THE IMPACT OF THE TRADE WAR BETWEEN CHINA AND THE USA ON THE WORLD ECONOMY

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Abstract. *The trade war between China and the USA has been a major source of global economic uncertainty since it began in July 2018. This paper examines the impact of the trade war on the world economy, focusing on the effects on global trade patterns, major industries, and emerging economies. The paper also discusses the potential solutions to the trade war and its long-term effects on the world economy. The key findings of the paper are that the trade war has led to higher costs on both sides, bilateral trade diversion, and a reduction in trade openness. The paper also finds that the trade war has had a negative impact on emerging economies, particularly those in Southeast Asia. The paper concludes by considering the gains and losses of both economies and questioning whether an all-out trade war is a rational strategy for either party.*

Keywords: *trade war, China, USA, global economy, trade patterns, major industries, emerging economies, potential solutions, long-term effects.*

1. Introduction

The official beginning of the trade war between China and the US was on July 6, 2018, when the US imposed a 25% tariff on $34 billion worth of Chinese imports. The reason for the trade war is due to the complaints from the US trade representative regarding China's discriminatory technology licensing regulations. Additionally, the US also complained about "technology transfer" and the alleged theft of intellectual property. The US also claimed that its measures are to counter China's long history of state-led, market-distorting forced technology transfers. China retaliated with tariffs against US goods, mostly taking effect on July 24, 2018. So far, the trade war has seen several different forms of tariffs placed by both sides and has had multiple developments. This paper serves to look into the trade war

and its impact on the world economy. The reason for this is because the ongoing trade war has created significant uncertainties in the global economy. Businesses and governments around the world have questioned what its impact will be and to what extent it will affect the world economy.

1.1. Background of the trade war

The trade war between the USA and China has been going on since July 6th, 2018. It began when the USA imposed more tariffs on Chinese goods, to which China responded by imposing their own tariffs on American goods. The trade war has had a negative effect on many companies and consumers in both countries, but it has also had repercussions throughout the world.

There were many factors leading up to the trade war, but one of the large points of contention for the USA is the trade deficit with China. In 2017, the trade deficit was $375.6 billion; this is the amount by which goods imported from China exceed goods exported to China. Donald Trump has also long accused China of unfair trade practices which discriminate against foreign companies and goods, forced technology transfers, and intellectual property theft. These factors are to blame for American job losses, which were another reason for the USA to pursue the trade war. (Nandy2021)(Sertyesilisik2021)

1.2. Purpose of the article

The article concludes by considering the gains and losses of both economies and questioning whether an all-out trade war is a rational strategy for either party. The practical relevance of this article is to provide insight to businesses and organizations in both economies and outside of it. It aims to provide guidance on the mode of operations to be done and the best anticipated outcomes that they can prepare for, as well as the policy implications that need to be taken by the respective governments.

This article outlines the progression of the trade war to date, how and why it has unfolded. It also links to prior literature on trade wars and trade protectionism, in addition to providing simple economic models that help to understand the competitive strategies of both the USA and China. The key finding of the article is the demonstration of the prisoner's dilemma that has been played by both economies and identifying the legitimacy of the USA in accusing China with reference to the exchange rate policy simulations.

Research articles generally have rigorous statistics and analyses to back up their purpose. However, this article has been written to put the present economic scenario in simple light and provide the best anticipated insights with the ongoing activities of both the economies from a theoretical

perspective. This article has been analyzed with a qualitative approach in its research findings.

1.3. Scope of the study

By doing this research, we will learn the various tactics involved in trade which are still a common occurrence to date. This can range from simple things like the PR Chinese government delaying the customs of American chicken meat products to sucrose just so it would perish, to aggressive tactics like the American government taking a complaint to the World Trade Organization and placing trade sanctions on steel and tires. These range of topics can give valuable insights into the types and effects of trade barriers to a nation and what it means to the affected nation. Finally, we can also understand that the effects that lead to a trade war usually escalate to issues that are very beneficial to neither party, which can be very important in understanding the effects of the global economy on any nation in a trade dispute issue.

