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THE SATURDAY ESSAY

Who Won the U.S.-China Trade War?

Neither country got the concessions it sought, and both damaged their economies. The real beneficiaries? Vietnam and others who stepped into the breach.

By Bob Davis Follow *and Lingling Wei* Follow

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Between 2018 and 2020, the U.S. and China fought the biggest trade war since the 1930s, hiking tariffs, upending markets and threatening to plunge the global economy into recession. Since then, the battle has been the subject of dozens of economic studies and lots of political posturing in both countries.

Who won? Figuring out the answer is surprisingly complicated and contains important lessons for those tempted to wield tariffs like weapons.

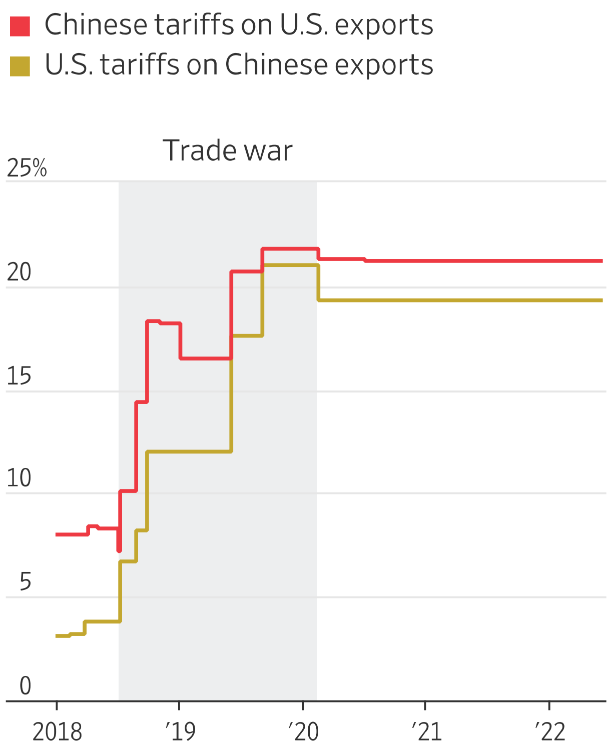
Economists routinely say that no one wins a trade war because costs rise on all sides. If that's the case, the U.S., which started the fight and eventually slapped steep tariffs on three-quarters of everything China sold to the U.S. to force changes in Chinese economic policy, lost by not winning.

There is plenty of evidence for a U.S. loss. During a trip to Beijing in May 2018, top Trump administration officials laid out their demands: cut the bilateral trade deficit by $200 billion, end subsidies for advanced technology, halt pressure on U.S. companies to hand over technology and strengthen intellectual property protection.

The list was so sweeping that Michael Pillsbury, a China expert at the Hudson Institute and a favorite of President Trump, said "it would be like the Chinese flying into Washington and telling us to change our Constitution."

To press Beijing to comply, the administration carried out four rounds of tariff hikes, which raised average U.S. duties on Chinese goods to 21% from 3.1%. China retaliated with similar levies. The tariffs targeted a bigger chunk of the global economy than even the Smoot-Hawley tariffs of the 1930s, which are blamed for worsening the Great Depression, according to calculations by the economists Pablo Fajgelbaum of Princeton University and Amit Khandelwal of Columbia University.

U.S.-China tariff rates



Source: Peterson Institute for International Economics

The two sides signed a Phase One trade agreement in January 2020, which acted as a kind of truce in the trade war. But the deal left nearly all the tariffs in place, so American pressure on China has continued since then.

Even so, little changed. China fell 40% short of its commitment in the Phase One deal to buy an additional $200 billion of U.S. goods over two years, says Chad Bown, a trade expert at the Peterson Institute for International Economics. As for U.S. complaints about Chinese coercion, technology theft and other misdeeds, United States Trade Representative reports on China's trade practices are clear: No progress. Earlier this year, USTR used nearly the same wording as in 2017, before the trade war, to describe Chinese subsidies ("caused injury to U.S. industries"), excess capacity ("world's leading offender") and pressure to hand over technology ("U.S. concerns...remained unresolved").

"Clearly, they [the Chinese] haven't changed," says Clete Willems, a former Trump trade negotiator now at the law firm Akin Gump. "We made it more costly for them, but they are still trying their same policies," though he thinks it's too early to declare a trade-war winner.

