

# The Looming USA-China Trade War and Its Consequences<sup>1</sup>

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*Abstract: This paper looks at the evolution of the US-China economic relations from their complex, strong, multi-dimensional co-dependency, built up along many decades, to their growing disengagement and rivalry, following the lose-lose option for a trade war. The analysis places the trade tensions against the backdrop of the international production structured into global value chains and production networks, stressing upon the inadequacy of the policies adopted by the two actors, primarily by the US, and demonstrating why the consequences of the conflict are expected to be negative. The clash of the two world economic giants, which has unrolled since the beginning of 2018, but has intensified especially in its second part, has disrupted not only the two rival economies, but also their other partner countries and the world economy as a whole. As such, in its final part, the paper focusses on the expected consequences of the trade war for the economies, companies and populations of the US, China, South-East Asia and the EU, concluding that the US-China trade war will have no winners and recognising its real rationale as the scramble for the economic and technological dominance of the world.*

*Key words: US, China, trade war, tariffs, economic and technological domination*

*JEL Classification: F13, F23, F51*

## 1. Introduction

Globalisation has deeply changed the setup and functioning of world industrial production and of the international trade. In the 21st century, their salient feature rests in their structuring into, and operating within global value chains (GVCs) and international production networks (IPNs). Manufacturing has become international, its whole process – from design, to delivery and marketing – being decomposed into segments of activities which are allocated to companies in various countries according to their comparative and competitive advantages, so that the final goods can be subsequently assembled and offered at optimal cost and quality levels. Integrating companies into GVCs plays an essential role in transferring technology and technical, organizational and managerial know-how to the developing countries, as well as in job creation, skills and competitiveness enhancement, production and foreign trade furthering and, ultimately, in stimulating economic growth. Affiliation to GVCs has been fundamental in attaining the „miracle” development and progress of some investment and export-driven economies with outstanding ascent, such as China and the „Asian tigers”<sup>2</sup>.

Against the backdrop of the current global production setup, trade in components makes the largest part of the world commercial exchanges, the majority (two thirds) of the global trade takes place within the GVCs and, as such, the fundamentals of the international trade are dramatically changed, at least in two major regards (Sally, 2013):

- (i) Exports have come to depend more than ever on imports, so that, in most economies, the value added abroad accounts for about 30% of their total export value, double the average proportion it accounted for in the 1990s.
- (ii) Services have gained higher importance, accounting for about 30% of the global exports value, on average (30% in China and over 50% in the US and the EU).

As such, when trade policies are reformulated, or when measures with an impact on the international trade are taken (especially by economies with a significant weight in the global economy, such as the US and

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<sup>1</sup> This title was registered at the *Romania-China Academic Round Table, Bucharest, 20-21 September 2018*, before the US-China trade war flared up and it addresses the time-frame precursory of mid-September 2018.

<sup>2</sup> South Korea, Singapore, Hong Kong, Taiwan, Thailand, the Philippines, Indonesia, Malaysia.

China), the current architecture and functioning of the world manufacturing cannot be overlooked, and that implies taking into account the following realities:

- GVGs transform into non-sense the mercantilist approaches built on the belief that “exports are good and imports are bad for the national economy”, as nowadays competitive exports vitally depend on large and free access to imported inputs;
- GVCs, which define the current reality of global production and trade, can maximize competitive advantages only provided that trade is free, economies are open to both foreign trade and foreign investments, private property is protected and the business environment is friendly and efficient;
- GVCs delegitimize any arguments in favour of traditional industrial policies which include, for instance, the selective protection and promotion of specific industries or companies (e.g. fostering “national champions”).