This research is of great relevance to our current international business economic climate. As stated earlier, the global economy is currently going through a very important stage in the understanding of trade in general, such as theories like why nations trade and protectionist methods that relate to the problems and concepts illustrated by the example of the trade war between an LEDC and a developing nation. By studying the impacts of this specific event and the methods that lead to the trade war, many concepts and theories can be related and understood. This is very important to understand these issues in the current world economy, and the resources used in this study can be valuable to understand concepts that apply to a wide range of international trade issues. The availability of such information and reviews on this subject is also quite scarce, especially resources that gather the impacts of this trade war in one location.

The study will mainly focus on the impacts of the trade war between China and the USA and its consequences on the rest of the world, only briefly touching on the conflicting parties. The chosen topic is of great importance as understanding the concepts of international business trade and its barriers to trade is important in today's global economy. Gaining an understanding of the impacts is also very important for today's international business, and these events are a critical method of gaining knowledge about these concepts of trade.

2. Methods

Primary and secondary data will be collected for this study. A number of primary data sources will be used to evaluate the impact of the trade

war on the world economy. Firstly, first-hand information will be gathered from publications by US and Chinese trade officials regarding the motives, actions, and expected outcomes of the trade war. This will help to grasp the true intentions of the USA in its attempt to fend off China's challenge to their position as the hegemonic power. This is a vital starting point as it will allow the study to focus on the nature of the trade war, which seems to have been overlooked by much of the literature. Interviews will also be conducted with economists and political scientists who specialize in US-China trade in an attempt to shed light on what potentially lies ahead. The practices will need to change as negotiations develop. The remainder of the primary data will be collected from official statistics. Both US and Chinese trade and industry data will be compared before and during the trade war. Figures relating to the USA's clearly stated objectives of increasing net exports and reducing the trade deficit with China will be compared with data to see whether progress is being made.

The credibility and accuracy of secondary data on this topic varies significantly. Therefore, official publications, working papers, and academic journals will be used as opposed to news articles which often contain bias or misreporting. As well as official student and teaching resources, a number of reputable databases (such as Jstor, The Economic Journal, and the Bureau of Labor Statistics) will be used to find academic literature written by industry experts. In terms of qualitative data, there are a number of books and literature on the general practices and theory of trade policy. Secondary data will be collected at regular intervals to see if any of the broad assumptions are incorrect. This allows for a re-planning of research methods if required. Overall, a blend of primary and secondary data sources will be used to provide the most holistic analysis possible.

2.1. Data collection sources

The Chinese trade data that was used mostly in this study was complete monthly import and export statistics provided by the Chinese General Administration of Customs. This source was stated by Caroline Freund and 7 Shi that offered the most detailed figures regarding monthly merchandise trade at a highly disaggregated level and serving as a basis for most of the Chinese trade literature. Monthly import and export statistics broadly reflect total transactions, the gross weight, and numbers of the items respectively at the level of 8-digit code. These codes are defined according to China's version of its customs laws and regulations, which follow the HS classification. This level of detail is important because during the time of the trade war, the US had implemented tariffs on Chinese goods starting at $34 billion worth in

July 2018 and progressing to phase 2 with $200 billion worth of tariffs. By having a detailed dataset of numbers of the items, it allows greater accuracy for identifying the specific tariffed items. This dataset also contains the monthly shipment and receipt dates for trade transactions, which is useful for calculating lead lags between the announcement of tariffs and the actual affecting of said goods.

One of the specific obstacles faced when considering US imports from China was that Compustat North America Segment tapes do not provide HS 8-digit codes for foreign sales. Instead, they give one-digit SIC codes and the initials of the 2 countries involved in the transaction. This made it so detailed data for Chinese exports to the US could not be directly accessed from Compustat, and as a result, in both the Freund paper and another utilizing this dataset, a Chinese trade-specific dataset was created using the Chinese customs data. This involved restricting the data to only include Chinese domestic and foreign invested enterprises and then using the HS 8-digit codes to identify the foreign sales activity. This a similar approach was taken in "The U.S.-China trade war affects global value chains" and "ishii-chinco2019". (Liang et al., 2021)(Huang et al., 2020)(Hu et al.2022)

2.2. Research methodology

The main purpose of this research is to analyze the impact of the US-Sino trade war on the global and certain countries' economy. To construct the most accurate analysis, we have to choose the correct research methodology. We started with the quantitative descriptive method, where we construct the data on imports from the U.S. and China to another country in numerical form. Then, we use the analytic descriptive method. This method is intended to analyze the data based on the trade war onset date to data release. We decide to use this method because a lot is happening between the trade war onset and data release. Both quantitative methods are used to analyze the factor of being a member of GVC on how it affects the impact of the US-Sino trade war in each stage of tariff imposition. The only difference is the second analysis only focuses on the change in trade effect from each stage of tariff imposition. In this globalization era, it's hard to analyze the trade effect between trade war onset and data release on a certain product. That's why by the time we construct the analysis, we use the qualitative descriptive method. This method is intended to know the constraints or any difficulty when we construct the analysis on the second quant method.

