

***Emerging countries: winners and losers in the trade war.
A brief note***

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Outline

- ***The fourfold short-run impact of the tariff war on trade flows***
- ***Trade contraction***
- ***Export re-direction***
- ***Supply-switching and crowding out: winners and losers***
- ***Some caveats and main findings***

- **The Trump administration's primitive view of trade policy tools is that the main effect of tariffs is to punish the country on which they are applied, while favouring the country which applies them. Such zero-sum view of trade war seems to be far from reality. In fact this type of conflict presents many other costs, including on the country applying the tariffs, due also to the other contender's retaliation.**
- **Alongside these widespread costs, trade wars tend to engender a lot of reshuffling of world trade flows even in the short term.**

The fourfold impact of the tariff war on trade flows

Tariffs generally tend to cause an increase in the import price of products. The increase in domestic price of imports may have *four direct effects* (Fig.1). To illustrate such consequences, I prefer not to use the standard terms deriving from the trade literature, namely the terms ‘trade diversion’ and ‘trade creation’, as they refer to welfare analysis, which is not the aim of the present note.

➤ ***Trade contraction***

By making the imported products relatively more expensive, the imposition of restrictions tends to reduce trade flows among the contenders (that’s why the restrictions were imposed in the first place!).

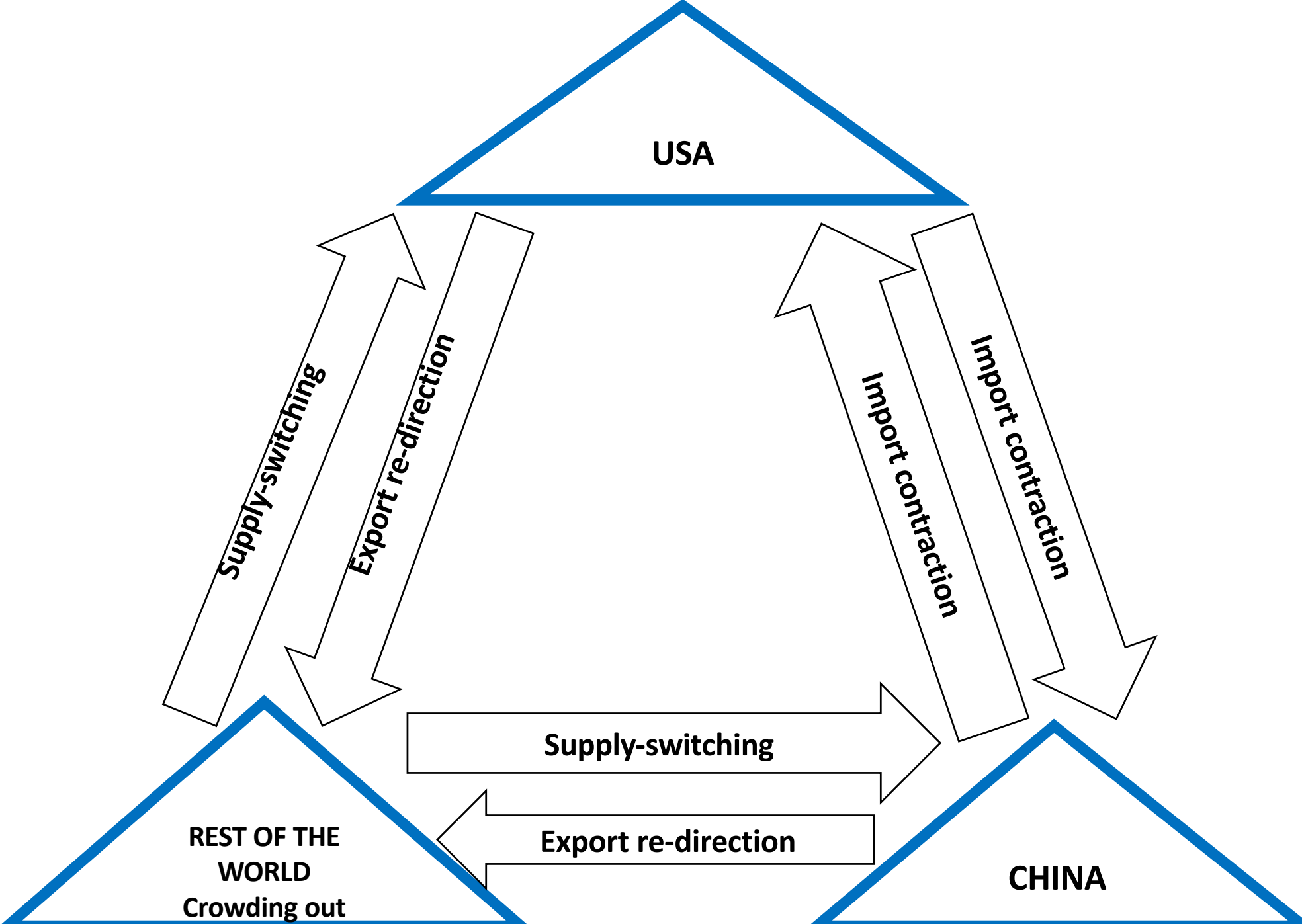
➤ ***Export-re-direction***

The imposition of tariffs prompts also a possible change of direction of existing trade flows. The first form that it takes is *export-re-direction* , i.e. the imposition of a duty leads to a possible re-direction of the affected country’s exports to third markets.

