

The United States-China Trade War: How the Future is Going to Evolve Based on the Past

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Abstract: This paper will judge the background, the present and the future of the trade war from an objective point of view. The researches being done regarding the topic will not only embrace one side of ideas but both sides of advantages and disadvantages regarding all specific topics of the trade war.

1. Introduction

The drastically different political system in China and the US have attributed to the rising concern regarding the political feasibility of the two parties being involved in the trade war. When analyzing the political feasibility of the US' involved in the trade war, one needs to realize that the President's decisions are highly based on the public's opinions. It all involves making an impression to the public and influence the voting system which will ultimately decide the presidency of the United States. Hence, even if President Trump's desire to declare the trade war on China has a long-term effect that can only become apparent in the future, he also needs to lower the short-term damages caused by the trade war as low as possible as a result of satisfying the US public and make them believe that his plan is working efficiently. The core of the Republican's voters is based in the mid-western US, which covers the agriculture-exporting states of Iowa and Ohio where most of the soya bean producers are located. While a significant portion of the Republican supporters is from agricultural-exporting areas, these voters have not been pleased with the recent results of the trade war as China has imposed tariffs on selected export items from the US including soya beans, poultry feed, and other agricultural products. This is seen as a strategic move by the Chinese authorities to put pressure on the US government to de-escalate the trade war.

2. Economic Feasibility of the Trade War

During Donald Trump's presidential campaign, his slogan was "Make America Great Again" which emphasized the shifting of manufacturing jobs to China that had caused severe job losses in the US. According to the Department of Commerce, U.S. exports of Goods and Services to China supported an estimated 911,000 jobs in 2015. As a result, many supporters of Trump's populist politics are blue-collar workers. As much as the amount of confidence that these voters have placed on the Trump Administration to "make America great again", however, Trump's governing during the past 3 years has now shown significant improvement in the job market. Figure 34 shows that during Trump's presidency between 2017 and 2018, the employment rate in the US has declined. The industry sectors of which Figure 1 drew its data from are consist of mining and quarrying, manufacturing, construction, and public utilities, under divisions 2-5 or categories C-For Categories B-F. Although the dissatisfying employment rate during Trump's governing is not completely his fault because the US' overall employment rate has drastically dropped since the 2008 Great Recession, he made a promise to his voters that have raised their expectations in the improvement of employment rate during his presidency. Hence, if the trade war has not improved the employment rate in the US as efficiently as how the blue-collar voters expected, they will be greatly disappointed which will likely have negative impacts on Trump's next presidential election.

