The United States – China Trade War

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A trade war happens when countries attack each other’s trade with tariffs and quotas, and it can be referred to as a side effect of protectionism. This kind of economical war is usually sparked up when one country raises tariffs, i.e. a tax that is imposed on imported products made abroad. Imposing a tax on a product means that people are less likely to buy them, because they've become more expensive. As a result, people buy cheaper local products instead which consequently boosts the local economy (Investopedia). Trade wars can hurt other nation's economies and lead to rising political tensions between them.

United States of America and People’s Republic of China are two largest economies it the world, according to data from the International Monetary Fund. China’s economy is expecting to eclipse the US economy by 2050 (PwC 2018). United States is China’s largest trading partner while China is for US second largest trading partner after European Union (Smith 2018). Both countries are the members of the World Trade Organization (WTO) which also provides decision-making platform for all of its 164-member states in the trade-related disputes.

The first move towards the trade war between US and China was enacted when the President of the United States, Donald Trump, instructed the U.S. Trade Representative in August 2017 to initiate an investigation of China to determine, whether certain policies of the Government of China (i.e. misusing of the intellectual property and unfair trade practices) are harming the US economy (USTR 2017). Based on this investigation Donald Trump imposed tariffs on tens of billions of dollars’ worth of goods on China’s imports into the United States. USA launched this resistance towards China’s trade policies in the time of cease firing trade tensions with the European Union. This garnered a tit-for-tat response from China and thus escalated the trade war. How did President Donald Trump justify these moves?

Trade deficit of the United States

One of the main reasons why Donald Trump decided to impose tariffs on Chinese goods was to reduce a trade deficit. This is one of the main points of his new trade policy that he announced in March 2018 (Lighthizer 2018). In addition to balancing the trade deficit, the new trade policy agenda also stresses the issue of protection of the U.S. intellectual property rights.

The harmfulness of the trade deficit is a controversial issue. It is perceived to have a negative effect on the economy. This is because surpluses of imported goods lead to high unemployment rates, This, in tangent, leads to the inability of local manufactures and markets to compete with the prices and quantity of the imported items. A trade deficit commonly emerges when a state does not supply its citizens with enough goods. In other words, a deficit in trade shows that the population has enough money to afford more goods than the amount that is currently being made in their state. Moreover, China can produce consumer goods at lower costs than many other countries can. This combined with China’s protectionism might also cause the trade deficit. During a period of scarcity, a trade deficit may not be dangerous, but the fact of the matter is that the surplus of imported foreign products causes a decline in prices and an

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1 Protectionism refers to government actions and policies that restrict or restrain international trade, often with the intent of protecting local business from foreign competition. Investopedia. “Trade War”.
2 Trade deficit is an economic measure of international trade in which a country’s imports exceeds its exports. Investopedia. “Trade Deficit”.
inability to create enough working places. Local enterprises and companies might start to have difficulties to compete, conform and correspond to the lower prices. The consequential shortages in manufacturing then in turn lead to the increase of imports, and the deterioration of an already frustrating situation (Irwin 2018).

**How has the U.S. trade deficit changed over the recent decades?**

The U.S. imported $505,469 billion worth of goods from China in 2017 (US Census Bureau – Imports), while having exported nearly $129,89 billion worth of goods to China. Subsequently, the economy of the United States in the year of 2017 was in a shortage of around $375.23bn (US Census Bureau – Exports).

**Figure 1:** US Trade in goods with China

As the graph above shows, China’s trade with the United States has greatly surged in the past 20 years, mainly thanks to the accession to the WTO in 2001. Economy-wise, China was benefiting more from its trade relationship with the United States; therefore, economically speaking China is the one suffering more after the newly imposed tariffs. In the previous years, there had been negotiations on a free trade agreement between US and China, called CHUSFTA (Songfeng). However, after Trump’s imposition of new tariffs it will be increasingly difficult to reestablish negotiations on a free trade agreement between China and the US.

