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The escalating China-US trade dispute: economic and geopolitical implications for Sub-Saharan Africa

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Summary

The trade tensions between the United States and China will cause only minor immediate damage to their giant economies. However, tariffs have important and diverse effects on individual sectors and cause heightened uncertainty. The main adverse effects on Sub-Saharan Africa will therefore be through global investor confidence, economic growth and commodity prices, and these effects could be severe if the dispute escalates further and endangers the rules-based trading system. The trade tensions are also a symptom of the growing rivalry between China and the United States, raising challenging questions for African development strategy and diplomacy.

President Trump's decision to increase tariffs from 10% to 25% on $200 billion-worth of imports from China, and his threat to do the same to the other $300 billion-worth of US imports from China which have not been penalized so far, marks a new and dangerous phase in the deterioration of international trade relations since his election in 2016.

China has just announced retaliation on $60 billion-worth of imports from the United States, a relatively mild response. The new tariffs raise three questions of general interest and more specifically for Sub-Saharan Africa (SSA): what will be the effect of the tariffs on the American, Chinese and, ultimately, the economies of SSA? What are the implications for the multilateral trading system on which SSA is crucially dependent? The questions for African are actually much broader than those that relate to trade: how will African nations be affected by the increasingly evident geopolitical competition between the two giants? I do not claim to give a definitive answer to these questions in a short brief, but I hope that the indicative response I provide below will trigger deeper study. I begin by providing some context on SSA's external trade relations with China, the United States and the rest of the world.

1. This policy brief draws in part on a blog by the author posted on the Bruegel site. http://bruegel.org/2019/05/implications-of-the-escalating-china-us-trade-dispute/

The External Trade of Sub-Saharan Africa

External trade (exports plus imports of goods and services to and from the rest of the world) is important for SSA, amounting to over 50% of the region's GDP. Internal trade is less important. In 2017, Only 22% of the total exports of SSA countries were to other SSA countries, and only 16% of SSA countries' imports are from SSA. Tariff and non-tariff barriers within Africa remain high - a problem that the African Continental Free Trade Agreement (ACFTA) negotiations aim to resolve - but SSA enjoys nearly complete duty-free access in its main trading partners outside the region, including Europe, China and the United States, though not in India. Transport links to outside the region by sea and air are also often better than transport links inside the region.

Trade of SSA with Europe is governed by various bilateral trade agreements, providing more assurance that trade will remain open and predictable, while in China and the United States SSA's export access depends on unilateral preferences. These are unlikely to be withdrawn but do provide the donors with leverage that can be used if, as expected, the geopolitical competition between China and the United States intensifies.

By far SSA's largest trading partner is Europe. Thus, Europe and Central Asia account for over 30% of Africa's exports and imports. The next largest trading relations are those with India and China, which both account for around 9% of SSA's exports. However, SSA is far more dependent on imports from China, which account for over 16% of Africa's total imports. The United States is a large trading partner for SSA, although it trails the others, accounting for around 6% of SSA trade. The effect of trade disputes among the big powers on SSA thus depend not only on their direct effect on the parties to the dispute, but the indirect effect on the rest of the world and most notably on Europe, SSA's main trading partner. Europe and the United States are also parties to a brewing trade dispute over Europe's large trade surplus and export of cars to the United States.

The product composition of SSA's trade also matters to understand the effect of the trade disputes. In 2017, raw materials accounted for 44% of SSA's goods exports of which about half consisted of petroleum products, and another 28% of intermediate or semi-finished products. Only about one-quarter of SSA's exports consist of consumer or capital goods. Given its export composition, SSA is unlikely to benefit much from displacing Chinese exporters on US markets or from displacing US exporters on Chinese markets. The implication is that trade disputes will probably have the largest impact on SSA insofar as they depress the quantity demanded and prices of petroleum and of other raw materials. Trade in services – which has, so far at least not been the object of the major trade restrictions – also matters for SSA. Its trade in services is about 40% as large as goods trade. However, SSA is mainly an importer of services and its exports of services, such as tourism, account for less than 4% of SSA's GDP.

