WHICH COUNTRY CAN REPLACE CHINA'S TOP SHARE IN US IMPORT?

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SUMMARY

- US imports from China declined on year-on-year basis beginning 2019 as a result of additional tariff measures, while imports from Vietnam and Taiwan increased. When companies move their production bases to export goods to the US from a location other than China, using free trade agreements (FTA) and the Generalized System of Preferences (GSP) enables tariff-free export to the US.

- Vietnam does not have a trade agreement with the US that allows tariff exemption or reduction. However, other countries' trade agreements offer limited tariff benefits on textile products, Vietnam's main export item, and Vietnam has become a popular destination for relocation from China. The lack of any useful trade agreement does not necessarily give Vietnam a disadvantage.

CHANGES IN US IMPORTS FROM CHINA IN RESPONSE TO ADDITIONAL TARIFFS

US monthly imports from China declined in 2019 compared to the previous year as a result of the additional tariffs under Section 301 of the US Trade Act. Imports from China can be currently categorized into three groups: a. imports without additional tariffs (in addition to untargeted items up to now, the group includes List 4 goods, some of which are subject to a 15% additional tariff from September but are not reflected in the latest data); b. List 3 items on which additional tariff was 10% from September 2018 and which was raised to 25% from May 2019; and c. List 1 and List 2 imports with 25% of tariff since July and August of 2018. Year-to-Date Imports (January to June) in all three categories declined in 2019 compared to the previous year, with the biggest decline seen in group c., followed by b. and a. (Table 1). In other words, the longer a tariff of 25% is imposed, the greater the decline in imports. The 25% tariff appears to be effective in reducing imports.

Table 1. Changes in US Import Values (US$ millions)

	Additional tariff	Item	Jan-Jun 2018	Jan-Jun 2019	YoY change	2017	2018	YoY change
Chinese imports			249,996	219,044	**-12.4%**	505,470	539,503	**6.7%**
a. No additional tariffs	**0%**	**List 4, others**	135,358	134,103	**-0.9%**	294,207	304,496	**3.5%**
b. $200 bil worth of goods	**10→25%**	**List 3**	89,490	68,357	**-23.6%**	165,316	189,960	**14.9%**
c. $50 bil worth of goods	**25%**	**Lists 1 & 2**	25,148	16,584	**-34.1%**	45,947	45,048	**-2.0%**
Total imports			1,232,372	1,235,760	**0.3%**	2,341,963	2,542,788	**8.6%**
From Vietnam			22,811	30,441	**33.4%**	46,477	49,174	**5.8%**
From Taiwan			21,641	26,016	**20.2%**	42,426	45,756	**7.9%**
From Japan			70,174	72,886	**3.9%**	136,481	142,596	**4.5%**

Note: Although additional tariffs were imposed on some of the items in List 4 from September 2019, they are included in group a. because the additional tariffs were not included in the statistics available at the time.
Source: Prepared by MGSSI based on US Department of Commerce statistics

Although Chinese imports continued to rise in 2018 as companies rushed to skirt the additional, higher tariffs scheduled for the year end, the momentum waned in 2019, and year-to-date imports (January to June) recorded a 12.4% year-on-year decline. Instead, imports from Vietnam (up 33.4%) and Taiwan (up 20.2%) are on rise, potentially reflecting a change in the pattern of trade in avoiding the tariffs. However, the change is hardly a result of relocating production sites. The relocation follows various patterns, depending on the company. Companies that manufacture only in China and export only to the US, a pattern seen mainly in US SMEs, need to seek new locations outside China. However, for companies that have bases in China and other locations such as ASEAN countries and also export to markets other than the US, it is possible to keep their bases in China and use these outside China locations for products destined to the US. The imports increase from Vietnam and Taiwan is believed to be a reflection of this trend. Japanese companies follows the same trend in relocation: Sharp is reported to be planning to move production of laptops from China to Vietnam, and Ricoh has announced that it will move production of multifunction printers from China to Thailand. In both cases, the move involves products destined for the US.

