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POLICY PAPER

THE TRADE WAR AND THE U.S. ELECTION: WHAT'S AT STAKE FOR DEVELOPING COUNTRIES?



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This paper examines the implications of the U.S.-China trade war for developing countries, particularly in light of the 2024 U.S. presidential election. The study traces the origins and escalation of the trade conflict, analyzing its multiple impacts on global trade patterns and economic growth. While some developing countries have benefited from trade diversion and supply-chain shifts, others, especially resource-exporting nations and the least-developed countries, have faced significant challenges. The paper presents data showing that almost every country group, except OECD countries, has experienced a decline in its trade-to-GDP ratio in the wake of the trade war, with heavily indebted poor countries and least-developed nations suffering the most.

The paper outlines three potential scenarios based on the outcome of the U.S. election: a shift towards reconciliation, continuation of current trends, or increased protectionism. Each scenario presents unique challenges and opportunities for developing countries. The study also explores the concept of 'friend-shoring' and its potential impact on Africa, highlighting the continent's notable absence from major friend-shoring initiatives, and the risks this poses to its economic prospects. In response to these challenges, the paper proposes a range of strategies for developing countries, including regional integration, South-South cooperation, strategic protectionism, economic diversification, and investment in education and innovation. The paper concludes by emphasizing the need for developing countries to remain agile in the face of uncertainty, balancing strategic autonomy with productive engagement in the global economy.

INTRODUCTION AND BACKGROUND

The 2024 U.S. presidential election has the potential to significantly impact developing countries through various channels, including trade and investment, foreign aid, climate policy, security arrangements, and immigration. It is poised to have a more pronounced impact on developing nations than previous elections for several reasons.

First, escalating geopolitical tensions between major global powers, along with shifts in the global balance of power, mean that the policy stance of the next U.S. president on these relationships could profoundly influence developing nations caught in the middle of these dynamics. Second, compared to a decade ago, the world has become increasingly interconnected, with global supply chains, digital communications, and financial systems more deeply intertwined than ever. Third, the ongoing U.S.-China trade war and the trend toward reshoring or 'friend-shoring' of supply chains could see the next administration's trade policies reshape global commerce, potentially impacting many developing economies.

This policy brief focuses specifically on the potential impact of the U.S. presidential election on developing countries through the lens of the U.S.-China trade war. Rather than predicting a winner in the close race between Donald Trump and Kamala Harris in the November 2024 election, this paper discusses various scenarios that could unfold depending on the outcome. It analyzes the potential impact on developing countries in each scenario. Finally, the paper proposes several policy recommendations for developing countries to mitigate potential adverse effects, and adapt to the changing global landscape.

THE 2018 TRADE WAR

The roots of this trade war can be traced back to long-standing economic tensions between the United States and China. For decades, the U.S. has criticized China's trade practices, including allegations of intellectual property theft, forced technology transfers, and state subsidies that give Chinese companies an unfair advantage in global markets. China has viewed many of these criticisms as attempts to stifle its economic rise, and to maintain U.S. hegemony in the global economic order.

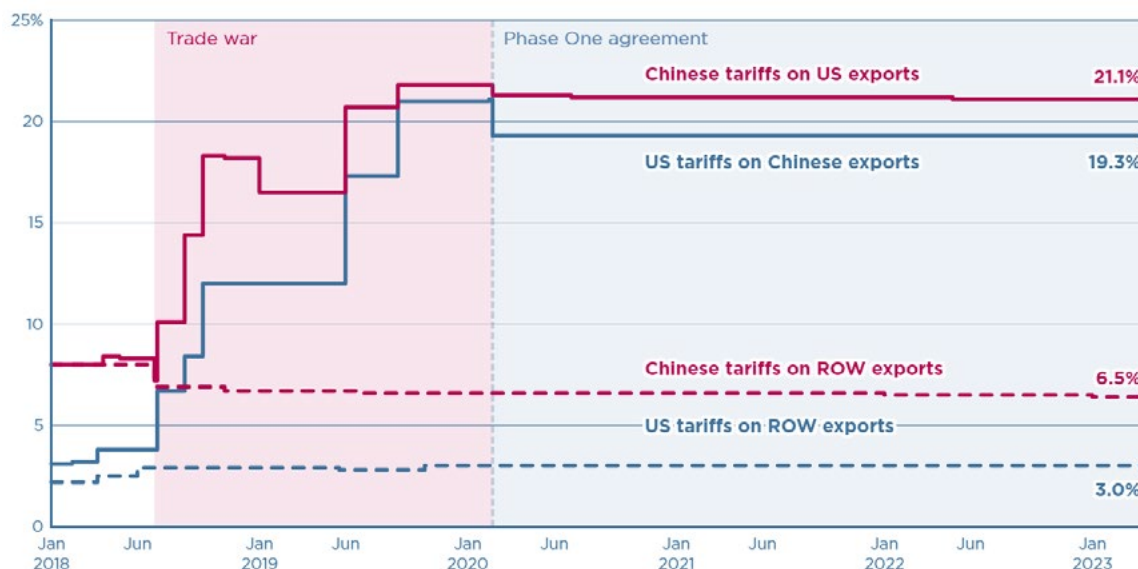
The 2018 trade war refers to the Section 301 duties applied to Chinese goods imported into the U.S., which were the largest in terms of total value of imports to which duties applied. In addition to these Section 301 duties, the U.S. also took other tariff actions, including duties applied to certain steel and aluminum products from various countries under Section 232 and to imports of large residential washers and solar cells and modules from all countries under Section 201. Because these other tariffs do not aim at any particular country, they are not part of the trade war discussed in this paper.

These Section 301 tariffs were implemented in response to China's alleged unfair trade practices, particularly concerning technology transfer, intellectual property rights, and cybersecurity. Prior to 2018, the U.S. primarily used Section 301 authorities to pursue dispute settlement through the World Trade Organization (WTO). However, the Trump administration shifted this approach, citing inadequacies in WTO procedures and rules to address certain Chinese trade practices. In March 2018, the U.S. Trade Representative (USTR) released a report detailing China's problematic practices, including forced technology transfer, unfair licensing terms, systematic investment in U.S. companies to acquire cutting-edge technologies, and unauthorized intrusions into U.S. companies' computer networks. The Section 301 tariffs aim to address these issues.

The chronology of the trade war was updated and shown very clearly by Chad Bown of the Peterson Institute for International Economics (Figure 1). In July 2018, the U.S. imposed tariffs of 25% on \$34 billion worth of Chinese imports. China immediately retaliated with similar tariffs on U.S. goods. In September 2018, the U.S. implemented 10% tariffs on \$200 billion of Chinese goods. China retaliated with tariffs on \$60 billion of U.S. products.

Figure 1

U.S.-China Trade War Tariffs: An Up-to-date Chart



Source: Chad Bown (2023), Peterson Institute for International Economics.