In summary, this brief review of the structure of SSA's trade suggests that the main effect of international trade disputes on the region will operate through the macroeconomic channel, i.e. the effect on global economic growth and commodity prices, rather than directly though trade restrictions. The effect of the trade tensions on growth in Europe is especially important for Africa.

Direct Economic Effect of the China-US Trade Dispute

From the outset, it should be noted that the negotiations between China and the United States could still lead to a win-win outcome and an easing of the trade restrictions imposed so far. Reformers in China know that their state-owned enterprises are inefficient, subsidies are costly, capital is mis-allocated, and the nation's surging endowment of intellectual property must be protected. All these reforms are in the direction many American businesses and the moderates in the United States administration want to see. Both countries need and want a deal and the situation is fluid. Negotiations are expected to resume, with Presidents Trump and Xi Jin Ping scheduled to meet in Tokyo at the end of June.

Yet the situation could also deteriorate because the US has so far applied tariffs almost exclusively on intermediate products (capital goods and parts) imported from China. This measure penalizes US producers vis-à-vis competitors across the world, discourages investment in the United States in some sectors, and so represents an unstable equilibrium. If tariffs remain, they may create strong incentives to apply tariffs on China's consumer product exports as well, in line with President Trump's threat.

The direct aggregate effect of the tariffs on the welfare of the US and Chinese, while negative, is likely to be very small. It is possible to model the effect of tariffs in extraordinary detail but ultimately their direct aggregate effect on welfare is small. This is essentially because tariffs represent a transfer from consumers, importers and partner exporters to the government imposing the tariffs, a point that President Trump has seized on and voiced repeatedly, even though he mistakenly believes that only the Chinese will pay for the tariff. One can assume that sooner or later, the American consumer will bear much of the cost of the tariff though higher prices but also that tariff revenue returns to American residents in some form. The negative aggregate welfare effect of tariffs thus arises because, at the margin, they displace more efficient producers by less efficient ones who may be domestic or who may belong to third parties[2]. They also arise because, at the margin, tariffs artificially reduce the consumption or use of imports in favor of domestic goods or goods imported from third parties. These two effects ('welfare triangles', in the jargon) turn out to be very small – and especially so in the case of giant economies such as China and the United States, whose bilateral trade represents a small part of GDP, and who have abundant access to alternative third-party suppliers and customers. This is why various estimates of the size of aggregate direct effects of the tariffs imposed so far tend to be in the region of 0.1 % of GDP or so on the country that imposes the tariff. The welfare effects of Chinese tariffs on the affected US exports to China (which represent only about 0.5% of US GDP) and of US tariffs on the affected Chinese exports to the US (which represent about 1.6% of China's GDP) are also very small when account is taken of imported inputs contained in exports and the ability of exporters to pass on some or most of the cost of the tariff to importers. To be sure, all these effects will be larger insofar as the tariffs are raised and imposed on more products.

However, tariffs have very uneven effects and are severely negative for some sectors. The distributional effects of tariffs can be many times larger than the net economy-wide effects. In the case of the United States, for example, while the Treasury will see increased revenue, and some producers who compete with imports will gain, small companies that depend on imported parts from China are likely to be very badly affected by tariffs. Their capacity to negotiate lower prices with the Chinese or to pass on higher prices to consumers is limited, and they cannot easily and quickly find new suppliers or reorient their sales onto third markets when they face Chinese retaliation. Many such companies will be forced out of business.

Larger importers will also be adversely affected, but have more market power and resources to shift onto new suppliers and markets. US farmers who depend on Chinese markets have already been badly hurt by Chinese retaliation to the first round of tariffs and will suffer even more as the dispute escalates. All this means that the political salience of tariffs far outstrips their aggregate economic impact. Indeed, Trump's belief that tariffs will help his large constituency in the rust-belt – whether correct or not – reinforces his protectionist bent. In summary, the aggregate and distributional effects described here are small, and are unlikely to have a discernible effect on third parties except in some sectors. The same cannot be said of the effect on investor confidence.