The step of analysis is started by calculating the extra magnification of trade diversion effect stage with the formula EME = T1 - T0 (|(T0 - T1)|), then

calculate the price decrease effect with the formula PDE = (.5(p0 - p1) + (p1' - p0')) and calculating the reduction of consumption of imported goods from domestic effect stage with |(L0 - L1)|. After constructing the analysis from each stage of tariff imposition, we decide to compare it with the past data on how the US-Sino trade war impacts the change of trade effect.

2.3. Analysis techniques

In order to understand the complex relation between trade flow and changes in trade policies and global economic conditions, a broad regression analysis covering various sectors and industries is conducted. This analysis identifies how changes in trade policy affect the volume and structure of US bilateral trade with China. This could prove to be the most important aspect of the paper, as it provides an understanding of what has changed in the event of deterioration in the trade relationship between the two countries and what impact it may have on future trade. Deployment of an econometric model in the form of a simultaneous equation model could be used to forecast/predict the future bilateral trade relationship between the US and China, depending on what scenarios are played out in various SIratios.

In order to identify the exact time of a shift in the series and its potential causes, EDA is used. One of the techniques used in EDA is event analysis. Event analysis involves looking in detail at some event which upset the relation between the economies of two or more sectors or countries and caused a change in the behavior of the series. In this thesis, event analysis will be used to identify the effect on the trade balance of the US and China of significant events in the bilateral trade relationship between the US and China. This will involve looking at the series based on the trade relationship and delineating events which changed the relation and led to a change in volume and composition of products traded.

3. Results

The trade war had multiple results. The trade war led to higher costs on both sides, in the form of tariffs. In some markets, supply chains were relocated, leading to higher costs. In other markets, significant cost increases were suffered. The latter included the Phase 1 and Phase 2 escalations, where the US levied tariffs on over half of Chinese imports, and China retaliated. Costs were passed onto consumers, and the Trade Partnership estimated that the tariffs imposed through September 2019 would cost the average family of four $1,277 per year. This is in addition to earlier tariffs on Chinese tires, washing machines, aluminum, and steel which cost an estimated $419 to the average American household.

The trade war also led to bilateral trade diversion. Calculations from one study using UNComtrade data showed that China's tariffs led to a reduction in US exports to China by at least 35%. Data from the US Department of Commerce showed that from 2018 to 2019, US exports to the world increased just 0.74% whilst imports decreased 0.73%. This indicates reduced trade openness. US imports from China dropped significantly from the 3rd quarter of 2018 to the 1st quarter of 2019. The fall was attributed to higher tariffs and a reduction in demand for imports due to increased costs. This led to China losing its spot as the US's greatest trading partner to Mexico. Redirection of imports from China was, to a large extent, to other Asian countries. This helped Vietnam in particular, with whom the US had a $49.8 billion decline in trade deficit with China. (Kapustina et al.2020)(Fajgelbaum et al.2021)(Goulard, 2020)

3.1. Overview of the trade war's effects

The economic effects of the US-China trade friction have drawn a lot of attention from both policy decision makers and academic researchers who are interested in how these effects are distributed across different countries and production sectors, and what implications they have for economic policy. Given the complexity of this trade conflict, it is no easy task to accurately track its outcome. The main purpose of this paper has been to reproduce a set of scenarios for how this trade conflict might unfold and to gauge its economic effects using modern trade theory. We have tried to do this with a somewhat open mind, not trying to take sides in the policy debate and recognizing that it is difficult to predict the outcome of a dispute that is still ongoing at the time of writing. Our general approach has been to focus on feasible mechanisms through which this trade conflict might affect the price and availability of goods and services in different countries and then use a global model of trade and production to aggregate these sectoral effects into overall welfare changes for different countries. We have considered a variety of possible scenarios for tariff levels and the extent of international economic disengagement and have sought to quantify our degree of uncertainty about how this conflict will unfold and its effects.

