



Institute of Strategic and  
International Studies (ISIS) Malaysia



# The US-China Trade Conflict

Is Malaysia benefiting from diversions in  
US import demand?

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4 October 2019

ISIS Malaysia Staff Presentation



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11 October 2019  
ISIS Malaysia Staff Presentation

## The US-China Trade War: Has Malaysia benefited from diversions in US import demand?

Calvin Cheng, Firdaos Rosli, Maya Kartika  
September 2019

[LINK](#) to Policy Brief



**ISIS**  
**POLICY BRIEF**  
Economics, Trade and Regional Integration  
ISSUE #2-19

**The US-China Trade War: Is Malaysia benefiting from "diversions" in US import demand?**

Calvin Cheng, Firdaos Rosli, Dwintha Maya Kartika  
September 2019

**KEY TAKEAWAYS**

- Trade wars can have wide-ranging negative impacts on the global economy, weighing down on global growth and investment, while increasing uncertainty and market volatility. Malaysia is similarly vulnerable, being a small and highly open economy that is deeply integrated with global supply chains. Nonetheless, opportunities for trade and investment 'diversion' may be an upside to the US-China trade conflict.
- Using detailed US Census Bureau data, we attempt to gauge the extent and impacts of 'diversions' in US import demand into Malaysia. Overall, we find that so far, 'diversions' from US import demand have been minimal. Instead, the data up to July 2019 suggests that Malaysia's regional peers, including Taiwan, Japan, Vietnam and South Korea appear to have reaped most of the benefits from shifts in US import demand.
- Similarly, evidence of investment 'diversion' into Malaysia so far has been mixed, with manufacturing FDI flows remaining soft well into 2019, even as approved manufacturing expansion/diversification investment increased.
- While this analysis focuses on shifts in US import demand, and does not closely examine other channels of trade 'diversion' from shifts in and/or third-party import demand, the results of this analysis suggests that Malaysian policymakers should play a much more proactive role in negating the risks of rising trade protectionism, through accelerating unilateral reforms and deepening regional integration with non-US regions.

**1.0 Introduction**

On 6 July 2018, the Trump administration imposed the first<sup>1</sup> round of tariffs (List 1) on US\$34 billion worth of Chinese imports amid allegations of China's unfair trade practices related to intellectual property (IP). Subsequently, over the course of 2018, two more rounds of US tariffs were applied—on US\$16 billion worth of Chinese goods (List 2) in August 2018 and on US\$200 billion worth of Chinese goods (List 3) in September 2018.

Despite initial optimism that a trade deal would be reached amid temporary truces in December 2018 and in June 2019, reaching a deal has proven to be difficult for both sides. Stumbling blocks include concerns surrounding IP enforcement and industrial subsidies, in addition to how quickly the bilateral tariffs can be removed if a deal was signed.

In September 2019, the US-China trade conflict escalated further with the US imposing new tariffs affecting US\$112 billion of Chinese goods (List 4a). More US tariffs on US\$160 billion of Chinese goods are set to come into effect in December 2019 (List 4b). In retaliation, China has imposed tariffs on a total of about US\$188 billion worth of US goods. While trade talks are still ongoing and President Donald Trump has hinted at the possibility of an interim agreement, the prospects of both sides agreeing on a comprehensive US-China trade deal in the near-term remains somewhat cloudy.

Accordingly, this paper attempts to gauge the effect of these tariffs on the Malaysian economy, by focusing on shifts in US import demand after the imposition of US tariffs on Chinese imports. The first part of this paper will examine the existing research and international evidence on the macroeconomic impacts of trade wars. Then, the main part of this paper contains an analysis of monthly US Census Bureau imports data for each product affected by the first three rounds of US tariffs (trade data up to June 2019 are yet to be affected by List 4 tariffs). The next part will look at investment data in Malaysia, both investment approvals and FDI flows, to gauge the extent of investment 'diversion'. Finally, this paper will discuss conclusions and potential policy implications for Malaysia and other regional economies.

In this analysis, we focus on trade 'diversions' resulting from US import demand shifts due to the similarity in export structures between regional economies in Asia and China, and the limitations in availability of granular China imports data. For data consistency purposes, this

<sup>1</sup> Excluding section 332 tariffs imposed on steel and aluminium in June 2018, and global safeguard tariffs imposed on washing machines and solar panels early-2018.

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01

# US-China trade tensions

A series of unfortunate events

 **Tariff action**  **Truce**  **Planned**

## 2018

**Early 2018**

**Jan:** US applies tariffs on **all washing machines and solar panel** imports

**March:** US applies tariffs on **all steel (25%) & aluminium (10%)** imports

**July 2018**

US applies **List 1 tariffs** (25%) on \$34b Chinese imports

China **applies 25% tariffs** on \$34b US imports in retaliation

**Aug 2018**

US applies **List 2 tariffs** (25%) on \$16b Chinese imports

China **applies 25% tariffs** on \$16b US imports in retaliation

**Sep 2018**

US applies **List 3 tariffs** (10%) on \$200b Chinese imports

China **applies 10% tariffs** on \$60b US imports in retaliation

**Dec 2018**

US and China agree to a **temporary trade truce** at sidelines of G20 summit in Buenos Aires

## 2019

**May 2019**

Progress on trade talks slow, US breaks truce and **raises the tariff rate on List 3 tariffs** from 10% to 25%

**June 2019**

US and China agree to a **temporary trade truce** at sidelines of G20 summit in Osaka