In May 2019, the U.S. increased tariffs from 10% to 25% on the \$200 billion of Chinese goods affected by the September 2018 measure. In August 2019, President Trump announced 10% tariffs on the remaining \$300 billion of Chinese imports, effectively placing tariffs on all Chinese goods entering the U.S. In January 2020, the U.S. and China signed the 'Phase One' trade deal, in which China agreed to increase purchases of U.S. goods and services by \$200 billion over 2017 levels, and to address some U.S. concerns about IP practices and forced technology transfers. Despite the Phase One agreement, most tariffs remained in place, and tensions continued to simmer. The average U.S. tariff on Chinese imports rose from 3.1% in January 2018 to 19.3% by 2019, while China's average tariff on U.S. goods increased from 8% to 21.1% over the same period.

In May 2024, President Biden announced major tariff increases on a variety of imports from China, including electric vehicles (EVs), semiconductors, and medical products. Although the amount of current U.S. imports affected by these tariffs is small—\$18 billion in the context of total 2023 imports from China of \$427 billion—the new tariff increases have significant implications for U.S. trade strategy. Dinh (2024) analyzed these implications.

The significance of these tariff actions can be seen by comparing the current trade war with the Smoot-Hawley Tariff Act of 1930, considered one of the largest tariffs increases in U.S. history and widely believed to have worsened the Great Depression in the U.S. and around the world. Fajgelbaum and Khandelwal (2022) noted that the imports from China subjected to the raised U.S. tariffs corresponded to about 2.6% of U.S. GDP, while the U.S. exports on which retaliatory tariffs were applied by China amounted to about 1% of GDP. Hence the trade war affected about 3.6% of U.S. GDP. The corresponding figures for China were

1.9% of GDP (for China's imports from the U.S.) and 3.6% (for China's exports to the U.S.), for a total of 5.5% of GDP. By contrast, the Smoot-Hawley Tariff Act of 1930 affected only 1.4% of US GDP.

The COVID-19 pandemic, which began in early 2020, further complicated U.S.-China relations and global trade patterns. The trade war is no longer a bilateral issue between the U.S. and China. Its effects have reverberated across the global economy, with particular significance for developing nations. These countries, often dependent on trade with both economic giants, have found themselves caught in the crossfire, facing both challenges and opportunities as the global economic landscape shifts.

MAIN CAUSES OF THE TRADE WAR

The U.S.-China trade war stems from a complex interplay of economic, political, and strategic factors. To understand its progression, we need to examine both the long-term causes and the specific events that triggered and have escalated the conflict.

From the U.S. perspective, the main concerns include unfair trade practices, a large trade deficit, job losses and economic inequality, intellectual property (IP) theft, and national security concerns. The U.S. says that by engaging in these practices, China undermines fair competition and harms U.S. economic and security interests. It argues that its large trade deficit with China is a result of unfair trade practices, including currency manipulation (though the U.S. has softened this charge in recent years), and mercantilist government policies that promote exports over imports. This trade imbalance has led to the loss of manufacturing jobs in the U.S. and exacerbated economic inequality, as American companies struggle to compete with low-cost Chinese goods, which benefit from Chinese state intervention.

The U.S. criticizes China's industrial policies that heavily subsidize Chinese companies, especially state-owned enterprises (SOEs). It argues that China's state interventions distort global markets by giving Chinese companies an unfair advantage in industries including steel, solar panels, and electric vehicles. The U.S. points to China's 'Made in China 2025' initiative, which is seen as a strategic plan to dominate key global industries, from advanced manufacturing to semiconductors, through government support and intervention. The U.S. is concerned about China's growing technological leadership, particularly in emerging industries including 5G, artificial intelligence, and biotechnology. It claims that China's advances in these sectors have been achieved through unfair means.

From China's perspective, the trade deficit is not solely due to unfair practices but rather structural economic factors within the U.S. economy. For instance, the U.S. imports more because of its high consumption and lower domestic savings. China also points out that many of its exports to the U.S. are produced by multinational companies, including U.S. firms, taking advantage of China's manufacturing capabilities. It stresses that trade is mutually beneficial and claims the China-U.S. imbalance is a result of economic choices and global supply chain dynamics, not manipulation or unfair practices.

China denies systematic IP theft, and claims that it has made significant progress in strengthening IP protection. The country has passed new laws, established more specialized courts, and increased penalties for violations. China defends its industrial policies, including subsidies and SOEs, as part of its development strategy, similar to how other countries, including the U.S., historically supported key industries. It argues that China's industrial policies are consistent with World Trade Organization (WTO) rules. Furthermore, Beijing accuses the U.S. of having its own protectionist policies through measures such as subsidies for certain industries. Beijing sees the concern about technological leadership as an attempt

to suppress China's legitimate aspirations to become a global leader in technology. It argues that it has the right to pursue leadership in fields including 5G, artificial intelligence, and electric vehicles.

The conflict went beyond simple tariff impositions, encompassing technology restrictions (such as those on Huawei), investment scrutiny, and even extending into areas such as accusations of currency manipulation. The trade war's progression demonstrates how economic disputes can quickly escalate and become intertwined with broader geopolitical tensions, creating ripple effects that impact the entire global economy.

IMPACTS ON U.S.-CHINA TRADE

The trade war has had significant and multifaceted impacts on both the United States and China. In this section, we first discuss the U.S. government's evaluation of these tariff actions before turning to the findings of academic research. The Chinese government did not provide its own evaluation in this area.

In its May 2024 report, the Office of the U.S. Trade Representative (USTR) considered that the Section 301 tariffs have been "an effective tool in changing some of China's technology transfer-related acts, policies, and practices." However, it stated that despite some positive developments, China persisted in efforts to transfer technology from U.S. companies, and the burden of China's technology transfer-related acts, policies, and practices on U.S. commerce has increased.

According to the USTR report, the impact of these tariffs on China has been significant. China's market share of U.S. imports decreased from 21.6% in 2017 to 13.7% in 2023, the lowest level since 2005. This shift has benefited other trading partners, particularly ASEAN countries and India. Foreign direct investment (FDI) in China also declined dramatically, from over \$100 billion in 2018 to just \$6 billion in the first half of 2022. Estimates suggest that the tariffs cost China's economy between 0.31% and 0.36% of GDP annually, amounting to \$190-\$221 billion over five years. In addition, the tariffs likely reduced the exposure of American intellectual property to China by shifting production to other countries.

The report indicated that the impact on the U.S. economy has been mixed. It cited the U.S. International Trade Commission (USITC) report (2024) and other studies showing that the tariffs had a small negative effect on overall U.S. economic welfare and real incomes in the short run. The estimated GDP loss was around 0.13%, with more significant impacts in specific regions and industries. However, the tariffs did lead to an increase in the value of domestic U.S. production for directly affected industries, averaging 0.4% each year. Prices of domestically produced affected products increased by about 0.2%. The pass-through of tariffs to U.S. importers was generally complete, though these costs did not significantly increase prices for ultimate consumers in the short run. Contrary to expectations, the tariffs did not lead to a net increase in U.S. manufacturing employment. While some industries benefited from protection, higher input costs and retaliatory tariffs caused job losses, especially in regions reliant on trade with China.

