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Europe in the Sino-American Trade War

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The US trade policy is severely destabilising the international trade system. The European Union is fighting to maintain the latter's stability, which is under dire threat.

In March 2018 the US introduced a succession of protectionist measures that mainly targeted China. Currently, nearly 70%[1] of American imports from China are subject to additional duties. The average customs duty applied by the US on imports of Chinese goods is now 21.2%, whilst it was 3.1% at the end of 2017[2]. Likewise, since China retaliated with each American measure, the average tariff implemented on American imports to China was 21.8% in September 2019, whilst it was 8% at the beginning of 2018. Hence, as soon as we hear "trade war" we think of the stand-off between the US and China.

The European Union has not managed to escape this "war" completely. Firstly, because it was directly involved in one of these battles and because it could be the target of one in the future. And also, because a trade protection measure always has an indirect effect, even on products and countries which are not directly in the firing line. This is especially true in a world in which economies are linked together by extremely fragmented chains of value. Finally, because trade tension has also affected an international trade system that was already in crisis for other reasons. International trade is now subject to greater uncertainty than when the system was governed by well-defined rules that were independent, at least in the short term, from inter-State power struggles. In this new context what position might the European Union, the world's leading trade player, adopt?

TRADE WAR: WHAT'S THE STATE OF PLAY? WHAT DOES IT MEAN?

The protectionism initiated by the American President Donald Trump has not come as a total surprise: it was announced in the electoral campaign on 28th June 2016 in Pennsylvania. Most of the changes in the American trade policy which have taken place featured in this. Firstly, there came the US withdrawal from the Transpacific Partnership (TPP), the free trade agreement that grouped together the 12 countries around the Pacific Ocean; since then this agreement has been renamed the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP) and was signed in March 2018 by 11 other partners. Then came the renegotiation of the North American Free Trade Agreement (NAFTA), which associated the US, Canada and Mexico. The speech of June 2016 also mentioned the intent to use the American legislative arsenal to have measures to reduce trade with China, to the backdrop of an exaggerated focus on the trade deficit.

However, since March 2018, it has clearly emerged that the change was going to be radical in both shape and content, and that the effect on the international trade system was going to be permanent. This was when the first additional customs duties were imposed. They targeted American aluminium and steel imports, to a value of 50 billion $, in the name of national security. Then, there were three specific successive waves of measures of increasing amounts against China in retaliation against the Chinese industrial policy: firstly on 50 billion $ of imports between July and August 2018, then on 200 billion $ in September 2018 and finally on 300 billion $ (in two waves) as of September 2019. Moreover, in May 2018, an investigation into car imports, still in the name of national security, was launched: the outcome of this has yet to be published, but it might have serious implications for the European Union, the leading exporter to the USA. Finally, in July

[1] All figures quoted refer to the amounts traded in 2017, the last year when trade was not affected by American measures, introduced as of March 2018.

[2] Bown, C. (2019), US-China Trade War: The Guns of August, Trade and Investment Policy Watch, Peterson Institute for International Economics, 26 August 2018

2019 another investigation was launched, specifically targeting France, in retaliation against the approval of the bill involving the taxation of digital services[3]. Several elements are new in these different measures: the tools of the American legislative arsenal that have been used and the reasons quoted, the amounts of trade affected and the means of implementation, which will remain uncertain until their entry into force.

In the first battle in March 2018, the US imposed additional customs duties on steel and aluminium imports (25% and 10% respectively). The first striking feature was that this measure covered all export countries (except for Australia) and not just China, the designated target that had been anticipated by the other players in world trade. It affected 50 billion $ worth of American imports. The leading suppliers of the US market, prior to the introduction of additional duties, were the EU and Canada, with share in total imports of 14% and 65%, respectively: the EU was in fact the leading exporter of steel and the 5th of aluminium[4]. China exported very little of these materials (around 7%) to the US, since they had been targeted by anti-dumping and prohibitive anti-subsidy duties for many years. The second unexpected element was the repeated mention of national security on the part of the US, in line with section 232 of the 1962 Trade Expansion Act. Historically this argument had been used in the event of major imports from countries that were deemed not to be allies. The last measure taken in virtue of this dated back to 1982, with an embargo on oil imports from Libya[5]. The European Union, many of whose States are NATO members, as well as Canada, were doubly surprised by these measures. Moreover, their rapid introduction turned into a drama comprising several episodes: the measures were announced on 8th March 2018, were modified on 22nd March, then on 30th April, and finally in May 2019: the EU, Canada and Mexico were added, after initially being exempted, and some countries witnessed a transition from additional duties to quantitative restrictions. This increased the uncertainty that the measure had over the markets and therefore over sales, and in the long term, over industrialists' investment choices.