Since the beginning of Trump's presidency, Trump has been accusing China of unfair trade practices. Besides the balancing of the trade deficit, President Donald Trump feels injustice in the trade relation between the United States and China. For example, certain Chinese laws strictly dictates foreign companies to engage in joint venture with Chinese entity what is perceived by United States as counteracting of intellectual property rights. On August 14, 2017,
President Trump issued a memorandum to the Trade Representative, saying: “China has implemented laws, policies, and practices and has taken actions related to intellectual property, innovation, and technology that may encourage or require the transfer of American technology and intellectual property to enterprises in China or that may otherwise negatively affect American economic interests” (Office of the USTR 2018). Later, August 18, 2017 the Trade Representative Robert Lighthizer stated in an official press release, that he had begun an investigation of Chinese trade practices under a legal document, Section 301 of the Trade Act of 1974 (USTR 2017). An official with the U.S. Trade Representative’s office later said, “after 7 months of investigation, U.S. officials found strong evidence, that China uses foreign-ownership restrictions to compel U.S. companies to transfer technology to Chinese firms” (Fortune 2018). Consequently, after the start of the investigation, the world is witnessing the first tariffs being imposed on China.

**Actions towards the beginning of the trade war**

On January 2018, The United States – based on the decision of President Trump – began imposing tariffs on imported washing machines and solar panels. The tariffs’ amount was set to 20% on the first 1.2 million washers and 50% of all subsequent imported washers in the following two years. Furthermore, a 30% tariff had to be imposed on solar panel components, with the rate declining over four years (Gonzales 2018).

A second round of tariffs was announced on March 8, 2018 when President Trump ordered an imposition of 25% tariffs on imported steel and 10% on imported aluminum – to be taken into effect 15 days after the announcement, March 23. Canada and Mexico were the only countries not included in the list of nations that were to be tariffed (Horsley 2018).

**Figure 2: Donald Trump on Twitter**

On June 15, President Trump declared in a short statement, that the United States would impose a 25% tariff on $50 billion worth of imports from China. Tariffs on $34 billion worth of products came into effect on July 6, and an additional $25 billion on August 23, with 279 goods’ categories listed. These tariffs targeted goods related to China’s strategic plan Made in China 2025 to dominate high-technology industries that would “drive future economic growth for China” (White House 2018). Made in China 2025 with Belt and Road Initiative poses cornerstones of president’s Xi global trade strategy.

A list of $200 billion worth of additional products – which were planned to be put under tariff already in September – was published on July 11, 2018. This list includes over 6,000 items (BBC 2018). The USA had been contemplating the implementation of the new tariffs, which could be set on imported goods at a level of 10% or 25%, depending on the recommendation of the United States Trade Representative (Martin 2018). A new round of tariffs, if imposed, may touch up to 40% of the whole trade between Washington and Beijing. September 6, 2018 was
established as a final day of the consultation period, and probably the most crucial point in the trade war between the two economical giants. President Trump told reporters, that “now we’ve added another U.S. $200 billion. And I hate to say that, but behind that, there’s another US $267 billion ready to go on short notice if I want. That totally changes the equation” (Churchill 2018).

**How did China react on imposed tariffs?**

As a response, China imposed retaliatory tariffs on U.S. imported goods. However, U.S. exports to China amounts of $129,89 billion, which is roughly one third of the amount that China exports to the U.S.

At first, China played it hard with the imposition of tariffs on $3 billion of the U.S.’ imports in response to the steel and aluminum tariffs in March 2018, and later in April threatened to levy 25% tariff on imports of 106 products from the USA (Partington 2018). But as the United States got bolder with the tariffs, with no signs of backing down, China changed its approach. At the end of April 2018, China proclaimed to cut car import tariffs by half (Bloomberg 2018). In May 2018, they offered to significantly increase purchases of U.S. goods and considered buying more U.S. coal to narrow the trade deficit (Bloomberg 2018). Fast forward to July 2018, the U.S. had not backed off after all these offers and applied tariffs on $34 billion worth of products and in August additional 16$ billion. This got the exact same retaliatory response from China on $50 billion worth of goods imported to China (Delaney, Lu 2018). Whether or not President Donald Trump will impose tariffs on all imports from China depends on the future development of the U.S.-Chinese relations.