➤ ***Supply-switching and crowding out***

A second form is represented by *supply-switching or import source diversion*. The reduction of imports of the countries that have suffered tariff increases comes possibly in favour of other countries that were not affected by the protectionist measures. At the same time, there could also be a third form of change, that is some of the “winning” countries’ exports may substitute some of the “losing” countries’ exports on the two contenders’ markets - the *crowding out* effect.

FIG. 1 - The fourfold impact of the tariff war on trade flows



The objective of the present note

- **After the inception of the tariff war launched by the Trump administration, several studies by international organizations, consulting firms and independent analysts have been conducted on the *potential welfare impact* of this conflict through the use of different variants of CGE models.**
- **The present note, an initial assessment of an ongoing research, is much more limited in scope: it aims at estimating what *actual changes in trade flows* took place already since the start of the conflict and which emerging countries could be defined as “winners” or “losers” in terms of increases/decreases of export flows. In this initial note, the analysis will be limited to the short-term impact on global trade flows, leaving the analysis of the commodity composition to a later stage.**
- **The analysis rests on monthly data of trade in goods derived from the US Census Bureau and the General Administration of Chinese Customs database. The two periods under comparison are January-July 2019 (most recent data available at the time of writing) as against January-July 2018, a period when the effects of the trade war were not fully felt yet.**

Trade contraction

- **As expected, the tariff war accompanied by quite a lot of reduction in the US-China trade flows over the period under consideration.**
- **US total imports from China went down by 9.1% . The decline was particularly sharp in all the groups of products on which tariffs were imposed, concerning, inter alia, many intermediate products, auto parts, machinery, rubber and plastics. The drop ranged between 30% and 50%, according to the different sectors affected by tariffs.**
- **Such US import reduction might have been larger, since, in cases where there was a delay between announcement and implementation of tariffs, or tariff increases, US importers increased their imports in advance of the effective dates, thus accounting for the sharper decline in imports thereafter.**
- **As China imposed retaliatory tariffs, the US total exports to China declined even more - by 28% on average - ranging from 20% to 60% according to the different list of products affected by tariffs. The sectors most affected were agricultural commodities and products, chemicals, motor vehicles, various types of machinery, paper waste and cotton.**

