Episode 215. How China's trade is holding back developing countries

Episode webpage

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Transcript

(lightly edited)

Chad Bown: Hey *Trade Talks* listeners, Chad Bown here. Some news. And yes bear with me, it is about our new book, *How to Win a Trade War.*

Tonight, Monday May 18. Soumaya Keynes and I were invited to go on *The Daily Show* with Jon Stewart.

Jon Stewart: "Welcome once again to the Daily Show, My name is Jon Stewart…"

Chad Bown: Hold on, let me say that again: *The Daily Show* with Jon Stewart. I know, absolutely wild. We talked about the book and a lot more. I will post a link to the interview with Jon Stewart in the show notes on the *Trade Talks* episode website.

Lots more going on this week. On Wednesday May 20, Soumaya and I have our Peterson Institute book launch with Greg Ip of the *Wall Street Journal* and Inu Manuk of the Council on Foreign Relations. Make sure to register on the Peterson Institute website to join us in person, or it will be streamed online. Then on Friday May 22, *How to Win a Trade War* will be at Politics & Prose at the Wharf in Washington DC, where Soumaya and I will talk about the book with Joey Politano. It's free. If you are in town, please come.

Please order the book this week if you have not yet done so. It is now available anywhere that you buy books.

And with that, here's the show.

THE EPISODE

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.

In this episode, we are going to talk about China.

Today, you are going to hear about a different kind of problem that China is causing in the international trading system. This one hurts other developing countries. China just won't stop producing so many clothes, shoes, and toys.

To make sense of all this, I will be joined by a very special guest.

Arvind Subramanian: I'm Arvind Subramanian, senior fellow at the Peterson Institute.

Chad Bown: Arvind Subramanian is my colleague here at the Peterson Institute. Arvind was the chief economist for the Indian government from 2014 to 2018. He is an amazing scholar, having published important studies about nearly every area in international economic policy during his distinguished career. And today, Arvind is going to share some brand-new research.

Hi, Arvind.

Arvind Subramanian: Hi, Chad.

Chad Bown: We are going to get into China's impact on developing countries momentarily, but first let's start with what we know about rich countries.

How has China's integration into the global economy over the last 30 years impacted high-income economies like the United States and Europe?

Arvind Subramanian: Since about the mid-1990s, the world experienced what I've called hyper-globalization, and part of that was this enormous boost to the world economy that came about because China, and to a lesser extent India, joined the world economy, and I think it's one of the biggest productivity shocks that the world ever experienced.

Essentially, it's saying about 300-500 million labor force in the two countries entered the global economy, supplying cheap goods, showing productivity increases, and frankly, the world economy boomed in the early 2000s for about 10-15 years, in large part because of the entry of these two giants into the global economy.

The most positive channel was prices remained low and came down even for many manufacturing goods and for manufacturing inputs.

So in the first instance, I think advanced economies experienced it as access to cheaper goods and services, and macroeconomically in the form of low inflation. You know, macroeconomists talk about the great moderation from about the mid-1980s to about 2010-2015, inflation remained low. A lot of it was, I think, the fact that China produced consistently cheap goods and services for the whole world.

Chad Bown: So that is the huge positive effect of China's integration for advanced economies. What about the negative effects?

Arvind Subramanian: The way the negative shock felt itself in advanced countries was because China, with its cheap labor, was producing such competitive goods and services, countries like the US that were producing these goods got out-competed.

A classic example is Hickory, North Carolina, and there was a *New York Times* piece[1] on it last month, where it was producing furniture that could last for years and years and decades, just got wiped out because Chinese furniture was much cheaper, and that led to a lot of unemployment, and all the pathologies that come with a small town losing factories and jobs.

The estimate is that in the US, for example, something like two to two and a half million jobs were eliminated by this competition in cheap goods from China.

Now, we have to be careful. I think that's contested because, while it's true that those parts of the country that were more exposed to China and that were explicitly competing with Chinese goods did suffer, but I think it's more disputed whether there were aggregate job losses in manufacturing because you lose jobs somewhere, jobs are created elsewhere because of the dynamism that we spoke about earlier.

[1] Davis, Bob. 2026. "The Town That Reveals All of Trump's Bad Economic Ideas." *The New York Times*, April 20, available at https://www.nytimes.com/2026/04/20/opinion/america-manufacturing-recovery-china.html

But it's clear that some parts of the country, some regions, were very adversely affected. So that's China shock one.