Acting within this reality, but trying to mold it in its favour in ways which defy free market economy rules, China is developing new industrial policy programmes (e.g. Made in China 2025, Internet+), aiming at swiftly climbing the technology ladder and becoming the „key stone” of the GVC that will buttress the global industries of the future. To that end and defying the same rules, it has used both the influx of foreign capital (FDI) into its economy<sup>3</sup> and, more recently, its own outbound direct investments (ODI)<sup>4</sup> – plus some other „unorthodox” methods<sup>5</sup> – to accelerate its access to, and mastering of the western state-of-the-art technologies.

On the other hand, amid the same reality of GVCs dominance, but seeming to ignore it or to believe that it can overrule it, the Trump administration also wants to tailor the world to US interests, but it hopes to get that by breaching the market economy rules in a different way: by introducing barriers to international trade (both to US imports and to some sensitive US exports), by hindering the free movement of entrepreneurial capital and even by trying to compel a partner country (China) to give up its economic development programmes. Ignoring, defying or even forcing the objective reality in which it develops its policies, the US will most probably come to feel the boomerang effects of at least some of these measures.

## 2. US-China relationship: from co-dependency to uncoupling and trade war

### 2.1 From codependency to uncoupling

US and China are entangled in a complex, symbiotic relationship of co-dependency, which has been built up gradually since the ‘70s, when both countries needed new recipes of economic revival and, as such, they turned to each other, trying to tap on their complementarities.

(a) The first and most obvious field was that of the *bilateral trade*: China, a low-costs country starting to implement the reforms of Deng Xiaoping, setting up a new export-led economic model and opening up to the global market, could deliver great quantities of affordable goods, while the US, a consumption-oriented economy, could provide for a large market, with high absorption capacity.

It is important to highlight that, more often than not, the American imports from China are considerably larger than the Chinese imports from the US, resulting in a significant American commercial deficit. In 2017, for instance, the US imported Chinese goods worth USD 505 billion, over four times more than China’s total annual imports from the US, worth only USD 130 billion. Such imbalances have kept generating trade deficits with China, year by year. The 2017 deficit, worth USD 375 billion (US Census Bureau, 2018), is undisputably large and chronic, but it only accounts for less than half (about 47%) the overall American commercial deficit - worth USD 800 billion in 2017 -, as the US are chronically running trade deficits with many other countries besides China. In 2017, there were 102 such countries worldwide (Roach, 2018).

Nevertheless, if before the outbreak of the global economic and financial crisis (2007), China relied heavily on external demand and exports to attain high economic growth, afterwards, it opted for a different strategy and its interests and aims have substantially changed. The country started the transition from its

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<sup>3</sup> e.g. Compulsory joint ventures with local companies, followed by forced technology transfers;

<sup>4</sup> e.g. Takeovers of selected western hi-tech companies which own advanced innovative capabilities and valuable IP portfolios, mainly by Chinese State-owned enterprises (SOEs), but also by Chinese private-ownership enterprises (POEs), all of them backed by the Chinese government.

<sup>5</sup> e.g. Imitation and copying, reverse engineering, industrial and cyber spying, IP theft etc.

investment and export-driven development model, to a new growth model led by domestic demand, consumption, services and high technologies. The shift has already resulted in a significant decline of its dependence on foreign, and specifically American, demand: in comparison with 2007, when exports accounted for 37% of GDP, in 2017 they came to account for only 18% of the Chinese domestic product (Roach, 2018). Therefore, while the Chinese economy continues to be driven to a certain extent by exports and as the US continues to be its largest market, following a decade of reforms focussed on economic rebalancing, China can now rely more on its domestic demand and better cope with the external pressures on its exports. Its dependence on the US market is gradually decreasing.