**Impact on the currencies of the both rivalling nations**

With a much lower volume of imports from the United States, China is running out of goods to tax. Therefore, it uses other means to leverage the United States. One of those options is the Chinese currency, Yuan. The fluctuation of its value is controlled by the Central Bank of China, which is owned by the Government of China. As seen on the graph below, from to September of 2018 the Chinese government continuously devalued its own currency against the US dollar. Their reason for doing this was to make China’s exports cheaper and therefore more competitive against U.S. manufactures. However, China’s premier Li Keqiang insisted that Beijing had not been deliberately weakening its currency to make its exports weaker and had no intention of manipulating the yuan downwards in the future either (Elliott 2018). Although it brings about a risk of destabilizing the Chinese financial system, letting the Yuan weaken against the U.S. dollar softens the impact of tariffs on the Chinese economy, nearly to elimination (Guilford 2018).
Figure 3: Currency fluctuation graph of the Chinese Yuan versus American Dollar

The graph below shows the US dollar surging from its lowest point since February 5, 2018 to its peak of the last 11 months, May 9, 2018. This significant raise could be considered as a side effect of the tariff announcement. However, it instead shows that the tariffs haven’t had a weakening effect on the currency of the United States.

Figure 4: Currency fluctuation graph of the American Dollar versus stable Swiss Frank

Impact of the imposed tariffs on market and companies

Since the implementation of the tariffs, their impact on the market has varied. Michael O’Rourke, chief market strategist at Jones Trading in Greenwich, Connecticut, has explained the situation on the market: “The steel company earnings have been strong as a result of the tariffs the administration put in place already. Investors are worried that with the trade war escalating today it’s better to sell and take profits” (Carew, Dalgleish, Berkrot 2018). The situation he was describing was concerning the falls of the steel stocks on the U.S. market. They surged in May 31, 2018, shortly after the imposition of the taxes on steel and aluminum but went on to fall two weeks later in June 15, 2018 after the threat to impose new tariffs (Ravikumar 2018).

Newly imposed tariffs affect U.S. Companies who manufacture in China. Several big U.S. companies are changing their policies under trade war conditions, for example Ford has
decided not to import the Ford Active model to the United States from China (Williams 2018). Apple Inc. has commented on the imposition of the new tariffs as well, saying, that it is harming their production and will raise the price of the final product for the consumer (Salinas 2018).

In addition, the imposition of the tariffs had approximately similar impact on both Chinese and U.S. markets. This trend can be observed from the fact that China-vulnerable U.S. stocks dropped by 3.2%, while U.S.-vulnerable Chinese stocks dropped by 3.4% (Steil, Rocca 2018). Therefore, the impact of the tariffs on both markets is almost equal.

What are there experts’ opinions on tariffs?

Larry Kudlow is Donald Trump’s economic advisor. In his article he explains why tariffs have historically almost never worked as intended and almost always had an unhappy ending. Kudlow gives historical examples such as “The Smoot-Hawley Tariff Act of 1930. It was signed into law by Republican President Herbert Hoover and contributed to the Great Depression (Kudlow 2018). Kudlow then continues with the case of Richard Nixon’s 10% import surcharge, which contributed to the stagflation of the 1970s, and finally, “George W. Bush trying to save the steel industry by imposing tariffs on steel - if those tariffs worked, we wouldn’t be having this discussion today. We tried to save the color TV industry with protectionist measures and instead they wiped out the domestic production” (Kudlow 2018). Michael Froman, member of the Council on Foreign Relations and former U.S. Trade Representative under President Barack Obama, claims that “once tariffs are in place, they tend to be pretty sticky” (Stewart 2018), meaning that once the tariffs are imposed, it is quite difficult to get rid of them. One example of this is The Chicken War of 1963, when the United States put 25% tariff on imported trucks from the European Union as a retaliation where the European Union kept the United States’ chicken out of their market (Stewart 2018).

