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Trump Administration's Trade Policy Toward China

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I. Introduction

Donald Trump was elected as the 45th President of the United States of America following the election held on November 18, 2016. Wielding the campaign slogan of "Make America Great Again," he promised to bring back jobs to the U.S. and reduce inequality for blue-collar white Americans, the main group that supported Mr. Trump.

Even during his campaign, President Trump blamed the major trading partners of the U.S. for "unfair trade," insisting that such trade had widened trade deficit and decreased employment. This bellicose manner displayed by the U.S. president signaled other countries to prepare for aggressive action on the part of the U.S.

As protectionist policies are expected under the new U.S. president, his administration may mainly accuse China of protectionism, particularly when considering how the U.S. has criticized its biggest trading partner for currency manipulation, illegal subsidies, intellectual property rights, and many other subjects that are relevant to its trade activities since accession to the World Trade Organization (WTO) in 2001. Therefore, this study focuses on a possible scenario where trade conflicts deepen between the U.S. and China, and the economic impact this would have on Korea.

II. Main Strategies of Trump Administration's Trade Policy toward China and Its Expected Outcomes

1. Protectionist Policies of the U.S. Government

Upon his inauguration, President Trump began to implement aggressive trade policies such as the signing of the Presidential Memorandum to withdraw the U.S. from the Trans-Pacific Partnership (TPP), a multilateral trade agreement with 11 other countries that was led by his predecessor. Furthermore, he ordered to review the causes for U.S. trade deficits with its major trading partners and to investigate certain import products prior to enacting trade remedies.

In addition, the current U.S. administration is putting forth efforts to utilize various tools that could limit imports. Section 201, Section 232 and Section 301, which had fallen out of use recently, are examples of the tools being employed by the administration, and U.S. authorities are also deliberating whether to execute import restriction policies. Such movements show how the U.S. is executing policies based on U.S. laws, rather than trying to resolve the trade conflicts at the international level.

2. Trade Deflection Effect

The Department of Commerce and the U.S. International Trade Commission, the authorities in charge of the investigation and decision whether to impose antidumping and countervailing duties (AD/CVD), are expected to continue using such tools to restrict imports. Imposing AD measures will decrease the amount of U.S. imports from a target country, which may induce other countries to export more of this product to the U.S. to fill the gap. Such an effect is referred to as trade deflection effect (TDE).

Our study analyzed the TDE to non-named countries resulting from the U.S. imposing AD measures on Chinese products. According to our analysis, OECD countries and non-OECD countries (excluding China) appeared to benefit from the TDE, while non-OECD countries benefit more than OECD countries. The results were not statistically significant in the case of Korea, however, making it difficult to conclude that Korea's exports would increase in the event of such U.S. actions toward China.

3. Economic Effect from Chinese Yuan Appreciation

Throughout his campaign, President Trump blamed China for manipulating its currency, the Chinese yuan, and insisted on designating China as a currency manipulator. The U.S. did not choose to designate China as a currency manipulator in Department of Treasury reports published in April and October 2017. Yet, it still remains possible that the Trump administration will apply pressure on China regarding the currency issue, and our study analyzes the economic effect this would have under a scenario of Chinese yuan appreciation.

According to our analysis, which uses a structural vector autoregressive model (SVAR), Chinese yuan appreciation may not alleviate the U.S. trade deficit. Moreover, appreciation of Chinese currency will not only hamper China's economic output but also have a negative effect on the U.S. economy. These results indicate that designating China as a currency manipulator would not help the U.S. to reduce its trade deficit with China, while having a negative impact on the two largest economies in the world.

4. Economic Impact Realized by the Korean Economy from U.S. Trade Policy Targeting China

As expected, the Trump administration's restrictions on Chinese imports are escalating in level. Such pressure may impact the Korean economy both in positive and negative ways, and in a direct or indirect manner. First, the majority of Korea's export products to China consist of intermediary goods that U.S. import restrictions on China would have a decreasing effect on. Second, Korea may use this opportunity to increase its exports to the U.S. due to such restrictions. A third possibility suggests that increasing conflict may lead to a trade war between the G2 countries, which would negatively affect not only the Korean economy but the entire global economy as well.