**Sep 2019**

US applies **List 4A tariffs** (15%) on \$112b Chinese imports

China **applies 5-10% tariffs** on 1,717 goods from the US

**Oct 2019**

US plans tariff hikes on Chinese goods in List 1 and List 2 from 25% to 30%

**Dec 2019**

**List 4B tariffs** is set to take effect (15%) on \$160b Chinese imports

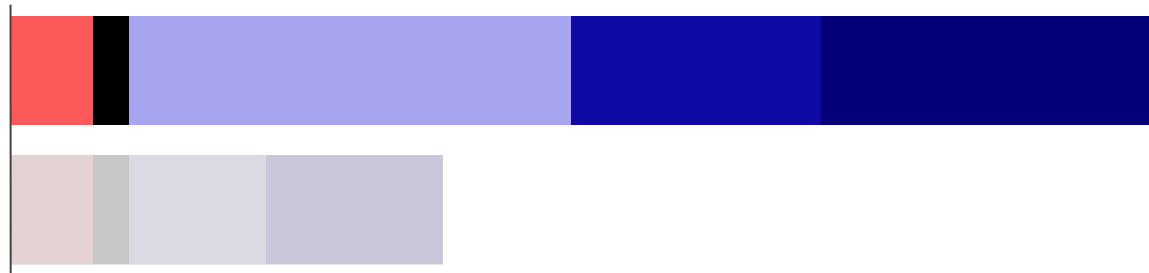
China intends to apply **5-10% tariffs on ALL US imports**

# US-China trade tensions

By the numbers: US tariffs on Chinese goods

US tariffs on Chinese imports

China tariffs on US imports



## US List 1 tariffs

Applied: July 2018  
Tariff Rate: 25%\*

Coverage:  
1,096 items  
(US\$34 bil worth)

Aircraft parts,  
machine parts,  
electrical machinery,  
electronic parts,  
motor vehicles,  
turbines

## US List 2 tariffs

Applied: Aug 2018  
Tariff Rate: 25%\*

Coverage:  
279 items  
(US\$16 bil worth)

Oils & chemicals,  
machine parts,  
electronic circuits,  
railway parts, diodes,  
electronic parts

## US List 3 tariffs

Applied: Sep 2018  
Tariff Rate: 25%\*

Coverage:  
5,964 items  
(US\$200 bil worth)

Seafood &  
agricultural products,  
minerals & ores,  
chemicals, wooden  
furniture, textiles,  
electronics, motor  
vehicles & parts

## US List 4A

Applied: Sep 2019  
Tariff Rate: 15%

Coverage:  
3,244 items  
(US\$112 bil worth)

## US List 4B

Applied: Dec 2019  
Tariff Rate: 15%

Coverage:  
557 items  
(US\$160 bil worth)

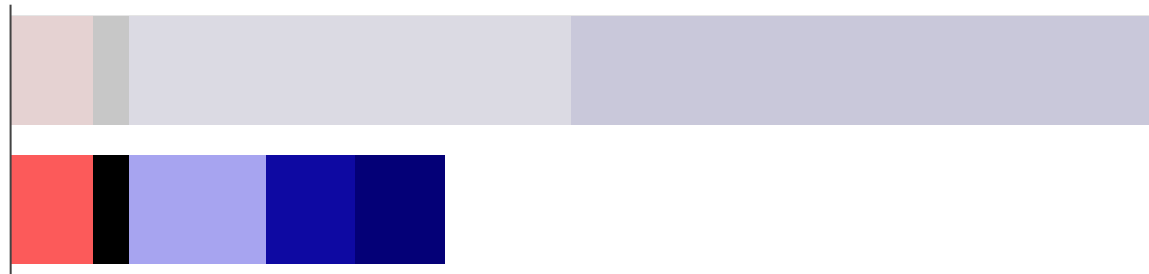
\*Increasing to 30% on Oct 1 2019

# US-China trade tensions

By the numbers: Chinese tariffs on US goods

US tariffs on  
Chinese imports

China tariffs on  
US imports



## China tariff 1

Applied: July 2018  
Tariff Rate: 25%\*

Coverage:  
545 items  
(US\$34 bil worth)

Soybeans, wheat,  
electric vehicles,  
meats, seafood,  
alcohol & tobacco

## China tariff 2

Applied: Aug 2018  
Tariff Rate: 25%\*

Coverage:  
333 items  
(US\$16 bil worth)

Aircraft parts,  
machine parts,  
electrical machinery,  
electronic parts,  
motor vehicles,  
turbines

## China tariff 3

Applied: Sep 2018  
Tariff Rate: 25%\*

Coverage:  
5,140 items  
(US\$60 bil worth)  
*updated 1 June 2019*

Aircraft parts,  
machine parts,  
electrical machinery,  
electronic parts,  
motor vehicles,  
turbines

## China tariff 4A

Applied: Sep 2019  
Tariff Rate: 15%

Coverage:  
1,717 items  
(US\$75 bil worth)

## China tariff 4B

Applied: Dec 2019  
Tariff Rate: 15%

Coverage:  
3,361 items  
(US\$75 bil worth)

# Macroeconomic impacts of trade wars

What can existing academic research tell us?

Trade wars are generally bad news for the global economy...



## Direct effects

- Lower global trade flows
- Lower global GDP growth
- Higher consumer prices
- Increased uncertainty

## Indirect effects

- Drop in investment due to **increased policy uncertainty**
- Lower productivity as global supply chains are disrupted
- Higher financing costs

ISIS Malaysia, Berthou et al. 2019.; Handley & Limao. 2017.

## Case study: Evaluation of the US tariffs

- **US consumers bore the costs**  
Higher input prices from the tariffs were mostly borne by US consumers
- **Net loss to US consumers and US economy**  
Certain protected producers benefited, but overall net loss for the US economy and consumers

## Welfare loss to US consumers



Source: Amiti, Weinstein & Reading. 2019; Faigelbaum. 2019.; ISIS Malaysia

# Looking at potential impacts on Malaysia

What can we speculate about Malaysia's prospects?

Why the Malaysian economy may be deeply affected...

## Small and highly open economy

71% exports-to-GDP  
132% trade-to-GDP

## Highly integrated with global supply chains

50% M'sian SMEs and  
82% large firms are  
globally integrated

## High exposure to Chinese economy

Top source of  
investment, trade, and  
tourism

...but opportunities for trade and investment 'diversion'?