(b) A second realm of the US-China codependency was gradually formed by way of *investments while the international production system configured into GVCs and IPNs has developed*. To tap on the cost advantages presented by China, more and more western companies, American ones included, have relocated segments of their industrial activities to this country, building international supply and production chains and integrating China in them. The (segments of) activities initially transferred to China were mainly in the low value-added range, i.e. placed in the middle of the production chain (assembling, finishing, packaging, delivery), while the „chain ends”, which add much more value to goods (RDI<sup>6</sup>, design, planning etc., at one extreme, and marketing, branding, advertising etc. at the other) were usually retained further on in the western units of foreign companies. However, all parties enjoyed benefits: foreign firms obtained diminishing costs, improved productivity and competitiveness and higher profits, while Chinese companies benefitted from FDI, new jobs, skills, technologies and the diversification of industrial activities, plus know-how transfer, increased production and export, access to new export markets etc.).

At the same time, trade within GVCs between the American MNCs<sup>7</sup> and their units or partners in China, has contributed to the growing US trade deficit with this country. However, one should note that statistics may be catchy in this respect and should consider the following:

- First, that Chinese exports by foreign-invested companies account for a large proportion of the overall Chinese exports (46%, in 2014) and their weight is even larger when the destination of exports is the US (60%) (Lovely & Young, 2018). In other words, what appears at first sight to be Chinese exports to the US, might in fact be – with a high probability (60%) - those of some western businesses, American included;
- Second, that according to OCDE and WTO data, at least 40% of the US trade deficit with China results from the functioning of the world components supply chains: China is supplied components from all over the world to assemble them into final goods and then export them to various destinations, primarily to its largest market, the US. As they leave China, these goods are registered as Chinese exports, although they incorporate parts produced and value added elsewhere. In other words, not all the exported value recorded as Chinese, is Chinese production. A considerable part of it is produced in many other countries. According to Roach (2018), if the GVCs effect could be removed and only the value added by China would be considered, then China’s weight in the US trade deficit would fall from 47%, to about 28%.

For now, due to their companies’ tight integration into GVCs, US and China maintain a strong relationship of co-dependency in terms of international production, investments and trade, but that is going to change once the trade war and the growing technological rivalry between them will lead to the reconfiguration of the GVCs and IPNs, or, potentially, in the longer-run, even to a wholly different architecture of the world manufacturing and trade, as well as to a new world order. Far away as they might seem today, such mutations are on the great powers’ agendas and they may become reality sooner than they seem now. China, for instance, has reinforced its economic development approach with selective industrial policies (e.g. Made in China 2025, Internet+, national champions etc.) with a view to gaining technological prowess, restructuring regional and global value chains in the industries of the future and remodeling the entire global order according to its national interests. That obviously implies not only the uncoupling from the US, but fighting against the US for economic, technologic, military and strategic supremacy.

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<sup>6</sup> Research-Development-Innovation

<sup>7</sup> Multi-National Companies

(c) A third area of bilateral dependency is *technology*. To do away with its technological backwardness, for many years China has pre-conditioned the access of foreign companies to its market, by *technology transfers*. Foreign companies looking to access China's market were legally bound to set up joint-ventures with Chinese partners and to give them access to their technology. Sometimes they were even lured to remise their IP<sup>8</sup> rights. Eager to get access to a huge and growing market, to the local comparative advantages and economies of scale, foreign companies, the American ones included, usually accepted to give away their technologies, knowledge, good practice and know-how and to train the Chinese employees. Additionally, besides benefitting from these transfers, Chinese firms have also practiced intensively the reverse engineering and copying of western products, advancing gradually to a stage when they could improve and diversify those products by their own innovating effort. Also, in time, quite many of the American and other western companies decided to tap on the local pool of creative talents and transferred to China parts of their research-development and innovation activities.

All these developments in the bilateral relation of the two countries contributed, this time, to creating a third form of strongly asymmetric co-dependency involving the *technology, knowledge and know-how transfers*. Aiming at building a knowledge-based, technology-driven economy and society, China is increasingly investing huge amounts in its own research and development, making significant strides in various research fields, but the gap that separates it in this respect from the western economies, and especially from the US, is still sizeable. Despite all its great efforts, China was and still is highly dependent on the US and on other western technologically-advanced countries<sup>9</sup>.