Investment is Deterred and Growth is Penalized by Tariff Uncertainty.

The biggest adverse effects of tariffs on aggregate economic activity is through investment, and this is also where the most significant effect on the trading partners of China and the United States, including Africa, may arise. Lower investment is the natural result of the tariffs' big distributional effects, as discussed above, and the uncertainty they engender. Uncertainty tends to be associated with a reluctance to lend and tightening financial conditions. This effect of tariffs on 'animal spirits' is difficult to model and impossible to quantify with precision, though many try. In the October 2018 edition of the World Economic Outlook, for example, the International Monetary Fund has estimated that a high-intensity trade dispute (consisting mainly of China and the US applying 25% tariffs on all their bilateral trade and the US applying 25% tariffs on all its car imports and retaliation by its partners) could depress economic growth by 0.4% after one year[3]. Europe, which is a region highly dependent on international trade, would suffer. The effect of a slowdown of this magnitude on the revenue from commodity exports (combining volume of commodities demanded and their price would be major), perhaps in

2. There are also negative effects of tariffs on productivity as competition is reduced, innovation pressures moderate, and there are less opportunities for economies of scale. However, these effects take a long time to materialize and are likely to be very small since the volume of trade affected is small relative to the size of the Chinese and American economies.

3. https://www.imf.org/en/Publications/WEO/Issues/2018/09/24/world-economic-outlook-october-2018

the region of 5% for the most sensitive commodities such as oil and metals. Previous IMF studies concluded that economic growth of net commodity exporters is lower by 0.5% to 1.25% during sustained commodity price downturns than during upswings.

Some net oil importers in SSA and elsewhere in Africa, such as Morocco, a large oil importer, may benefit from lower prices but SSA overall would be the loser. Investor uncertainty would also contribute to slower demand for Africa's other exports of services, capital and consumer goods. China is by most accounts already the largest investor in Africa, taking the form both of Foreign Direct Investment and loans for infrastructure. A slowdown in China would almost certainly be reflected in less Chinese investment in Africa, even though – assuming the tariffs remain - there may be instances of Chinese firms scaling up manufacturing in Africa to go around the new tariff barriers facing them on US markets.

Unfavorable as these scenarios might be, things could turn out to be worse still. In trade as in military matters skirmishes can turn into battles and battles can turn into war. The skittishness of investors reflects the fear of extreme outcomes that could entirely disrupt global supply chains, as well as that of their progressive deterioration. The uncertainty over tariffs is most damaging when it calls into question not only domestic conditions but the viability of the global trading and investment system, to which I now turn.

The Effect of the China-US Dispute on the Trading System

If allowed to escalate, the trade dispute between China and the United States will significantly increase the likelihood of a global protectionist surge and a collapse in the rules-based international trading system, for which the beleaguered World Trade Organization provides the bedrock.

Even prior to the events of recent days, great damage has been done to the WTO by the United States' refusal to replace members of the Appellate body, by its decision to impose tariffs on aluminum and steel for its allies (invoking national security), and by its use of Section 301 to proclaim a first round of tariffs against China – in clear violation of WTO rules.

The negotiations between China and the United States are being conducted outside the WTO framework for settling disputes and widely reported measures included in the draft agreement – such as Chinese promises to buy more soybeans, natural gas, and aircraft from the United States – would violate the non-discrimination principle of the organization. The United States is also widely reported to insist on maintaining tariffs against China as a measure to ensure compliance with the agreement, which would also violate the WTO rules. By agreeing to negotiate in this way, China and the United States undermine the organization that many expect them to lead.

Anyone who has worked on trade policy knows that, while many recognize that trade benefits consumers and enhances productivity, protectionist and free-trade interests are typically quite evenly balanced in countries across the world. The examples of the United States – stakeholder of reference in the rules-based system – raising tariffs, and of China – the world's largest trader after the European Union – doing the same in retaliation, all outside the WTO system, inevitably tips the balance in favor of protectionists everywhere.