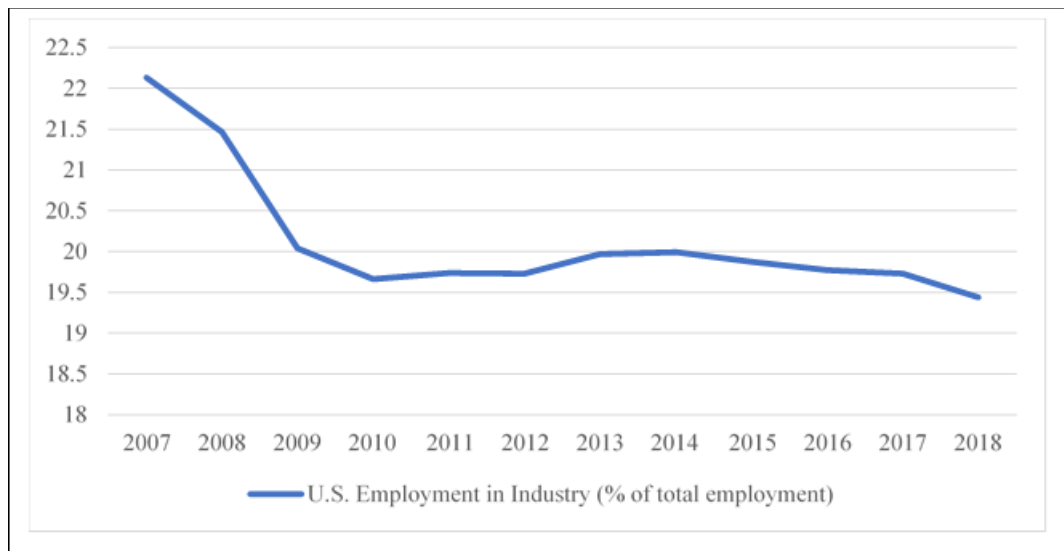


Fig.1: U.s. Employment in Industry (% of Total Employment), 2007-2018 Source: International Labour Organization, Ilostat Database

2.1 U.s.' Economic Gains and Losses

The main source of economic benefits that the US has been receiving from the trade war is its rising tax revenue. Figure 2 shows that in 2017, shortly after the declaration of the US-China trade war, the US' tax revenue has had significant growth. However, the tax revenue soon dropped to a level similar to its 2016 records of performance. This series of drastic changes started after Trump started imposing additional tariffs on selected import goods from China, but the significant gain from tariffs proved to be only temporary when China also started imposing retaliation tariffs on U.S. goods. While Donald Trump repeatedly emphasizes his achievement in gains of tariffs in his Twitter account, the available set of data shows that such gains could only be temporary.

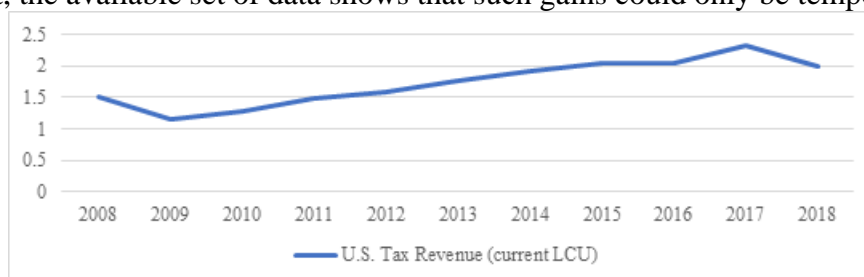


Fig.2 : U.s. Tax Revenue (Current Lcu - Trillion), 2008 – 2018

Source: International Monetary Fund, Government Finance Statistics Yearbook

Another economic benefit that the US has gained from the trade war is the reduction in trade deficit with China. The U.S. goods and services trade deficit with China was \$378.6 billion in 2018, and the U.S. services trade surplus with China was \$40.5 billion in 2018. If to measure Trump's economic achievements by comparing the U.S. trade deficit before and after the trade war until 2018, he had not remotely made the slightest progress in meeting his expectation. However, according to Figure 3 which was mentioned in the background section, the US' trade deficit has encountered a significant drop in between 2018 and 2019. Although the overall number of trade deficit that the US has with China in 2019 is still considered significant, it could be the start of a trend in declination of U.S' trade deficit with China and might eventually achieve the proximity of bilateral balance in trading with China that the US government desired.

Despite the considerable economic benefits that the US has gained, there are certain economic risks that the US has to face from the trade war. To start with, the US-China bilateral relationship, which was built based on trust and a mutual understanding of both parties' desire to gain economic benefits from the relationship, has been strained. The damages to the relationship can cause long-term negative impacts on the trade efficiency between the US and China and lead to

significant losses in the US economy. To demonstrate the extent of the bilateral relationship's importance to the US economy, in terms of exports, China was the US' third-largest goods export market in 2018. The export revenue had totaled \$120.3 billion in 2008 which was up 527 percent from 2001 when China was not yet a member of the WTO. Notably, China is the US' fourth-largest agricultural export market that U.S. total exports of agricultural products to China totaled \$9.3 billion in 2018. U.S. exports of services to China were estimated to be \$58.9 billion in 2018 which was 272 percent greater than its 2008 level, and it was up approximately 997 percent from 2001 when China was not yet a member of the WTO.