Robert Lighthizer, President Trump's trade representative, who acted as the U.S. field general for the trade war, says the U.S. came out ahead in a much more important area. The battle highlighted how China had used trade to get rich at the expense of American workers, he says, and how Beijing relied on subsidies, theft and pressure on U.S. companies to get ahead. "My objective was to convince people that China is a problem—an existential threat to the U.S.," says Mr. Lighthizer. "I think we convinced people."

Political leaders in both the U.S. and China argue that the trade war paid them important political dividends.

Since the trade war, fights between the two countries have only hardened attitudes. The Trump administration blamed China for covering up the origin of the coronavirus pandemic, and the Biden administration has clashed with China over Taiwan and Russia. The Chinese leadership has accused the U.S. of hypocrisy, arrogance and trying to block China's rise.

According to a recent Pew Research Center poll, 82% of Americans now view China unfavorably, compared with 47% in 2018. A Gallup poll last year reported that 45% of Americans view China as America's "greatest enemy"—four times as many as made that choice in 2018.

In Washington, lawmakers compete to be seen as tough on China. The Biden administration has continued the Trump administration's tariffs and other sanctions, though it is considering rejiggering some duties and has sought to line up allies in the fight.

Mr. Lighthizer also argues that tariffs hobbled Chinese companies by increasing their costs, particularly when coupled with restrictions the U.S. has placed on Chinese purchases of advanced technology. "We are beginning the process of getting rid of the unfair advantage they had in some areas, especially in technology," he says.

The rift with China, coupled with later problems getting supplies from Chinese factories and ports closed because of the pandemic, has also encouraged U.S. companies to relocate from China—another U.S. goal. Nearly 80% of manufacturing executives who have operations in China have either moved part of their work to the U.S. or plan to do so in the next three years, according to a survey by Kearney, a management consulting firm.

Sometimes, though, tariffs have had the opposite effect, prompting companies to expand outside America to sell to China. BMW AG increased SUV production in China rather than export the cars from Spartanburg, S.C. after China raised its tariffs on automobiles to 40% from 15% as part of the trade war. "We try to match manufacturing capacities of a particular model to where the demand for that model is," said a BMW spokeswoman.

But there is also plenty of data to show that China was the loser in the trade war because it took a bigger economic hit than the U.S., with much of the evidence compiled by Chinese economists. China's economy is more dependent on trade for growth than the U.S., so tariffs make China more vulnerable. President Trump had that in mind, according to aides, when he would tell them the Chinese will "run out of bullets first."

China has doubled down on the state-led economic model the Trump administration had set out to change.

Chinese companies facing American tariffs exported less to the U.S., reduced hiring, spent less on research and development and were less likely to start new firms, according to economists at Peking University, Fudan University and other leading Chinese universities. Overall, China's GDP loss was three times as high as the U.S., estimates Yang Zhou, a Fudan university economist who did her research at the University of Minnesota.

Recognizing that China's official statistics might be subject to what they termed "manipulation and censoring," Dartmouth College economist Davin Chor and University of Hong Kong economist Bingjing Li studied satellite imagery of the nighttime sky in China. Industrial areas subject to tariffs were noticeably less luminous than areas that weren't, indicating a reduction in economic activity. Per capita income declined 2.5% in the tariffed areas, they estimate, compared with unaffected areas.

"Overall, the trade war reveals to have negative impact on firms and job seekers in China," write Chuan He of Huazhong University of Science and Technology, Mingzhi Xu of Peking

University and Karsten Mau of Maastricht University.

Similar to the U.S., though, political leaders in China argue that the trade war paid them important political dividends. Chinese President Xi Jinping agreed to sign the Phase One deal, even though the U.S. only slightly reduced tariffs, because he was pursuing higher priority policies, say officials with knowledge of the leadership's thinking.

Beijing figured the deal would give it leverage: If Washington pushed too hard, Beijing could threaten to scrap the trade deal. When Washington did little beyond rhetoric to defend the autonomy of Hong Kong in the summer of 2020 after Beijing imposed a wide-ranging national security law, Chinese leaders counted their strategy as a success.