One significant outcome of the tariffs has been the diversification of U.S. supply chains. The USITC report estimated that Section 301 duties led to a 13% decline in the value of U.S. imports from China in affected industries, with increases in imports from a diversified set of sources such as Mexico, Korea, Malaysia, and Taiwan for the advanced technology industries it analyzed, including computer equipment, electrical equipment, and semiconductors. The tariffs have prompted a restructuring of U.S. supply chains, reducing dependence on China. However, it noted that the shift to countries like Vietnam and Mexico often

still involved indirect links to China. If sustained, these shifts may generate increases in diversification and resilience across U.S. supply chains, although there may be associated costs in the short term.

In general, these findings from the U.S. government were consistent with academic research. The trade war was found to have slowed U.S. annual economic growth very slightly, by less than one percentage point of GDP. Amiti *et al* (2019) estimated that by December 2018, import tariffs were costing U.S. consumers \$1.4 billion per month in deadweight welfare (efficiency) losses, about 0.08% of GDP in 2018. But the effect was not even. U.S. farmers were particularly hard hit. Soybean exports to China fell from \$12.2 billion in 2017 to \$3.1 billion in 2018, according to the U.S. Department of Agriculture. The Trump Administration provided about \$28 billion in aid to farmers between 2018 and 2020 to offset losses. Some U.S. manufacturers benefited from reduced competition, while others struggled with higher input costs.

Using actual economic data, Table 1 below shows the ratios of trade (exports of goods and services plus imports of goods and services), merchandise trade, imports and exports of goods and services to GDP for both China and the U.S. over 2000-2023. The trade-to-GDP ratio of China dropped from an average of 43.7% in 2010-2018 to 36.7% in 2019-2023 while that of the U.S. decreased from 28.7% to 25.4%. It thus appears the trade war affected China more than the U.S.

Table 1

Trade-to-GDP ratios for U.S. and China (%)

Country Name	Series Name	Average	Average	Average
		2000-2009	2010-2018	2019-2023
United States	Trade (% of GDP)	25.3	28.7	25.4
United States	Merchandise trade (% of GDP)	19.7	21.9	19.5
United States	Imports of goods and services (% of GDP)	14.9	15.9	14.3
United States	Exports of goods and services (% of GDP)	10.4	12.8	11.1
China	Trade (% of GDP)	52.4	43.7	36.7
China	Merchandise trade (% of GDP)	51.6	40.2	33.1
China	Imports of goods and services (% of GDP)	23.9	20.6	17.2
China	Exports of goods and services (% of GDP)	28.5	23.0	19.5

Source: Author's calculations from World Development Indicators; last updated 06/28/2024; accessed 09/12/2024.

In fact, China's economic growth slowed to 6.0% in 2019, its weakest expansion in 29 years, partly due to trade tensions. The average annual GDP growth of China fell from 8% in 2010-2018 to 5% in 2019-2023 while that of the U.S. fell from 2.4% to 2.1%¹. Of course, not all these effects could be attributed to the trade war as COVID-19 also played a big role over this period, but the trade war impact could be seen in 2019, before COVID-19 began. In 2019, China's exports to the U.S. fell by 12.5% compared to the previous year, and the trade (exports of goods and services plus imports of goods and services) to GDP ratio dropped from 43.7% average 2010-2018 to 35.9% in 2019.

Some U.S. manufacturers began moving production out of China to avoid tariffs. A 2019 AmCham China survey found that 40% of respondents were considering or had relocated

1. The U.S., being an advanced economy, naturally has a lower growth rate than China due to convergence.

manufacturing facilities outside China. The Chinese yuan depreciated against the U.S. dollar, falling past the symbolically important level of 7 yuan per dollar in August 2019 for the first time since 2008. The trade war also prompted China to accelerate efforts to reduce reliance on exports and U.S. technology. This included increased investments in domestic semiconductor production and the acceleration of the “dual circulation” economic strategy².

On the whole, both countries have seen some decoupling of their deeply intertwined supply chains, a process accelerated by the COVID-19 pandemic. The trade war expanded into a technology war, with restrictions on companies like Huawei affecting both nations’ tech sectors and global technology supply chains. But despite the tariffs, China remained the United States’ largest goods trading partner in 2019, with \$558.1 billion in total (two-way) goods trade, according to the U.S. Bureau of Economic Analysis (BEA). In 2023, this deficit dropped to \$279 billion.

These impacts highlight the interconnectedness of the U.S. and Chinese economies and the far-reaching consequences of their trade dispute. While both countries have experienced negative effects, they’ve also demonstrated resilience and adaptability in the face of these challenges. The trade war has led to a reconfiguration of global supply chains and trade relationships, with significant implications for the global economy, particularly for developing countries.

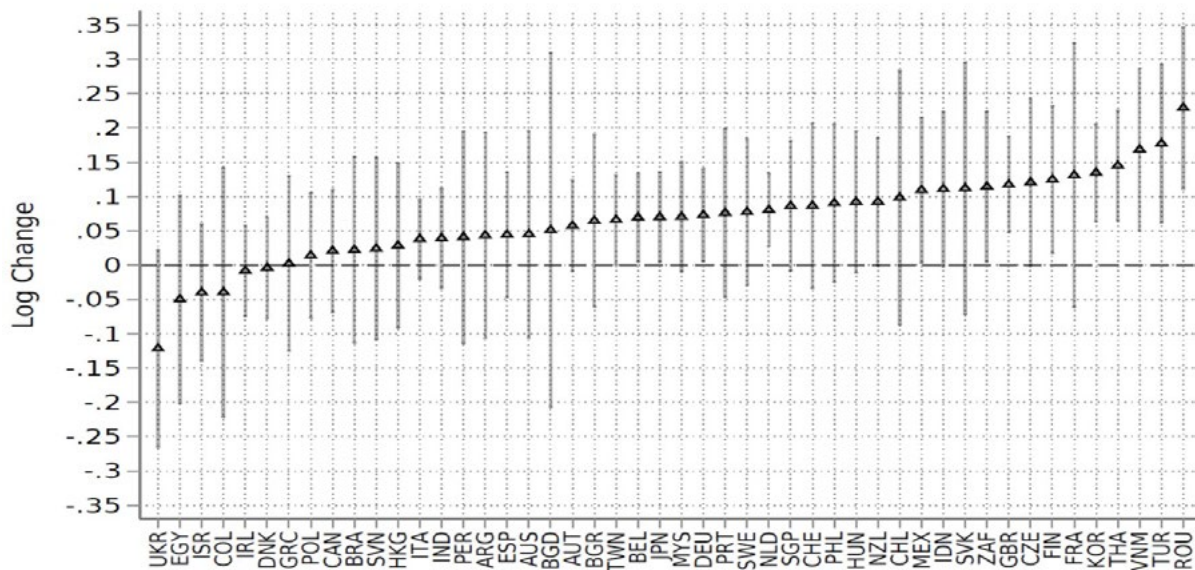
IMPACTS ON DEVELOPING COUNTRIES

Fajgelbaum et al. (2023) found the U.S.-China trade war actually increased overall global trade by 3 percent by creating trade opportunities for “bystander” countries. In a study which matches these tariff changes to trade flows to 48 large exporters (excluding oil exporters) they found that following tariff increases, U.S. exports to the rest of the world (excluding China) increased slightly, and China’s exports to the rest of the world (excluding the U.S.) also rose slightly. Trade for the tariffed products increased among the “bystander” countries. Not only did these countries reallocate global trade flows following the tariff increases, they also exported more to the world while keeping their exports to China largely the same (Figure 2).