That being said, despite the trade deficit that the US has been experiencing from trading with China, the US has been significantly benefited from the Chinese market that the loss from the trade deficit is already considered to be fairly compensated. Hence, if China continues at refusing to give in easily to accept the US' new requirements on their trading relationship, Trump's plan of greater economic gains from the trade war can backfire and cause a greater economic loss instead. Regarding the US' accusation of China's unfair practices that are not in compliance with the WTO rules, even though the international tension caused by it arises, the extent of export gains that the US has achieved from China's market after China joined the WTO is undeniably significant.

2.2 China's Economic Gains and Losses

The potential costs of the weakening bilateral relationship are experienced by both the US and China. China was the United States' largest supplier of goods imports in 2018. U.S. goods imports from China totaled \$539.5 billion in 2018, up 427% from China's period of pre-WTO accession in 2001. U.S. imports from China account for 21.2% of overall U.S. imports in 2018. U.S. total imports of agricultural products from China totaled \$4.9 billion in 2018, their third-largest supplier of agricultural imports. U.S. imports of services from China were an estimated \$18.4 billion in 2018 which was 68.3 percent greater than its 2008 level, and it was up approximately 414 percent from 2001 before China joined the WTO. From this set of data, it becomes apparent that even though there is a significant trade imbalance between the US and China, they both benefit at a fairly similar percentage of economic gains in comparison with their past overall performances.

China is at the advantage of dominating an incredibly solid consumer market and having a government that can make dictatorial decisions without worrying about issues associated with reelection. Hence, China is capable of engaging in the trade war against the US for a considerable period. The US does have power over China's economy regarding the advanced technologies that certain Chinese organizations need but have not possessed the ability to produce those technologies by themselves. However, even if the US completely stop supplying those technologies to China, its negative impacts on the Chinese market can only become apparent after approximately 10 years because of the stability of China's consumer market. Also, the US companies will not likely to participate in prohibiting the technologies from entering the Chinese market even if the US government asks them to. Considering the size of the Chinese market, prohibiting the US companies' technologies from entering China will damage their relationship with the Chinese government and ultimately result in these companies' hundreds of millions of USD losses; and on top of that, they cannot be sure when the trade war will end while their companies endure those losses, which they simply cannot tolerate.

3. U.s.' Previous Trade War Tactics Against Other Countries

Historically, the United States has indulged in trade wars against various countries. Despite the trade wars that the US engaged in with different countries have resulted in various consequences, the trade war against China remains to be a unique case mainly due to its political structure's characteristics and its consumer market's solid ability to balance the nation's economy with or without interferences from foreign countries. Hence, it is not reasonable to predict the final results of the US-China trade war based on historical results of the US' trade wars against other nations. However, there is going to be a certain pattern of behaviours that the two parties engage in, and this

pattern could be identified by combining and considering the US' previous trade war tactics with China's unique characteristics.

3.1 Smoot-Hawley Tariff Act (1930)

In 1930, the US was experiencing productivity growth attributable to the nation's significant technologies advances such as electrification. Hence, to compensate for the overproduction of the US economy, the US government enacted the Smoot-Hawley Tariff Act in which reportedly increased tariffs on 20,000 selected import goods from different countries. Unlike the tariffs imposed on Chinese goods to reduce losses from the trade deficit, right before the Great Depression hits, the US trade records had an aggregate surplus in 1930.

By imposing tariffs on certain Chinese goods, the Trump administration disrupted the bilateral nature of the trading relationship with China, and as a result, exposed itself to the risks of losing seats in the Congress if their plan does not succeed in achieving the results they desired. That being said, Trump won the election by committing to his populist strategies. He won the election because the US is in the severe economic imbalance between people of different classes, and his vision to "Make America Great Again" had given many U.S. citizens hope that certain aspects of their dissatisfaction in lives could be resolved. Hence, if Trump has not exposed himself to the risk of losing political support from the public and the Congress, he could not have become the President of the United States in the first place. Therefore, instead of considering the trade war against China as a mere process of realizing a certain plan that Trump has envisioned, it is rather considered as a necessary mission of which Donald Trump has promised to the US public for the incentives of selecting him as the US president.

