to foreign providers of these financial services.

Yilin Wang: Here too, US financial services exports to China remained lower than pre-COVID levels.

Chad Bown: The third part of US exports to China involved energy products. Now, one concern is that the purchase commitments only really covered fossil fuels – i.e., carbon-based energy products like coal, crude oil, and liquefied natural gas, or LNG.

US exports to China of these products did go up a lot in 2020 and 2021. But in 2022, US exports of energy products to China dropped. And the details are even worse than the headline.

Yilin Wang: In value terms, US energy exports to China fell by only 13 percent. But this really understates the decline. In volume terms, US shipments to China of energy products just disappeared. LNG and coal shipments, for example, fell by more than 75 percent.

Russia's invasion of Ukraine is a big part of the story here.

Chad Bown: After Russia invaded Ukraine, Russia weaponized its energy supplies by cutting off natural gas pipeline sales to Europe. Europe also ended up restricting imports from Russia of coal and oil products as part of its sanctions packages.

The United States stepped in to help Europe. It shipped its exports of coal, oil and LNG to the EU and UK instead of to China. China then started buying its energy from Russia and other countries instead.

The last category of US exports to China is agriculture. Agriculture was always in the headlines during the trade war for political reasons. Farming communities tend to vote Republican and were big supporters of President Trump. Soybeans especially were some of the most politically important products targeted by Chinese retaliatory tariffs. Because of those tariffs, farm exports disappeared during the trade war. As compensation, the Trump administration gave those farmers tens of billions of dollars of federal subsidies.

Now, under the “phase one” agreement, agriculture was the one sector to mount an export comeback. China did not quite reach the purchase commitments in the phase one agreement for agriculture, but it was close. US farm exports to China did very well in 2020 and 2021.

In 2022, that continued.

Yilin Wang: Agriculture was the only bright spot for US exports to China. Farm exports were 16 percent higher than 2021. Soybeans are the biggest part of that, and soybean exports increased by 27 percent in 2022. Cotton also did well last year.

But beyond those products, US farm exports to China had some problems.

Chad Bown: Similar to the energy story, prices of farm products skyrocketed in 2022. There were lots of contributing reasons why, including the Russia-Ukraine war. But there was also bad weather in various parts of the world, as well as countries imposing export restrictions. Each of these negatively impacted global supplies and the prices facing consumers.

Yilin Wang: For corn and sorghum, US export values only increased in 2022 because prices went up. Shipments of corn and sorghum actually went down.

For pork and wheat, export shipments to China fell sharply as well.

Chad Bown: On agriculture, one last question involves US-China dependency. Are Chinese buyers shifting toward other suppliers? Are US farmers finding other markets to sell to.

Yilin Wang: Perhaps surprisingly, there is some divergence here. China seems to be becoming less dependent on American farmers. In 2009, 27 percent of Chinese farm imports came from the United States. Last year, that was only 18 percent.

On the other hand, US farmer dependence on China remains high. American farmers shipped 19 percent of their exports to China last year. This is the highest ever, and up from 14 percent right before the trade war.

Chad Bown: China is becoming more diversified, while US farmer export dependence on China remains high. American farmers appear just as exposed as they were during Trump's trade war.

For China, soybeans is an important area where the government is worried about foreign dependence and is trying to reduce it.

Yilin Wang: At the end of 2021, China's Ministry of Agriculture set expanding domestic soybean production as a major political goal. China not only wants to buy less soybeans from the United States, it wants to be less dependent on the outside world.

Chad Bown: This may not be good news for China. In a world with more and more weather shocks like floods and droughts, increased self-reliance for agriculture may not be that great an idea. Increased concentration locally may expose China to other kinds of food insecurity problems.

Overall, US exports to China were the highest ever in 2022. But that is a bit misleading. Manufacturing and services exports are still incredibly low. Energy exports fell and would have been worse but for high prices. Even booming farm exports were not as good as the headlines suggest.

Thus, there are signs that China is decoupling from US exports. China is continuing to import from the rest of the world. It's just that US exports are not keeping up.

One last point on US exports goes back to the concern that Europe and third countries had with Trump's "phase one" agreement. They were afraid that China was not going to expand its imports overall, that China was going to shift and buy $200 billion of exports from the United States instead of from them. In the end, that was not something they needed to worry about.

PART 4. US IMPORTS FROM CHINA (33:39)

Chad Bown: Despite the US-China trade war, US imports from China have not disappeared. Just like US exports, in 2022, US [goods and services] imports from China were also the highest ever recorded.[1] But just like US exports, the real story involves looking more closely into the data.