Fast-forward, say, twenty years to today. Essentially we're in a world where rich countries, and the US in particular, now largely competes with China on more high-skilled goods. So just to be clear, by low-skill goods we mean apparel, textiles, footwear, leather, toys, and stuff.

And now as we go up this technology and skill chain we're talking about things like, let's say, EVs, electric vehicles, solar panels, batteries.

I think, President Trump put it very well. He said, "Now we produce tanks, not T-shirts."[2] And so the West now competes with China in these more sophisticated goods.

And now the competition is therefore much more sectoral rather than broader based, especially in electric vehicles. And what you find is that the German development model, as it were, which was based on cars and the internal combustion engine, is actually being decimated by exports from China. And that's China Shock 2.0.

THE BENEFITS AND COSTS OF CHINA'S RISE FOR DEVELOPING COUNTRIES

Chad Bown: The China 2.0 story, the one that you just described, really does drive the narrative today, and that seems to be all that anyone can talk about when they're talking about China.

But I want to talk with you about how China is impacting developing countries. So first, let's work through some of the ways that China's emergence has actually been a positive for these poorer countries.

Arvind Subramanian: I think in the early 2000s when China was booming, Chad, I think the big way that developing countries benefited were as commodity exporters because Chinese manufacturing required a lot of commodities: zinc, nickel, iron, steel. And all those poorer countries that were producing commodities, especially in Africa, Zambia is the canonical example. There was so much demand for their goods and services, prices went up, and so they were booming on the back of that.

The other way in which I think it felt itself is those countries, say, in East Asia that were part of the Chinese value chain, i.e., either they were supplying to China or getting goods from China,

[2] Mason, Jeff. 2025. "Trump Says US Wants to Make Tanks, Not T-Shirts." *Reuters*, May 25, available at https://www.reuters.com/world/us/trump-says-us-wants-make-tanks-not-t-shirts-2025-05-25/

because China was doing well, they also were doing well by being close to China. Because you're close to China, you buy more and sell more to China, including selling stuff that China required to export elsewhere. So I think there were two really big benefits from China.

Chad Bown: Now maybe let's turn to the ways that China's economic rise has not been so great for other developing countries.

One is relatively obvious. For many countries, it's the same China shock one story that you told us hit rich countries. If China's exports into your market kill off your country's domestic manufacturing industry, like it was those low-skilled, labor-intensive goods in the United States, then that's going to be bad for you.

But you're arguing that there's more to the story here. What's the theory?

Arvind Subramanian: We call this the China squeeze. China produces garments and apparel, and it's being felt mostly in the same low-skilled goods. And here's the paradox and the puzzle, which is that we spoke about China Shock 2.0. China is becoming richer, technologically very advanced. It's able to produce things at scale very cheaply, taking advantage of its large market, and so it's becoming very competitive in EVs and solar panels.

But why is it continuing to produce footwear, garments, et cetera, et cetera, when it should stop producing those, or at least producing fewer of those goods and services, and concentrating on the high-skilled things?

Chad Bown: You argue in your research that looking at this standard export data all by itself is the wrong way to do so, or it tells us an incomplete story. Why? What data should we look at instead, and what do you find when you do?

Arvind Subramanian: The statistic we have which I think is striking is that China's share of low-skill exports to the world peaked around 2014, 2015 at about, let's say, 50 percent and started declining.

But, and this is a subtle point, when a country exports a good, let's say a T-shirt. It's a T-shirt and we count T-shirts. But all the value that goes into the T-shirt, not just the T-shirt, but the raw materials that go into it, like the zips, the cotton, the yarn, where is all that produced?

Now, if you aggregate all that up, and we call this value added, essentially the payments that goes to the labor predominantly that works on these goods, we find that for China's [exports], this value peaked at about 64 percent in 2015, but it's remains at, if anything, maybe it's marginally gone up, and you would expect that should come down significantly.

Chad Bown: Let me play devil's advocate. China's value-added share of exports for these low-skilled manufactured goods is either growing or is flat at least.