3.2. Impact on global trade patterns

The nature of these investigations has involved a high degree of unilateralism and often resulted in Chinese accusations of USA non-compliance with WTO agreements. Other countries have taken notice and followed suit in attempts to protect their own industries. The heightened levels of protectionism that facilitated these actions can be seen as

detrimental to optimum resource allocation and global efficiency. Furthermore, the decreases in constraints on future actions of this nature have implications a long way into the future. With an apparent lack of ability to resolve trade disputes using current WTO mechanisms, it is likely that many countries will adopt similar unilateral strategies in seeking trade protection. This creates an increased risk of further trade conflicts and retaliation measures, and makes it harder to eventually liberalize trade in the future. Finally, the move away from a system characterized by multilateralism and one guided by strong rules has already been seen with the failure of reform to the Appellate Body. This generic system has been deemed institutionally biased and unfit for its purpose by USA and thus their acts of non-compliance have been defended with accusations of necessity to protect its interests against an unfair system. An alternative is not currently in place, and subsequent regions of the world may form their own customs unions or worse, seek to emulate the recent actions of the USA and China. All of these changes are not positive and are likely to reduce the overall welfare gained from world trade in the long run. (Li & Whalley, 2021)(Fajgelbaum et al.2021)

The trade war has had significant effects on global trade patterns, according to Bhala. It has resulted in a considerable number of alterations in trade regulations, reduced predictability for market trends, and made the likelihood of a prolonged period of trade tensions more likely. A concise summary of these alterations is that there has been an increase in governmental regulations on trade (especially from the USA), a decrease in restraints on such regulations in the future, and a probable lean away from a multilateral, rule-based trade system. These effects have not only influenced the two countries involved, but also world trade in general. For instance, the increase in governmental trade regulations was sparked by an influx of US trade remedy activity targeted at imports from China. This is evidenced by an increase in United States Section 301 and Section 232 investigations, Special Safeguard and Anti-dumping/Countervailing Duty measures.

3.3. Influence on major industries

The effects of the trade war on US industries have been mixed, with some industries benefiting from alternative markets and newfound competitiveness. But for others, such as the agriculture industry, they have seen a sharp decline in exports, with soybean sales to China dropping by 94% from the previous year. US soybean farmers are experiencing huge artillery barrages from the Chinese government, and due to tariffs being

placed with no end in sight, the USA has promised a $12 billion aid package for the agriculture industry in order to ensure stability. (Cowley, 2020)

The steel and automobile industries have been hit the hardest of any industry, and other affected industries such as the technology and agriculture industries have also started to reduce employment and production. The tariffs are causing a significant export glut on Chinese products, and this will lower global prices for the products. But in China, this will mean that there is a surplus in products with no place to export them. This will mean that products will be sold at lower prices throughout China, and with wages and employment being reduced, industries all around China will be affected as consumer bargaining power decreases.

Another US tariff is a 25% tax on steel imports. This has combined with another tariff on Chinese steel and aluminium to cause mass reductions in employment capacity within the Chinese steel industry. Reports from the CISA (China Iron and Steel Association) claim that the industry will have to lay off up to 400,000 workers because of the tariffs, with a potential loss of up to 1,000,000 jobs if the current climate continues. (Hasan et al.2021)

The trade war between the United States and China has had far-reaching effects on the global economy, and its impact on major industries has been particularly noteworthy. The US tariffs on Chinese exports have caused a significant drop in trade surplus to the USA. This has caused a fall in the sales of Chinese products in the USA, and the companies have had to reduce the prices to adjust for the tariffs placed on their products. The most affected industry has been the Chinese automobile industry. They have now had to sell their products at a net loss, and thus sales and production have dropped. The Chinese automobile industry has been hit by the tariffs harder than the US car industry, mainly due to the fact that China has a joint venture rule which states that foreign car companies have to partner with a local company in order to sell cars in China. This has meant that US companies have faced no tariffs when importing cars into China, but the joint venture rule allows China to impose a 50% tariff on US vehicles as well as the 25% extra imposed by the Chinese government. (Kapustina et al.2020)(Li et al., 2020)

