The Washington Post
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ECONOMY

U.S. companies are buying less from China as relations remain tense

Chinese imports down 24 percent through May, and Mexico is now the U.S.'s top trading partner

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August 6, 2023 at 6:00 a.m. EDT

U.S. companies are accelerating efforts to reduce their dependence upon Chinese suppliers, even as officials in Washington and Beijing labor to put a floor under their sour relationship.

Through the first five months of this year, U.S. imports from China were down 24 percent from the same period one year ago, according to the Census Bureau. Companies such as HP, Stanley Black & Decker and Lego are among those that have been repositioning their supply lines for American consumers, either to avoid the risk of being pinched between rival superpowers or as part of a longer term strategy to produce goods closer to customers.

Either way, China's role at the center of global manufacturing may be facing its stiffest challenge since the country joined the global trading system more than two decades ago. Mexico, Vietnam and Thailand are nibbling at China's dominance, though they lack its size and world-class infrastructure.

A combination of political and economic forces is driving the supply chain makeover.

U.S. tariffs on roughly two-thirds of Chinese goods, imposed during the Trump administration, have cut into new orders. Wages for Chinese factory workers have risen, eroding one of the country's competitive advantages. Chinese President Xi Jinping's state-centric economic strategy, related crackdowns on private companies and wary approach to the Biden administration have further chilled commercial ties.

"The behavior of the governments toward each other — the more hostile, confrontational stance — is starting to affect private-sector decision-making because it changes the risk profile," said Adam Slater, lead economist for Oxford Economics in London.

Chinese products account for roughly one out of every six dollars Americans spend on imports, down from nearly one in four before the pandemic, according to Oxford data. Japan also is buying less from China. But European countries such as Germany and France are largely standing pat.

Foreign investors, meanwhile, are building fewer new Chinese factories, suggesting that other Asian countries will keep increasing their share of U.S. imports at China's expense. Annual spending on new or "greenfield" sites in China fell from around $100 billion in 2010 to $50 billion in 2019 and hit just $18 billion last year, according to Oxford data.

"What we're seeing from the U.S. decoupling seems set to continue," Slater said. "The only real question is how far it spreads."

The Biden administration has been putting a positive spin on U.S.-China trade, seeking to reassure the Chinese government that the United States wants only to "de-risk" commercial ties by moving critical supply lines to the United States or allied countries — not pursue an economic divorce.

Amid rising national security concerns, the administration has restricted exports to China of the most advanced semiconductors and plans soon to announce new limits on U.S. investment in Chinese technology sectors.

During a trip to Beijing in July, Treasury Secretary Janet L. Yellen said "record" high U.S.-China trade last year demonstrated "there is ample room for our firms to engage in trade and investment."

But even before this year's drop in U.S. purchases from Chinese supplies, trade between the two countries was shrinking in real, or inflation-adjusted, terms. Accounting for rising prices, last year's $690 billion two-way trade was 7 percent lower than the pre-trade war peak in 2018, according to calculations by Alfredo Carrillo Obregon, a research associate at the Cato Institute.

The inflation-adjusted value of U.S. imports from China last year was down 12 percent from five years ago.

A senior Treasury official, who spoke on the condition of anonymity to discuss internal deliberations about the secretary's remarks, said the inflation-adjusted total remained "highly significant and close to an all-time high."

Earlier this year, Mexico became the United States' top trading partner, as manufacturers increasingly favored regional supply networks rather than global ones. Mexico, Canada and China have taken turns occupying the No. 1 spot since the start of the 2018 trade war.

Vietnam and Thailand have emerged as leading alternatives for companies looking to diversify out of China while staying in the neighborhood. And India is attracting attention from manufacturers such as Apple, which plans to beef up its production of iPhones there.

The electronics industry is leading the push to new manufacturing locations. China's share of U.S. personal computer imports fell to 45 percent last year from 61 percent in 2016, according to S&P Global Market Intelligence. Over the same period, Chinese suppliers' share of U.S. printer imports fell to 23 percent from 48 percent.

Decisions made in countless boardrooms — not the White House — are behind the change.

"Governments don't do reshoring. Companies do reshoring," said Chris Rogers, head of supply chain research for S&P Global Market Intelligence.

