Trade

The Story So Far

China is the world’s largest trader, and trade liberalization played a key role in its post-1978 economic success. Despite a history of reform, China runs a persistent trade surplus shaped by residual and newly created forms of protectionism, undermining trade relations abroad and consumer welfare at home. To sustain its growth potential, China needs to remove trade and investment barriers that are inefficient for its consumers and cause friction with trading partners.

- Beijing prioritized “trade facilitation reform” (simplification, harmonization, standardization, and transparency) when it ratified the WTO Trade Facilitation Agreement (TFA) in 2015. The government formed a national committee on trade facilitation in March 2016. After piloting reforms in the Shanghai Free Trade Zone in 2015, Beijing issued several policies to transition to a “single window” system nationwide to simplify trade inspections, declarations, taxes, and other procedures. China was ranked 46th by the World Bank in “Ease of Doing Business” in 2018, a significant improvement from 78th the prior year, in part due to lower trade-processing delays and costs. Beijing implemented multiple rounds of import tariff cuts starting in 2015 on a wide range of goods, with a focus on information technology and consumer goods. These tariff cuts reduced the normal, non-discriminatory (“most-favored nation”) simple average tariff to 7.5% in 2018 from more than 9% in 2013 and slightly reduced trade-weighted average tariffs to 4.4% in 2017 from 4.6% in 2013.

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- China’s leaders emphasize the importance of increasing imports to facilitate both internal and external rebalancing. To stimulate imports and consumption, Beijing tested a series of policies, starting in the Shanghai Free Trade Zone in 2015, to facilitate cross-border e-commerce trade. Key developments include gradually lifting equity caps for foreign e-commerce businesses in free trade zones and passing a new E-commerce Law in 2018, which aimed to reduce the sale of counterfeit goods and services. In January 2019, the State Council increased the scope for tax-free cross-border e-commerce imports across 22 pilot zones.

- China has expanded and sought new free trade agreements (FTAs). Since 2002, China has signed 16 FTAs with 24 countries or regions; in 2016, trade with FTA partners (including Taiwan, Hong Kong, and Macao) constituted nearly 40% of China’s total trade volume and saw import duties reduced by RMB 42.2 billion ($6 billion) that year. Most recently, China signed FTAs with Georgia in May 2017 and with Maldives in December 2017. Beijing is currently negotiating seven other FTAs. In November 2019, China and 14 other nations concluded negotiations on the Regional Comprehensive Economic Partnership (RCEP) to reduce regional trade barriers; the pact is scheduled to be signed in 2020.

Methodology

To gauge trade openness, we assess the change in China’s imports using goods and services trade openness indexes. Scores higher than 100 indicate a growing role for imports relative to gross domestic product (GDP) since 2013 (i.e., relative liberalization of these goods and services), while lower scores indicate a falling role. Supplemental gauges look at other variables in China’s trade picture: current account-to-GDP ratios for goods and services, whether goods imports are consumed in China or just reexported, the services trade balance by component, exchange rates, and trade trends in overcapacity sectors.

Note: In this 2Q2019 edition, we are replacing the original Composite Trade Liberalization Index (CTLI) with an alternate indicator due to missing data.

The indicator indexes the changes in the import/GDP ratios for selected goods and services relative to 2014. Our proxy line for goods trade measures ordinary trade imports—referring to imports that are not for processing, assembly, and reexport and are therefore a closer approximation of final import demand—less three types of goods: crude oil, iron ore, and integrated circuits. We exclude these goods from our ordinary trade proxy as China’s imports of these goods dwarf other imports in value and are highly sensitive to external price effects in such a way that they could distort this indicator. Ordinary imports face more tariffs and other trade barriers than
processing imports, for which tariffs are typically low or zero, thereby favoring export growth above import openness; improvement in China’s trade regime would rebalance toward more import growth catering to final demand.

For services, we included all subsectors except tourism and transportation, which are less reform sensitive given the longer-term trend of growing outbound Chinese tourism, overseas education, and resident spending abroad. The quarterly import/GDP ratio (four-quarter rolling sum) of each category was benchmarked to 2014 to coincide with the Third Plenum in November 2013. We attempt to isolate the trade liberalization variable by screening goods and services whose import growth is most constrained by policy, and by measuring imports over nominal GDP; ultimately, however, other factors including prices and inflation, cyclical patterns, competitiveness conditions, and global trade conditions may impact the indicator.

Quarterly Assessment and Outlook

Primary Indicator: Alternative Trade Liberalization Index

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- Our assessment remains neutral: goods trade became less open due to U.S.-China tariffs, while services trade openness improved modestly.
- Goods and services trade flows are slowing under bilateral trade tensions, causing China’s reported global trade surplus to swell. China’s exports relied less on processing trade this quarter, indicating exports contained more domestically produced value, though this shift likely reflects trade war conditions more than new structural improvements.
- Trade talks with the United States have shifted from escalating tensions to closing a “Phase 1” deal, but most of the commitments Beijing is talking about were in motion long before the trade war broke out. Policy news centered on expanding free trade zones (FTZs): these do not affect immediate trade and investment flows and are increasingly geared toward national strategic goals and regional integration.