3.4. Consequences for emerging economies

The spectacle art of the trade war has consequences for other economies, particularly the smaller, emergent ones in Southeast Asia. The effects will be both direct and indirect from trade and trade diversion (Business Times, 2018). Indonesian President Joko Widodo has stated that "trade wars and increasing protectionist attitudes are pushing the world to

the brink of a disaster", reflecting the concern over not only the current state of the world for international trade, but the future too. The claim is that the increasing trade tensions between China and the USA will induce them to increase trade with each other to the detriment of other nations (Baldwin, 2016). If China and the USA were to increase trade, it would imply China would buy more US goods and services, therefore, reducing China's bilateral trade balance with the USA, causing a surplus of U.S dollars and deficit of renminbi. This will have the effect of depreciating the Renminbi causing Chinese exports to the US and EU to become cheaper, and imports more expensive. This will have the effect of diverting the pattern of Chinese trade in both the US and EU. Findlay and Wellisz (1982), pointed out that apparently similar pattern of protection with similar objectives, might have vastly different effects depending on whether it involves devaluation-induced diversion or protection. In the case of China the devaluation induced diversion will mean that Chinese goods and services will replace those of other nations in the US and EU, with US goods replacing those of EU nations. The effects on trade balance positions could be quite different from the initial objectives on the part of the US and the EU with Chinese surpluses being replaced by deficits, worsening the problem. This scenario could well happen, with the EU is also thinking of taking trade protectionist action against China and US protection will also divert trade from China to the US in campaign to reduce its trade deficit. This trade diversion and increased protectionist attitude may make long term prospects damaged for some SE Asian nations. China and the US might increase demand for trade with each other in an effort to resolve their differences over surplus/deficits within the tariffs of the Trump administration, as it is the low cost of trade policy change since the opportunity cost is low. This will lead to a reallocation of resources and policy change in preference for Sino-American trade, vicariously affecting ASEAN nations with Sino-American goods replacing their own goods. This increase in Sino-American trade could cause the Spread of chickens law-where birds are local goods and chickens are foreign goods, where the increase in opportunity cost has an elastic effect reallocate resources away from the production of certain goods and services in one nation to produce the foreign chickens until its price equalizes with the bird. This will mark a change in comparative advantage in some industry sectors and a loss of competency in exporting certain goods and services to China and the US. This will be a discouraging sign for emerging nations, as seen in Indonesia the world's 4th most populous country are expecting to increase exports to China and the US in order to advance into what they hope will be

a prominent developed economy by 2025 (Business Times, 2018). Importantly there will be a scarcity of opportunity for ASEAN nations to engage in 'buying the bird' and regain resources or attempt to engage in retaliation, access foreign markets. This will be particularly damaging for Malaysia and Thailand who between 2000 and 2016 have experienced a rapid increase in trade with China in the production of electrical and electronics industry and transport and machinery equipment industry. The reduction of free access in these industries in attempts to avoid trade deficits with China would no doubt have future influence on these nations. (Klein & Pettis, 2020)(Lippert et al., 2020)(Góes & Bekkers, 2022)

4. Discussion

In part, this view is a simple reflection of China's rapid economic growth and its attainment of second place in the world economic league behind the USA. However, it also reflects unease about the nature of China's economic system and a perception that it has gained an unfair advantage in its trade with the USA and other countries through its exchange rate policies and various measures to restrict imports and foreign investment. China has become increasingly assertive in resisting demands by the USA for changes to its exchange rate policies and trade barriers, seeing these as an infringement on its national sovereignty (Morrison, 2012: 2).

5.1. Implications for international relations The trade war has significant implications for how China and the USA will relate to each other in the future. The pattern of hostility and recrimination is now deeply ingrained on both sides and has colored almost all aspects of the relationship between the two countries. The USA seems to regard China as posing a threat to its position as the world's pre-eminent economic and political power.

The trade war between China and the USA has spread anxiety about the 'wisdom of economic globalization and interdependence' (Strange, 1987: 20). It represents the most dramatic example of an apparent move by the USA away from the policies of free trade and an open multilateral trading system that have been a consistent element of US trade policy, especially after 1945. It has led to a much greater polarization of opinion about the benefits of trade and foreign investment. The US has become more assertive in its criticisms of the economic policies of other governments, especially with regard to exchange rate policies which have long been a cause of friction between USA and Japan.