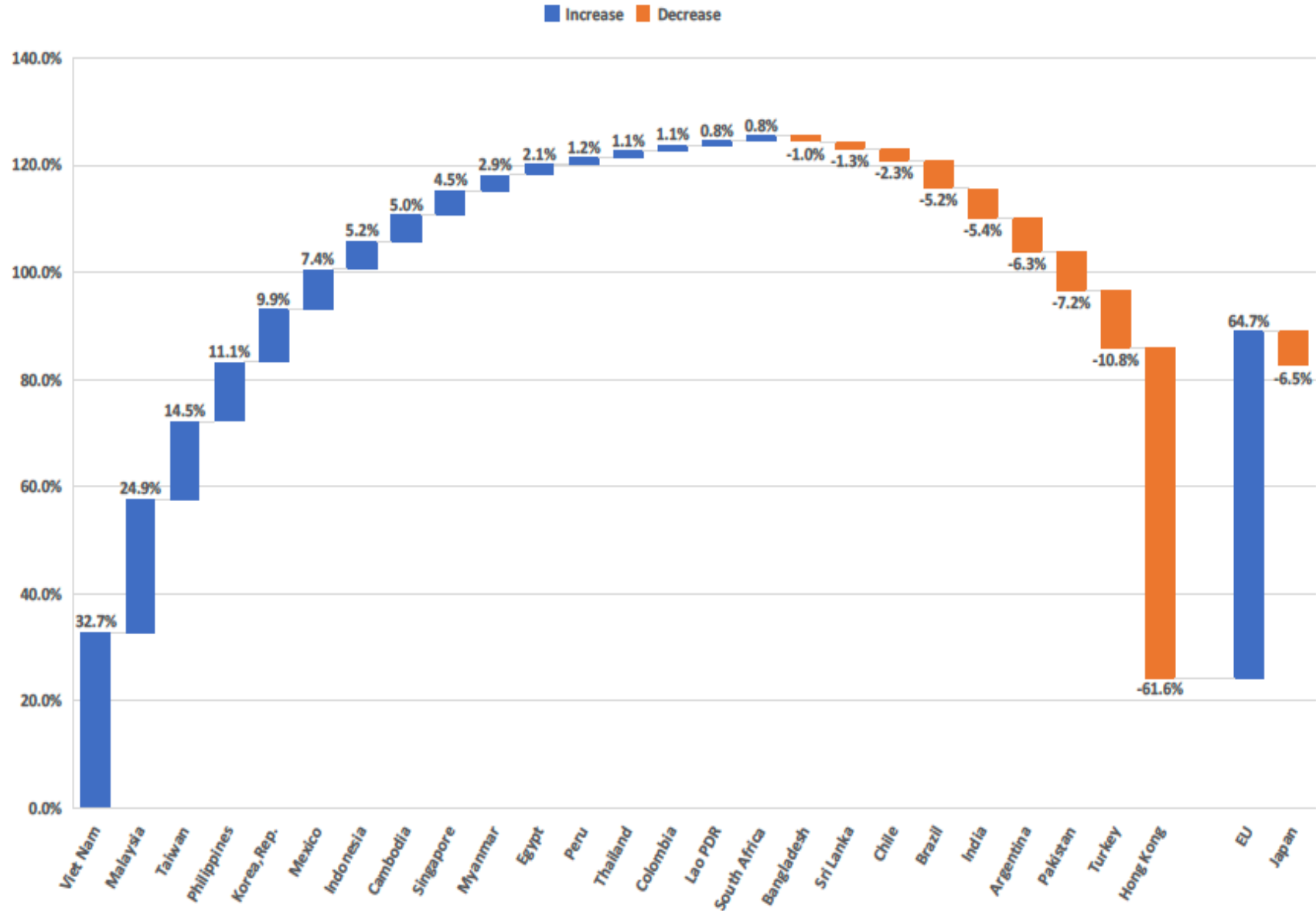
China's export re-direction

- **Since the present note concentrates on emerging countries and does not intend to analyse the US specifically, I am considering here only one of the contenders, China. Was this country able to re-direct partially or totally the exports that she lost vis-à-vis the US? How can we approach a measure of its export re-direction, lacking a precise indicator of it ?**
- **One indirect, suggestive indicator could be to compare the absolute amount of China's export increase towards each of the other countries with the absolute decrease of China's exports towards the US over the period under consideration. In the following figure (Fig. 2) this share was calculated for the major outlets among emerging countries, plus the EU and Japan as a memo.**
- **Overall the results seem to suggest that China might have succeeded in re-directing a substantial amount of exports away from the US towards other destinations.**

China's export re-direction (cont.)

- **The largest amount was destined to the EU, equal to 65% of the loss in the US market. Among the emerging countries, Vietnam (33%) and Malaysia (25%) come way in front of the others, the following country, Taiwan, accounting for 14.5% of the same. More in general, some re-direction took place towards most Asian countries, at the exception of Bangladesh, Sri Lanka, India and Pakistan (towards which an export contraction took place).**
- **The substantial export decline (equal to 61% of the US loss) towards Hong Kong is a case apart, since many of those exports (not officially reported) use Hong Kong as a platform, so that they should be added to the counting of China's losses.**
- **As for Latin America, some important re-direction took place towards Mexico and very little towards Peru and Colombia, while there was an export contraction towards the other major Latin American countries (more than 5% in the case of Argentina and Brazil), as well as towards Japan.**
- **Altogether, the positive re-direction of Chinese exports towards some countries (the blue sticks in figure 2) seems to have outpaced the opposite negative trend towards other countries (the red sticks), leaving a wide margin of possible re-direction away from the US.**

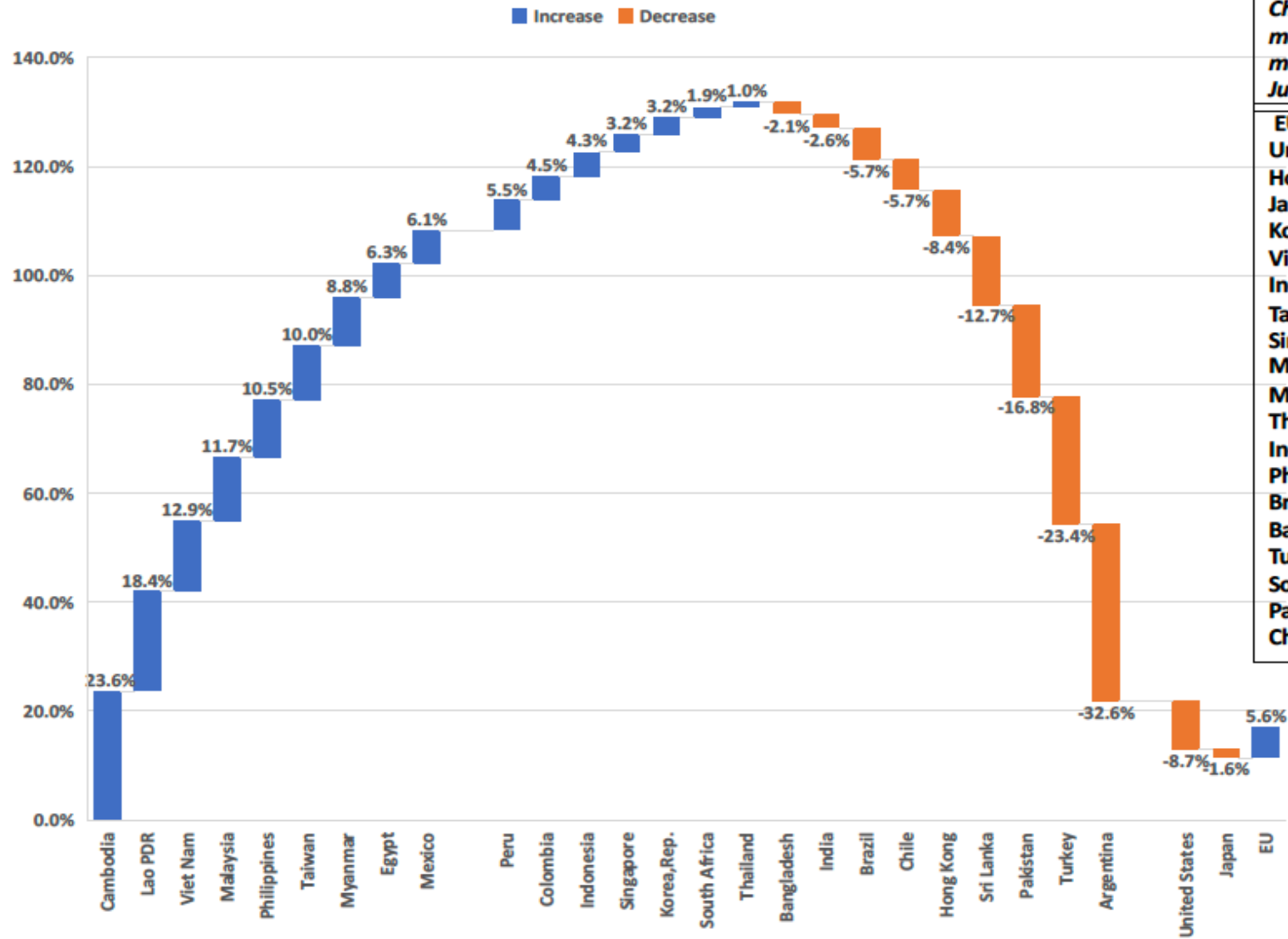
FIG: 2 Absolute China's export change to different countries as % of China's export decrease towards the US (Jan-Jul 2019/Jan-Jul2018)