This Quarter’s Numbers
(Missing data due to “technical problems,” according to China Customs, has plagued our primary indicator, the Composite Trade Liberalization Index [CTLI], for more than a year. While some of the missing data were updated retroactively, many gaps remain. Therefore, starting with this edition, we will use an alternative goods trade openness indicator and maintain the same services trade indicator.)

After a period of improvement in openness to goods imports from end-2016 to 3Q2018, imports for final consumption in China fell sharply relative to nominal GDP through 2Q2019. This is consistent with significant tariff liberalization that started in late 2015 and accelerated through 2018, and then the converse impact of tariff hikes on U.S. imports since late 2018. Services imports excluding tourism continued improving this year, though they still remain below 2013 levels.

The U.S.-China trade war has boosted China’s trade surplus, in conjunction with weaker domestic demand for certain imports amid slowing economic growth. China’s trade in both directions slowed in 2Q2019, but imports fell more than exports, pushing up the goods surplus to 3.5% of GDP compared with 3% the previous quarter (see External Trade). Less of what China imported was for reexport this quarter: processing imports relative to total exports fell to the lowest level since at least 2009 (see Structural Change in Goods Trade). That is typically the hallmark of a wealthier, less export-dependent country, but this quarter it is related to imports weakening more than exports.

Annualized, services imports and exports rose by their slowest pace in six quarters, to -5.8% year-on-year (yoy) and +0.3% yoy respectively in 2Q2019 from -5.6% and 5.1% in 1Q2019. With imports falling more than exports, the services deficit is narrowing modestly, from 2.1% relative to GDP last year to 1.9% this quarter. A significant fall in tourism abroad, and the related fall in transport services imports, drove an overall contraction. Payments for the use of intellectual property fell by 16% yoy in the first half of 2019, which is a negative signal for Services Trade Openness, even though imports of telecommunications, computer, and information services continued to rise.

China Dashboard Fall 2019
Policy Analysis

Trade tensions between the United States and China reached an inflection point, from escalation in our Summer 2019 edition to a tariff escalation pause and purported work toward a Phase 1 agreement. On September 11, President Donald Trump delayed the escalation of tariffs to 30% on $250 billion in imports from China from October 1 to October 15 as a “gesture of good will” in recognition of the 70th anniversary of the founding of the People’s Republic of China. Negotiations continued in September, culminating in high-level meetings in Washington on October 10. The next day, Trump declared that Phase 1 of an agreement had been reached, though details were still to be worked out.

What little is known about Phase 1 suggests that most of Beijing’s concessions will be in line with pre-Trump trade conditions or policy changes China is pursuing...
The accord is reported to see China buying more U.S. agriculture products, with purchases to total $20 billion in year one after an agreement is concluded and $40–$50 billion per year in the second year. However, the $20 billion year-one commitment is $7 billion lower than pre-Trump highs or projected U.S. agriculture exports to China in 2020 under pre-trade war conditions, while $40–$50 billion per year seems difficult to reach given supply and demand conditions.

Other Phase 1 commitments are unconfirmed. Trump tweeted that China would buy $66–$80 billion in Boeing planes, grant market access to U.S. financial services firms, and step up intellectual property rights (IPR) protections. Beijing has already made plans to open the market to all foreign firms in a number of financial services sectors in 2020 (see Cross-Border Investment), while legal amendments in 1Q2019 addressed some egregious IPR protection issues (see Summer 2019 edition of Innovation). These commitments are meaningless unless they are enforced fairly, transparently, and reliably, and Beijing still has a long way to go. Some reports say China committed to disclosing official currency interventions, though most of that activity occurs outside official channels. In exchange, Trump agreed to delay the October 15 tariff escalation indefinitely, though a new round of tariffs on consumer goods imports from China is still set to take effect on December 15.

On October 25, U.S. and Chinese officials said they are “close to finalizing” some parts of an agreement without offering more details. President Xi Jinping and Trump were expected to meet and potentially sign an agreement at the mid-November Asia-Pacific Economic Cooperation (APEC) summit in Chile, after it was canceled in late October, both sides are now looking for another venue to sign the agreement. Efforts to strike a Phase 1 deal were further complicated in late November, as the U.S. Senate passed a bill in support of Hong Kong protesters; Beijing vowed to retaliate if President Trump signs the bill.

As the bilateral trade outlook remains uncertain, China is pursuing regional solutions to boost trade and support economic growth. On November 4, China and 14 other nations concluded the Regional Comprehensive Economic Partnership (RCEP), intended to reduce trade barriers and harmonize trade agreements between the Association of Southeast Asian Nations (ASEAN) and regional partners China, Japan, South Korea, Australia, and New Zealand. After seven years of negotiation, the pact is set to be signed in 2020.

In late August, the State Council announced the creation of six new free trade zones (FTZs), increasing the national total to 18 from 12, to help boost regional trade ties. China’s FTZs have consistently been met with skepticism but remain a key trade liberalization talking point. New FTZs in southwest provinces Guangxi and Yunnan are meant to close the growth gap with China’s coastal regions; boost trade with Myanmar, Laos, and Vietnam; and grow international trade via a new sea trade corridor coming in 2025. Industrial base Heilongjiang’s FTZ will help develop regional cooperation with Mongolia, Russia, and Northeast Asia.