The second battle specifically targeted China. It involved measures taken to sanction the Chinese industrial policy regarding intellectual property rights and the forced transfer of technologies under section 301 of the 1974 Trade Act[6]. This was implemented in several waves, as of July 2018, on import totals of 50 billion $, then 200 billion and finally 300 billion, covering all types of product. The last of these waves is expected this December (2019). Additional duties total 25% on the first 250 billion $ and 10% on the last 300 billion $. The amounts in question are unprecedented, especially if we consider the retaliation measures implemented by China, which affects around 110 billion $ of US exports.

The use of section 301 is another detail of note. This allows the US to take trade measures against any foreign policy – and not just trade policy – which might damage American trade. Hence, this type of measure should be addressed under the WTO; the use of section 301 is yet another signal on the part of the US that it wants to withdraw from the multilateral trade framework. Moreover, it is interesting to note that both section 232 and section 301 provide that the final decision regarding the measures to apply lies with the President of the USA, unlike other trade measures, including those of an exceptional nature, like anti-dumping and anti-subsidy measures, which apply automatically, following a series of decisions taken by various US administrations. This explains the rapid and numerous changes in terms of implementation.
Of course, many of the countries affected by these protectionist measures retaliated with reciprocal measures on certain imports from the US. Chinese retaliation was the most extensive, and these measures now affect more than 70% of imports from the US, but they are not the only ones to have been implemented. The EU increased some of its customs duties in response to the US measures on steel and aluminium, on around 4 billion $ of US exports. It also took protective steps regarding steel, in the shape of an import quota.

ECONOMIC IMPACT ON THE EUROPEAN UNION: DIRECT AND INDIRECT EFFECTS

The measures that target the EU directly concern steel and aluminium. Regarding these two products, we are expecting a reduction in exports towards the US, with a possible downward price adjustment in the long term, especially since all exporters (except for Canada and Mexico since May 2019, as well as Australia) are being affected by these measures. To this direct effect

[3] On this issue see the joint press conference between the French and US Presidents at the G7 summit https://www.elysee.fr/emmanuel-macron/2019/08/27/g7-biarritz-conference-de-presse-conjointe-avec-le-president-americain-donald-trump

[4] Bellora C. and Jean, S. (2018), Pour comprendre la crise des importations américaines d'acier et d'aluminium, *The Conversation, 1 June 2018*

[5] https://fas.org/sgp/crs/misc/IF10667.pdf

[6] http://legcounsel.house.gov/Comps/93-618.pdf

we might add indirect consequences, particularly the diversion of trade towards new markets. This might affect Chinese products (or those from other countries, in the case of steel and aluminium) which are no longer exported to the USA. The EU introduced a protective measure in July 2018 to prevent the diversion from causing a major rise in steel imports.

The diversion might also cover US exports that were initially intended for the Chinese market. This is what happened on the soya market. In the first wave of reprisals against the measures taken under section 301, China increased customs duties on soya imports from the USA, from 1.5% to 26.5%. This was a dramatic increase on a major trade flow: in 2017 the USA exported to a total of 13.9 billion $ of soya to China, which represented 35% of their agricultural exports and 10% of all of their exports to this country[7]. Moreover, access to the Chinese market represents a major stake for American soya producers, nearly half of whose production (43%) is designed for export (all destinations together). Hence, as of July 2018 Chinese supplies mainly came from the other major world soya producer, Brazil. On the international market, the price of Brazilian soya increased, whilst those of American continuously decreased. The EU, a major soya import country, therefore changed the geography of its suppliers. Over the 2017/2018 crop season, the last that was not affected by trade measures, 36% of its imports came from the USA and 34% from Brazil. In 2018/2019, the share from the USA leapt to 72% that from Brazil dropped to 21%. It was in anticipation of this trade diversion that Jean-Claude Juncker, President of the European Commission, promised, during a visit to Washington in July 2018, that the EU would buy more American soya[8].

Trade diversion can affect all of the products impacted by the American measures or by the reprisals taken by third countries. Bellora and Fontagné[9] estimate the aggregated impact of it, on trade, but also on other economic indicators[10]. Hence in the long-term EU imports from the US would decline by around 19 billion $, whilst exports would increase by around 25 billion $, since the prices of products exported on the US market would become more interesting than those of the now overtaxed Chinese products. We should note that the decrease in US exports is occurring due to the accumulated effect of European retaliation on certain American products, but also due to the loss of competitiveness of American exports. Indeed, many products taxed by the US from China enter the goods manufacturing process, which are then exported by the USA to third markets including the EU. The measures taken against China also increase productions costs of certain American products and therefore reduce their competitiveness.