3.2 Voluntary Export Restraints (ver)

In the 1970s, the US automobile industry was facing difficult challenges of competing with Japanese companies like Nissan and Mitsubishi for producing cheaper and more fuel-efficient cars. As the competitions between the US and Japan progress and the consumers in demand of Japanese-produced cars continue to increase in US market, in 1981, Japan and the United States reached an agreement under which the former would export no more than 1.68 million cars to the US, initially for three years. However, due to a growing trade deficit with Japan, the US government extended this restraint for another two years. The VER drove up the prices of imported cars from Japan, however, sales of Japanese cars did not fall significantly because the demands for their high quality and fuel-efficient cars were inelastic. As a result of the increasing prices in Japanese automobiles, while the consumer demands continue to stay relatively stable within the US market, the consumers had to pay higher prices for automobiles which led to greater losses in social welfare. This plan of conducting VER on Japanese automobiles ultimately backfired. Hence, as a member of the WTO after the Uruguay Round, the US reached an agreement with other members to not further implement any future VER for better maintaining the trade balances between partners.

The plan of conducting VER eventually backfired mainly due to consumers' inelastic demands for the cheap and fuel-efficient automobiles imported from Japan. Although the elected Chinese goods and services Trump chose to impose tariffs do not necessarily possess the product-specific traits like Japanese automobiles that make their demands from consumers inelastic, they are inelastic in other aspects. For example, many US companies refuse to leave China because of their great hope in the future development of the Chinese market. Their manufacturing process has become more expensive in China due to the tariffs, but many manufacturers are willing to bear the costs because they are confident in receiving future revenue from the Chinese market that will not only overcompensate their losses from the trade war but also establish a permanent relationship with the market. As a result, when the majority of US manufacturers continue to invest in their manufacturing sectors within China, most of the products imported to the US will continue to be produced from China. Consequently, if the plan does not change the export status of China in the US, it is subject to the risk of backfiring like how the VER failed in restricting Japanese automobiles sold in the US.

4. Conclusion

In this paper, various subjects relating to the US-China Trade War were discussed. They include the background about the US-China bilateral trade relationship, the current progress of the trade war and how the associated institutions and individuals react to progress, the political and economic feasibility of the trade war for both countries involved, and several previous incidents of the trade war that the US has encountered with other countries and how those tensions were resolved eventually. Based on these gathered facts, a series of thorough interpretations was conducted to find any valuable aspects that might contribute to the future development of the trade war for both countries. While the initial attempt of starting this research paper was finding a certain direction of where the trade war is approximately heading; after so much research and analysis, one has to conclude with the most conscious objectivity that the definite conclusion for which country may gain more benefits from this incident and which country will likely to bear more costs is simply nonexistent.

First of all, both countries have their advantages and disadvantages in this trade war. For example, China's unique political structure allows the government to practice all kinds of policies without worrying about how the public will react to those policies. The US government, on the other hand, can never freely practice the policies however they like because they have to consider the public's negative opinions to stay in power. However, the US does have its advantages that China does not have. For example, the US has control over many advanced technologies that China needs for economic developments. Hence, when the trade war broke off, the US limited many technologies from furthering transactions to China which partially forced the Chinese officials to negotiate with the US officials on behalf of the Chinese government. It is not certain which country has more advantages over the other because it is difficult to measure the value of each advantage.