To start, it is worth the reminder that Trump's tariffs on over $300 billion of imports from China still remain. The evidence to date is that the costs of those tariffs are being born by US consuming industries. Given increasing geopolitical tensions, this now seems like a cost that US administrations are just willing to pay.

So the question is, are those tariffs leading to decoupling on the US import side. Put differently, to sell to American consumers, are companies moving some of their supply chains outside of China? Are US firms sourcing imports from other countries instead?

The answer is: maybe and sometimes. Here is what we know from the data so far: the United States is shifting from whom it buys some products it used to import from China.

Let's start with some of the imported products hit with 25 percent trade war tariffs.

Yilin Wang: Semiconductors – US imports of chips from China are way down. The same is true for furniture and hardware for information technology, and some consumer electronics.

Overall, US imports of products still facing those 25 percent tariffs are about 25 percent lower than their pre-trade war import levels. This is nearly five years later, and with some pretty high inflation in 2022 especially.

[1] According to data from the Bureau of Economic Analysis, total US goods and services imports from China in 2022 were $564 billion; in 2018 they were only $559 billion (Exhibit 20). Total US goods imports alone from China in 2022 ($537 billion) remained slightly below 2018 levels ($539 billion) according to data from Census.

Chad Bown: Today, the United States is buying 25 percent less from China of those products than prior to the trade war. Where the United States is buying from – instead of China – depends on the product.

Yilin Wang: For semiconductors, there are more imports from Taiwan. For certain consumer electronics and IT hardware, the US is buying more from Mexico. For furniture, Vietnam is a major source for those new US imports.

Chad Bown: On the US import side, we have some evidence of decoupling where the tariffs on China remain high.

Now let's turn to imports of Chinese products at the other extreme. These are the products that do not face any trade war tariffs at all. These are the ones that President Trump decided in August 2019 not to hit with tariffs because he was worried that prices would go up, ruining Christmas for American consumers.

Yilin Wang: These are things like toys and video game consoles and smartphones, laptops and computer monitors. Imports from China of those products are [42] percent higher than they were before the trade war. There are no signs of decoupling there.

Chad Bown: Imports of these products are now so much higher for a number of reasons.

One was the new demand spurred by the weird features of the pandemic. People were forced to stay at home. They needed to buy computer equipment to work from home or to get their kids into online schooling. They couldn't spend money on vacations or services. So, they bought more video games and toys and other consumer products. But these were disproportionately the ones that Trump had decided not to impose tariffs on.

Before moving on, there are one last set of imported products from China. This third set continues to face trade war tariffs – but with a much lower tariff rate of only 7.5 percent.

In 2022, US imports of those products from China remained just a tad lower than their levels before the tariffs went on. In terms of the impact of those tariffs, this makes economic sense. Imports of these products from China are right in the middle – not as low as the imports hit with the 25 percent tariffs, but not as high as the products where there were no tariffs.

Yilin Wang: Clothing and footwear are important examples of imports facing those lower trade war tariffs. US imports from China of these products have dropped off. The United States is now importing more from countries like Bangladesh and Vietnam.

Chad Bown: Clothing and footwear are hardly strategic products in a globalized economy. Some of these supply chains were moving out of China anyway, even without the tariff. These are very labor-intensive industries, and wages in China have been increasing, pushing the sector to move for other reasons. So production likely would have ended up in places like Bangladesh and Vietnam anyway, even without the trade war.

Chad Bown: Thanks, Yilin.

Yilin Wang: Thanks, Chad.

Chad Bown: That is how we reconcile what seemed like a contradiction. US imports from China in 2022 were higher than ever. Yet, there is also important evidence of decoupling.

Imports from China of the products that Trump never imposed tariffs on have boomed. But many of the products facing his trade war tariffs of 25 percent have started to decouple. The United States is beginning to source more of those products from other countries.

So, these is some decoupling on the US import side, and where you see it makes sense. You just need to use basic economics to know where to look.

These are the facts. But there is still a lot that we just don't know. These data can only tell us so much. For example, this evidence about "decoupling" comes from the final assembly of production. We know that China is buying more from other countries and less than expected from the United States. We also know that the United States is buying more from third countries. But that's it.

On those new sources of US imports, we don't know, for example, who is doing the final assembly in a country like Vietnam. We also don't know from where those Vietnamese final assembly plants are getting all of their inputs.

It's possible that not much else in the supply chain has really changed. Maybe it is the same exact company doing the final assembly, they are just doing it in Vietnam instead of China. Maybe that company is even Chinese. Maybe the company is also sourcing inputs from the same suppliers in China for their plant in Vietnam. We'll have to wait for other sources of data to learn the answers to those questions.