2. China’s “dual circulation” strategy refers to relying on domestic consumption while maintaining or expanding exports in key areas.

Figure 2

Relative Export Growth in Targeted Products across Countries



Source: Fajgelbaum et al. 2023.

Some of these 48 countries are developing nations, including Brazil, India, Malaysia, the Philippines, Thailand, Vietnam, and Turkey. However, none of them belong to the low-income group. The countries with strong export growth were found to be operating along downward sloping supply curves and selling products that substituted for those previously supplied by the U.S. or China. The countries that benefited the most were those with a high degree of international integration, as proxied by their participation in trade agreements and foreign direct investment. France, for example, increased its exports both to the U.S. and to the rest of the world in response to the tariffs. Spain increased its exports to the U.S., but its exports to the rest of the world shrank. In South Africa and the Philippines, the tariff increases reduced both exports to the U.S. and exports to the rest of the world.

Some developing countries have benefited from trade diversion as companies seek alternatives to Chinese products. Exports from Bangladesh, India, and Southeast Asian countries such as Malaysia, Thailand, and Vietnam increased. For instance, India's exports of electronics (HS8) to the U.S. grew from \$1.33 billion in 2017 to \$2.19 billion in 2019, an 80% increase, while Turkey's exports in the same category grew from \$161 million to \$305 million, according to the Atlas of Economic Complexity from the Growth Lab at Harvard University (2024). Many multinational companies have been relocating or diversifying their supply chains away from China to these countries as well. However, the slowdown in Chinese economic growth has led to decreased demand for commodities, affecting resource-exporting countries.

Table 2 shows various country groups and their average trade to GDP ratio (trade is defined as exports of goods and services plus imports of goods and services) for the last 23 years divided into three periods: 2000-2009, 2010-2018, and 2019-2023. This last period is the period after Trump's tariff increases. Because this period also covers the COVID-19 pandemic, data for 2018 and 2019 are also shown separately.

Table 2**Ratios of Trade to GDP (percentages)**

Country Groups	Average	Average	Average	2018	2019
	2000- 2009	2010- 2018	2019- 2023		
World	54.4	57.7	57.0	57.7	56.5
OECD members	47.9	55.2	57.1	57.0	56.4
Upper middle income	55.0	49.0	46.9	47.0	45.1
Lower middle income	54.6	55.9	53.2	55.1	52.4
Low income	49.6	51.6	50.6	53.6	51.2
Heavily indebted poor countries (HIPC)	57.9	59.1	53.3	55.1	54.3
Least developed countries: UN classification	54.8	56.4	51.4	53.3	50.8
Sub-Saharan Africa	N/A	60.5	56.4	57.4	55.4

Source: Author's calculations from World Development Indicators; last updated 06/28/2024; accessed 09/12/2024.

While the average global trade-to-GDP ratio decreased slightly following Trump's and China's tariff increases, from 57.7% to 57%, this slight decline masks large variations among different country groups. Every group, except OECD countries (high income group), suffered a decline in its trade-to-GDP ratio in the wake of the trade war. The countries that suffered the most were also those that could least afford it: the trade-to-GDP ratios of the heavily indebted poor countries and the least developed countries (according to the UN definition) declined by 5.8 and 5.0 percentage points, respectively. For both of these groups, the trade ratio dropped below the level in the 2010s. In fact, the same can be said about the lower and upper middle-income countries. While it is true that this adverse effect on global trade was also caused by the COVID-19 pandemic and not entirely by the trade war, the last two columns of Table 2 show this effect happened even before the pandemic which started in 2020.

However, there are also large variations among countries within each group. For instance, the trade ratio of Turkey among the upper middle-income countries, and of Vietnam among the lower-middle income group, have risen significantly (by 15.8 and 36.3 percentage points, respectively), while Egypt's declined. These cases broadly agree with Figure 2. Other countries do not show the pattern shown in Figure 2. For instance, the trade ratios of South Korea and Thailand declined by 7% and 11%, respectively, while Figure 2 predicts both would gain in export shares.

The difference observed can be attributed to various factors that influence actual trade ratios. The results presented in Table 2 are based on actual data, not simulations. For example, Nantembelele *et al* (2023) employed a computable general equilibrium (CGE) model from the Global Trade Analysis Project to simulate the effects of the U.S.-China trade war on the trade volumes and economic growth of sub-Saharan African (SSA) countries. They found that the trade war created opportunities for SSA countries, with exports and imports potentially increasing by up to 0.02% and 0.05%, respectively, depending on the scenario.

However, in reality, SSA's export-to-GDP ratio declined from 25.2% in 2010–2018, to 24.3% in 2019–2023, while the import-to-GDP ratio fell from 26.7% to 25% over the same period, according to the World Bank database (2024). A plausible explanation for the discrepancy between the simulated and actual outcomes is that SSA countries failed to capitalize on trade creation opportunities, likely because of their limited integration into global supply

chains. This suggests that while the trade war offered potential gains, structural barriers may have prevented SSA from benefiting fully in practice.

The Fajgelbaum study (2023) found that countries had widely varying responses to the increased tariffs on U.S. and China. The response appears to hinge on whether a bystander country produces goods that substitute for, or complement the output of the countries involved in the trade war. For example, when the U.S. imposes tariffs on China, if a bystander country like Vietnam produces a close substitute for a product being taxed, it stands to increase its exports to the U.S. On the other hand, if it produces a good that complements Chinese products -- such as a component of a machine made in China -- its exports to the U.S. could fall.

As the U.S. imposed restrictions on technology transfers to China, some Chinese companies responded by increasing their tech investments in other developing countries. A notable example was Alibaba's additional \$3 billion investment in its Southeast Asian e-commerce subsidiary, Lazada, in 2018. Additionally, certain countries benefited from China's search for alternative sources of agricultural products. For instance, Brazil's soybean exports to China rose by 30% in 2018, capturing market share previously held by U.S. producers.