But do we know that they're taking this away from other poor countries? Alternatively, if China is not only making the T-shirt, but China's making the sewing machine that makes the T-shirt too, China might be taking away this value added, not from other poor countries, but from industrialized countries, as the ones that used to make the sewing machines. Is there any chance that the data is capturing those sorts of issues?

Arvind Subramanian: That's certainly a possibility which we shouldn't rule out, but here's a small piece of evidence that I think is quite telling. We spoke about what happened that the fact that China's value-added share has either been flat or rising.

But for a five-year period from 2015, when China actually allowed its exchange rate to be a bit more flexible, that share actually declined. And then from 2020 onwards when China started intervening to keep its currency lo,w or cheap, its global value-added share started rising again.

It seems to suggest that there may be factors like what you mentioned, but clearly Chinese policies are affecting how much developing countries can effectively compete with China.

Chad Bown: Let's put this story about China into some sort of historical perspective. What do we know about the development path of other countries, today's rich countries, that were once themselves producing these types of goods? How does China today compare with these countries at their similar stages of economic development?

Arvind Subramanian: In 1965, the West, broadly considered, used to export 65 percent of all these textiles, leather – i.e., the same low intensive goods. Today, it's less than 20 percent, maybe 15 percent. Over time, rich countries have given way first to the East Asian tigers, Japan, then South Korea, Taiwan, Indonesia, and then finally China.

So when we compare whether China today is doing better or worse than other countries, you have to make two corrections to the data.

One is that you have to compare countries at the same stage of development. If you're richer, you're going to compete less or because you're going to be less competitive.

Similarly, when you compare today with the 1960s, there's just been more globalization.

So when you make these two corrections, what you find is that China is actually exporting much more than rich countries were at a comparable point in development. The number that comes

out from the data is that if China had followed that development pattern as other countries, something like hundreds of billions of dollars of low-skilled exports would be made available to poorer countries, and that's the China squeeze.

Chad Bown: So far we've been talking about China's exports, which have been booming. At the same time, another concern is that China's imports from the world have been basically flat over the last five years.

What about the slice of China's imports of goods that are particularly important for the exports of these other developing countries? How have those Chinese imports performed?

Arvind Subramanian: If you look at the same low-skilled intensive goods, China's imports of these goods from poorer countries has actually been declining over time.

And again, if you compare it with rich countries at a comparable point in development, rich countries used to import three to four times what China currently does. Therefore, to just sum it up, the China squeeze for developing countries is felt in developing countries' own markets, because China is very competitive in third markets, but also in the Chinese market itself, because China just doesn't import as much as it should.

Chad Bown: So the United States and, and other industrialized economies opened up to China, its imports came in and they experience a China shock. But China's not doing the same thing. China's not experiencing its own version of a China shock.

Arvind Subramanian: Exactly. China should be importing much more of goods that matter to poorer countries because China is presumably much richer than it used to be.

THE DRIVERS OF CHINA'S LOW-SKILLED MANUFACTURING DOMINANCE

Chad Bown: Let's turn to potential causes for these puzzling results that you have found about China and the fact that it's not vacating low-skilled manufacturing industries like other countries have in the past.

One possible explanation is wage suppression. China's not known as a country that is supportive of labor rights and collective bargaining. Are excessively low Chinese wages part of the story here?

Arvind Subramanian: I think the argument is very weak for wage suppression for the simple reason that Chinese wages have risen substantially. China's wages today are something like $10,000 in these manufacturing sectors. Bangladesh and India are $2,000-$3,000, maybe it is $4,000 in East Asian countries.

So Chinese wages today are still substantially greater in these manufacturing sectors than in comparable developing countries.

Chad Bown: So if it's not wage suppression, then what are the other factors that are likely driving this?

Arvind Subramanian: So there are two other factors.

One is industrial policy, China is giving subsidies, cheap credit, and other forms of support. And there, recent evidence from the IMF and from the Fed suggests that China does provide a lot of these subsidies, but it's much more in the high-tech sectors than the low-tech sectors. So that's not the primary cause.

Which leaves us, I think, with the final reason, which is the exchange rate, which as you know, affects all sectors, including labor-intensive sectors.

We do find evidence supporting cheap exchange rate or a manipulated exchange rate as the potential cause because, as I said, between 2015 and 2020, let's say, China did allow its currency to appreciate. Then in that period, developing countries did raise their global export market share. And conversely, when the Chinese exchange rate started being suppressed after 2020, again, global export market share of developing countries started declining once again.