To bridge the technological gap sooner, besides using the FDI inflows to its economy in the manner described above – a method which it will have to abandon rather soon, under the international pressure -, China has started to transform its outbound investments (ODI) into a means of getting access to the state-of-the-art technologies of the West. Both the Chinese state-owned enterprises (SOEs) and the privately owned ones (POEs), backed by the Chinese state, have started to implement the „going out, going global” (2002) and „Belt and Road” (2013) governmental strategies, aiming at acquiring some of the most valuable western strategic and high-technology assets, with the final purpose of taking over their research capabilities and IP portfolios and use them to propel China's technological ascent. Obviously, the better China attains its technological development goals, the sooner its economy will be technologically uncoupled from that of the US and the two countries will become fierce rivals.

The record acquisitions of numerous famous industrial assets finalized in 2015 and 2016 by Chinese enterprises, especially in Europe, but also in the US, as well as China's industrial strategy focussed on fostering ten industries of the future<sup>10</sup> (Made in China 2025) alarmed and worried the targetted countries and triggered their prompt backlash. Particularly the US acted very firmly by restricting certain sensitive exports and by reinforcing and tightening the mechanisms of *investment screening* through CFIUS<sup>11</sup> and FIRMA<sup>12</sup>. The EU is following a similar path. Both the new western vigilance and the Chinese measures aiming at forbidding and/or getting rid of „irrational” acquisitions have led to a major drop of the Chinese takeovers of US and EU high tech assets, in 2017 and 2018. For the US-China relations, such developments may be also considered elements of an uncoupling process in progress.

(d) Another facet of the US-China co-dependency is that reflected in the *financial* sphere, also reliant on the complementarities of the two economies: in the US, savings are very low, while investments and consumption - as a part of the American culture (consumerism) - are high, always above the level of total savings, whereas in China, on the contrary, the population still maintains a large propensity for frugal consumption and high savings, companies and institutions are also saving and such a behaviour results in the accumulation of considerable financial reserves. Additionally, for many years China has been running significant trade surpluses and has kept attracting huge FDI which contributed to the accretion of the *all-time*

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<sup>8</sup> Intellectual Property Rights

<sup>9</sup> For instance in the household appliances industry, where China is the global leader, the basic technologies are mainly of American, Japanese or South Korean origin, in the automotive industry, they are mainly German, American, or Japanese and in the photo voltaic (PV) panels industry, they are German (Pencea, 2017).

<sup>10</sup> State-of-the-art information technology (IT), artificial intelligence (AI) and robotics, airplanes and aerospace equipment, high-tech ships, high-speed trains, vehicles propelled by new energy sources, new materials, energetic equipment, high-tech agricultural machinery, biopharmaceuticals and high performance medical equipment.

<sup>11</sup> Committee on Foreign Investments in the US.

<sup>12</sup> Foreign Investment Risk Review Modernization Act.

*largest foreign reserve in the world*, reaching annual levels between USD 3,000 billion - USD 4,000 billion, in the last decade.

To make its budgetary deficit good, the US needed to repeatedly issue treasury bonds, while China, until not long ago, chose to capitalize safely on its foreign reserves by investing in American or other countries' state bonds. As such, China has come to hold in its external reserve US treasury bonds worth USD 1,300 billion, ranking first in the world in this respect.

However, more recently, the strong *financial co-dependence* established for many years between the two countries is weakening too. China has been taking steps in this direction for some years, by either acquiring other securities, or by redirecting its disposable foreign reserves towards outbound direct investments and loans, while implementing the „going out, going global” and the Belt and Road strategies. Numbers are relevant in illustrating the change that is already unrolling as regards the financial co-dependency of the two: during 2013-2017, in only five years, the weight of the American treasury bonds in the overall Chinese external reserve has dropped by 10.1%. And the process is going on. According to Roach (2015), as China will also more firmly shift from saving surpluses and financing American consumption and investments, to using those surpluses „... for building a safety net to Chinese citizens”, the United States will „... find it tough to fill the void.”