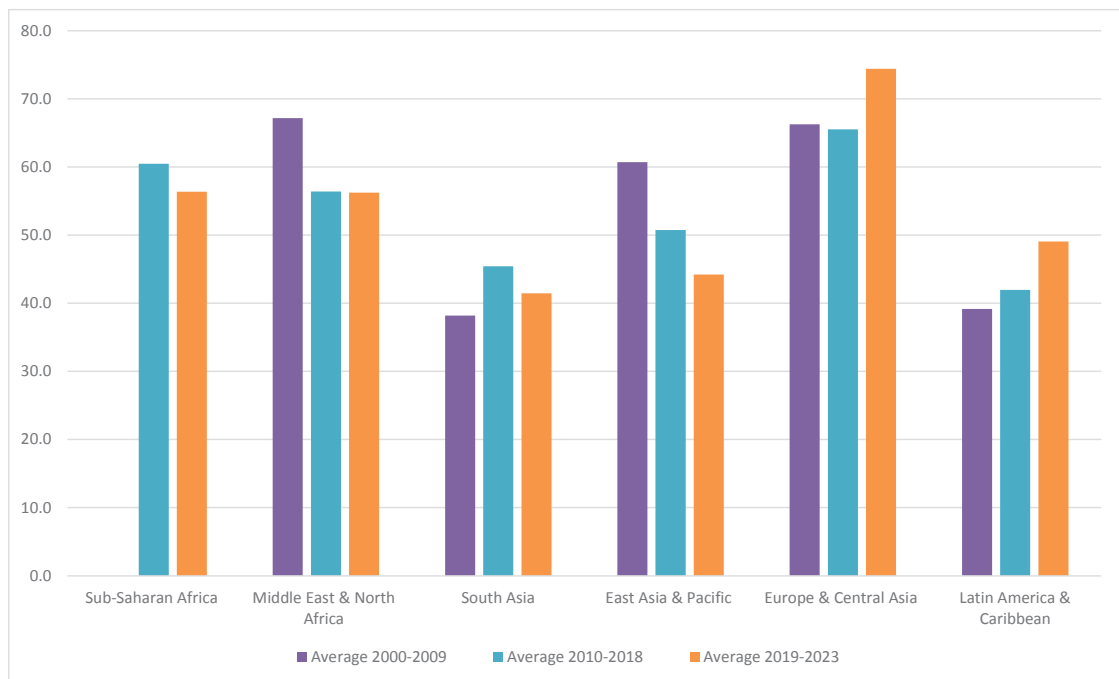
Countries that have gained from the trade war tend to be more integrated into global trade networks and rely primarily on manufacturing exports rather than natural resources. We will revisit this point later when discussing policy recommendations, as it highlights the importance of economic diversification and global trade integration in navigating geopolitical disruptions.

The trade war has forced many developing countries to carefully balance their relationships with both the U.S. and China. India, for instance, has strengthened its strategic partnership with the U.S., while maintaining economic ties with China. There is also a renewed focus on regional trade agreements as a buffer against global trade uncertainties. The African Continental Free Trade Area (AfCFTA), implemented in 2021, aims to increase intra-African trade by 52.3% by 2025 (UN Economic Commission for Africa projections). In terms of technology and cybersecurity, the U.S.-China tech war has put pressure on developing countries to choose sides in areas such as 5G infrastructure. Brazil, initially resistant to U.S. pressure, eventually excluded Huawei from its 5G network auction in 2021. These impacts demonstrate the complex and far-reaching consequences for the South of the U.S.-China trade war. While some countries have found opportunities amidst the disruption, many face significant challenges in navigating the shifting global economic landscape.

Figure 3 shows the trade-to-GDP ratios for various regional groups (excluding high-income countries). Sub-Saharan Africa, South Asia, and East Asia and Pacific all show declines in their trade ratios, while Europe and Central Asia and Latin America show increases.

Figure 3

Trade-to-GDP Ratios by Region (Excluding High-Income Countries), %



Source: Author's calculations from World Development Indicators; last updated 06/28/2024; accessed 09/12/2024.

FUTURE OUTLOOK AND POTENTIAL SCENARIOS

Why does the U.S. presidential election matter? One could argue that the global trade outlook does not necessarily depend on U.S. policies alone. It also depends on the policy choices of the Chinese government. This section looks briefly at the current Chinese economic situation to see why China is not likely to change its current policy position.

China Policy Outlook: As of mid-2024, China is grappling with slow economic growth, rising unemployment, a collapsing real estate market, and an aging workforce. In its August 2024 assessment, the International Monetary Fund (IMF) projected China's annual GDP growth at between 4.0% and 4.5% for the period from 2025 to 2029. This marks a significant decline from the 10.4% annual growth China achieved between 2000 and 2009, and is even below the average growth rate of 5.0% between 2019 and 2023, a period affected by the COVID-19 pandemic.

To revitalize the economy, the Chinese government has shifted its focus toward high-technology industries, referred to as 'quality industries', rather than relying on services as the primary driver of growth. Financial resources have been directed toward sectors such as electric vehicles (EVs), solar panels, and semiconductors. However, the challenge lies in finding markets for these industrial goods, which are largely designed for export rather than domestic consumption.

China's dependence on exports of these high-tech goods creates vulnerabilities, especially as global demand fluctuates and geopolitical tensions affect trade relations. The government's strategy highlights the need for new export markets and underscores the risks of relying heavily on industries that are sensitive to global competition and external

demand. This shift also reflects broader challenges in rebalancing the economy amid slowing domestic growth and demographic pressures.

China's domestic market cannot absorb the increased industrial output for several reasons. First, despite significant economic progress over the past three decades, average Chinese consumer income remains far below that of consumers in developed countries. Second, China has a longstanding culture of saving, and with consumer spending further dampened by slow economic activity, domestic consumption remains weak. Third, much of China's industrial capacity was initially built to serve export markets. Adapting production to suit domestic consumer preferences will take time.

China's reliance on industrial exports can be attributed to two additional key factors: structural overcapacity and the need to maintain low unemployment for social stability. U.S. officials, including the Commerce and Treasury Secretaries, have emphasized that China's overcapacity has disrupted global markets. Liu (2024) argued that China is producing significantly more output in many sectors than domestic and international markets can absorb, leading to shrinking profit margins. To generate sufficient cash flow to service their debts, producers have responded by lowering prices and increasing production volumes. This suggests that the problem is unlikely to resolve itself, and substantial changes in China's industrial policy seem improbable in the near term.

Ang (2024) highlighted that China's transition to a high-tech, innovation-driven economy is not progressing quickly enough to replace its traditional industrial base. To maintain social stability amidst economic slowdown and the local government debt crisis, China may have little choice but to continue relying on traditional manufacturing. While China aspires to move up the value chain, it remains tied to its older economic model in the short term, complicating efforts to rebalance its economy.

U.S. Policy Outlook: The major event of the upcoming U.S. Presidential election in November 2024 could significantly impact the course of U.S.-China relations and global trade dynamics. We consider three possible scenarios in this context. The first, and most optimistic, envisages a shift toward reconciliation between the U.S. and China, leading to more cooperative trade relations. The second scenario involves a continuation of current policies, maintaining the *status quo*. The third, more pessimistic scenario, foresees a worsening of global trade tensions, and further escalation of U.S.-China rivalry.

The outcome of the election will heavily influence the likelihood of each scenario. If Donald Trump is re-elected, the likelihood of the third scenario, characterized by heightened trade tensions, will increase. Conversely, if Vice President Kamala Harris wins, the second scenario, which reflects a continuation of current policies, is most likely. The first scenario, involving a move toward reconciliation, is considered improbable regardless of the election's outcome. This analysis underscores the critical role that U.S. leadership will play in shaping the future of U.S.-China relations and the broader global trade environment.

SCENARIO ONE: SHIFT TOWARDS RECONCILIATION

A new U.S. administration might seek to ease tensions and negotiate a more comprehensive trade deal with China. This could involve reducing tariffs, easing technology restrictions, and seeking more collaborative approaches to address trade imbalances. For developing countries, there would be a potential reversal of some trade diversion benefits, but a more stable global economic environment could boost growth overall. A new administration might seek to address China-related trade issues through multilateral institutions such as

the WTO. This could involve building coalitions with allies, including the E.U. and Japan, to pressure China on issues including intellectual property rights and state subsidies. For developing nations, this represents an opportunity to have a greater voice in global trade governance, although the risk would persist of being caught between competing blocs.