The importance of China's export re-direction for individual countries

- **How important is the value of this re-direction compared to China's trade flows with each country? In order to gauge the question, the amount of China's re-direction towards each country was compared to the level of China's exports in January-July 2018 towards the same countries (Fig. 3).**
- **The rise of exports appears particularly important for some of today's 20 major emerging countries' export markets for Chinese goods: Vietnam (6th major outlet in the world) +13%; Malaysia (10th) +12%; Philippines (14th) +10.5%; Taiwan (8th) + 10%; Mexico (11th) +6.5%; while other important outlets exhibit also an increase, although more modest: Indonesia (13th) +4%; South Korea (5th) and Singapore (9th) +3%; South Africa (18th) +2% and Thailand (12th) +1%.**
- **Some marginal markets display a considerable upsurge, pointing to a possible future expansion of Chinese exports: in particular, neighbouring countries like Cambodia (+24%), Laos (+18%) and Myanmar (+9%). Chinese exports have also risen, although in a milder way, towards some farther away countries like Egypt (+6%) and Peru (5.5%), while Colombia, Bangladesh and India have witnessed growth rates between 1% and 4%.**
- **Finally, the decline of Chinese exports appears particularly relevant in the case of Argentina (-33%), Turkey (-23%), Pakistan (-17%), Sri Lanka (-13%), Chile and Brazil (-5%), while India and Bangladesh lost only about 2% each, the data for Hong Kong having to be appraised according to the previous caveats.**

FIG. 3 China's export re-direction as % of Jan-July 2018 exports



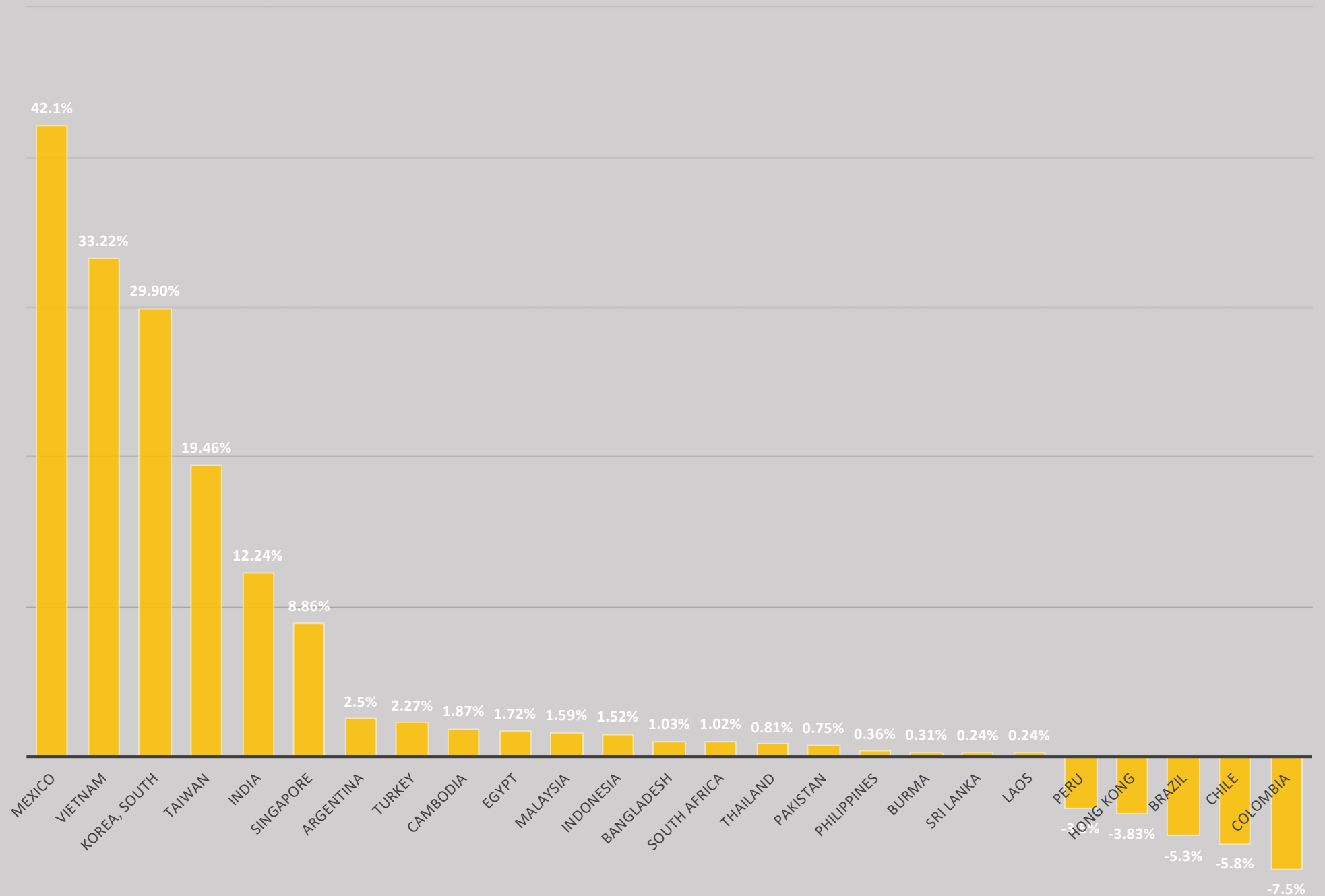
MEMO:
China's 20 major export markets, Jan-Jul 2019:

- EU
- United States
- Hong Kong
- Japan
- Korea, Rep.
- Viet Nam
- India
- Taiwan
- Singapore
- Malaysia
- Mexico
- Thailand
- Indonesia
- Philippines
- Brazil
- Bangladesh
- Turkey
- South Africa
- Pakistan
- Chile

Supply-switching. Winners and losers in the US market

- **In the short term, if the US and China charge higher tariffs on each other's imports, companies will have an incentive to replace these expensive imports with products from other countries. The latter will be considered "winners" if they succeed in raising their exports, "losers" if they see their exports retreat.**
- **For the sake of the analysis, I separate the effects on the two markets of the contenders.**
- **A useful indicator suggesting a process of supply-switching on the US market is to compare the gains obtained by the most important winners with China's losses over the same period. The results are illustrated in Figure 4. The value of Mexican gains were equal to 42% of China's losses, Vietnam (32%) and South Korea (30%) following suit. Less buoyant, but still remarkable attainments were achieved by Taiwan (19%), India (12%) and Singapore (9%). All the other 'winning' countries display a ratio between 0.2% and 2.5%, not particularly meaningful to our purpose. As a whole, one Latin American country and five Asian countries obtained most benefits in the US market. Minor gains were obtained by Argentina, Turkey, Egypt and South Africa, plus a host of Asian countries (as indicated in Figure 4).**

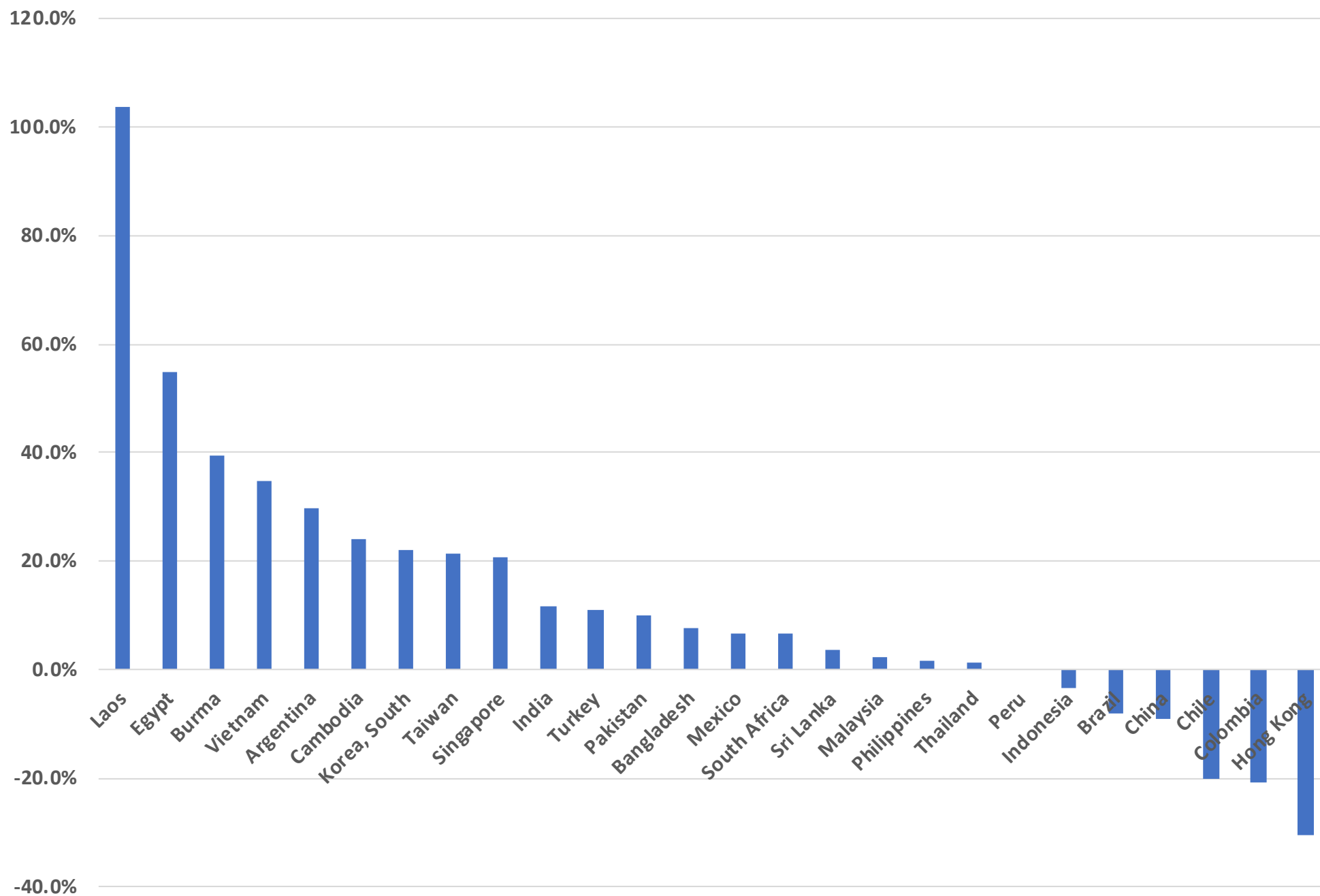
FIG. 4 - US market: gains and losses as % of China's losses