(e) Finally, there is another US-China bilateral linkage that has become, in time, quite close and significant in the field of *academic relations*. Over 300,000 Chinese students are studying yearly in the US, many of them are getting their doctor's degree and/or are remaining in the US to work in research, banking or in large corporations. Other graduates travel to the US to exchange experience. According to the American National Science Foundation, 92% of the Chinese students were still in the US five years after their graduation (GCP, 2018). On the other hand, tapping on the bilateral academic exchanges, the American professors, researchers, students and artists had also much to gain from their exposure to oldest, uninterrupted civilization of the world (Bader, 2018).

But the trend is shifting in this field too, and the Chinese policies aimed at attracting the graduates back home are increasingly more successful, as both the wages offered as part of their „return package” and the funding available for research programmes are now similar in China to those in the US. At the same time, in the US, these highly-educated experts are, more recently, openly accused of spying and of IP theft, president Trump expresses his doubts as regards their presence in sensitive activities, such as the US research, and he wonders if it is worth offering them US scholarships in the future. This kind of pressures help many of the graduates decide to return home and it enlarges the trail of „sea turtles”<sup>13</sup> that go back to China to give a major boost to the Chinese national research, industry, finance and education and to contribute to speeding up their country's advancement to the top technological prowess. This outcome is exactly what president Trump wants in principle to obstruct, but in fact he encourages to happen through his messages and actions.

Numbers are quite impressive. According to Chinese statistics (Ministry of Education), the number of Chinese students studying abroad raised to 540,000 in 2016, 37.6% larger than in 2011, while the number of the returned (430,000) increased by 57% during the same time-frame. Among the returned, 11,1% had a doctor's degree (GCP, 2018).

All the developments that are unrolling in the five main realms of US-China co-dependency are redirecting their bilateral relationship towards uncoupling and increased rivalry. They have been generated by the major changes undergone by the two countries, mostly during the recent three decades. Without elaborating here on the complex transformations of the two great powers, we confine to briefly pointing out some of the main changes that are worth mentioning in the light of our subject matter.

On the one hand, as regards **the US**, the terrorist attack of September 2001 led to some subsequent unilateral US decisions subsumed to the „anti-terrorist fight” that involved bending international norms and rules. This was an unfortunate signal, that might have shaken the belief of many developing countries' leaders, the Chinese leadership included, in the western principles-and-rules-based system, in which each and every actor should theoretically observe, without exception, the same, binding-for-all, rules.

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<sup>13</sup> Affectionate naming by the Chinese of the their young, who left home, travelled far way overseas in search of the best education and then are returning home, bringing everything they have accumulated to contribute to the progress of their motherland.

Secondly, the global economic and financial crisis of 2007-2010, that was triggered by the US, has badly damaged the western world, demonstrating that the western economic development model was not in reality as strong and stable as it had seemed to be. Again, this might have shaken China's trust in the western way and its resolution of following it, the more so as **China** itself managed to navigate very well through the crisis, recovering very quickly, turning the crisis into a range of opportunities and helping, at the same time, other countries to cope with its misfortunes.

Moreover, as opposed to the lengthy malaise of the developed countries in the aftermath of the global economic crisis, its own success has encouraged China to become more vocal and assertive at global level, to trust more in its own development solutions and to proclaim and promote its own development model as more performant and efficient than the western one. Its domestic reforms and evolutions in the recent five to ten years have also changed China considerably and contributed to moving it away from the western model, which it had seemed to target in the 1992-2001, but it obviously abandons now (Rosen, 2018). Among these:

- ✓ The change of its development model from export-led, to consumption-driven growth;
- ✓ The rebalancing its economy from manufacturing to services, from traditional, labour-and-resources-intensive industries, to high tech, knowledge-and-skills-intensive industries, from polluting heating, manufacturing and transport, to green, renewable energy use;
- ✓ The reinforcing of selective industrial policies (e.g. Made in China 2025);
- ✓ The reinforcing of the Chinese Communist Party's (CCP) and Chinese state's involvement in the macro and micro-economic management of the economy and the consolidation of SOEs, envisioned to become national champions;
- ✓ The increasingly vocal claim of having a more sustainable alternative development model distinct from the western one. „*The key distinction drawn is that the western model is just market oriented, while the Chinese model uses markets to allocate some resources but the state, represented by the Communist Party, to run the economy.*” (Rosen, 2018);
- ✓ The devising of strategies aiming at establishing China's regional and global domination (e.g. Belt and Road, with both its land and maritime components);

For short:

- China gives up its long-preserved ambiguity regarding the nature of its system and its tacit option of adopting western norms, vouching that its system is different;
- The US no longer considers China a country in transition to the western system of norms and rules, it defines and treats it as a *strategic rival* and it switches to *disengagement*.

Until recently, the US-China co-dependency has acted as a brake to the escalation of distrust and confrontation, preserving a certain global balance and the world stability. As the US and China are now gradually shifting from co-dependency to uncoupling, strategic rivalry and trade war, major risks to the global stability are nurtured.

## 2.2 The US-China trade war synopsis

Since the US presidential elections and all along his first mandate, Donald Trump has often spoken about the huge and unjust trade deficit with China, about China's unfair practices in international trade, competition, market access, forced technology transfers, IP protection and development strategies. By the end of 2017, and especially between January and September 2018, the American president has complemented his critical discourses and threats, with concrete decisions and actions: he started to raise in stages, the tariffs on the US imports from China, and China retaliated similarly to each of his measures. US and China, the first two largest economies and commercial powers of the world, were at war, a trade war. In the way they selected the lists of products, sequence and the tariff levels, each of the two actors tried to hit the most sensitive areas of the other, without hurting itself too much. In a world dominated by GVCs this is a very difficult undertaking, the more so as the confrontation keeps escalating and not many fields remain untouched.

Looking at the big picture of trade hostilities (Table 1), one finds out that in 2018 there have been three significant rounds of import tariff rises, doubled by retaliations, involving lists of goods worth a total of USD 360 billion (2017 levels), of which USD 250 billion American imports and USD 110 billion Chinese ones.

By the end of 2018, about half of the American imports from China (worth USD 255 billion) and only 15% of the Chinese imports from the US (worth USD 20 billion) were still unaffected by the tariff war.

**Table 1: The US-China trade war synopsis (USD, billion; %)**

US-CHINA TRADE, 2017 <sup>14</sup>	TARIFF INCREASES IN US-CN TRADE, 2018	
	US	CN
<ul style="list-style-type: none"> <li>➤ CN exports to US      \$ 505 bn.</li> <li>➤ US exports to CN      \$ 130 bn.</li> <li><b>TOTAL TRADE:      \$ 635 bn.</b></li>   <li><b><u>US TRADE DEFICIT:</u></b></li> <li>➤ US Total*              \$ 800 bn.</li> <li>➤ US vs. CN              \$ 375 bn.</li> <li>US vs. CN              46.9%</li> </ul> <p><i>*US is currently running trade deficits with 102 countries</i></p>	<ul style="list-style-type: none"> <li>▪ July:      \$ 34 bn.*      \$ 34 bn.*</li> <li>▪ August:   \$ 16 bn.*      \$ 16 bn.*</li> <li>▪ Sept.:     \$ 200 bn.**      \$ 60 bn.***</li> <li><b>TOTAL:     \$ 250bn.      \$ 110bn.</b></li> <li><b>                 \$ 360bn.</b></li> <li>(56.7% of the bilateral trade)</li>   <li>Still unaffected by tariff rise:</li> <li>                 \$ 255bn      \$ 20 bn.</li>   <li>✓ US raised tariffs on goods worth \$250bn./49.5% of its imports from CN</li> <li>✓ CN raised tariffs on goods worth \$110bn./85% of its imports from the US</li>   <li><i>* new tariffs raised to 25%</i></li> <li><i>** new tariffs raised to 10% and, potentially, further, to 25%, by December 2018</i></li> <li><i>*** new tariffs raised to 5%-25%</i></li> </ul>	