HP Inc. is planning to make more of its business-oriented laptops in Mexico while boosting production of consumer models in Thailand. In a statement posted on its website last month, HP said it is adding in Mexico "incremental notebook PC production to serve customers throughout the region" and hopes to expand its existing printer manufacturing facility in Corvallis, Ore.

With 12,000 Chinese suppliers and a top research and development center in Shanghai, the company remains committed to China.

"We are always looking at ways to improve the resiliency of our global supply chain ... One of the key lessons of the past three years is the need to have added flexibility, and a growing number of customers are demanding multi-source production," an HP spokesperson emailed in response to questions.

Stanley Black & Decker is redesigning its supply chain to strip out $1.5 billion in annual costs by 2025. The toolmaker is consolidating plants; it closed a Chinese power tool factory in Shenzhen three years ago, and now serves the North American market from a plant in Mexico. "With our supply chain transformation, we have taken steps to improve responsiveness and delivery for our customers, accelerate innovation and time to market," a spokesperson said.

Toymaker Lego also has been reducing shipments from China to the United States. In 2015-2017, an annual average of almost 18 percent of the company's U.S. products came from China, according to S&P Global. That dropped to just 3 percent last year.

Mexico, which has long provided more than half of the company's U.S.-bound shipments, including its most popular items, now accounts for 70 percent.

Lego has had a regional sourcing strategy for roughly 15 years, said Oliver Leach, the company's senior communications manager. Lego serves the Chinese market from a factory in Jiaxing and expects to open a $1 billion factory in Vietnam next year to handle growth in Asia. In 2025, the company plans to open a new factory in Richmond to supply the Americas.

"By locating production and prioritizing suppliers close to our major markets this allows us to meet local demand quickly, shorten supply chains and reduce disruption and environmental impact of shipping products long distances," he said.

Still, China remains the world's factory, accounting for 31 percent of global manufacturing value added, compared with 17 percent for the second-ranked United States.

With modern ports, highways and high-speed rail, along with factory clusters that can rapidly adjust to changing conditions, China retains advantages that no other country can match. Chinese suppliers still dominate markets for goods such as electric vehicle batteries, kitchenware and aluminum door and window frames, S&P Global said.

"Countries like Mexico, India, and Vietnam are taking advantage of global supply chain realignments to nip at China's share in world manufacturing but will not fundamentally alter its dominance anytime soon," said economist Eswar Prasad, a senior professor of international trade policy at Cornell University. "The reality is that no other economy can match the scale and scope of China's manufacturing sector, although the evolution of both domestic and external factors suggest that we have already hit or passed the peak share of China in world manufacturing."

Some economists say the drop in Chinese shipments to the United States may not be as dramatic as the Census Bureau data suggests. Chinese government reports show a smaller decline.

U.S. and Chinese trade numbers have long disagreed, partly because they differ in their accounting for shipments via Hong Kong. But a bigger gap between the two sets of books opened during the trade war. U.S. companies appear to have underreported their imports from China to escape tariffs imposed by the Trump administration, according to a 2021 Federal Reserve research note.

Smaller Chinese shipments to the United States also reflect conditions in specific industries. Retailers such as Target and Walmart are ordering fewer Chinese goods while they focus on reducing unusually high inventories. And changes in the pan-Asian electronics trade also may be clouding the picture, as some products that originate in China are sent to Vietnam for

some minor finishing touches before heading to the United States, according to economist Brad Setser, a senior fellow at the Council on Foreign Relations.

"China's U.S. market share has fallen far more if the U.S. data is used than if the Chinese export data is used," he said in an email. "There is no doubt about the recent weakness by the way — but some real doubt about the extent the U.S. really has decoupled with China."

Shortcomings in U.S. trade policy are keeping some American buyers from shifting more factory orders out of China.

Since the expiration three years ago of a program that allowed goods from many developing nations to enter the United States duty-free, companies no longer have an incentive to shift their orders from China to those locations, said Steve Lamar, president of the American Apparel and Footwear Association. A similar program for dozens of African nations is set to lapse in 2025.

"The federal government has done a clear job of encouraging diversification away from China," he said. "But it has not clearly suggested where that diversification needs to go."