Supply-switching. Winners and losers in the US market (cont.)

- Among the losers, four Latin American countries (Colombia, Chile, Brazil and Peru) and one Asian country, Indonesia. Hong Kong also lost, but this a case apart (see before).
- However, all in all, *the global value of the gains of emerging countries seems to outweigh by far the global value of the losses.*
- If we compare the gains with the value of the trade flows at the start of the period, in some cases such gains appear rather important for the countries involved (Fig. 5). Such is the case, for instance, of Laos (more than 100%, starting obviously from a very low level of trade), Egypt - more than 50%, Myanmar (Burma in the US statistics) - almost 40%, Vietnam - more than 30%, Argentina - 25%, Cambodia - 22%, and South Korea, Taiwan and Singapore - more than 20 % each.
- Finally, some of the “winners” exports might have crowded out some share of the “losers” exports on the US market. Although hardly measurable, such crowding out effect is all the more likely insofar as the value of the emerging countries’ win was largely higher than the value of the emerging countries’ loss.

FIG. 5 - US market: import gains and losses in Jan-Jul 2019 as % of US imports in Jan-Jul 2018



Supply-switching. Winners and losers in China's market

- As expected, winners and losers on the Chinese market are not always the same as on the US market.
- In terms of the absolute values of emerging countries' trade flows change as compared to US losses, the seven countries that benefitted the most appear to be Malaysia, Brazil , Argentina, Myanmar, India, Cambodia, Mexico and Bangladesh: that is 5 Asian countries and 3 Latin American countries (Fig.6).
- All the other emerging countries seem to have lost, particularly so South Korea and Taiwan (probably due to an initial disruption of global value chains involving them). Indonesia, Vietnam and Singapore saw their exports diminish too.
- Compared to the US losses, the value of the winners was roughly only 30%, while the losers showed about the same value as the US losses.
- All in all, a mirror image of what happened on the US market: in China's market the losses of the emerging countries outweighed the gains. One of the possible reasons being the conflicting specializations of the countries involved.
- However, if we compare the gains of the "winners" with the value of the trade flows at the start of the period, in some cases such gains appear rather important for the countries involved. Such is the case, for instance, of Argentina (about 50%), Cambodia and Myanmar (20%), while Malaysia, Brazil and Mexico gained about 5% (Fig.7).
- Let's remember that China's major suppliers in the most recent period have been the EU, Japan, Taiwan, the US, Brazil, Malaysia, Vietnam, Thailand, Singapore, Indonesia, Chile, South Africa, Philippines, and India, in the order.

