

## United States – China trade War and its effects on Global Economy

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### ABSTRACT

*The main idea of this paper is to make it possible the understanding of the concepts of trade war, the reasons that led the United States of America to start one with China, such as the idea that economically, China's large surplus has become of great competition and threat to American's producers, for the development of its technology and the assumption of theft on American intellectual property rights. Besides that, this study will also aim to explain how the trade war affects not only American and Chinese economies, but how it will affect global economy.*

**Keywords:** Economy, Trade War, Unites States of America, China.

### INTRODUCTION:

Economy studies all the activities related to production, consumption, and the trade of goods and services in a country. Such study is important to understand how a country works and what areas must be improved in order to achieve economic growth.

Various aspects of a country influence on the development of it. On this paper the focus is on China and United States of America (U.S.A), and not only on their economy but how the decision made by them influences the rest of the world. In order to understand how economy works and it's measured is important to understand the concept of not only economy itself, but the areas involved in it.

United States and China have become the first and second strongest economies in the world, and their decision making affects the world as a whole.

After the election, USA new president, Donald Trump, implemented one of his campaign's ideas, which was that in order to protect American Economy, taxations should be increased on imports. Many countries suffered from this measure, but, unlike the other countries, China decided to retaliate the measures taken, by imposing taxes on products originated from the U.S. The tension between both countries have been happening for the past years, but it got intensified after Trump's political campaign, and election as US president. Chinese President, Xi Jinping, has already made clear that China will continue with the trade war as long as the United States continues. And in this war of titans, the whole world has a lot to lose.

### LITERATURE REVIEW:

Edward D Mansfield (1994), analyses different scholars' opinions on his work, where he studied the distribution of power, international trade and war. Claiming that the concentration of power and trade may lead to war, taking into consideration different reasons of why that it would happen, the example briefly given by the author is that the introduction of nuclear weapons might have relocated the power distribution. He also claims that neorealism (an international relation theory that says that power is the most important factor in international relation) and political economy perspective are required in order to explain and understand a war in the international system.

According to the article of Kevin Lai and Olivia Xia (2016), in a trade war between the United States of America and China, it would be economically complicated for China to face, because of its greater exposure to

exports and FDI (Foreign Direct Investments), since China's balance of payments is already in deficit due to its outflows.

Doug Campbell (2006) explain in his article the antidumping policies, and claims that nations have turned into them in order to achieve trade protection. During the article the author takes into consideration the opinion of various economists, who claim that the antidumping policy actually harms a country's economy more than it gains from such measure.

Since Johnson (1953), one strand of the literature has looked for various generalizations allowing for different policy instruments—specific tariffs in Horwell (1966), quotas in Rodriguez (1974) and Tower (1975), arbitrary numbers of countries and goods in Kuga (1973), and alternative formulations of governments' preferences in Bagwell and Staiger (1999)—without modifying

Johnson's main conclusions. Grossman and Helpman (1995) introduced domestic political agendas into the analysis of international relations with terms-of-trade externalities, under the assumption that national leaders are concerned not only with maximizing welfare but also with collecting campaign contributions from special-interest groups. These authors studied the formation of the tariff equilibrium and the possibility of a cooperative policy equilibrium.

On the article written by Gene M. Grossman and Elhanan Helpman (1995), the structure of protection in both cooperative and noncooperative policy equilibrium is studied. The article analyzed a small or isolated country which sets its own trade policies without considering the other existing countries and their reactions. The study follows "Putnam (1988), who argued that international relations are best seen as just such a 'two-level game'. Considering how political pressures limitates countries' international relations.

Mark Melatos, Pascalis Raimondos-Møller and Matthew Gibson (2007), study and define what a trade war is and who is more likely to win it, noticing that even though they believed that "big countries win trade war", if a country has enough substitutability against a its rivals, the size of the country will not matter.

## **METHODOLOGY:**

The main objective of this study is to understand China and United States of America economy, trade history and the reason why a trade war was started between the world's two greatest economies. Also, this paper will bring understanding on the concept of trade war and its possible effects on global economy. As it is a newly matter, this study will focus on describing the events and analyzing its possible outcomes.

