The Economic Implications of the US-China Trade War

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China's Rise to Global Prominence

Throughout the last several decades, China has risen to global eminence. Before 1978, China had an annual 6 percent growth in gross domestic product (Hu, 1997). However, in 1978 China underwent an economic reform that has been cardinal to its growth. Since then, there has been an annual 9 percent growth, with a plethora of years peaking at 13 percent (Hu, 1997). There have been evident advances in several aspects of China's infrastructure, education, and healthcare. A few years ago, COVID-19 impacted China's economy largely but the country has managed to recover and is now at a steady rate of economic growth. The U.S. and China have a long-lasting trade history and are both among the largest export markets for each other. Trade between these two countries is essential not only for the Chinese economy but for the American and global economies as well.

Impacts of U.S. and China's Trade Relations on U.S. Stakeholders

The trade relations between these countries engendered numerous advantages for the United States. As a whole, consumers have benefited due to the decreased cost of goods. This happens because Chinese goods are often produced with a lower cost of production. Since China is a major exporter of low-cost goods, consumers pay less for goods like electronics, clothing, toys, and household items. Furthermore, the influx and variety of affordable goods from China have kept inflation in check thus, indirectly moderating the cost of living for many American citizens. U.S. firms have also seen an exponential increase in total revenue by accessing China's market. In a 2019 study by Xavier Jaravel and Erick Sager, an increase in trade between the U.S. and China augmented the purchasing power of the average United States household by $1,500 yearly between 2000 and 2007 (Siripurapu, 2023). Moreover, American firms have been able to generate hundreds of billions of dollars annually from sales in China (Siripurapu, 2023).

Contrarily, this trade relationship also posed various problems for U.S. stakeholders. Firstly, there is a trade deficit between the United States and China as the United States imports significantly more goods than it exports (Moschella, 2023). Secondly, there is speculation that when joining the World Trade Organization, China synthetically lowered its currency by accumulating U.S. dollar reserves. This was done because a weaker currency allows Chinese exports to be cheaper and U.S. exports to be more expensive resulting in a greater trade deficit between parties (Moschella, 2023). This then caused a loss of jobs in specific sectors of the United States, like the manufacturing industry. Over time, the United States had become driven by apprehensions regarding the trade deficit between countries, intellectual property theft, and market access barriers.

The U.S. Response

In January 2018, President Donald Trump took action by imposing tariffs and investment restrictions on China. These policies aimed to limit China's access to U.S. markets and prevent intellectual property theft, particularly in sensitive industries like semiconductors. This has, in turn, had pervasive impacts on American firms, consumers, and workers. At the time, the U.S. announced a 10% tariff on $200 billion of imports from China, whose retaliatory tariffs between 5% and 10% will apply to $60 billion of imports from the U.S. (Reuters, 2019). A few years later, President Joe Biden decided to further impede China's rise to economic power. In addition to the sanctions imposed by Trump, he has kept in place additional tariffs worth about $360 billion. Biden has also instituted export controls that limit Beijing's access to modern technology and prohibited some U.S. investment in sensitive technologies that could be used to support China's expanding military (Siripurapu, 2023).

Effect on U.S. Firms

Imposed tariffs and investment restrictions have created many impacts on United States firms. Firstly, many firms in the U.S., specifically manufacturers, rely on Chinese inputs to manufacture their final goods. However, due to tariffs from the United States, the price of those inputs has increased. This then increased the cost of production for Firms and has had implications for their total returns. Secondly, U.S. firms that export their goods to China also saw a decline in profitability. This is because China retaliated with tariffs of their own. Thus, increasing the difficulty to sell in the U.S. market. Overall, these firms have a loss in revenue not only domestically but also internationally. Third, the trade war has resulted in the stagnation of the Chinese economy. Therefore, the revenue generated from investments in the Chinese economy by U.S. firms has slowly diminished (Amiti, 2023).

Even U.S. firms with no trade relationships with China can also be affected. Trade tensions have caused an atmosphere of unpredictability, posing difficulties for firms in formulating long-term or future strategies. This has impacted many firms' overall investment plans. Additionally, some firms may also receive benefits from the U.S. tariffs, as the announcements of tariffs may increase the anticipated returns of domestic firms that compete with foreign imports (Amiti, 2023).

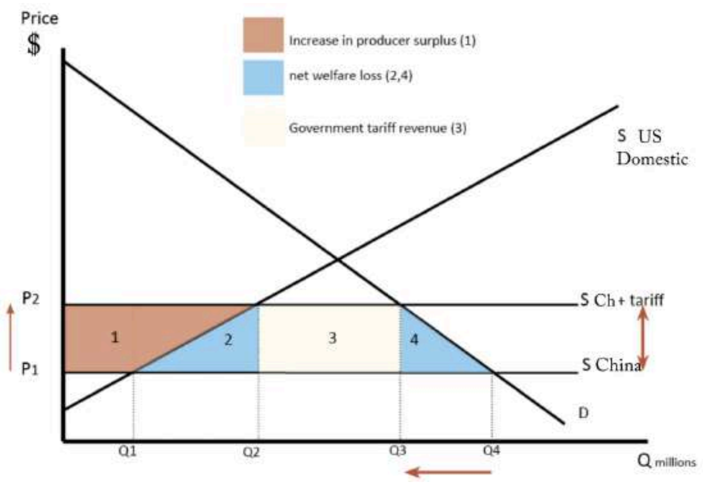

Fig 1. Effect of Imposed Tariffs on Free Market
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This diagram represents a tariff imposed by the government on a free market and its effects on producers and firms. Several different impacts are shown like the gain in surplus to domestic producers (1) and government tariff revenue (3) (Pettinger, 2019). It also shows the loss to consumer surplus (1, 2, 3, 4). It leaves a net economic loss of (2 + 4).