FIG. 6 - China's market: gains and losses as % of US losses

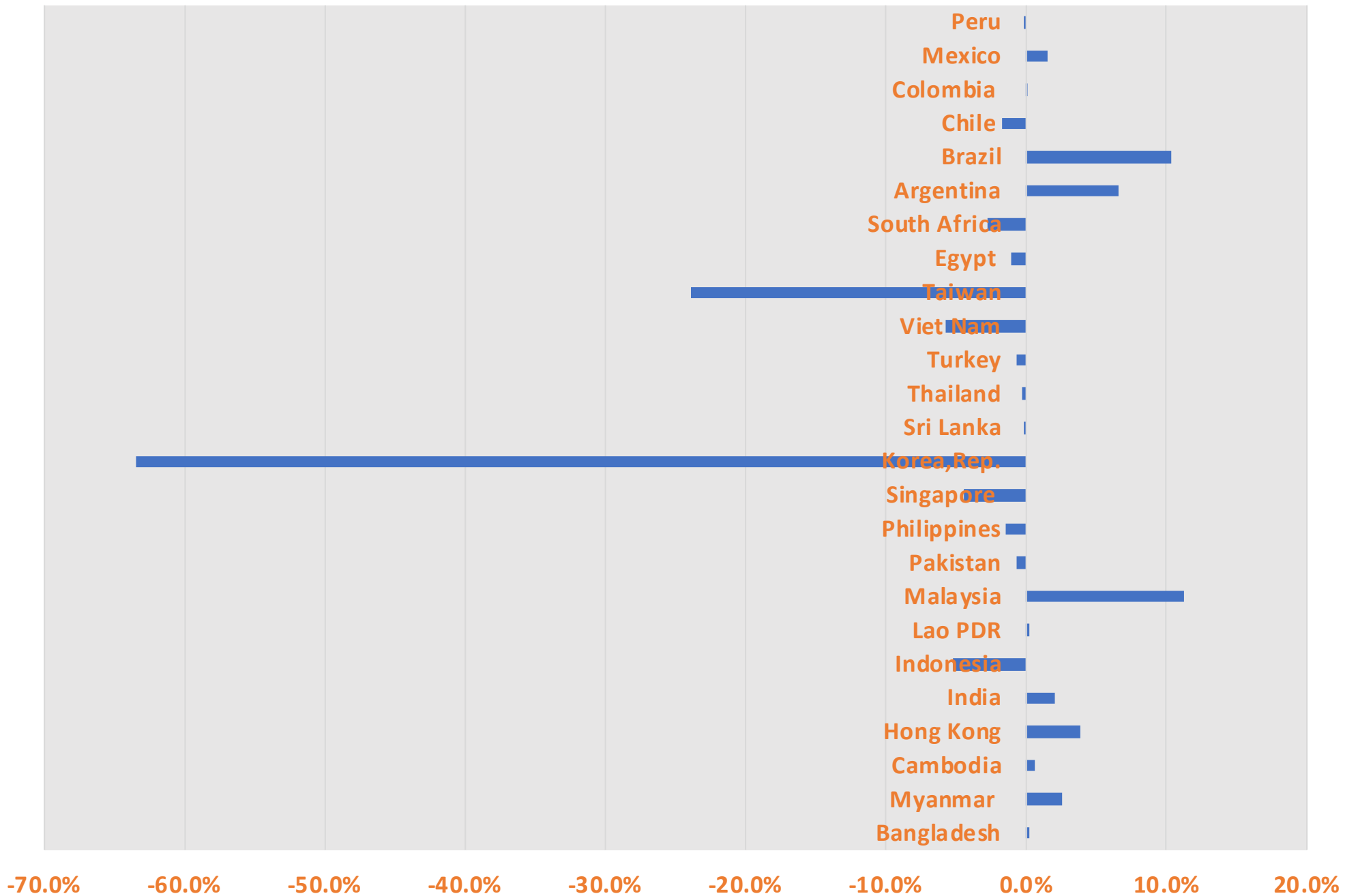
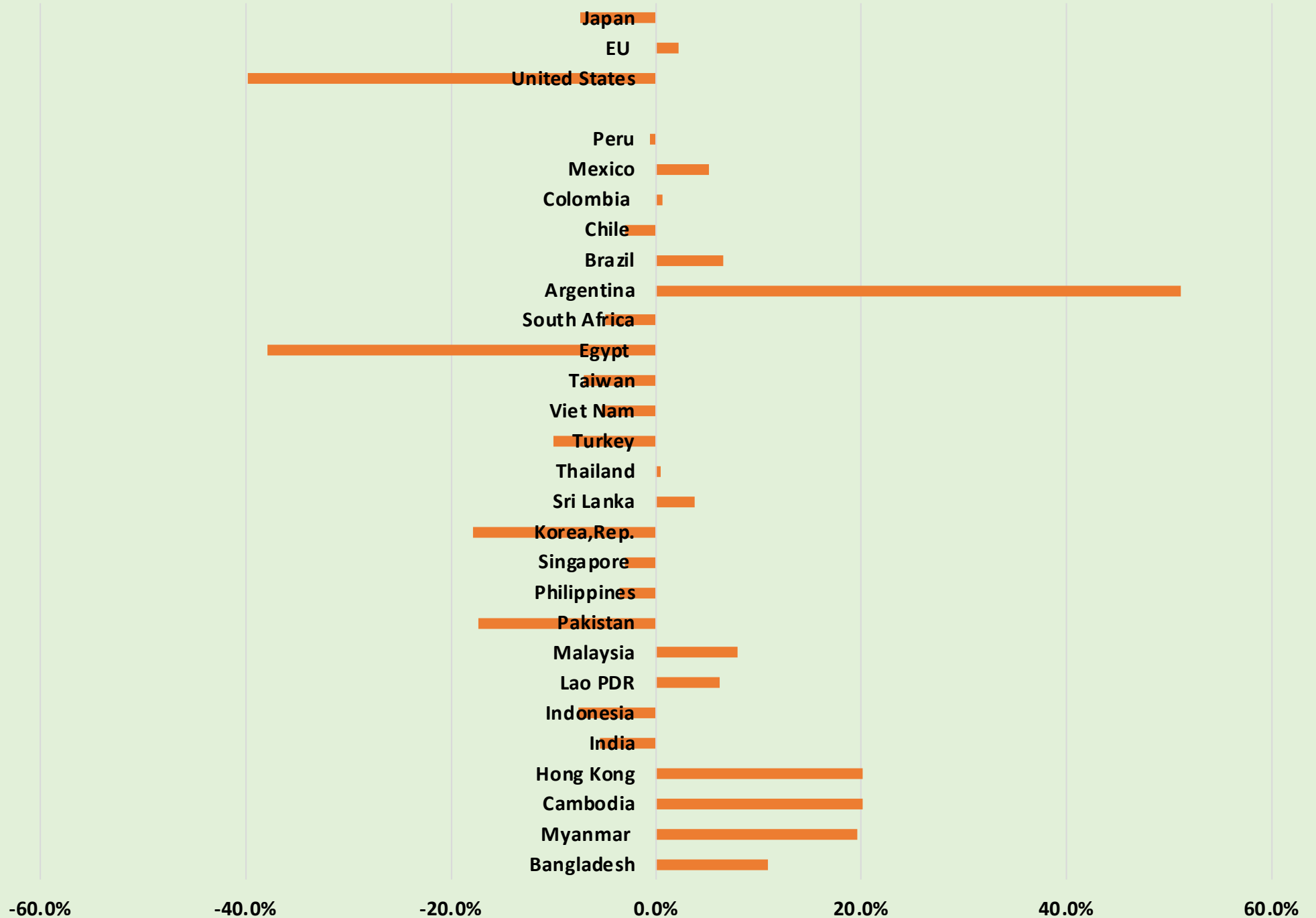