### **Economies:**

According to the economist Marshall (1890),

*"Economics is a study of mankind in the ordinary business of life. It examines that part of individual and social action which is most closely connected with the attainment and use of material requisites of well being".*

**Following Marshall's definition, economy is the study of situations caused by the interaction and cooperation of groups of people in a society:**

Economy is the study of the factors involved in a society – production, consumption, distribution and behavior. As various factors influence a country's economy, measuring how well a country is doing is no easy task. The economist Simon Kuznets, in 1937, presented a way to measure a country's economy, and so the concept of GDP – Gross Domestic Product, was introduced. The idea behind it is to analyze the value added of the goods and services produced in a country for a specific period of time, usually one year. Such standard is important for indicating if an economy is growing or decreasing.

Since economy studies several factors involved in a country, determining a healthy and strong economy requires the analyses of not only the GDP, but a variety of aspects.

### **United States of America:**

The United States of America (U.S.A) has been developing and growing over the past hundreds of years. The country's economic growth was intensified after the Second World War, when with a devastated Europe and the fallen of Gran Britain, the U.S.A, in an attempt to keep capitalism alive, approved the Marshall Plan (1948), where low interested loans were offered to European countries chasing their recovery. Not only that, but also the Gold Standards (started in 1933, and abandoned in 1971), helped make the United States not only a great economy – which had already been established before – but also made the US Dollar the strongest currency global wide.

According to the International Monetary Fund, in April 2018, the strongest GDP belonged to the USA. Such fact can be understood by knowing how US Economy works. According to the article by Amadeo (2018, How does the US Economy work), there are seven components that influence an economy, the first one, already discussed, it's a country's GDP. Secondly, Supply and Demand, which measures consumption and unemployment. Followed by, Inflation and Deflation, Fiscal Policy, Monetary Policy, Trade Policy and Financial Markets. All components have already been learnt by the American Economy, due to its losses and problems in the past – Great Depression, Wars and trade wars, such issues have helped shaping US Economy to what it is now.

The table below demonstrates American GDP in the past ten years, and how much it has developed.



### China:

The Chinese economy, on the other hand, had a slow start, the loss of many wars and territory to other countries left Chinese administration shook. But in 1978, after a great deal of economic amendments and the usage of public subsidies, the country focused on producing products at a low price, aiming becoming a great exporter of low price products. Such measure and cheap labor caused the country great economic development, turning it into an export power.

China kept its borders closed until after 1989, when with a strong domestic economy – built by the amount of multinational companies within China, development of technology, mass production and cheap labor - The country opened its borders providing the world with low price products and became the world's most wanted trade partner.

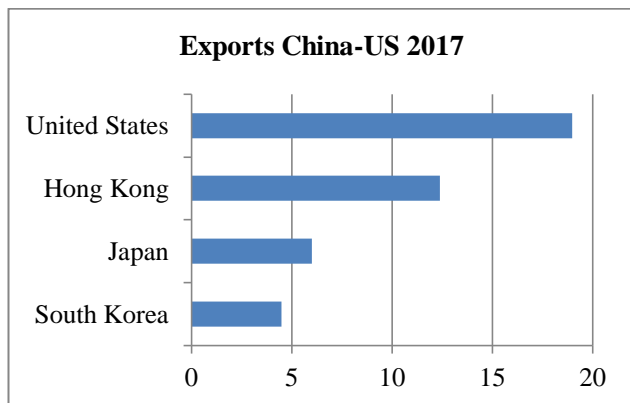
Chinese GDP has increased drastically over the past years, as showed on the table below, making China the 2<sup>nd</sup> strongest economy in the world.



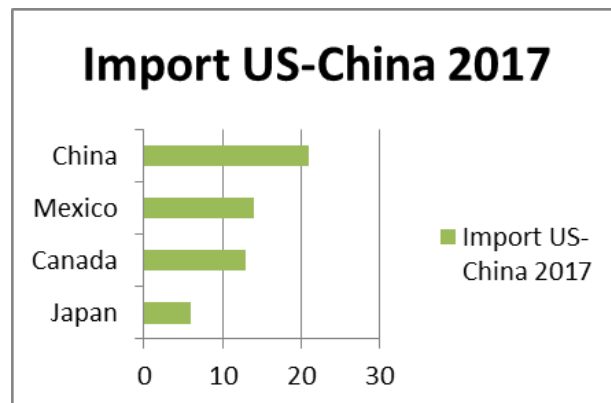
### The Trade War:

American and Chinese trading History started even before Chinese borders were open to international trade. In 1979, the Chinese leader Deng Xiaoping opened Chinese borders to foreign investments and signed a commercial agreement with the President of the USA at the time, Jimmy Carter. The Agreement, *Trade Relations Between the People's Republic of China and the United States of America*, states that in non-discrimination basis, both countries would grant each other “most-favored-nation treatment”, meaning that the countries would “establish commercial and trade institutions, protect each other's patterns of trade, copy rights and trade marks and resolve bilateral trade issues through negotiations”.

China relied its growth on foreign investments and until today it relies on American investments to develop its economy. However, a great deal of Chinese exports goes to the USA, causing a surplus to the Chinese Economy, while the USA faces economical deficits.



Source: <https://atlas.media.mit.edu/en/profile/country/chn/>



Source: <https://atlas.media.mit.edu/en/profile/country/usa/>

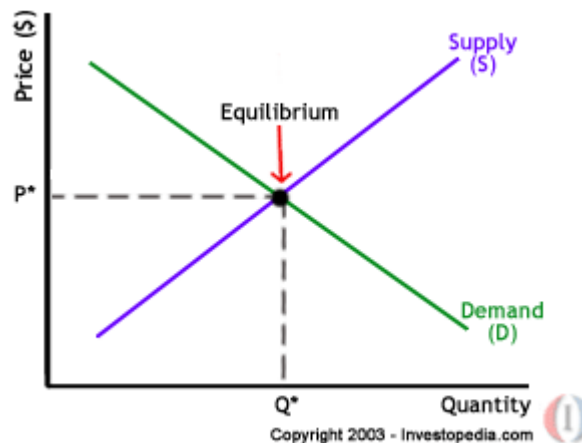
Such growth from the Chinese economy became a threat to the Americans, and not only that, the American President, Donald Trump, in order to punish China for its “unfair” Trade, approved a bill which imposed 25% tariffs on 34 billion dollars products originated from China. This measure will not only increase the price of Chinese products within the US, but it will also force Americans to start recurring to domestic products, which in theory would be cheaper. The Chinese Government, almost immediately responded by saying that the US had started “the largest trade war in economic history to date” and retaliated such measure by imposing 25% of tariffs on imported products originated from the USA. As a response, the Trump administration released a list of another 200 billion dollars products that would receive 10% to 25% of tariffs, and again the Chinese government responded by saying that they would “introduce counter-measures to defend the country’s dignity. These actions were the start of today’s trade war between these countries.

A trade war starts by the imposition of barriers, such as tariffs – a tax imposed by the government on import and export in order to protect domestic producers by increasing the price of imported goods and making them less competitive compared to the domestic ones – or quotas – a government imposition of quantity or value of goods to be imported or exported - from a country regarding international trade in order to protect its own economy.

The United States – China is not the first trade war faced by the USA. The Smooth-Hawley Tariff, is the last great trade war heard of. It happened during the Great Depression in the USA, on 1930. The American government imposed tariffs on products from Europe and Canada, in order to protect American’s farmers. Those countries retaliated by imposing tariffs on products coming from the US. The protectionism idea Americans had, resulted in imported products becoming a luxury only wealth people could have, leaving most Americans worse-off, dependent on domestic products and production.

Even though the idea of a trade war is to protect domestic economy and create jobs, closing a country’s borders to international trade, or imposing a great deal of barriers tends to cause more loss than benefits, once it results in loss on economic growth.

### Effects on Consumer and Producer Surplus:



<https://www.investopedia.com/university/economics/economics3.asp>

The graphic above represents a supply and demand chart. When the supply and demand meet, the economy reaches an equilibrium point. If something happens to that economy, either the demand or supply increases or decreases, the curve shifts leaving the economy in disequilibrium. Eventually, the equilibrium will be restored. Many reasons can cause the curve to shift, and the imposition of tariffs is one of them, since once tariffs are imposed the amount imported decreases - the idea of this measure is to make imported goods more expensive, leaving the domestic market better off, once the consumers will turn to them looking for cheaper products - on the other hand as the prices increase, the demand decreases - prices increase, because now as there isn't as much competition, domestic suppliers can work at a higher profit margin, increasing the price of the products, and as the products get more expensive, less consumers tend to buy them.