Furthermore, based on the current progress, it is also hard to predict approximately when the trade war may end. Although the US and China have already engaged in several rounds of negotiations, the public officials have not announced any aspects of the progress they have made and what both parties have agreed and disagreed so far will likely remain for closed-door discussions. However, it is immensely likely that the trade war will continue for a long time regardless of Trump's re-election results. China's consumer market has developed to a certain extent that even the negative impacts of the trade war cannot significantly undermine its degree of contribution to China's economy. Hence, even if the trade tension has made a few companies stop investing in the Chinese market, the majority of the companies remain their level of confidence in the future development of the market and chose to stay. As a result, the Chinese government can afford a long duration of continuous tariff-battles with the US; and judging from their series of retaliation tariffs against the US imported goods, they do not intent to cater to the US government's demands easily. Although both countries intent to end the trade war as soon as possible, they both would only give in when they become fairly satisfied with the final agreement. Consequently, when they have failed to reach agreements from multiple attempts of negotiations, there must be certain aspects of the agreement that both parties are claiming that may take years to resolve.

Also, the US and China's political and economic feasibilities are different. The US is encountering distinctively more difficulties in terms of political feasibility in comparison to China mainly due to the different political structures that have been mentioned. For the record, when comparing and contrast which political structure is more beneficial to the progress of the trade war, it is not meant to conclude which politics is fundamentally better. The comparison is only conducted for the sole purpose of predicting which structure is more beneficial in achieving each country's desired results from the trade war, but not meaning to conclude which structure is better for the overall development of each country's political and economic matters. The history has proven that whenever the US government engaged in conducting the protectionist policies, they never end well or their positive results never last long. Hence, when Trump proceeded the protectionist measures this time, he the Republican party to the risks of backfiring that they may again lose the public's trust if they do not achieve what they have promised and it might even ruin the long-established bilateral trade relationship between the US and China.

However, both countries have fair shares of pros and cons in terms of the economic feasibility of the trade war. The US has gained a tremendous amount of tax revenue from China which ultimately deduced RMBs' currency value, and the US' trade deficit with China has significantly reduced. However, the strained bilateral relations between the US and China could cost the US greater costs in the long-term. The trade war has drawn a few companies from shifting their manufacturing sectors outside of China and it had caused the stock-prices in China to drop. However, China's consumer market has proven to be rock solid, which gave the majority of foreign companies enough confidence to stay in the Chinese market. Also, even though the RMB-value has declined, the Chinese market is huge enough to operate by itself that the Chinese citizens are barely affected by the drop in currency-value except for a few individuals and institutions that have direct contacts with the foreign market. Hence, even though the trade war has undoubtedly affected the Chinese economy negatively, China can afford to act adamant during the negotiations to a certain degree and can hopefully reach a mutual agreement that can satisfy both parties.

It should be noted that even though China and the US are the two countries that are most involved in the US-China trade war; however, they are not the only parties that bear the resulted costs. For instance, in Europe, many countries are particularly affected because they rely on trade war and are open to trade. Although the trade war has shifted some manufacturing jobs from China to other countries, European countries where labour costs are high and regulations are strict are not necessarily sharing the benefits of shifting jobs. Instead, their export forecast has gone down, and caused many companies to slow down their investments in European countries. As a result of the trade war, the world economy encounters greater discrepancy and imbalance as the costs are not being shared equally among different countries. Ironically, even though the US government was the party that initiated the trade war, the US economy remains the least exposed of the world's 20 largest economies to declining exports because of its massive domestic consumer spending base. Hence, even though the US and China could afford to continue the trade war for a long time before a relatively settlement is reached, considering that they are not the only parties involved to bear the costs of the trade war, they should reach a settlement as soon as possible.

In conclusion, it is nearly impossible to accurately predict which country will eventually gain more from the trade war than the other country. There are simply too many elements that need to be considered. Any unpredictable future incident can also change the entire pattern of the progress, especially when the trade war is likely to last for a long duration that the amount of uncertainties accumulates even more. Hence, it is best to stay close to the news about the trade war, observe all the changes, and interpret the implications based on the background and gathered facts about the US-China trade war. Hopefully, the US and China could reach an agreement soon because they are not the only parties that have to bear the costs of the trade war.

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