**US\$165  
billion\***

Amount of goods  
diverted per year to  
avoid tariff incidence

Many countries in  
Asia have export  
structures **similar**  
to the products  
on the US tariff  
lists

### 3 channels for trade diversion:

- 1) Shifts in US import demand
- 2) Shifts in Chinese import demand
- 3) Supply chain shifts

Source: Amiti, Reading, Weinstein, 2018



# Methodology

A primer on HS Codes

## How trade is classified internationally

The Harmonized System is an international nomenclature for the classification of products.

International standardisation goes up to the 6-digit level, anything beyond that, up to the 10-digit level, is decided by the countries themselves.

- 01 Live Animals ✓ ✗
- 02 Meat And Edible Meat Offal ✓ ✗
- 62 Apparel Articles And Accessories, Not Knit Etc. ✓ ✗
- 63 Textile Art Nesoi; Needlecraft Sets; Worn Text Art ✓ ✗
- 64 Footwear, Gaiters Etc. And Parts Thereof ✓ ✗
  - 6401 Waterproof Footwear, Rubber Or Plastics, Bond Sole ✓ ✗
  - 6402 Footwear, Outer Sole & Upper Rubber Or Plast Nesoi ✓ ✗
  - 6403 Footwear, Outer Sole Rub, Plast Or Lea & Upper Lea ✓ ✗
  - 6404 Footwear, Outer Sole Rub, Plast Or Lea & Upper Tex ✓ ✗
  - 6405 Footwear Nesoi ✓ ✗
    - 640510 Footwear Nesoi, Uppers Of Leather Or Comp Leather ✓ ✗
      - 6405100030 Fwvr W/uppers Lether/composition Leather Men, nesoi
      - 6405100060 Oth Ftwear W Uppers Leather/composition Leather W
      - 6405100090 Oth Ftwear W Uppers Leather/comp Leather Ot Person
    - 640520 Footwear Nesoi, Uppers Of Textile Materials ✓ ✗
    - 640590 Footwear Nesoi ✓ ✗
  - 6406 Parts Of Footwear; Insoles Etc; Gaitors Etc, Parts ✓ ✗
- 65 Headgear And Parts Thereof ✓ ✗
- 66 Umbrellas, Walking-sticks, Riding-crops Etc, Parts ✓ ✗
- 98 Special Classification Provisions, Nesoi ✓ ✗
- 99 Special Import Provisions, Nesoi ✓ ✗



# Methodology

What we did in the Policy Brief

## 1 US imports data at the HS-10 level

Source: US Census Bureau

30,355 data points

- 01 Live Animals
- 02 Meat And Edible Meat Offal
- .....
- 62 Apparel Articles And Accessories, Not Knit Etc.
- 63 Textile Art Nesoi; Needlecraft Sets; Worn Text Art
- 64 Footwear, Gaiters Etc. And Parts Thereof
- +  6401 Waterproof Footwear, Rubber Or Plastics, Bond Sole
- +  6402 Footwear, Outer Sole & Upper Rubber Or Plast Nesoi
- +  6403 Footwear, Outer Sole Rub, Plast Or Lea & Upper Lea
- +  6404 Footwear, Outer Sole Rub, Plast Or Lea & Upper Tex
- 6405 Footwear Nesoi
- 640510 Footwear Nesoi, Uppers Of Leather Or Comp Leather
- 6405100030 Fawr W/uppers Lether/composition Leather Men,nesoi (
- 6405100060 Oth Ftwear W Uppers Leather/composition Leather Wrr
- 6405100090 Oth Ftwear W Uppers Leather/comp Leather Ot Person
- +  640520 Footwear Nesoi, Uppers Of Textile Materials
- +  640590 Footwear Nesoi
- +  6406 Parts Of Footwear; Insoles Etc; Gaitors Etc, Parts
- 65 Headgear And Parts Thereof
- 66 Umbrellas, Walking-sticks, Riding-crops Etc, Parts
- 67 Prep Feathers, Down Etc; Artif Flowers; H Hair Art
- .....
- 98 Special Classification Provisions, Nesoi
- 99 Special Import Provisions, Nesoi

## 2 US Tariff Lists

Source: US Trade Representative's Office

U.S. 301 Final List 4A | 15% Additional Tariff | Effective September

Note: there are some 10 digit HTS numbers in ALL CAPS

HTS	Product name
6403.59.60	Footwear w/outer soles and uppers of leather, not cov. ankle, n/welt, for me
6403.59.90	Footwear w/outer soles and uppers of leather, not cov. ankle, n/welt, for p
6403.91.11	Footwear w/outer soles of rubber, plastics & uppers of leather, covering ank
6403.91.30	Footwear w/outer soles of rubber/plastics/composition leather& uppers of
6403.91.60	Footwear w/outer soles of rubber/plastics/composition leather& uppers of
6403.91.90	Footwear w/outer soles of rubber/plastics/comp. leather & uppers of leathe
6403.99.10	Footwear w/outer soles of rubber, plastics & uppers of leather, not covering
6403.99.20	Footwear w/outer soles of rubber/plastics/comp. leather & uppers of leathe
6403.99.40	Footwear w/outer soles of rubber/plastics/comp. leather & uppers of leathe
6403.99.60	Footwear w/outer soles of rubber/plastics/comp. leather & uppers of leathe
6403.99.90	Footwear w/outer soles of rubber/plastics/comp. leather & uppers of leathe
6405.10.00	Footwear, nesoi, w/outer soles of other than rubber/plastics/le