DEVELOPING COUNTRIES' CHALLENGES AND RESPONSES TO CHINA'S TRADE DOMINANCE

Chad Bown: So what do we do about it? This is not a point of emphasis in your paper, but I wanted to have us think about the underlying political economy here.

Arvind, you were in the Indian government as the chief economic advisor between 2014 and 2018. You know how governments work. Was this an issue at the time for the Indian government that you heard as part of the conversation?

Arvind Subramanian: Yes, it was, and as it was for many other countries. But Chad, here's the interesting thing: Most of that was focused on cheap Chinese imports into these economies.

And that's why, as you know, if you look at the data, and you know this better than anyone, is the number of what we call anti-dumping, countervailing actions, i.e., import restrictive action against cheap imports. Developing countries were the major users, and most of those actions were targeting Chinese imports. So there, I think it was being felt.

But here's the puzzle, and maybe it's not a puzzle, is when you're competing in third markets, it's a bit trickier because it's like a foregone opportunity. It's like a counterfactual rather than an actual.

When imports come in, it's an actual problem, and it becomes more salient. But if you're competing, say, well, we could have exported more, that has less salience in policy circles.

Chad Bown: So when I was the chief economist at the State Department, I went around the world, and part of my job was to listen to other countries, including to policymakers in developing countries, and to hear what their concerns were. And it was exactly as you noted. It was the fear of imports from China coming in and devastating their industries.

But I didn't hear much about the concerns that you raised, which is competing in, in third markets in China, not vacating that space. So it does raise the question of why.

I have a theory. It's a two-part theory. Let me put it out there, and I'm curious about your reaction to it, and I think it's consistent with what you just suggested.

The first part of the problem is that any potential exporting economy, when it wants to benefit from access to a new foreign market, if the foreign market isn't open to your firms yet, so suppose we're talking about India here, then those Indian firms don't actually exist.

There aren't these mega Indian exporting textile and clothing firms supporting the global economy. And if they don't exist, then they're not there to lobby for policy actions to get those markets open.

This was a point stressed in a great paper by Raquel Fernandez and Dani Rodrik[3] in the early 1990s, that it's really the uncertainty over who's going to benefit from China vacating a space like this that prevents the collective action of the firms to lobby in the first place to ask for it. So you don't know who those beneficiaries are going to be. So that's the first problem.

[3] Fernandez, Raquel, and Dani Rodrik. 1991. "Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty." *The American Economic Review* 81(5): 1146–1155.

But second, even if there were firms lobbying in a country like India to push for something like this, when you start to think about it, no individual developing country has the incentive to go out and do it on its own.

Imagine the Indian government were to sit down with the Chinese government and then engage in some sort of trade negotiations to solve this problem. What the Indian government would be asking for is to say, "Hey, China, stop exporting so much to the United States, to Europe, to Japan, all of these other countries out there in the world. We want access to that."

Well, trade negotiations are typically reciprocal. China's going to request something from India in exchange, equivalent to what it's going to have to give up.

But the problem is India's not going to be the only one benefiting from China actually giving up all of those exports to all those other markets, because if China actually did that, not only would the Indian firms enter, but companies from Bangladesh, Vietnam, Angola, and all these other countries of the world will also be able to benefit from that too.

That is the kind of standard free rider collective action problem where no individual country has an incentive to be the one to step up to negotiate to make this kind of thing happen.

So what do you think? Do you buy that argument?

Arvind Subramanian: I like both the arguments and let me see what variation I can think off of those. So let me start backwards actually with the, with the second thing you said, Chad.

It's going to be very difficult for smaller countries to get China to change its policies. Even if they got together, China is just so massive that I think it would be difficult to persuade China.

So I think the strategy therefore for countries on this, and this relates to your first point as well, is then to go to these third countries where the competition happens and try and negotiate free trade agreements so that you get a competitive advantage vis-a-vis China by having more favorable access. For example, Vietnam negotiated a free trade agreement, and under the GSP and other schemes, Bangladesh, for example, had more preferential access.

One way in which I think it manifested itself is just saying, "How can we have a leg up against China in these markets?" Not via China's policies, but by the policies of those other countries who may be more open to listening to that.