Imports increase from Vietnam is largely contributed by mobile phones and smartphones, accounting for approximately 60% of the increase, followed by increases in furniture, finished PCs, and textile products. Although mobile phones, smartphones, and finished PCs are not yet subject to additional tariffs on the currently available statistics, the move to Vietnam in us export is considered to be a precautionary measure by companies wary of the further additional tariffs. In the case of Taiwanese imports, semi-finished PC components (motherboards, etc.) accounted for approximately 60% of the increase. These products are subject to the additional tariffs (List 3), and companies are moving their export bases from China to Taiwan to skirt tariffs.
Which countries are prospective alternatives to China as bases for US market, and will the current trade tension change East Asian supply chains? In considering which country to relocate to, companies need to consider the trade agreements countries conclude with the US, and to estimate how much tariff benefit can accrue depending on the agreements. While there are other factors, such as labor costs and geographical distance, this article will put those factors aside and will focus on the tariff benefits.

CONSIDERATIONS ON AVAILABLE TRADE AGREEMENTS

The possibility of using FTAs and GSP

A free trade agreement (FTA) is a trade policy tool for tariff-free export to the US. In the Asia-Pacific region, the US has FTAs with Singapore, South Korea, and Australia, as well as the North American Free Trade Agreement (NAFTA) with Mexico and Canada. The most recent FTA, the US-Korea Free Trade Agreement, went into effect seven years ago, and tariffs have already been eliminated on most goods.
In addition to FTAs, companies can use the Generalized System of Preferences (GSP) program, which is offered by the US as part of its support for developing countries. Covered item, when exported from a beneficiary country to the US, can bring a tariff-free benefit (detailed in the section headed “Merits and demerits of each country”). Since GSP can be used by companies regardless of their nationality, Japanese companies operating in a beneficiary country can also enjoy its benefits under the GSP program. The rules of origin (ROO) criteria is 35% for all items on a value-added basis, which is basically the same as US FTAs. Accordingly, if parts made in China are exported to a GSP beneficiary country such as Thailand or Indonesia using the ASEAN-China FTA, and are finished as a product in that country by adding the same value as original parts, the value added in the GSP beneficiary country will be 50%, and the product will clear the GSP ROO criteria. In this way, companies can export goods to the US using production bases in both China and the ASEAN region without incurring additional tariffs. Because the country of origin in this supply chain is legitimately changed by the added value, there are no grounds for claiming that it is transshipped through third countries.
That said, there are a number of limitations in the eligible products, and GSP is no perfect tool. Firstly, US sensitive items such as textile products and finished motor vehicles are not eligible for GSP (automobile parts are eligible). Among 13,000 US imports items based on an 8-digit HS code, only about 3,300 of the items are eligible for GSP. Moreover, the tariff-free treatment is not unlimited as certain restrictions apply, in that the annual import value per item from a single country (1) must not exceed US$190 million (2019), and (2) must not exceed 50 % or more of the US worldwide imports of that product. However, the least developed countries (LDC) are exempt from these restrictions and more items of about 4,800 are eligible.

Another thing that puts GSP in a dim future is that the Trump administration is accelerating the review of GSP eligibility, and it is not clear whether a beneficiary country will continue to enjoy GSP status for the long term. The purpose of GSP is to support development, and in the US, GSP status is granted on the basis of criteria such as a developing country's level of economic development, the status concerning the granted GSP by other major developed countries, the extent to which the country protects the intellectual property rights of US products, and the extent of reciprocity of market access. However, the Trump administration's focus is firmly on the question of "reciprocity", claiming that there is a lack of reciprocity in market access for US products, and in June 2019, the US withdrew GSP status of India. This could be considered uncharitable, but in fact, the US has been rather lagging behind in reviewing its GSP policy. At the end of 2014, Canada graduated 72 out of the 175 beneficiary countries and regions from its preferential scheme, including China, Indonesia, Malaysia, Thailand, and India. Out of the original ASEAN member states, only the Philippines currently remains a beneficiary of the Canadian scheme. In the same year, the EU also graduated countries like Malaysia from its GSP scheme. It appears that many emerging economies have grown to such an extent that they can no longer benefit from the preferential schemes for developing countries.

Items that provide tariff benefits

In considering how to make use of these two measures, the first consideration is the US general tariff rate on the item (the tariff in the case of importing from a WTO member country). If the general tariff is zero, there is no need to use a trade agreement and imports of the item from anywhere other than China will be tariff free. This is particularly true in IT products, which accounts for Taiwanese exports increase to the US.