## 3 Match using R (US imports and Tariff Lists)

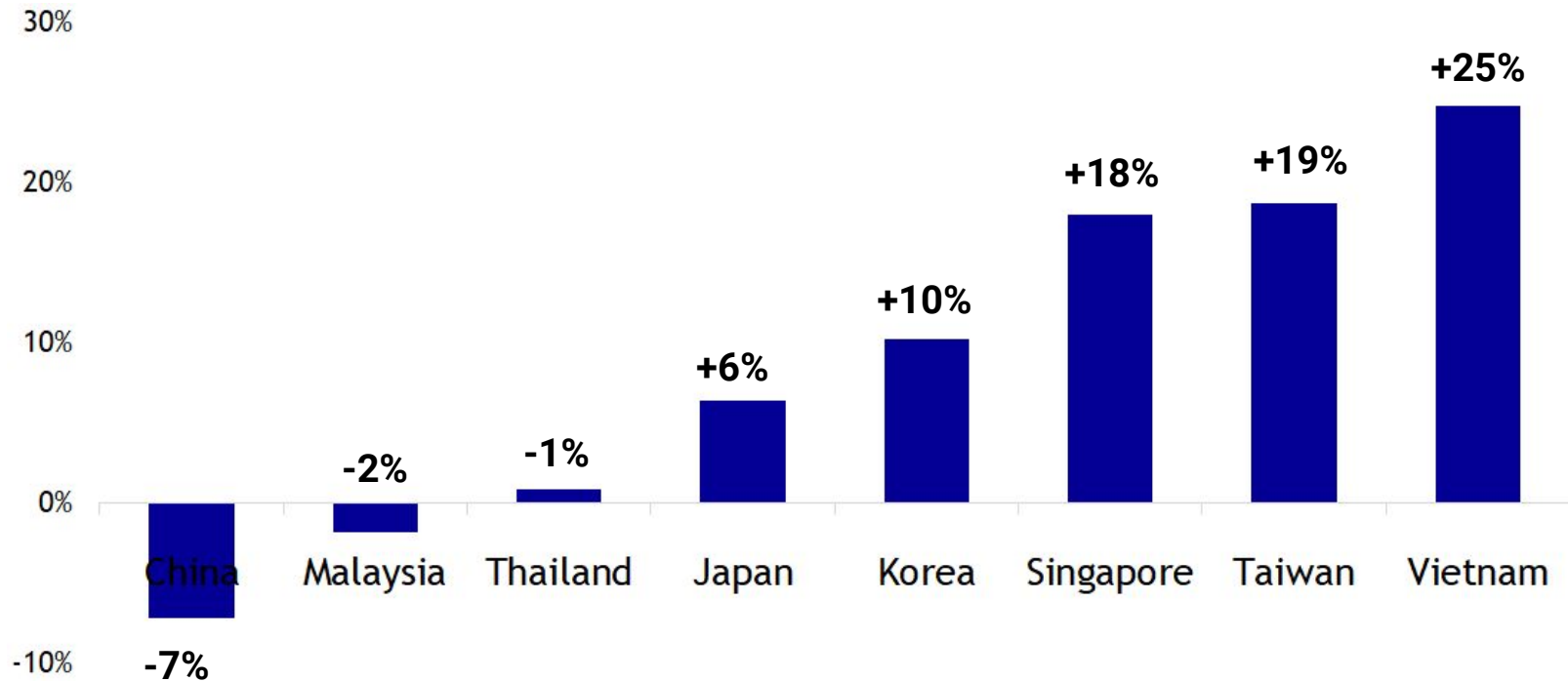
## 4 Analysis (Post-tariff average - pre-tariff average)

# Empirical Analysis

What does the data say?

## Change in Overall US imports

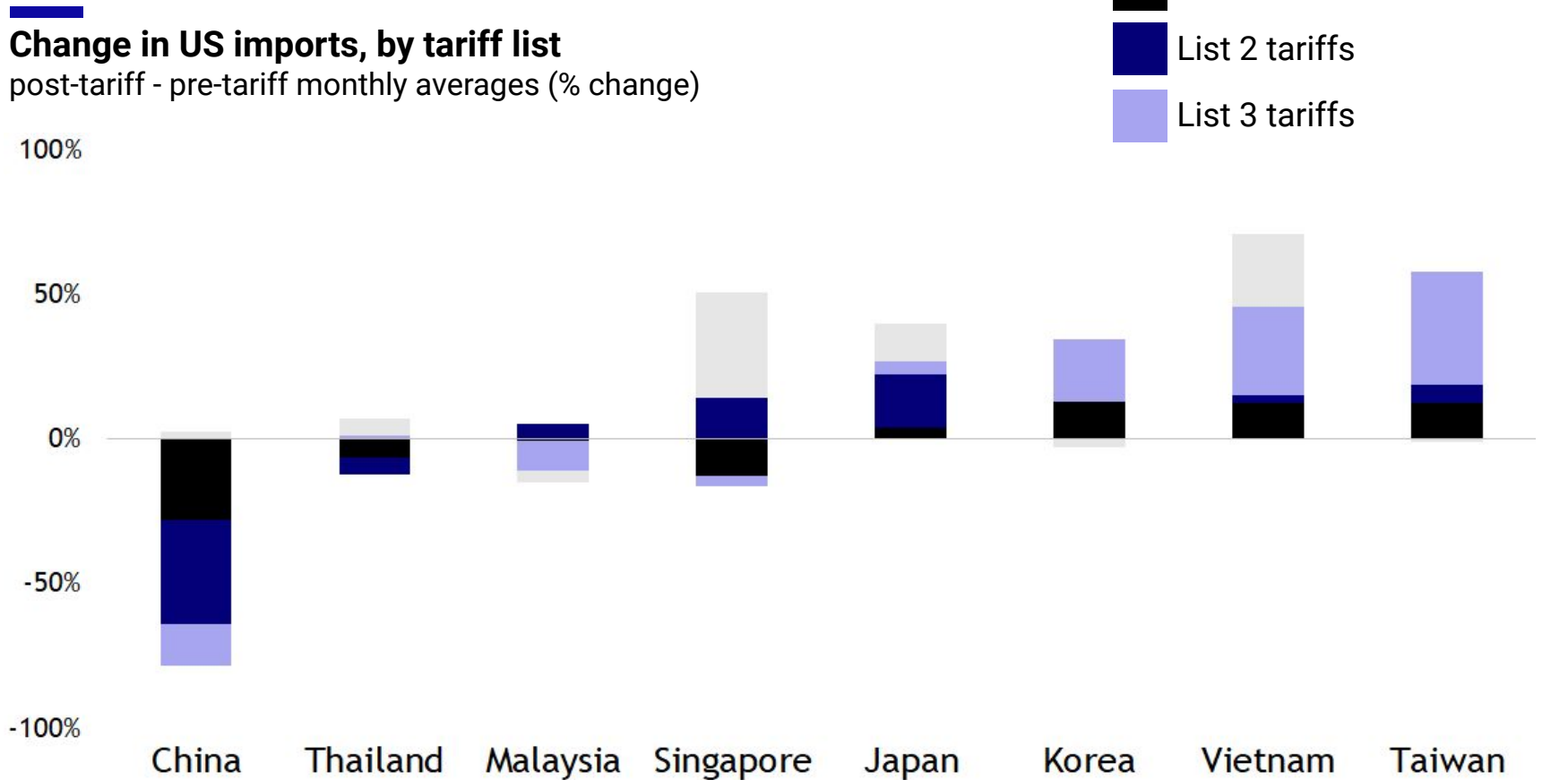
post-tariff - pre-tariff monthly averages (% change)