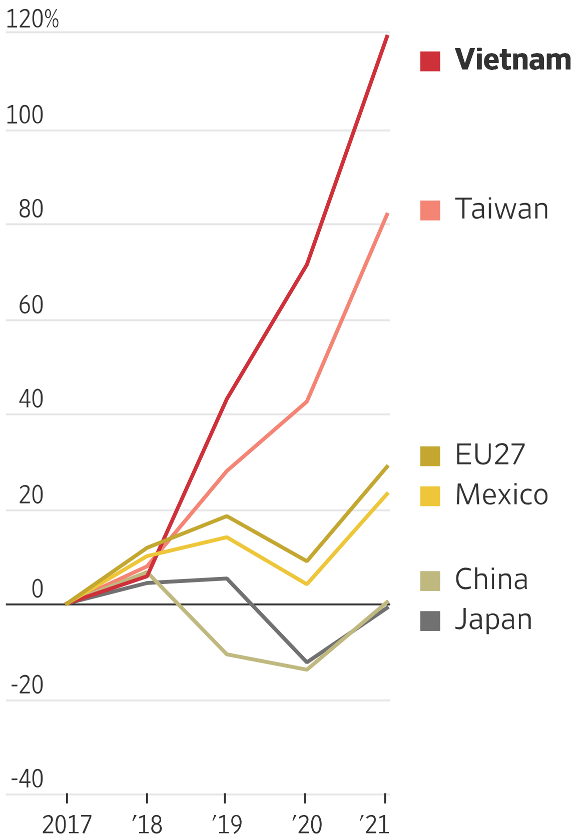
Charlene Barshefsky, President Clinton's former trade representative, also thinks that Beijing came out ahead politically. "They did not change their economic model one iota, reinforcing to Xi Jinping that their economic model can withstand even aggression by the United States," she says. Chinese exports to the U.S., for instance, have rebounded to pre-trade war levels, though much of the export gains are in products like mobile phones, laptops and toys, which weren't hit by tariffs, says Mr. Bown, the Peterson Institute economist.

Overall, Chinese officials believe the trade war hurt the U.S. more than it has hurt China, pointing to the heightened inflationary pressure as a result of American tariffs on Chinese products. Inflation is now presenting a powerful threat to the Biden administration as November midterm elections approach. "Tariffs are a poisonous legacy of the last administration that this administration should remove," says a senior Chinese trade official.

The trade war also reinforced to Beijing the need to reduce its reliance on American technology—a longtime Chinese goal. To that end, China has doubled down on the state-led economic model the Trump administration had set out to change.

Chinese authorities increased their use of subsidies—including cash infusions, discounted loans and cheap land—to try to dominate high-technology industries. In addition to the state-owned companies the government typically helps, last year Beijing pledged at least $1.5 billion in the coming five years to support more than 1,000 smaller, privately held firms, dubbed "little giant" startups. As part of that push, China last year published guidelines directing hospitals and other state entities to reserve for domestic firms between 25% and 100% of their purchases of technology items like medical equipment and imaging tools.

Value of goods imported to the U.S., change since 2017



Sources: Census Bureau; Moody's Analytics

Weighing whether China or the U.S. came out ahead in the trade war is an exercise in counting gains and losses. But some countries had nothing but wins; they started exporting to the U.S. goods that China once sold. "Any time we impose tariffs on a single country, countries that can provide substitutes will ramp up," explains Dartmouth economic historian Douglas Irwin.

Who won the U.S.-China trade war? In many respects, it's been Vietnam.

According to calculations by Kearney, China shipped $50 billion less in manufactured goods to the U.S. in 2021 than it did in 2018, as tariffs increased the cost of Chinese imports. During that same time, Vietnam—free from those U.S. tariffs—increased its factory goods shipments to the U.S. by $50 billion. Looked at from another angle, exports of manufactured goods from 14 low-cost Asian nations, including China, tracked by Kearney, increased by $90 billion in 2021 compared with 2018. Vietnam accounted for about half that increase.

Vietnam had become a manufacturing hub well before the trade war. Following the path pioneered by other export-heavy Asian countries, Vietnam welcomed foreign investment, improved its infrastructure and benefited from being close geographically to China and paying cheaper wages.

Vietnam's early export successes were in labor-intensive industries like apparel and furniture, but it has now become a center for electronics manufacturing too, with big investments by Intel Corp. and Samsung Electronics Co. The U.S.-China trade war accelerated that change, say economists.

"Vietnam positioned itself well to take advantage of the crises that occurred," says Trinh Nguyen, a Natixis economist in Hong Kong. The trade war was one such crisis.

Alex Shuford, the CEO of RHF Investments Inc., a furniture maker in Hickory, N.C., shifted his orders for leather couches to Vietnam from China after the tariffs made Chinese imports too expensive. During a recent scouting trip to Asia, he didn't bother to stop in China because prices there were still too high, and the country was going through another set of Covid lockdowns. "Some years ago, we would have started in China," he says.