For dutiable goods, tariffs can be zero by using trade agreements, and countries have different agreements available. Here, we give examples of two products where China's share of US imports has slumped. In both cases, China's lower share following the US-China trade tensions is a result of company operation alignments to increase imports from existing bases rather than shifting bases out of China.

First, we cite automobile parts (e.g., radiators) as an example of low-tariff items. The general tariff on these items is 2.5%, but they are currently on List 3, and an additional tariff of 25% is imposed on Chinese imports, resulting in a tariff of 27.5% (Table 2). If the radiators were to be imported from Japan, the tariff would be 2.5% because a Japan-US trade agreement on goods is currently not yet in place. In this respect, US tariffs on these items from Canada and Mexico are zero by using the NAFTA agreement as well as those from Indonesia under the GSP scheme. If we look at US radiator imports of year-to-date (January to June 2019) compared to the previous year, these countries are gradually increasing their import share as China's share declines. Mexico's share in the period slightly overtook that of China.

Table 2. Example of change in US import share (low-tariff item)

Item	HS Code	Country of Export	Import share (%) Jan-Jun 2018	Import share (%) Jan-Jun 2019	Trade Agreement	Tariff (%)
Automobile radiators	8708-91-50	China	40.9	34.1	【List 3: +25%】	27.5
(General tariff: 2.5%)		Mexico	34.0	35.9	NAFTA	0.0
		Canada	6.5	10.9	NAFTA	0.0
		Indonesia	3.7	4.4	GSP	0.0
		Taiwan	2.9	2.8	None	2.5
		Germany	1.8	1.7	None	2.5
		Japan	1.5	1.6	Japan-US TAG (pending)	2.5

Source: Prepared by MGSSI based on US Department of Commerce statistics

In the case of high-tariff items, a switch from China to GSP beneficiary countries is evident. The general tariff on attache cases and suitcases with an outer surface of synthetic fiber is significantly high of 17.6%, and because these items are in the List 3, the total tariff on Chinese items is 42.6% (Table 3). However, because the US tariff is zero when imported from Thailand, Cambodia, and Myanmar using GSP, the imports share from these countries has risen while China's share has fallen. Because Thailand is treated as a standard GSP beneficiary, it loses the benefit of tariff-free access when the imports reach the annual limit of US$190 million, while GSP LDCs like Cambodia and Myanmar have no limits.

Table 3. Example of change in US import share (high-tariff item)

Item	HS Codeコード	Counry of Export	Import share (%) Jan-Jun 2018	Jan-Jun 2019	Trade Agreement	Tariff (%)
Attache cases,	4202-12-81	**China**	86.8	74.0	【List 3: +25%】	42.6
suitcases		**Thailand**	4.9	9.4	GSP	0.0
(Synthetic outer surface)		**Vietnam**	5.0	8.8	None	17.6
(General tariff: 17.6%)		**Cambodia**	0.5	3.4	GSP	0.0
		France	0.0	0.9	None	17.6
		Myanmar	0.0	0.9	GSP	0.0

Source: Prepared by MGSSI based on US Department of Commerce statistics

MERRITS AND DEMERRITS OF EACH COUNTRY

The following summary is the particular attributes of various countries when exporting goods to the US as alternatives to China.

Vietnam

While Vietnam is frequently cited as a destination from China as a result of US-China trade friction, it is not actually a GSP beneficiary country. This is because, in principle, the US does not grant GSP status to communist countries (which is why China was not either granted such status), and that situation is unlikely to change. Vietnam skipped all steps to participate in the TPP negotiations in pursuit of an FTA with the US, but this aspiration was shelved when the US withdrew from the agreement soon after Trump administration started. The possibility of the US returning to the TPP 11 in its present agreement is deemed to be low, even if the Democratic Party wins the 2020 presidential election, and the day when Vietnam will enjoy the tariff benefits with a US trade agreement looks distant.

That said, textile products, which is one of Vietnam's principal export item, are not subject to the GSP. For this reason, with the exception of Singapore, which has an FTA with the US, Vietnam is not in a disadvantageous position compared to Thailand, Cambodia, and other ASEAN countries in textile exports to the US. In other words, the general tariff applies for all ASEAN countries except Singapore when exporting textile products to the US. It can therefore be said that the textile industry is centered in Vietnam because it is on an equal footing with its neighbors in tariffs.