Source: Author's calculations, US Census Bureau data

# Empirical Analysis

What does the data say?



Note: does not include Tariff Lists 4A and 4B, as they only come into effect in October/December 2019

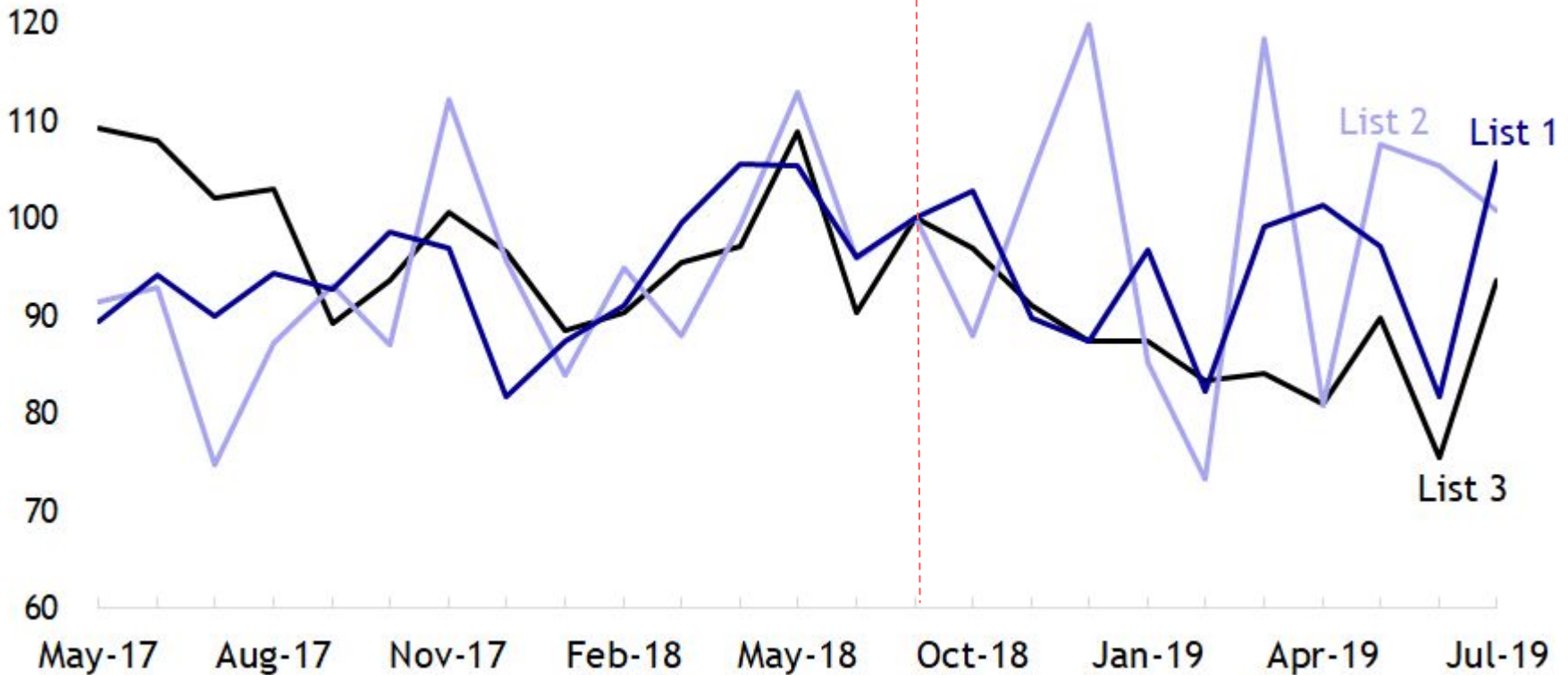
Source: Author's calculations, US Census Bureau data

# Empirical Analysis

What does the data say?

## US imports from Malaysia, by tariff list

Index (July - Sep = 100)



Source: Author's calculations, US Census Bureau data

# Empirical Analysis

Which products have gained?

Top 10+ gainers (US imports from Malaysia)	Average monthly gain (RM mil)
<b>Photosensitive semiconductor devices</b>	<b>+36.3</b>
<b>Memory parts (RAM)</b>	<b>+12.2</b>
<b>Printed circuit assemblies</b>	<b>+11.6</b>
Radio receivers used in motor vehicles	<b>+9.0</b>
Medical rubber gloves	<b>+8.3</b>
Non-medical rubber gloves	<b>+7.2</b>
<b>Electronic integrated circuits: processors and controllers</b>	<b>+6.4</b>
<b>Telecommunications instruments and apparatus</b>	<b>+3.5</b>
<b>Instruments and apparatus for for measuring or checking semiconductors</b>	<b>+3.4</b>
<b>Tantalum fixed capacitors; electrolytic capacitors</b>	<b>+3.3</b>
Electro-medical instruments and appliances; nesoi	<b>+3.3</b>
Bedroom furniture	<b>+3.2</b>

Note: does not include Tariff Lists 4A and 4B, as they only come into effect in October/December 2019

Source: Author's calculations, US Census Bureau data

# Empirical Analysis

Which products have gained?