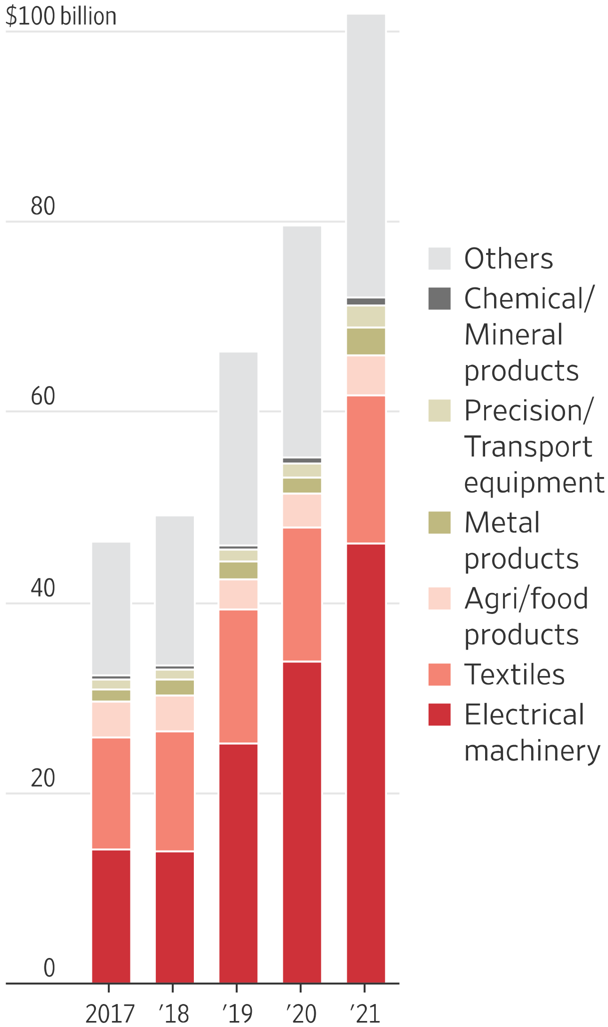
Additional export revenue helped Vietnam to build up its industrial parks, ports and roads and attract higher-paying industries like electronics. According to Moody's Analytics, a market data firm, 46% of Vietnam's exports to the U.S. now consist of electrical machinery, three times the percentage as before the trade war. Lower-value textile and apparel shipments also increased but at a much slower rate.

Over this period, America's trade deficit with Vietnam also exploded nearly threefold to $90 billion. During the Trump administration, that gap attracted the attention of Mr. Lighthizer, who launched two investigations into Vietnamese trade practices that could have resulted in tariffs.

But the Biden administration, which sees Vietnam as a potential ally in its competition with China, ended both those probes. It now seeks Hanoi's participation in a pan-Asian trade effort it is launching: a win for Vietnam and a win for the U.S.

Still, the changes have hardly left China out in the cold. Chinese manufacturers also rushed to set up operations in Vietnam. More than half the fresh exports from Vietnam to the U.S.

U.S. imports from Vietnam



Sources: Census Bureau; Moody's Analytics

during the trade war originated from Chinese-owned factories, estimates Patrick Van den Bossche, a Kearney partner. Since 2017, Chinese investment in Vietnam more than doubled to $1.9 billion in 2020.

Luxshare Precision Industry Co., a supplier of components to Apple Inc. and other American companies, was one of many Chinese firms to cite U.S. tariffs as a reason to expand in Vietnam. In 2019, Luxshare announced it would build four factories in Vietnam. So far it has invested more than $3 billion there and plans to eventually shift one-third of its production to Vietnam.

The trend worries officials in Luxshare's home base of Shenzhen, in southern China, which counts on high-technology firms for a big chunk of its tax revenues. "Relocation of production capacity is a big issue for us," said a Shenzhen official.

In yet another wrinkle in the trade war, Shenzhen is now focusing even more on domestic technology development to free itself from dependence on American suppliers. It is offering preferential tax, funding and other policies for entrepreneurs, along with generous grants to universities and other institutions to encourage them to team up with companies and pursue leading-edge technology—the kinds of subsidies the U.S. had set out to dismantle.

Mr. Chor, the Dartmouth economist who studied satellite images of China's nighttime sky for clues about the impact of the trade war, says that the debate over who won and who lost will continue. "We'll be talking about this in 25 years' time and 50 years' time," he says.

Ms. Wei is a reporter for The Wall Street Journal and Mr. Davis is a former Journal reporter. They are co-authors of the 2020 book "Superpower Showdown: How the Battle Between Trump and Xi Threatens a New Cold War."

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