US-China Trade War: The Modern Day Cold War?

Introduction

China has experienced unprecedented growth the past two decades, recently surpassing Japan to become the world's second largest economy. In front, the United States is the largest economy in the world. As the nominal GDP gap between the United States and China continue to narrow, fear and uncertainty naturally arise regarding the trade practices of China. Prior to President Trump's election, the relationship between the United States and China was rocky. The Obama administration attempted to navigate through this relationship by devising the "rebalance to the Asia-Pacific" policy, a plan to contain China. However, such endeavors ultimately failed.

Now, President Trump has initiated a trade war against China, arguably the largest trade war to date. Even prior to his presidential campaign, Trump has long criticized China's trade practices. The Trump administration ultimately believes that the imposed tariffs are necessary to protect the intellectual property of U.S. businesses and reduce the U.S. trade deficit with China. I will explore the imposed tariff provisions, the implications of such tariffs and finally provide my thoughts moving ahead.

Tariff Provisions

The first wave of tariffs was imposed in February and March of 2018, where the U.S. imposed a 30% tariff on solar panel imports, 20% tariff on washing machine imports, 25% tariff on all steel imports, and 10% tariff on all aluminum imports. Although they were not specifically targeted towards China, they laid the foundation for pending war. China retaliated by imposing 15-25% tariffs on $3 billion worth of products in April. Three months later, the U.S. imposed China-specific tariffs on Chinese products valued at $34 billion, with China responding with tariffs on U.S. products valued the same amount. The third round of tariffs were finalized and released in August, where the U.S. imposed tariffs on $16 billion worth of Chinese goods, in which China responded with the same. Finally, in September, the U.S. implemented an enormous tariff on $200 billion worth of Chinese products. China retaliated with tariffs on comparatively smaller $60 billion worth of U.S. goods. Ultimately, the total U.S. tariffs applied exclusively to China is worth $250 billion, while the Chinese tariffs applied to the U.S. total $110 billion.

During this entire process, trade re-negotiations opened up multiple times. However, an agreement is never reached, as neither President Trump nor President Xi Jinping are willing to back down.

Implications: Who are the Winners and Losers?

The primary U.S. goods subject to tariffs include soybeans, automobiles and aluminum. On the other hand, the primary products affected in China comprise of electrical products, solar panels and medical devices. On the surface level, major losers are businesses who produce the products targeted by the tariffs. U.S. exports to China decreased 28.2% on the month of August, affecting sales for soybean farmers. Washing machine imports plummeted. Consequently, the price of washing machines increased by 20% in the U.S. following tariffs on metal imports, whereas the price of all appliances on average jumped by 7%.

As a result of such tariffs, American consumers face higher prices on Chinese imported products. On the supply side, soybean farmers, U.S. automakers and airplane producers suffer from lower prices. U.S. companies with supply chains in China such as Apple and Lenovo also face higher costs.

Contrarily, U.S. steel and aluminum industries are projected to be winners through these tariffs. By making it more expensive for the country's manufacturers to buy foreign steel, the hope is to direct manufacturers to purchase domestic steel instead. This policy goes hand in hand with Trump's promise of revive manufacturing jobs in America. Because steel is a critical good due to its strong backward and forward linkages, it is thought that many jobs will be created to support the multitude of linked industries.

Evaluation

In 2017, 8% of U.S. exports went to China, amounting to $184 billion. If the war is exacerbated, the United States will lose an enormous amount of exports. A decrease in exports will inevitably lead to an increase in unemployment, as workers are laid off from rising costs and lack of sales. Thus, GDP growth rate will decline as well.

Implications do not only occur within China and the United States, however. Trade within emerging markets and ASEAN countries are impacted heavily as the two major economies turn to other countries for trade. Because most trade is vastly intra-regional, I believe that greater trade will occur between China and ASEAN countries as Chinese businesses begin shifting production away from the United States. At the same time, because most ASEAN countries' growth is pegged to China's growth, there will be a net negative effect on global trade if China experiences an economic slowdown from the imposed tariffs. Business confidence will also erode where investment decisions will be postponed due to greater risk for a global recession.

Risk for a global recession continue to rise if a trade agreement between China and the United States are not negotiated. However, negotiations will not be reached anytime soon as it is evident that the Trump administration does not plan to back down on its attacks on China. As indicated in the successful negotiation regarding the replacement of NAFTA with USMCA, there includes clause stating participant countries can withdraw from the pact if one of the others enter a trade deal with a "non-market economy," implying China.

Conclusion

Tariffs are a form of import tax. They can either be utilized as a source of revenue or to protect certain domestic industries. In this case, the United States are using tariffs not only to protect their steel industry, but also to threaten another country. The implications are massive – a back and forth exchange in tariff imposing between the two largest economies in the world will have ripple effects across the world. While there are winners and losers, I believe cooperation rather than unilateralism will ultimately maximize the welfare of both countries.

Sources

https://en.wikipedia.org/wiki/2018_China%E2%80%93United_States_trade_war
https://www.weforum.org/agenda/2016/12/america-china-relationship/
http://www.china-briefing.com/news/the-us-china-trade-war-a-timeline/
http://fortune.com/2018/09/17/trump-200-billion-tariff-against-chinese-products/
https://www.bloomberg.com/news/articles/2018-04-04/as-china-fires-back-in-trade-war-here-are-the-winners-and-losers
https://www.fb.org/market-intel/tensions-with-china-take-a-bite-out-of-u.s.-soybean-acreage
https://www.ft.com/content/8c33d966-bc13-11e8-8274-55b72926558f