## Top 10 gainers (US imports), East Asia

Japan	Taiwan	Korea
<b>Motor vehicles (1500-3000cc)</b>	<b>Circuit assemblies</b>	<b>Circuit assemblies</b>
Machines for semiconductor manufacturing	Processing units	<b>Motor vehicles (1500-3000cc)</b>
<b>Motor vehicles (1000-1500cc)</b>	Machines for audio/image processing	<b>Jet fuel</b>
Phosphides, Inorganic compounds	Electronic integrated circuits	<b>Motor vehicles (1000-1500cc)</b>
<b>Parts of aircraft</b>	ADP control/adapter units	<b>Vehicle parts</b>
Track-laying excavators	ADP machine aprts	Semiconductor devices
Marine-propulsion motors	Metal tanks, reservoirs	<b>Parts of aircraft</b>
<b>Transport vehicles</b>	Metal screws	Plastic sheets, foil
<b>Jet parts</b>	Radio/navigational apparatus	<b>Electric motor vehicles</b>
Compression piston engines	Office furniture	<b>Aircraft turbojets</b>

Source: Author's calculations, US Census Bureau data

# Empirical Analysis

Which products have gained?

## Top 10 gainers (US imports), Southeast Asia

Vietnam	Singapore	Thailand
Machines for audio/image processing	Machines for semiconductor manufacturing	ADP disk storage
<b>Wooden furniture</b>	Parts of machines for glassware manufacturing	Truck/bus tires
<b>Chairs w/ wooden frames</b>	Liquid filtering apparatus	Motor vehicles (1000-1500cc)
Electric control panels	Jet parts	Rice
<b>Bedroom furniture</b>	Electrical instruments using optical radiation	Circuit assemblies
<b>Frozen catfish</b>	Manganese batteries	Synthetic staple fibers
Polyethylene (Polyester for clothing)	Lubricating oils	Tuna
LED panels	Insulated electric conductors	Non-medical rubber gloves
Batteries used for electric vehicles	Platinum	Pet food
Seats w/ metal frame	Electrical parts	Natural rubber

Source: Author's calculations, US Census Bureau data



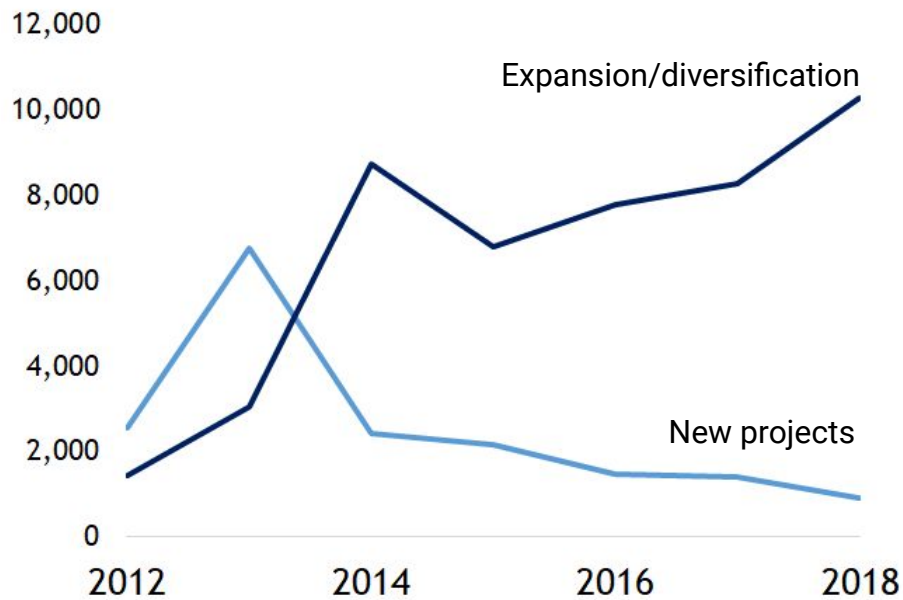
# Empirical Analysis

Looking at the investment statistics

Anecdotal evidence of investment diversion ...but difficult to see in the hard data as of yet

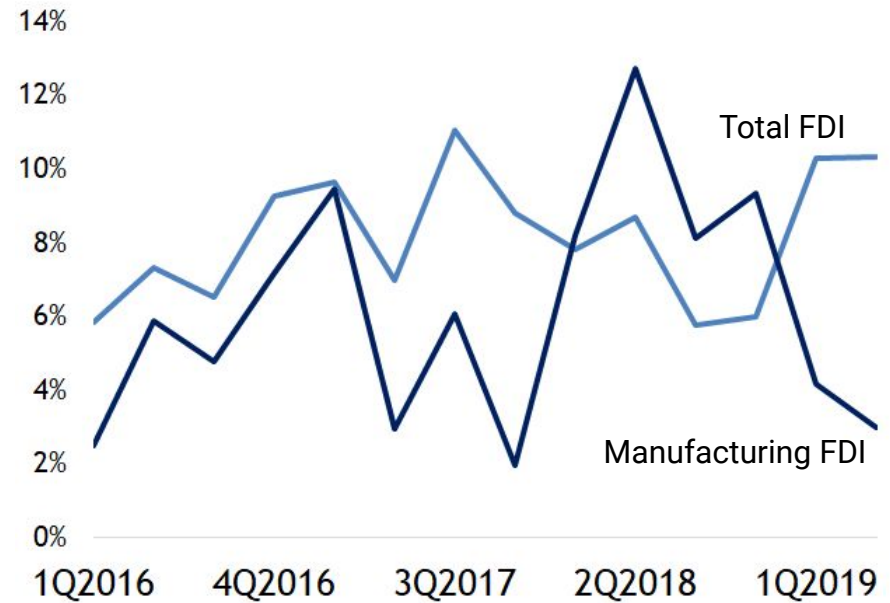
## Approved E&E Manufacturing Projects

By type of investment



## Foreign Direct Investment (FDI flows)

By sector



Note: The increase in overall FDI was driven mainly by increases in FDI into financial and other services sectors, and the mining & quarrying sectors