Effects on U.S. Consumers

Consumers bear the brunt of tariff-induced price increases. The U.S. tariffs on imports were almost completely passed to prices of goods in 2018 (Weinstein, 2018). At the time, a greater incidence of the tariffs fell on consumers, with minimal effects on costs for foreign exporters (Weinstein, 2018). With the rising prices of imported goods, household income is impacted leading to a decrease in their purchasing power. Therefore, a loss of domestic sales will occur. There is an additional cost of $14 billion to U.S. consumers and importers through tariff revenues (Weinstein, 2018). All in all, the U.S. government must find a balance between protecting United States markets and ensuring affordable access to goods for consumers.

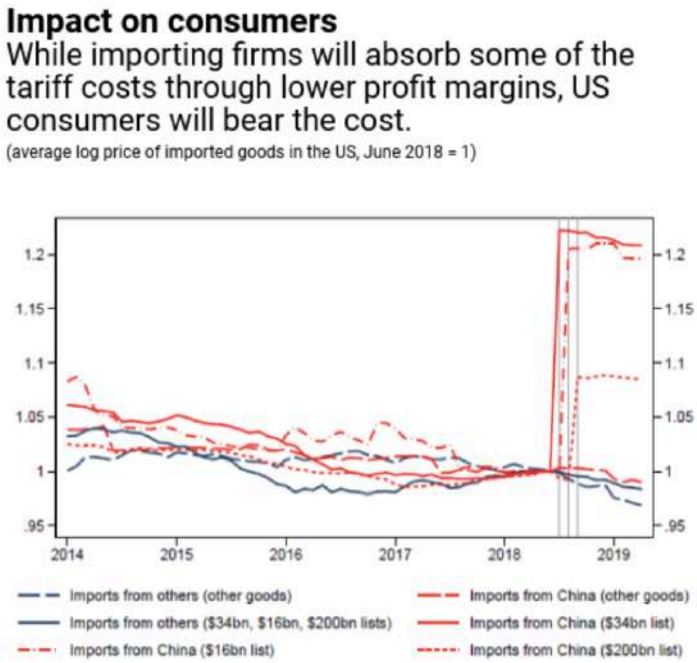

Fig 2. Tariffs' Monetary Effect on Imports
Cavallo, Gopinath, Neiman, and Tang (2019)

Effect on U.S. Workers

The trade war directly impacts the American workforce, particularly in industries vulnerable to tariff retaliation from China. Job displacement and uncertainties surrounding employment security become inevitable. Additionally, an even greater loss of jobs manufacturing industry has occurred. Ultimately, due to the trade deficit, 3.82 million people lost their jobs in the United States (Heritage, 2023). The increased issues caused by tariffs and investment restrictions have put many workers in the United States in a vulnerable position. It has fostered uncertainty regarding job security and has shifted employment patterns undoubtedly.

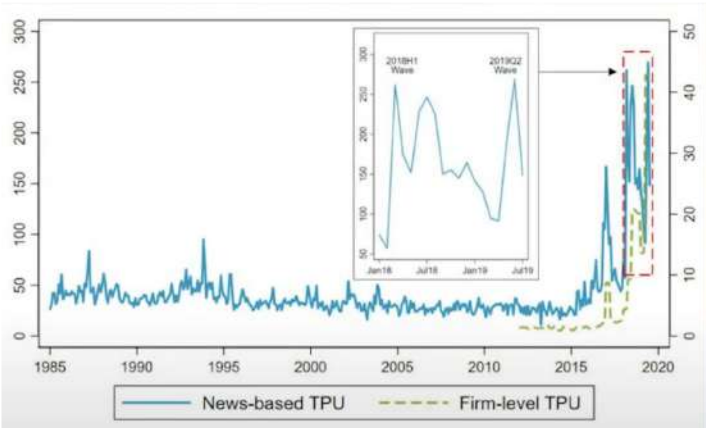

Fig 3. Trade Policy Uncertainty 1985-2019
Caldara, Dario, Iacoviello, Molligo, Prestino, Raffo (2019)
"The Economic Effects of Trade Policy Uncertainty"

Perspectives on the US-China Trade War

The United States and China trade war elicit many different perspectives. There are people in favor of the war, against it, and on both sides. People who stand with the war's ideals believe that the protection of intellectual property and the increase in national security are vital to U.S. society and economic sustainability. They see the positive impacts of the trade war like encouraging competition between markets and more research leading to technology advancements. On the other hand, many people are against the war and argue that its downsides outweigh its positives. They argue that this war is slowing down global economic growth and that there is no such thing as a bilateral trade war, rather it affects many other countries as well. They would show how these tariffs cause increased prices and underline the negative implications on consumers, producers, and workers. However, many people think that both sides have validity in their points. They understand that it is important to combat trade deficits and protect intellectual property. However, there must be a valid solution to these problems that solves them without any great impacts on society as a whole.

Truly solving the trade war would be close to impossible as there would always be trading tensions between two countries of great economic power. However, there are a plethora of things that can be done to ease the situation and return things to the way they were before the war. Firstly, both countries should prioritize diplomacy and ensure that they are working together on concerns. Additionally, having just up-to-date trade agreements is very important for maintaining an economic relationship. Investments in innovation and modern technology like artificial intelligence can be a way both the U.S. and China can foster economic growth. Whenever deciding upon deals or negotiations occur, both parties should keep the other's interests in mind and ensure that the trade deficit should not be put into greater order. Lastly, clear guidelines on the protection of intellectual property and market access can reduce trade tensions between parties.

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