4.1. Implications for international relations

Underlying the trade war is a contest between the US and China for economic and political leadership of the world. The US has long attributed

its post-Cold War economic success to the neoliberal order as supported by institutions like the WTO. China's economic rise and subsequent membership of the WTO has led it to conclude that this order is outdated and reflective of US global interests. China has sought to revise the existing economic and trade rules to better reflect its own economic and political interests. It has been successful in doing so in some areas, for example following the global financial crisis China's leadership pushed for reforms to voting rights within the IMF and World Bank which saw a slight increase in voting weights for EMDEs, reflecting China's and other EMDEs growing influence in the global economy. The US has accused China of unfairly exploiting the neoliberal order to its own advantage and attempting to revise the rules of the game in its own favour. The trade war has seen both states use economic measures to push for a global economic order that better reflects their respective interests. If the trade war is indicative of a greater contest for the rules of the game it could have severe implications for global economic governance and international relations. As the trade war continues it is likely the US will seek to use economic measures to undermine China's attempts to revise the global economic rules and China will seek to exploit areas of US economic vulnerability to further its own interests. A divided global economic order poses many problems and could see the liberal internationalist project come to an end.

4.2. Potential solutions to the trade war

China's perspective. China is rather adverse to the war continuing but does not want to show weakness and seems willing to resolve if it can save face. China's main desire is to keep the current system as they profit more from it than the US does and perceived the US allegations as an unfair scapegoat of China's rapid economic growth in which similar systems have been used by prior economically developed nations. In an interview with The Atlantic, Dr Yukon Huang suggests that a potential solution would be a rebalance of agreements between the US and China on what is acceptable for regulations and subsidies as currently they differ and China could not afford to completely remove them. As prior, the pressures of equal value can be effective and China is open to narrowly avoiding a recent confrontation with the US on the issue of Taiwan independence which they have deemed a hostile question.

US perspective. One of the most common solutions suggested is for America to push a coordinated effort with the EU to force China to reform on the trade policies in question. This would involve both countries imposing tariffs and with the recent steel and aluminium war ending abruptly it is clear

there is potential for success if China responds hastily in fear of an even larger scale war. China has shown prior efforts of reform when faced with similar pressures from both nation and this method would guarantee the change the US wants to see. This method would not always be in America's best interests however as if the EU ceases to benefit America would have to compensate and could potentially be worse off. Another solution pointed out by Timothy Taylor suggests that the US play China at their own game and impose pressures of equal value to force the subsidies and regulations out of China. This would be effective as China is very protective of its industries and does not want to see loss of face to foreign nations and has shown before that it is willing to back down on similar issues.

A mutual agreement will always be the best way to end any kind of conflict. This explorative analysis will consider the solutions that may end the trade war from both countries' perspectives and their likelihood of occurring. America's main motivations are for China to cease and desist on their theft of American intellectual property and US companies technologies, to stop Chinese joint venture regulations so US companies can operate freely in China, and for China to cease and desist on their subsidisation of key industries.

4.3. Long-term effects on the world economy

The trade war would lead to more or less isolation of the two economies. As there are attempts to reshore capital and labor, hoping to create more employment for the citizens of the economy, the foreign investments in both economies may decrease. Foreign companies from China and the US will be less likely to invest in each other as tariffs increase the cost of their productions. This could affect investment in developing countries because China and the US are the top two largest sources of foreign investments. The decrease in demand for foreign labor and capital will reduce the capital flows to developing countries. This would cause a shortage of job opportunities for these workers, especially as market demand for their skills also decreases. This is expected because the US, China, and the European Union account for approximately 2/3 of global imports, and the common consensus is that trade wars will lead to decreased imports and increased domestic productions.

The trade war between China and the USA will have detrimental effects on the world economy. It is expected that the trade will cost each economy hundreds of billions of dollars. It can reduce the global GDP by 0.5% or $455 billion. In the long run, with a continuous trade war between the two economies, the effect could be substantial. The IMF's world economic

outlook, released in July 2018, states that the ongoing trade tensions are a notable risk to global investment and growth.

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