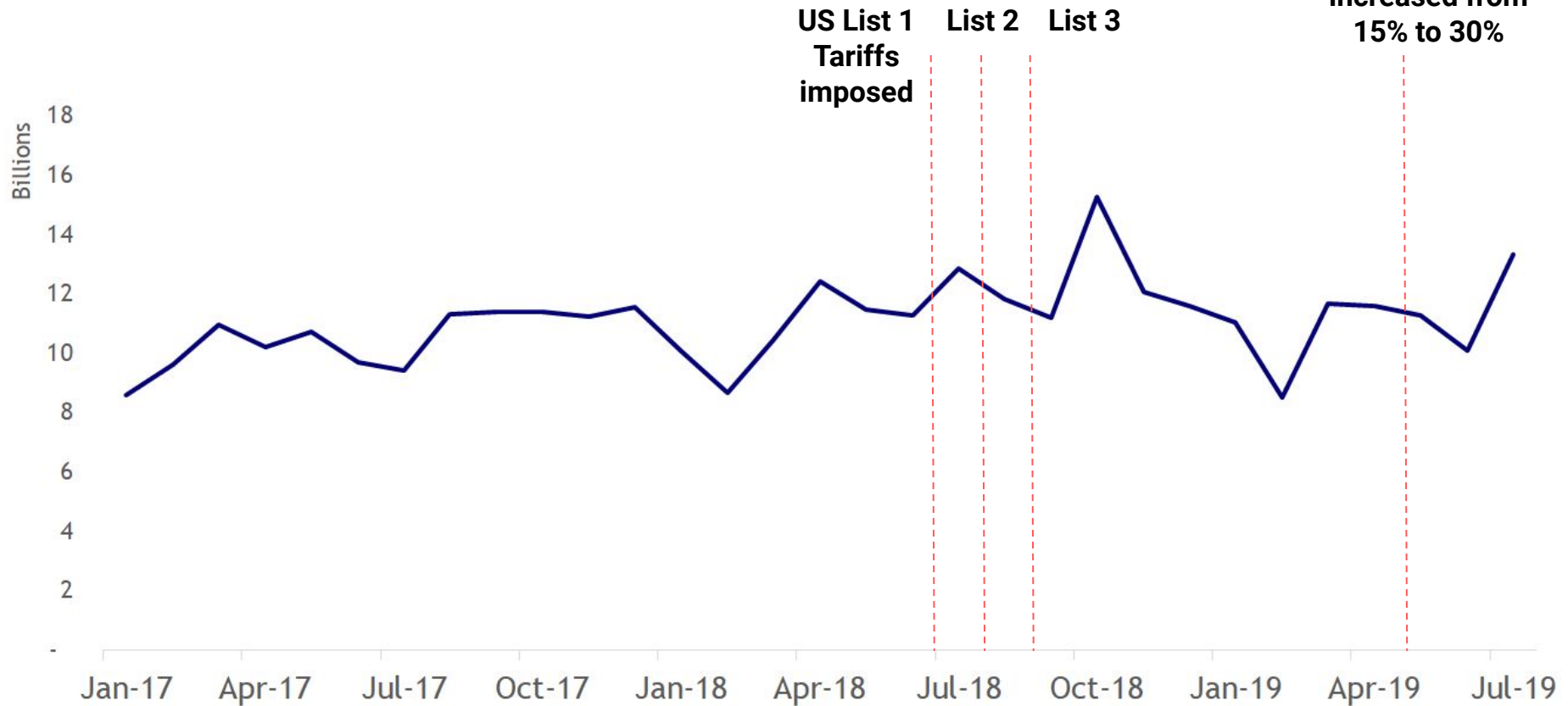
Source: Author's calculations, MIDA, DOSM

# Quick Look

What about shifts in Chinese import demand?

## Malaysian exports to China, overall

In RM billions



Source: Author's calculations, DOSM, METS

# Quick Look

What about shifts in Chinese import demand?

## Top gainers in Malaysian exports to China

post-tariff - pre-tariff monthly averages (% change)

Product (HS2 level)	Average monthly % gain
Wood pulp; recovered paper scraps	+38329%
Iron and steel	+533%
Lead and lead-related articles	+531%
Pharmaceutical products; bandages	+207%
Seafood	+179%
Furskins and artificial fur-related products	+159%
Tobacco and tobacco substitutes	+129%
Explosives and pyrotechnic products	+128%
Photographic or cinematographic goods	+115%
Aluminium and articles thereof	+108%