In the long run the greater risk confronting Africa may be a resurgence of protectionism and a return to a power-based instead of rules-based trading system. Such a system favors large nations and increases the dependence of small and poor nations on them. There can be little doubt that, under such a scenario, the likelihood of diversification of Africa's economy and of a sustained export-led acceleration would be significantly reduced.

Geopolitical Implications

As many believe, the trade dispute between China and the United States is only partly about trade, and perhaps it is not even mainly about trade - like the regional proxy-wars between the Soviet Union and the United States during the cold war, the underlying motive is not so much about a specific measure but about great-power competition. It follows, as others have also predicted, that even if this trade episode is resolved amicably, confrontations will recur – and some of these are likely to unfold outside the trade arena, where they may turn out to be even more dangerous.

Africa has big economic interests in a stable and growing world economy, and that means stable and growing

Europe, China and the United States, in order of the size of their trade relations with Africa. While Europe will remain SSA's largest trading partner as far as the eye can see, China's importance as an export market, source of imports and investor in Africa is growing by leaps and bounds. The United States remains not only an important donor in Africa but also a large market and, as the world's unchallenged military superpower, plays a significant role as a determinant of security in Africa, albeit usually an indirect one.

In recent years, the United States has come to see China as a strategic competitor, including in Africa. Referring to China's Belt and Road Initiative to which many African nations adhere, United States Vice President Michael Pence said recently:" China uses so-called "debt diplomacy" to expand its influence. Today, that country is offering hundreds of billions of dollars in infrastructure loans to governments from Asia to Africa to Europe and even Latin America. Yet the terms of those loans are opaque at best, and the benefits invariably flow overwhelmingly to Beijing. Just ask Sri Lanka, which took on massive debt to let Chinese state companies build a port of questionable commercial value. Two years ago, that country could no longer afford its payments, so Beijing pressured Sri Lanka to deliver the new port directly into Chinese hands. It may soon become a forward military base for China's growing blue-water navy."[4]

The Chinese economy is already about as large as the US economy in purchasing-power-adjusted terms, China's population is more than four times larger than that of the US and its GDP per capita is growing at least three times faster. African nations will not want their relationship with the United States to deteriorate, but they also will not want to forego their trade and investment opportunities in China. Africans have concerns about China's investment and trade practices in Africa, and some of these differences mirror the concerns expressed by the United States, but far from being in geopolitical or military competition with China most African nations see China's rise mainly as a big economic opportunity.

The increased competition between China and the United States raises important questions for Africa: How should African nations navigate relations between two indispensable partners? How do African nations maintain their freedom of maneuver on trade, infrastructure investment, and aid fundraising? How do they pursue their economic, security and political objectives without alienating one or the other of the sparring giants? It is safe to assume that these questions will preoccupy African policymakers far into the future.

Some Policy Implications

In conclusion, African nations need to adjust quickly to the new trade and geopolitical environment. They should prepare for a possible marked deterioration in the trading environment and in global economic growth, implying a downward turn in the commodity price cycle in a low-case scenario. They should eschew protectionist responses, which would add to their problems instead of alleviating them. Rapid progress towards the ACFTA has become even more critical. African nations also need to redouble their efforts to support the WTO, thus preserving a rules-based trading system. Their economic diplomacy should be triangular, i.e. promote Africa's interests while responding to the needs and perceptions of America, China and Europe. Clearly, African nations need to maintain and deepen their historical close links with Europe, which remains committed to free trade and to the multilateral trading system. They should continue to cooperate with China as part of the Belt and Road Initiative or in other ways while taking care to select projects carefully and avoiding excessive build-up of public and external debt. Last but not least, they should reassure the United States that their growing economic links with China do not imply strategic or military alliances but only the pursuit of attractive business propositions.

4. https://www.whitehouse.gov/briefings-statements/remarks-vice-president-pence-administrations-policy-toward-china/

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