FIG. 7 - China's market: imports increase as % of Jan-Jul 2018 imports



Some caveats

The previous analysis calls for a few caveats when interpreting the results.

First and most important, short-run trade flows changes may be due to factors other than the tariff war. Some increases or decreases are the natural outcome of trade trends. Others derive from the evolution of the individual countries' economies. For example, China's slowing growth rate has certainly influenced her declining imports in the last few months.

The choice of the benchmark period might also affect the results. I chose the first seven months of 2018 corresponding to the monthly trade data available for 2019 at the time of writing. In a short-run analysis, adding one or two months may lead to some difference in the results, especially in those cases where the size of the win or of the loss is limited.

Moreover, the analysis is based on global trade data. As it is well known, the evolution of global trade data may mask different trends of single product groups. A case in point is represented by Brazilian exports to China, where the gains of soya beans exports might have more than compensated losses in other sectors. A better understanding of the tariff war impact will derive from the second stage of the research, conducted at a detailed commodity composition of trade flows.

Some caveats (cont.)

However, even at the product level, results should be taken with great caution.

Some changes in the short run trade flows or their absence might be due to the changing behaviour of exporters and importers.

Exporters might lower temporarily their export prices, annulling in this way partially the effect of tariffs imposed upon them. Importers might still import after the imposition of tariffs, while charging higher prices domestic consumers, both of final goods or intermediate products.

Trade wars include also phases of threats to apply new protective measures or increased tariffs on the goods concerned: in such case importers might suddenly increase their imports in order to avoid the tariffs at a later stage. Correspondingly, one may even witness an import surge now and a lower level later.

Exchange rate fluctuations might also have an impact on trade flows. A case in point is the recent yuan depreciation which might have softened the impact of some of the American tariffs on Chinese goods.

In addition, unilateral liberalization or free trade agreements might enhance trade flows among the participating countries (see the lowering of Chinese tariffs towards many countries other than the US or the new agreements between the US and Mexico or the agreements between China and some of its neighbours).

Some caveats (cont.)

Finally, a small part of the export boom by some emerging countries and part of the official contraction of Chinese exports might be due to fraudulent re-routing of Chinese products through other countries with the help of fake local product-origin certificates, as companies try to sidestep U.S. tariffs. The most blatant example being Vietnam, where the government revealed that it had discovered numerous Chinese products fraudulently labelled “Made in Vietnam”, ranging from textiles to agricultural goods and destined to the US market.

This is not a new phenomenon: there have always been leakages to avoid tariffs, especially strong through countries that are geographically closer to the contenders. And conversely, there has always been an incentive for countries outside a trading bloc to re-route their products through the member countries of the agreement to enjoy the lower preferential tariff rates.

Evidence of less overtly fraudulent trade diversion tactics include the process known as “knockdown”—that is, “knocking down” a product into its component parts and reassembling them outside China. This could simply represent a temporary diversion of trade that might return to China if the trade war calms down.

Main findings

- **Notwithstanding these limitations, the present note suggests a few interesting findings.**
- **The tentative indicators used in the note about ‘winners’ and ‘losers’ would suggest that there are countries which appear on the winning side on both the US and China’s market. Mexico is the most important case, although much more skewed toward the US market. Argentina also, although at a lower level of trade. In Asia, Malaysia and, to lower levels of trade, Laos.**
- **In most cases, emerging countries seem to have gained in one market, while losing on the other. Vietnam is the most important case: second greatest winner after Mexico on the US market, but somewhat losing on China’s market. A similar pattern is followed by other important Asian countries, like South Korea, Taiwan, Singapore, India, Pakistan and Thailand. Only two countries seem to lose on both markets: Indonesia and Chile. In both the positive and the negative outcomes, the importance of the change in trade flows appears to be rather relevant for some emerging countries.**
- **There exists a final further possible outcome on the two markets: the winning emerging countries might not only substitute the two contenders’ exports, but also crowd out some of the losing countries’ exports. Although not directly measurable, such crowding out is particularly possible where the gains are much higher than the losses among the emerging countries, as it appears to be the case of the US market, but not so much on the Chinese market.**
- **Altogether, a big reshuffling of trade flows appears to have taken place so far during the present trade war.**