SCENARIO TWO: CONTINUATION OF CURRENT TRENDS

In this scenario, the new administration would continue the existing policies started by Trump and sustained by Biden. This could mean maintaining or even slightly increasing tariffs, continuing technology restrictions, and further decoupling of supply chains. For developing nations, this implies prolonged uncertainty, but also continued opportunities for countries benefiting from trade diversion and supply-chain shifts. In this scenario, the trend towards supply-chain diversification is likely to continue. Developing countries that have invested in infrastructure and skills development may continue to benefit from this trend. For example, India's Production Linked Incentive (PLI) scheme, launched in 2020, aims to boost domestic manufacturing, could go into full force, potentially positioning India as a key alternative production hub.

In terms of technology and digital economy, the global technology landscape will likely remain influenced by U.S.-China competition. Developing countries may face continued pressure to choose sides in areas including 5G infrastructure, potentially impacting their technological development, while some countries might leverage this competition to negotiate better terms for technology transfer and investment. In this scenario, continued global trade tensions might accelerate regional integration efforts in the South. The success of initiatives like AfCFTA could become more critical for economic resilience, and there is potential for increased South-South cooperation as a hedge against U.S.-China tensions.

Changes in U.S.-China trade dynamics will continue to impact global commodity demand and prices. Resource-rich developing countries, particularly in Africa, will need to prepare for potential volatility and should accelerate diversification strategies. The low-income countries will continue to struggle with the debt overhang, although some countries may see changes in the availability and terms of development loans and investments from both powers.

SCENARIO THREE: INCREASED PROTECTIONISM FROM THE WEST AND DIVERSION OF CHINA'S SURPLUS TO THE SOUTH

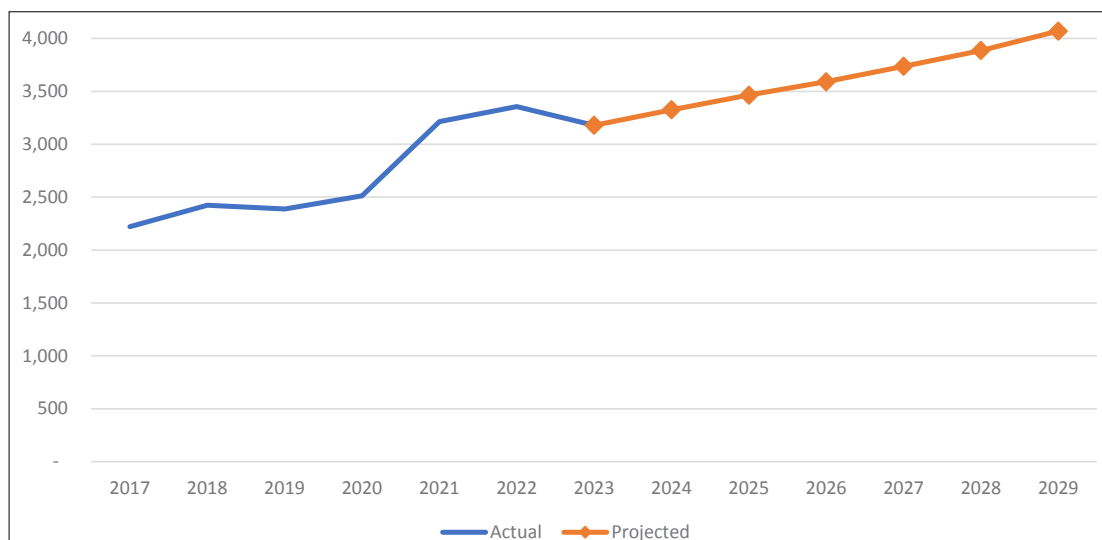
An important, though pessimistic, scenario to consider is one in which the new U.S. administration, followed by its allies, significantly increases protectionist measures, not just against China but more broadly against other countries. In this case, for reasons mentioned above concerning the need for exports and to maintain domestic stability, China could redirect its exports to other countries. Such a scenario could have severe and long-lasting impacts on developing economies.

In 2023, China exported about \$3.2 trillion (Figure 4), about half of which went to developed economies—the U.S., the EU, Japan, and South Korea—and half went to the rest of the world. The IMF currently projects these exports to rise to \$4.1 trillion in 2029. If the U.S. and

its allies, following the U.S. Presidential election, were to decide to raise tariffs against China, and succeed in doing so, this trade surplus could create serious effects on the balance of payments, economic growth, and employment situations of developing countries.

Figure 4

China's Actual and Projected Exports of Goods (\$US billions)



Sources: IMF Article IV Consultations, 2024 and 2023.

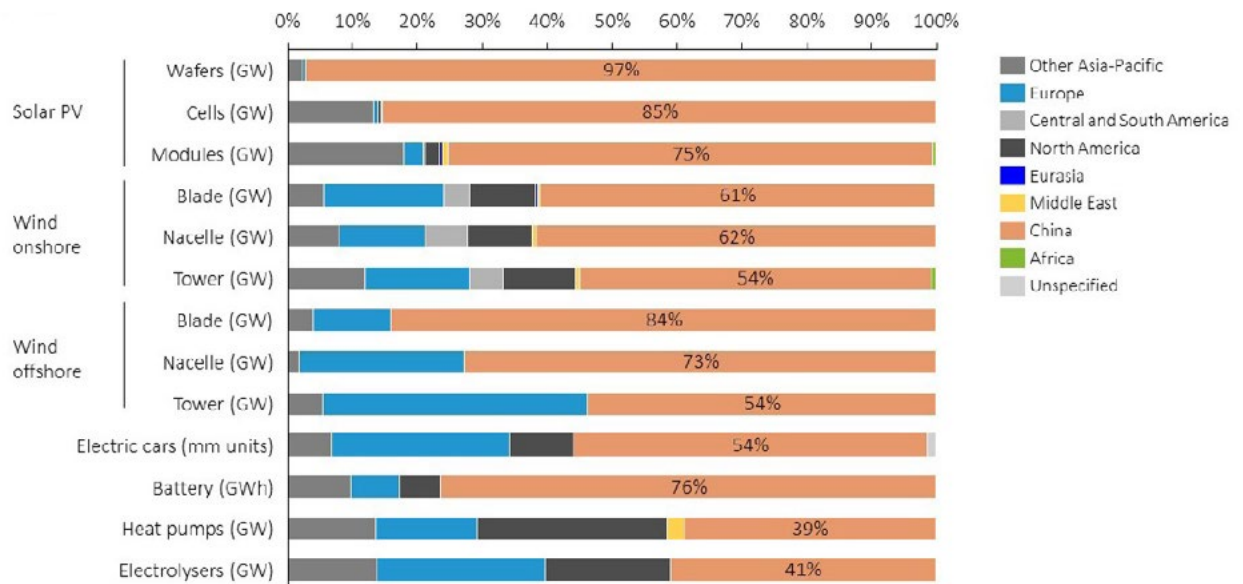
The surplus goods, mostly in manufacturing, could flood developing countries' markets at prices below the production costs of local industries. For example, in the textile industry, a glut of cheap clothing could devastate local producers in countries such as Bangladesh, Cambodia, and Ethiopia, leading to widespread closures and job losses. In electronics, this could be damaging for countries such as Malaysia or Vietnam, and in automotive parts, for countries such as Morocco and Thailand. This could potentially derail the industrialization efforts of these countries, especially as they try to move up the value chain. Typically, employment in the manufacturing sector accounts for about 10%-30% of total employment in a country, and a shock to this sector could have wide-ranging social impacts. From a balance-of-payments perspective, this could lead to recurrent trade surpluses for China with the developing world and consequently higher indebtedness for the latter.