Taiwan

Taiwan does not enjoy any tariff benefit from trade agreements with the US, without bilateral FTA or GSP as a developed country status. While some adovocate a US-Taiwan FTA, there are several hurdles due to political considerations. However, IT products (PCs and PC components, semiconductors, phones, etc.), which are Taiwan's main export items, are mostly covered by the WTO's Information Technology Agreement (ITA). This means that the general tariff on these items in the US is zero, and they can be exported tariff free. Since Chinese semiconductors are on List 2 and are therefore subject to an additional tariff of 25%, there is significant merit in switching to Taiwanese products.

ASEAN GSP beneficiary countries

In the ASEAN region, the Philippines, Thailand, Malaysia, and Indonesia are standard GSP beneficiary countries, while Cambodia and Myanmar are GSP beneficiaries treated as LDCs. Laos is not a GSP beneficiary, but the US Trade Representative (USTR) is currently in consultation over granting the status.

Among ASEAN beneficiaries, Malaysia is on the path to becoming a high-income country, and it is expected to graduate from the GSP in the near future. In May 2019, Turkey graduated from the GSP scheme when it was designated a high-income country. A comparison of the nominal GDP per capita of the two countries (US$,

2018) shows that Malaysia actually has a higher GDP at US$10,942 than Turkey's US$9,346. Graduation from the GSP is not decided purely on the basis of income; in Turkey's case, there has also been a deterioration in the bilateral relationship with the US, particularly over Turkey's introduction of a Russian missile defense system, but Malaysia needs to prepare for graduation in the next few years. The story is similar in Brazil, which is seeking to join the OECD. While the US is supporting Brazil's bid, the real reason is that it wants to graduate Brazil from the GSP soon. If Brazil wishes to maintain tariff-free access to the US market after the graduation, the US will offer to negotiate a bilateral FTA for reciprocity.

FTA partner countries (Singapore, South Korea, Australia, Mexico, Canada)

Singapore, South Korea, Australia, and Canada are all advanced countries, and based on a breakdown of the items they export to the US, generally speaking, few cases are expected of switching export base from China to these countries. In the case of Mexico, as automobile production is expected to shift more towards NAFTA, Mexico could provide an alternative to China in auto parts, as seen with the example of radiator imports. While NAFTA renegotiation reached an agreement, and its replacement, the United States-Mexico-Canada Agreement (USMCA), is awaiting US congress approval, the current NAFTA is still available for use. Many Japanese companies operating in the US have said that they intend to increase their procurement of raw materials from Mexico (FY2018 JETRO Survey on Business Conditions for Japanese Companies in the US). However, there is a risk that the Trump administration may threaten Mexico with tariffs, as a leverage to tackle the migrant issue.

CONCLUSION

Amid the current US-China trade friction, companies are focusing attention on how they can export their goods to the US while skirting additional tariffs. The tariff benefits from the exports depend on the items, and that is affected by the general tariff rate in the US and trade agreements which trade partners have with US. Since the number of US FTAs with ASEAN countries is limited, it is worthwhile for companies to consider using the GSP, although this does involve certain limitations. The tariff advantages of each country can be broadly summarized by item as follows: 1. Automobile parts: Mexico (with an eye on using the USMCA), or GSP beneficiary countries; 2. Chemicals, rubber products, leather goods: GSP beneficiary countries; 3. IT products (products covered by the ITA): anywhere other than China (i.e., Taiwan); and 4. Textile products: almost anywhere other than China (i.e., Vietnam).

As described in this article, recent statistics show that China's role as the top US import source is declining in certain products. This is probably due to adjustments in production between multiple production bases located in China and ASEAN countries, and many companies have indicated that it would take several years if they were to totally relocate their bases out of China. However, there are cases where companies can continue to enjoy the tariff-free benefits by using trade agreements and skirt additional tariffs without pulling out of China. In that case, we are likely to see a change in the flow of goods, with parts and materials exported from China to typically ASEAN countries and the finished products exported from ASEAN countries to the US.