The point is to be careful before jumping to conclusions about the extent or shape of decoupling based on this data alone.

PART 5. WHAT'S NEXT ON US-CHINA TRADE (40:34)

Chad Bown: To conclude this episode, I wanted to talk about what's next. At the moment, there is no US-China policy engagement on trade. There has not been much US-China policy engagement on anything.

News (February 16, 2023): *President Biden is about to address flying objects recently shut down in North American airspace including the February 4 downing a Chinese fine balloon off the South Carolina coast.…*

Chad Bown: The spy balloon incidents of January and February forced Secretary of State Antony Blinken and Treasury Secretary Janet Yellen to cancel long anticipated trips to Beijing. And with Russia's war on Ukraine, China's alignment with Russia also makes any US-China engagement difficult.

No one knows when the US Trade Representative, Katherine Tai, for example, would be able to connect with her Chinese counterparts to negotiate over the future of US-China trade relations, or if even that would be the Biden administration's approach.

However, when it comes to what's next on trade for the Biden administration, it does have IPEF.

President Joe Biden (May 23, 2022): *Thank you all for joining today for the launch of the Indo-Pacific Economic Framework for Prosperity… We're launching today with countries from across the Indo-Pacific. We're here today for one simple purpose. The future of the 21st century economy is going to be largely written in the Indo-Pacific and our region.*

Chad Bown: IPEF is not a traditional trade agreement. There are no negotiations over cutting tariffs. And that is a problem. US farm exports, for example, really do need to find other markets to diversify sales away from China.

And then there is the US import side. While US tariffs on average are quite low, they remain stubbornly high in sectors like clothing, textiles and footwear. For some products in those sectors, the tariff is 20 or 30 percent or more. Cutting those tariffs would be valuable for some of the lower-income, labor-abundant IPEF countries. Tariff cuts could be offered as carrots that would encourage those countries to take on the labor and environmental commitments of interest to the Biden administration.

The Biden administration has been criticized for not offering exporters in those thirteen other trading partners any additional access to the US market. But that criticism is not quite right.

Biden's decision to keep the trade war tariffs on China means the United States is giving all of these other countries at least a tariff preference into the US market when it comes to their major foreign competitor – China.

IPEF is saying, "If you make your product in Vietnam or India or Thailand or Singapore, you have to pay less to sell into the US market relative to making it in China." It is either 25 percent less or 7.5 percent less, depending on the product and the trade war tariff. That is additional market access.

Now, it is not just IPEF countries that can benefit from this new market access coming from the tariff preference. But for the firms now making the investments to create that additional supply chain and wondering where they should go, the Biden administration is signaling that these IPEF countries look OK.

In the data, we are seeing some of that now show up. For example, US imports of furniture are shifting toward IPEF countries, as are imports of some IT and consumer electronics.

This is not causal evidence. Some of that supply chain movement would have happened anyway – even without IPEF, and even without the US tariffs on China. Higher wages in China means labor-intensive production especially – things like clothing and apparel – were likely moving out of China to lower-wage countries like Vietnam or Thailand.

But what this does say is that IPEF actually has more economic meaning than it is currently being given credit for – once you combine IPEF with the decision to keep the tariffs on China.

IPEF is certainly not like an old-timey free trade agreement. But for us trade nerds, these are also no longer old timey times. Trade negotiators have to play the hand they are dealt.

GOODBYE FOR NOW

Chad Bown: And that is all for *Trade Talks*.

A big thanks to my colleague Yilin Wang, for all of her help this week on data.

We made reference to lots of data and charts in this episode – if you want more details and to see the charts, I will make sure to put links to all of this on the episode page on the *Trade Talks* website.

Thanks to Melina Kolb, our supervising producer. Thanks to Sarah Tew, on digital.

As always, thanks to Collin Warren, our audio guy. Do follow us on Twitter or Mastodon, we're on @Trade__Talks. That's not one but two underscores, @Trade__Talks.

<insert super funny double underscore joke here>. ■

Read more…

Bown, Chad P., US imports from China are both decoupling and reaching new highs. Here's how. *PIIE Chart*, 31 March 2023.

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Bown, Chad P. and Melina Kolb, Trump's Trade War Timeline: An Up-to-Date Guide. *PIIE Trade and Investment Policy Watch*, 2022. (Updated as events unfold since March 2018.)

Bown, Chad P., The US-China Trade War and Phase One Agreement. *Journal of Policy Modeling* v43, n4 (July-August 2021): 805-843.