The production costs for China's manufactured goods can be significantly lower than those of typical low- or lower-income countries, not primarily because of labor costs, but because of an efficient production ecosystem. This ecosystem is characterized by massive economies of scale, enabled by a vast domestic supply chain, organizational efficiency, and a well-trained, disciplined workforce. Over the past two decades, this workforce has honed its skills through extensive learning by doing.

China now accounts for about 30% of global manufacturing output, whether measured by total production or value added, and this share is likely to grow further. Figure 5 highlights the European Union's assessment of China's capacity in green manufacturing. When compared to other regions, China's dominant position in this sector remains undeniable, demonstrating its competitive edge in emerging industries as well. This combination of factors—scale, efficiency, and a skilled labor force—gives China a substantial cost advantage over other developing countries, further solidifying its position as a global manufacturing leader.

Figure 5

Clean Technology Manufacturing Capacity by Region (% 2021)



Source: Figure 7 in European Union (2024).

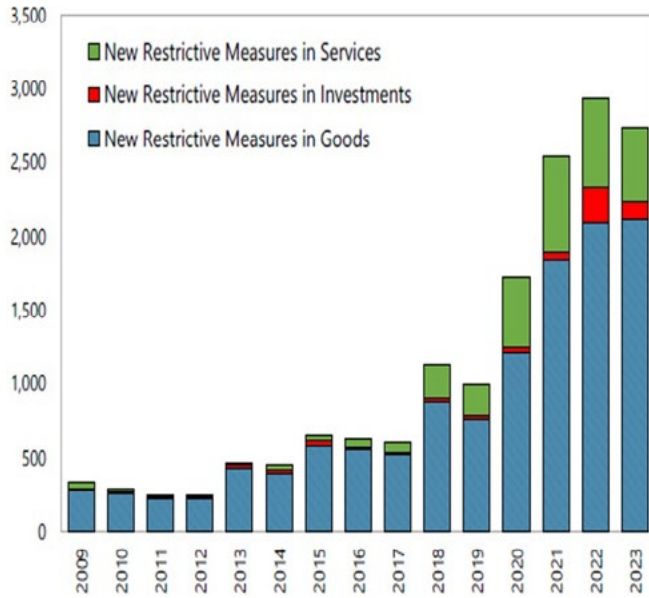
In David Ricardo’s theory of comparative advantage, when two countries engage in trade, a country such as China can have absolute advantages in producing certain goods over its partner, such as Zambia. However, according to Ricardo’s model, both countries should still benefit by specializing in the production of goods for which they hold a comparative advantage. What Ricardo did not anticipate is a scenario like that of China, where a single country is capable of producing almost everything at a much lower cost than countries like Zambia. A ‘do nothing’ scenario would leave Zambia with limited options, such as focusing on copper production, effectively trapping the country in a cycle of being a commodity producer and exporter, with all the negative developmental consequences that come with such reliance (Dinh and Dinh, 2016).

Furthermore, a passive or ‘do nothing’ approach to trade could lead to a global system in which, based purely on efficiency, one country might end up producing goods for the entire world (or a large group of countries). In such a scenario, importing countries would be left to produce only food, non-tradable services like haircuts, and IOU notes to pay for the goods provided by the producer country. While this setup may appear rational from a purely economic efficiency standpoint, it would be viewed as undesirable by many, as it could exacerbate inequalities and reduce economic sovereignty.

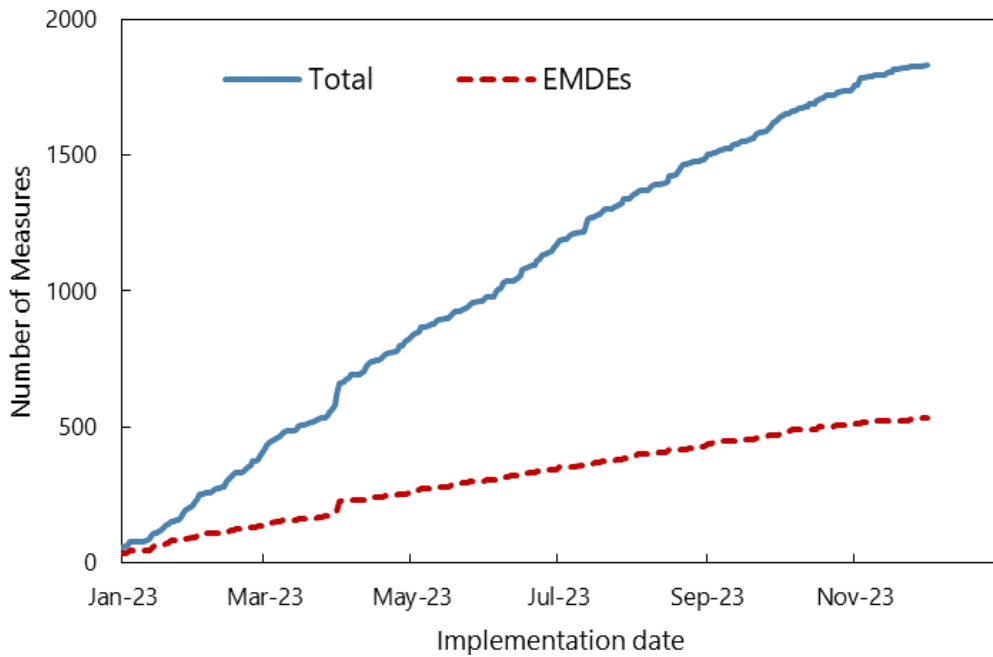
How likely is this scenario? Figure 6, Panel A shows the number of trade-restrictive measures imposed globally from 2009 to the present. Over the past decade, these measures have surged from 500 to over 2,500, with data for 2023 indicating that most of these restrictions have been implemented by advanced economies (Figure 6, Panel B). This trend suggests that global trade is becoming increasingly protectionist, making the scenario of one dominant producer country more plausible as countries turn to trade barriers to protect their own industries.

Figure 6

A. Number of New Trade Restrictive Measures



B. Industrial Policies Imposed in 2023



Source: IMF (2024a and 2024b).

Note: EMDEs stand for emerging markets and developing economies.