Trump claims “winning war on trade” with China at the 2018 UN General Assembly and China's response

On September 26, 2018, Donald Trump mentioned China in a speech that he was delivering at the UN General Assembly. Through the pattern of his typical rhetoric, he claimed that the United States is winning the trade over China. Speaking about the trade conflict between the United States and China he claimed, “Regrettably, we found that China has been attempting to interfere in our upcoming 2018 elections. They do not want me or us to win because I am the first president to challenge China in trade” (Alexander, Davies 2018). In November 2018, the United States will hold its midterm elections, where all seats in the Senate will be contested. Democrats taking over at least one of the Senate’s chambers would make Donald Trump’s governing as a Republican President much harder. In response to Trump’s speech, Chinese foreign minister Wang refuted the accusations later at the UN General Assembly meeting. He claimed that China has no interest and will not interfere in the elections of another country (Seznam 2018). On November 17, 2018, president Xi at the Asia-Pacific Economic Cooperation (Apec) summit claimed that “US-China trade war will produce no winners” and warned against any further escalation of tensions between the countries (BBC 2018).

Current de-escalation

The end of 2018 brought a significant shift in US-China trade war towards calming situation. After tariffs were imposed, escalation continued in rhetoric of the leaders on the both sides. USA planned to increase initiated tariff rates from 10 to 25 percent by January 1, 2019 and was

Progress in negotiations has been launched before December’s G20 summit in Argentina. Talks between the US president Trump and his Chinese counterpart Xi, which took place on the sidelines of the Leaders’ Summit, come under the spotlight of the entire world. A high-stakes meeting was considered as a turning point in the whole trade war. Hopes of a breakthrough over trade were pressed by companies and manufacturers in both countries which stressed, that escalation of trade war could mean higher costs and would in turn lead to higher prices for consumers (BBC 2018). Despite some negative predictions, personal meeting between presidents brought slightly positive outcome. President Trump and President Xi have agreed not to impose intended and the new trade tariffs for 90 days to allow for talks. Both sides work towards a larger trade deal as well. The new stage of negotiations started after summit and will continue in January 2019.

Conclusion

President Donald Trump kicked off the trade war as he announced tariffs on $50 billion worth of goods imported from China. This was met with retaliatory tariffs in the same amount being imposed on the United States’ imports to China. Later he threatened that if China imposes more retaliatory tariffs, then he will not be afraid to tax the entire volume of Chinese imports into the United States. However, if China decides to continue with retaliatory tariffs, it will quickly run out of goods to impose tariffs at. This is because the United States’ volume of imports to China is roughly one third of Chinese imports into the United States. Therefore, a trend has emerged throughout the last few. The Chinese government chose a nifty way to go around tariffs: letting the Yuan weaken against the US dollar. This move makes Chinese exports cheaper and more competitive, which mitigates effect of the tariffs.

President Donald Trump’s apparent lack of diplomacy and aggressive, business-like approach towards tariffs are noteworthy. In combination with assertive approach of China’s president Xi Jinping it represents the new era in China - US trade relations. With taxes and restrictions, he tries to “repatriate” all the belongings of the American nation with protectionist measures. Nevertheless, history has shown several times that this method is not generally met with positive outcomes. At this point, it is difficult to assess which side is going to come out of the trade war as a winner. However, current US - China trade war means significant threat to rules-based multilateral trading system.
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**Graphs/Figures**

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Figure 2: President’s Donald Trump Twitter Account. Twitter. @realDonaldTrump

Figure 3 and Figure 4: Reuters. “Currency converter”. https://www.reuters.com/finance/currencies.