The situation would surely be different if an increase in customs duties on American car imports (or car parts) became a reality (the decision is expected for November 2019). Indeed, the EU exports around 59 billion $ worth of these products to the USA, it is its leading supplier (just ahead of Japan). The customs duties applied by the US might increase from 1.8% to 25.7%. In this case simulations illustrate a sharp decline in European exports to the US, especially those of cars from Germany which would decrease by 8.8 billion $: to this we should add a decrease of 2 billion $ in components exports. France would be penalised mainly on its component's exports, since only the French Toyota and Daimler factories export assembled cars to the USA.

It is important to note that the possible impact of this type of scenario depends greatly on possible retaliation, i.e. products coming from the USA on which the EU would choose to increase its customs duties. Bellora & Fontagné assume that a European response will affect the main imported goods (in value) from the USA, including cars. Accordingly, the German car industry would be severely affected with a loss in added value of 2.4 billion $. Indeed, to the direct losses of German market shares on the American market due to the American customs duties, we might add the effect of European reprisals on vehicles assembled by German manufacturers in the USA, which are then imported and sold in Europe.

THE DESTABILISATION OF THE INTERNATIONAL TRADE SYSTEM

Beyond the effects already mentioned, the US trade policy is severely destabilising the international trade system, which has already been weakened.

[7] Bellora C. and Emlinger C. (2018), Le soja, graine de discorde entre les États-Unis et la Chine*, the CEPII Blog, Billet 19 October 2018.*

[8] See the Joint U.S. - EU Statement following President Juncker's visit to the White House*. 25 July 2018*

[9] Bellora C. and Fontagné L. (2019), http://www.cepii.fr/PDF_PUB/lettre/2019/let398ang.pdf

[10] These effects are estimated according the measures which were implemented in March 2019. Two new waves of increase in American protectionist measures (with the ensuing reprisals) have taken place since then.

Historically this system relies on standards and rules decided multilaterally, one of whose objectives is to make the conditions in which international trade occurs both stable and predictable. However, the American measures are now being taken without referring to the instruments of the World Trade Organisation (WTO), for instance in the name of national security, which places them outside of the WTO's jurisdiction, whilst they are clearly economically motivated. To this we might add the USA's blockage – prior to the election of Donald Trump – of the appointment of the members of the WTO's Appellate Body, which led to the neutralisation of the institution's "armed branch", its dispute settlement body.

The international crisis in the system pre-existed Donald Trump's rise to power. Indeed, several questions have been set without negotiation providing any answer. Firstly, the texts which govern international trade were negotiated at a time when trade only involved goods. Now the trade in services is greater. It is in these sectors incidentally that many countries find their comparative advantage, whilst they are only covered marginally and vaguely by the WTO's rules. Then some countries, deemed to be "developing" in the WTO's framework are major emerging powers, such is the case of China. In real terms the status of developing countries guarantees them special, differentiated treatment, whose reason for being is under challenge. Another issue is that of the updating of the subsidy usage rules, which do not appear adapted to the complicated shape they have assumed in China.

All that places international trade in a new, profoundly uncertain situation, which of course has impacted the EU, the world's leading trade power. Its trade may suffer high instability, due to the strategic rivalry between the US and China, which might lead to even greater tension between these two countries. Given the structural problems set by the international trade system and the loss of legitimacy on the part of international institutions, a return to the pre-crisis situation no longer seems possible. Different scenarios are possible[11], ranging from a total deletion of the rules to the upkeep of an international framework or a reform of the WTO rules. The effects of scenarios like these cannot be quantified, but they would be costly.

For the past few months the EU has been working towards maintaining the system's stability. On the one hand, all of the responses to the American measures were made in line with the existing WTO rules (declaration of retaliatory measures, launch of a protective measure, complaint to the Dispute Settlement Body etc.). On the other hand, it is continuing dialogue with the various parties involved in the trade tension, as well as with all of its trade partners. It has, amongst other things, made proposals[12] for a reform of the Appellate Body including with partners like China and India. But given the extent of the crisis, more systemic reforms, requiring a long-term strategy, must be taken. Not forgetting that these reforms will no longer just be commercial or economic, but they will have to be positioned from the viewpoint of sustainable development. The problem is vast, but it is also an historic opportunity to change and adapt the international system to the challenges of the future.

[11] Jean, S. (2019), Le commerce international en crise systémique, in L'économie mondiale 2020, éd. La Découverte

[12] https://europa.eu/rapid/press-release_IP-18-5786_en.htm *and* https://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157331.pdf

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