POTENTIAL RESPONSES AND MITIGATING STRATEGIES OF DEVELOPING COUNTRIES

- Facing the three scenarios, developing countries should ‘prepare for the worst and hope for the best’. Among the policy responses available to developing countries are:
- Regional Integration: Strengthening regional trade blocs (including ASEAN, MERCOSUR, or the African Continental Free Trade Area) could provide some buffer against external shocks.
- South-South Cooperation: Increased economic cooperation between developing countries could help create alternative markets and reduce dependence on the Global North.
- Strategic Protectionism: Developing countries might need to selectively protect key industries, though this could be challenging under current WTO rules.
- Diversification and Moving Up the Value Chain: Accelerating efforts to diversify economies and move into higher-value activities could provide some resilience. In particular, there is a need to renew industrialization efforts.
- Investment in Education and Innovation: Long-term investments in human capital and R&D could help countries develop unique competencies that are less vulnerable to import competition.

These measures highlight the urgent need for these countries to build economic resilience, foster regional cooperation, and have a stronger voice in shaping global trade rules. The international community, including multilateral institutions, would need to play a crucial role in preventing the third scenario from fully materializing, and in supporting affected countries if it does. In particular, the WTO, together with other multilateral organizations such as the World Bank and the IMF, should be willing to reexamine the existing rules to accommodate countries of the South.

Success is unlikely to follow a ‘one size fits all’ formula. Instead, developing countries will need to tailor their approaches based on their specific economic situations, development goals, and relationships with the U.S., China, the EU, and other major economies. Strategic protectionism will require a delicate balance of protection for domestic industries, measures to attract beneficial foreign investment, and strategic integration into global value chains.

A sensible approach to strategic protectionism involves identifying *a priori* a list of products in which a country has a comparative advantage in production. For existing products, the concept of *revealed comparative advantage* (RCA) provides a useful starting point. This traditional method relies on a country’s trade data to assess its relative strengths. RCA can be quantitatively determined using the Balassa index, introduced by Balassa (1965). The index reveals a country’s relative advantage or disadvantage in exporting a commodity, based on its actual export patterns compared to those of other countries. IMF (2024a) found that new industrial policies introduced by countries are correlated with their revealed comparative advantages, as well as with past industrial policy measures implemented by other countries in the same sectors. This finding suggests that industrial policy strategies are being shaped not only by current trade strengths, but also by past practices in similar sectors, reinforcing the importance of using RCA as a tool for formulating strategic protectionism policies.

Friend-shoring and its impact on Africa: Friend-shoring, a concept gaining traction in international trade, represents a strategic response to the economic and security vulnerabilities exposed by global supply chain disruptions. This approach aims to reduce dependence on nations with divergent political interests or unstable economies, particularly in critical sectors. The United States and European Union are at the forefront of this shift, focusing on securing supply chains for essential raw materials, commodities, and manufactured goods from more politically aligned and economically stable partners. President Biden further elevated the concept by making it a cornerstone of the Indo-Pacific Economic Framework (IPEF), an initiative designed to strengthen economic ties with trusted Asian partners including Japan, South Korea, and India. Europe has similarly embraced this strategy. By 2021, nearly half of European companies had diversified their supplier bases, a trend subsequently accelerated by the war in Ukraine. This conflict starkly highlighted the risks of over-reliance on Russian commodities, particularly in the energy, food, and fertilizer sectors. The EU's response has been to prioritize intra-bloc supply chain security, focusing on partners within the union.

Despite these global shifts, Africa has been notably absent from major friend-shoring initiatives. While the U.S. has introduced a new strategy for sub-Saharan Africa, it lacks concrete commitments to friend-shoring, and appears primarily focused on countering Chinese and Russian influence in the region. This exclusion poses significant risks to Africa's economic prospects.

Among the potential consequences for Africa are:

- **Trade Diversion:** As friend-shoring prioritizes trade with politically aligned nations, African countries could see a decline in trade volumes with major economies.
- **Investment Redirection:** Foreign direct investment (FDI) flows may be redirected towards countries included in friend-shoring networks, potentially reducing capital inflows to Africa.
- **Job Creation Challenges:** With manufacturing and production potentially shifting to 'friendly' nations, Africa might miss out on associated job-creation opportunities.
- **Reduced Competitiveness:** African exports may become less competitive as preferential trade agreements and supply-chain integration favor other regions.
- **Limited Access to Technology Transfer:** As supply chains consolidate among allied nations, African countries might have reduced access to cutting-edge technologies and know-how.
- **Weakened Multilateral Trade Benefits:** Africa's ability to benefit from initiatives such as the WTO's Aid for Trade program may be hindered as the global focus shifts to Indo-Pacific supply chains.

To mitigate these potential negative effects, African nations and their allies should consider the following strategies:

- **Industrialization Drive:** Africa must prioritize the building of a robust manufacturing base to make itself indispensable in global supply chains. Countries such as Kenya or Uganda are not inherently less trustworthy than Indonesia or Thailand, but they lack the manufacturing capacity that makes the latter attractive for friend-shoring initiatives.
- **Advocacy for Inclusion:** African leaders should actively lobby for inclusion in friend-shoring strategies. This includes pushing the U.S. administration to incorporate African nations into its friend-shoring plans, and encouraging the EU to develop stronger supply-chain ties with Africa.

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- **Strengthen Regional Integration:** Accelerating the implementation of the African Continental Free Trade Area (AfCFTA) could create a more attractive market for friend-shoring partners.
 - **Develop Critical Industries:** Focus on sectors crucial to friend-shoring initiatives, such as rare earth minerals processing, semiconductor manufacturing, or green technology production.
 - **Leverage Existing Partnerships:** Utilize platforms such as the African Growth and Opportunity Act (AGOA) with the U.S., or the EU-Africa partnership, to negotiate inclusion in friend-shoring initiatives.
 - **Invest in Infrastructure and Connectivity:** Improving digital infrastructure and logistics networks can enhance Africa's competitiveness in global supply chains.
 - **Defend the Multilateral Trading System:** African nations should continue to advocate for a robust multilateral trading system that supports their development needs, even as bilateral and regional friend-shoring agreements proliferate.

While friend-shoring presents challenges to Africa's economic integration into global markets, it also offers opportunities for strategic positioning. By proactively addressing the industrialization gap, advocating for inclusion in new economic frameworks, and leveraging existing partnerships, African nations can work to ensure they are not left behind in this evolving global economic landscape. The key lies in presenting Africa not just as a source of raw materials, but as a viable and valuable partner in resilient, diversified global supply chains.

CONCLUSION

The US-China trade war has reshaped the global economic landscape, creating a complex set of challenges and opportunities for countries in the South. As these nations navigate the shifting currents of global trade, their ability to adapt to changing circumstances, leverage their unique strengths, and forge strategic partnerships will be crucial.

The 2024 U.S. Presidential election adds another layer of uncertainty to this already complex situation. Developing countries must remain agile, preparing for multiple scenarios while continuing to invest in their own economic resilience and development.

Ultimately, the future of the global trading system and the place of the South within it will depend not just on decisions made in Washington and Beijing, but also on the collective actions and strategies of the developing world. As the global economic center of gravity continues to shift, the voice and influence of developing countries in shaping the rules of international trade and investment may well grow stronger. The countries that can successfully balance strategic autonomy with productive engagement in the global economy will be best positioned to thrive, turning the challenges posed by great power competition into opportunities for their own development and prosperity.

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