III. Policy Implications for Korea in Terms of Trade Policy with the U.S.

In accordance with the results of our analysis of possible scenarios in a situation of deeper trade conflicts between the U.S. and China, this study suggests policy implications for the Korean government.

1. Preparation for Diverse Import Restrictions from the U.S.

As mentioned above, the pressure from the U.S. to decrease its trade deficit is likely to be fierce compared to previous administrations. The Trump administration seeks ways to apply this pressure under U.S. law, rather than using international dispute settlement mechanisms within the framework of the WTO. This aligns with President Trump's "America First" agenda, and these actions are expected to continue under his presidential term.

Traditional import restriction methods employed by the U.S. such as AD/CVD may not affect Korea's exports directly as they target specific products from a specific country. Nevertheless, there are some U.S. legal provisions that restrict a certain product's total amount of imports to the U.S. which could hurt Korea as well. For example, Section 201, which is also known as the "safeguard" clause, restrains the import of certain products to the U.S. market. In fact, the U.S. International Trade Commission (U.S. ITC) started an investigation under Section 201 for solar cells and large residential washing machines in 2017, following a petition by U.S. companies. President Trump finally decided to take tariff rate quota (TRQ) action on both products in late January 2018. Korean businesses in relevant sectors were hard hit by this action since their exports of both products had won a certain portion of the U.S. market. Therefore, the Korean government should be aware that the rise of U.S. import restriction levels would both directly and indirectly hinder Korean products from entering the U.S. market, as the current U.S. administration is trying to utilize import-restraining tools which have not been used for decades. Other tools can be activated as well, such as Section 232 and Section 301, to heighten U.S. import barriers.

2. Keen Monitoring System for Korean Investors in China

Since the environment for commerce is changing as the international community is adapting to different circumstances, Korean companies should also be aware of the heightened geopolitical risks involved with investing in China. Deeper trade conflict between the U.S. and China may deter Korean companies from advancing into the Chinese market. In addition, geopolitical risks may have negative impacts on Korean companies located in China. For example, deployment of the Terminal High Altitude Area Defense (THAAD) system in South Korea has led to Korean businesses experiencing disadvantages in China.

Changes in the Chinese market itself are another factor that Korean companies should recognize. China was once called a global manufacturing factory for its low-cost labor, but the wage level in China is on the rise and is not as attractive as before. Also, this escalation in wages is leading to an increase in China's purchasing power, meaning that Korean companies may target Chinese consumers by developing and exporting high value-added products to China.

3. Decrease in Korean Trade Surplus with China

Decrease in China's export to the U.S. under stringent trade policy may increase its export to the Korean market due to the TDE. Korea continues to recording a trade surplus with China, but the size of this surplus decreased between 2014 and 2016 and its 2017 level is nearly two thirds compared to its peak in 2013. Increase in imports from China to the Korean market due to TDE may further decrease the trade surplus. The Korean government should prepare for such change by monitoring China's export products to Korea in case of dumping actions. At the same time, the government may have to decide on and execute antidumping duty related policies to prevent unfair trade.

4. Limitation of U.S. Trade Remedies

The results of our study suggests that an increase in imposing cases of U.S. antidumping duties may decrease China's export flows into the U.S. market, but such an effect may be offset by an increase of the same products from other markets. Moreover, the U.S. designating China as a currency manipulator is unlikely to happen in the near future as the weak U.S. dollar trend is continuing since President Trump's inauguration and China's foreign exchange policy is different from when it was criticized for currency manipulation. Yet, such options cannot be struck from the checklist since the situation can change in the future.

Even though the Trump administration is putting China on the top of the list for fixing its "unfair trade" practices, Korea is not free from U.S. trade remedy actions because it shares similar issues. Also, the fact that both countries are now sitting at the table to negotiate amendment of the Korea-U.S. FTA (KORUS FTA) is putting more pressure on the Korean administration. Therefore, it may be worthwhile for Korea to actively dissuade its counterpart from taking protective trade actions by explaining that such actions may not have the effect they want, as our study suggests.

More than 60 percent of Korea's trade surplus comes from the two largest economies in the world. This high level of concentration suggests that Korea should strive to diversify its export markets to reduce its high dependence on these two trade partners in the long term. KIEP