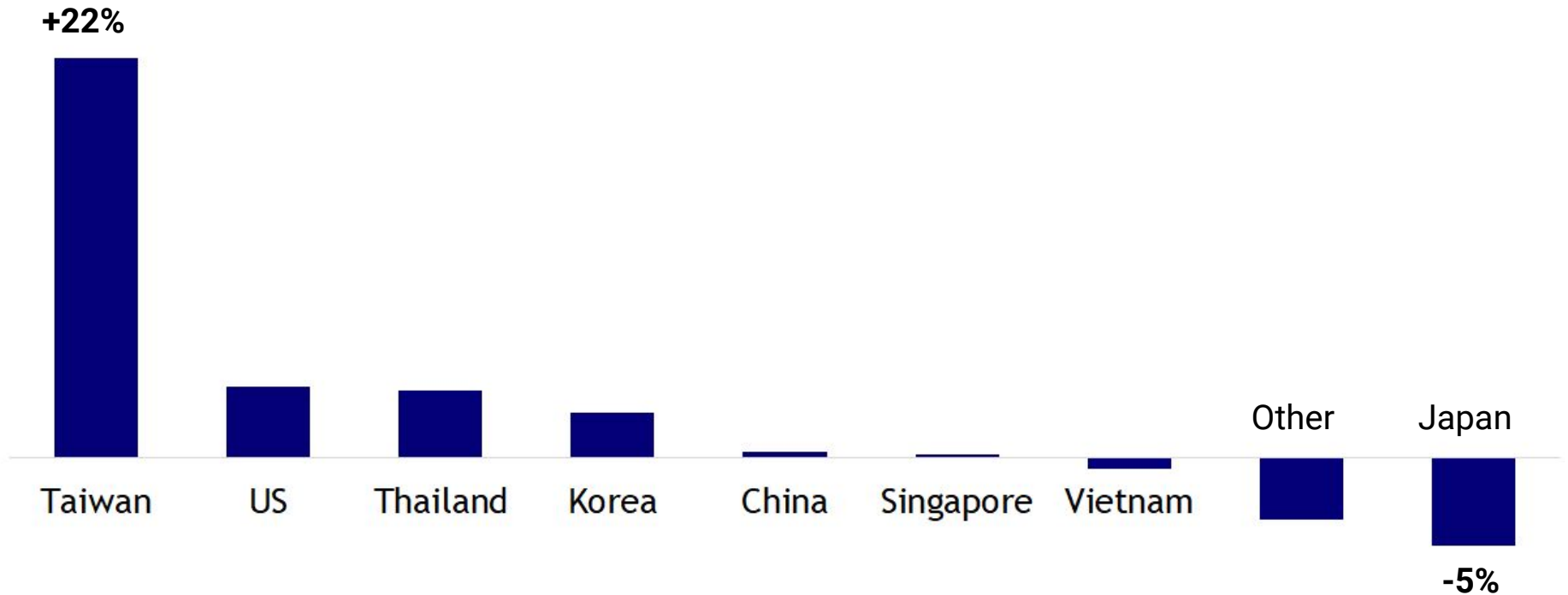
Source: Author's calculations, DOSM, METS

# Quick Look

What about third party demand shifts?

## Malaysian exports, by country

post-tariff - pre-tariff monthly averages (% change)



Note: Discrepancies between the US Census imports data and DOSM Malaysian exports data is apparent

Source: Author's calculations, DOSM, METS

# Policy Responses

What have some countries in the region already done?

## Malaysia

- Established 'trade war task force' in MITI
- Established investment committee to 'fast-track' investment approvals

## Indonesia

- Corporate rate tax cut: 25% to 20% starting in 2021
- Taxation reforms: to value-added tax, income tax and general taxation

## Thailand

- Comprehensive stimulus package "Thailand Plus" which includes:
  - Enhanced investment incentives
  - STEM Manpower development support
  - Automation investment support
  - Enhanced investment facilitation

# Policy Responses

What can and should countries do more?

## Shorter-term Policy Responses

### Boosting trade and investment

- 1. Deepening regional integration with non-US regions**
  - a. ASEAN+
  - b. RCEP
  - c. CPTPP
  
- 2. Unilateral reforms**
  - a. Regulatory environment
  - b. IP regulations, labour standards

## Longer-term Policy Responses

### Industrial upgrading & human capital development

- 1. Industrial upgrading**
  - a. Maximising FDI benefits
  - b. Economic complexity
  - c. Technology upgrading
  
- 2. Human capital development**
  - a. Education + constant learning
  - b. Reducing inequality of opportunity

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# Key Insights

A summary of major points

- **We focused on shifts in US import demand and trade diversions from the US side, matching imports data to HTS tariff lists, and tracked it across a period of 18 months to compare pre-tariff and post-tariff export performance for 8 regional countries**
- **Diversions from US demand into Malaysia were not significant, compared to other regional countries.**
- **Taiwan and Vietnam were big beneficiaries from diversion in US demand**
- **Looking at specific products: Malaysia gains from E&E, M&E and rubber gloves, bedroom furniture. East Asia: motor vehicles, aircraft parts; SEA: a mix of foodstuff and furniture from Vietnam and Thailand but also things like rubber and E&E parts**



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## Concluding Thoughts

- Overall: some specific gains, on aggregate looking grim, negative forces threaten to outstrip any diversion gains
- There are limitations of this type of analysis
- Trade wars are not good and easy to win, even for countries in Asia benefiting from trade and investment diversion
- Policymakers need to be more proactive in mitigating the impacts of trade protectionism on Malaysia
- Short-term focused on boosting trade and investment--boosting regional integration; Long-term focused on industrial upgrading



# The US-China Trade Conflict

Is Malaysia benefiting from diversions in  
US import demand?

## Thank you!

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# Empirical Analysis

A quick look at the numbers

Malaysia	Average monthly gain (RM)		
85312000	-3027321.141	List 3	Indicator panels incorporating liquid crystal devices (LCD's) or light emitting diodes (LED's)
85437099	-3119841.869	List 2	Other electrical machines and apparatus, having individual functions
84869000	-3247153.614	List 2	Parts and accessories of the machines and apparatus for the manufacture of semiconductor devices, electronic integrated circuits and flat pa
27101916	-3269814.867	List 3	Kerosene-type jet fuel from petroleum oils and oils of bituminous minerals (o/than crude) or preps. 70%+ by wt. from petroleum oils
27101906	-3435700.051	List 3	Distillate and residual fuel oil (including blends) derived from petroleum or oils from bituminous minerals, testing < 25 degrees A.P.I
85269100	-3584101.8	List 1	Radio navigational aid apparatus, other than radar
84717040	-4286654.483	List 1	ADP magnetic disk drive storage units, disk dia n/ov 21 cm, n/entered in cabinet, w/o attached external power supply, n/entered w/rest of a system
84717050	-7229047.435	List 3	ADP magnetic disk drive storage units, disk dia. n/ov 21 cm, nesoi, not entered with the rest of a system