I think that's why I think you saw a series of free trade agreements being negotiated by Europe and others with other developing countries, and that's why, in fact, India has negotiated with

the European Union and is on the verge of negotiating something with the US, partly to get that.

Chad Bown: Because one of the challenges there, though, is If the nondiscriminatory tariff, the MFN tariff, the tariff that China gets from a Europe is sufficiently low, then no amount of tariff preference is going to be enough to get these countries that competitive advantage relative to their Chinese competitors.

Arvind Subramanian: That's a good point, but as you know, if you look at the pre-Trump MFN schedules of the EU and the US, the highest tariffs were in low-skill goods – i.e., 15 percent, maybe 12 percent. That's a reasonable competitive advantage.

The second, I think, answer to your first point about if these firms are very small, or like take India as a great example of what you just said we have 2 to 3 percent of global market share. These companies just don't have the muscle and the heft, and they are actually distracted by other things that they want from the government. So to go to the government and say, "Work on China to change its policies," is a bit of a stretch.

But the final point I would say is that, and here's the funny thing, that if we believe in this case, as we just discussed, that the Chinese exchange rate is a big part of the problem, then multilateral mechanisms like the IMF and even some of the US currency manipulation action, those actually end up benefiting developing countries if successful.

But of course, the IMF has famously been fairly reticent about Chinese exchange rate policy and manipulation. I think, therefore, it's easier for developing countries to work through these other mechanisms than confront China directly.

Chad Bown: What would it take for China to not wait for reciprocity, but to just do this on its own?

Arvind Subramanian: In the current geopolitical moment, I would say China should have a unilateral incentive to actually listen to this complaint or grievance by developing countries and to act unilaterally for the following reason.

I think it does have aspirations to being a hegemon and to being considered a rival to the United States. And in this geopolitical moment when US unilateralism has upended all the rules, which affects all these countries adversely it's a moment for China to say, "Look, this is a moment where enlightened self-interest is something that we should consider," and that could involve actually saying – because to be fair to China, it has reduced tariffs on exports of sub-

Saharan African goods, for example, maybe to zero. But it could go just take that step further, that enlightened step further, and say, "Look, that's a policy action, but we want to make sure that it translates into outcomes and make sure that developing countries do compete more effectively in third markets."

So there's a geopolitical moment for, if its claims to benevolent hegemony have any serious bite to it, it should act unilaterally.

Chad Bown: One challenge that I think we've both identified here, though, is there really isn't a mechanism in the trading system in negotiations for countries to negotiate over access to third markets.

It may make sense for China to be self-enlightened and to want to do this, but oftentimes it takes negotiations. But the challenge is there isn't the other side asking China to stop doing this thing in third markets, and in exchange, I will give you something else. We just haven't had the pairings of a negotiating process that have typically addressed those sorts of challenges.

Now, we've never been confronted with a world like this before, and so one positive outcome coming out of your paper is maybe now everyone will see it and understand it, and this will open up new paths of opportunities for negotiators to do something productive with their time.

Arvind, thank you very much.

Arvind Subramanian: Thanks for having me, Chad.

GOODBYE FOR NOW

Chad Bown: And that is all for *Trade Talks*. A huge thanks to Arvind Subramanian, my colleague here at the Peterson Institute and the former chief economic advisor to the government of India. Do check out his new research with Shoumitro Chatterjee titled, " China's mercantilist squeeze on developing countries." I will post links to the paper on the *Trade Talks* episode website.

A big thanks as well to Isabelle Robertson, our audio producer. Thanks to Melina Kolb, our supervising producer, and thanks to Sam Elbouez and Sarah Allen on digital.

Please subscribe to *Trade Talks* on Apple Podcasts, on Spotify, or wherever you get your podcasts. Even if you're a long-time listener, please take two minutes to leave a review. That is how new listeners will find the show.

And thanks again if you've already ordered a copy of my new book titled *How to Win a Trade War*. It is available on bookshelves now wherever you find books. *How to Win a Trade War*.

See you next week, everybody.

MORE

Shoumitro Chatterjee and Arvind Subramanian, "China's mercantilist squeeze on developing countries" PIIE Working Paper, May 2026.

Soumaya Keynes and Chad P. Bown – "How to Win a Trade War," The Daily Show with Jon Stewart, May 18, 2026.