That's the idea and the problem on the The US – China trade war, as it will decrease the supply of products on each country relying mostly on domestic products and production, which will make the prices increase, resulting on a decrease in demand. In a long run, the prices of products will become so high to a point where only wealth people will be able to purchase them, such fact remind us of the Smooth-Hawley Tariff.

### Effects on Global Economy:

To understand how a trade war affects global economy, it's important to understand that each country plays a different role in international business and that it weighs differently on how it affected they will be. Below the countries referred to as small or large, don't relate about their sizes or population, but about its influence in the global market.

**Small Country:** Its production or demand doesn't quite interfere on the price of a product. With the trade war small participants on the world trade wouldn't suffer too much, since its participation on the global market is so little, and they mostly have to accept prices and quantities imposed by the countries which have a bigger part to play.

**Large Country:** While a small country has barely any interference in the international market, a large country goes the other way around. If a country that produces a great deal of petroleum starts producing more, the world supply will increase and this will make the prices decrease, or if it goes the other way around. A country starts producing less petroleum, so the prices will go higher, because there's subordination from other countries of that product.

Mainly, a trade war will affect the US and China domestically, since they will be receiving less goods and currency from each other. If the trade war continues, the country's trade partners will eventually have to pick a side, which will make one of the countries lose totally or partially a partner. For an example, if country A stops supplying or diminishes the amount of goods supplied to the USA in order provide more to China. The prices of that good within the USA will be increased, while in China with the higher supply the prices will decrease. In a short run the country that appears to lose the most is the USA, but on the long run all the countries involved will suffer from it.

The United States of America will rely mostly on domestic production, meaning less supply, less quality since now the suppliers don't really need to innovate, and higher prices;

China, the high supply will probably make the prices inferior to the ones domestically, which will cause loss on domestic economy. Resulting in the imposition of tariffs to protect domestic economy, or the cease of imports; Country A, as it relies mostly in one economy, if something happens to China, their biggest trade partner in such product, they will be stuck with an unnecessary amount of goods without having where to sell it to. And having that big supply domestically will decrease the prices and bring loss to producers.

Take for example Brazil, during 1929 the biggest importer of Brazilian Coffee Beans was the USA, but during that year the United States of America faced the greatest crises of their history until then. This made unviable the import of great amounts of the good. In no time salaries lost their purchase value and unemployment started. In order to re-establish the price and the economy, the Brazilian president at the time decided to buy 18 million coffee bags and burn them, this dramatic attitude re-established the prices, salaries started having their purchase power back, and there was a decrease in unemployment.

A trade war causes loss on economic growth, especially for large countries that rely so much in international trade as a way to keep its economy going. It harms each country separately as individuals, creates military tension and prevents economies from developing.

#### **Effects on Fluctuation of US Dollar and Chinese Yuan:**

The Yuan rate was also one of the reasons the trade war started, accused of manipulating its rate, China keeps its currency on an inferior rate compared to the American dollar, and this keeps China the possibility of selling its products in such low price.

The table below illustrates what has happened to the Yuan/Dollar exchange rates, in the past eight years.

Year	Rate
2010	6.827
2011	6.589
2012	6.294
2013	6.230
2014	6.050
2015	6.205
2016	6.534
2017	6.958
2018	6.491
<a href="https://www.thebalance.com/dollar-to-yuan-conversion-and-history-3306089">https://www.thebalance.com/dollar-to-yuan-conversion-and-history-3306089</a>	

A country's currency exchange rate depends on several factors, how strong is the economy, supply and demand – how many people are buying and selling the currency – the control the government has over the rates and so on. With the start of the trade war, Chinese Yuan fell to its lowest compared to 2016 and 2017. While the Yuan is weakening the US Dollar is strengthening, because of US still strong economy.

#### **CONCLUSION:**

Who wins a trade war? On the long run, there are only losers. The trade war isn't beneficial to any of the parts involved and such measures, will not only harm one country's economy, it will also harm international relations, how other countries will do business with them and create military tension. Donald Trump's protectionism will not only harm US and China economy, but large and small countries in different proportions by destabilizing the entire global system of trade.

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