Source: The author

It is significant to notice that in the first US list of imports from China, worth USD 50 billion, to which tariff increases of 25% were enforced in two stages (USD 34 bn. in June and USD 16 bn. in August, 2018), about 95% of the items were intermediate and capital goods needed by the American and foreign manufacturers located in the United States. The second US list of imports from China, worth USD 200 billion, to which tariff increases of 10% were enforced, in a first stage, in September 2018, included more consumption goods demanded by the American population.

At first, for an obvious reason, the retaliatory measures taken by China targeted the US agricultural products and food produced in the states that had voted president Trump, but then, they also aimed at other products, including components and other inputs for the Chinese factories that assemble for export. China could not parallel dollar per dollar the American measures, because it imports much less from the US, than the US does from China, and also because some American products - such as the semiconductors - are vital for its IT&C giants.

### 3. Expected consequences of the US-China Trade war

#### 3.1 The United States

**The American producers** were the first to feel the impact of increased tariffs, both as importers of intermediate and capital goods from China, and as exporters to the Chinese market. Some of them were affected only by one of these tariff increases (either that of the US, or China's), but others - who either import components and industrial equipment from China and then export there the final goods, or they first export machinery and components to be assembled in China for subsequent import of the goods assembled - were hit

<sup>14</sup> The 2017 bilateral trade volumes were the ones used as reference in all the analyses, debates, negotiations and decisions regarding import tariff increases in US-China trade.

twice. According to a study by Lovely&Yang (2018), some of the most affected companies will be the American MNCs that assemble final goods in China from parts made in the US. In their opinion, 87% of the items affected by the new tariffs are those of the non-Chinese MNCs and only the balance of 13% are items produced by Chinese firms. Another study, by the Federal Bank of San Francisco pointed out, back in 2011, that for each dollar spent on a product made in China, 55 cents are for services produced in the US (NYT, 2018). That means that the import barriers to their access on the American market impacts the US suppliers of such services more than they hit the Chinese firms.

The US import tariffs are ultimately paid by the American consumers and producers, not by the Chinese ones, and, usually, the country that imports more is prone to suffer more from a trade war. That's the case of the US, at least theoretically, in their trade relationship with China. Some of the affected American companies may decide, in case they can, to absorb the additional costs and diminish their profits. Others, may transfer those costs to the consumer, risking to lose clients, market shares and, again, profit. As exporters, they are also at a disadvantage in the international markets, where they may meet competitors which don't have these additional costs and, as such, become more competitive by comparison. In fact, more accurately, what happens is that the American companies lose competitiveness and, consequently, they are forced to find ways of either reducing costs, or increasing the value added to their goods.

To cut costs, US companies may try to replace their Chinese suppliers or assemblers, but normally, in a GVC, the market forces had already optimized costs, therefore the chance of finding replacements may be reduced, while the costs of identifying and integrating them efficiently into the GVC might be quite high and time-consuming. Some companies might also decide to postpone their investments and development plans, to cut other costs, freeze wages, fire personnel etc. Others might decide to relocate their activities in low-cost countries which are not subject of either the American, or the Chinese higher import tariffs.

On the other hand, there are many American companies - from Starbucks, Nike and Apple, to General Motors (which sells more cars in China than in the US), Ford and Boeing – that have developed great businesses in China. These companies, to which China became a key market, might suffer the consequences of the trade war not only by way of higher tariffs, but also in case Chinese consumers decide to boycott them, refusing to buy their goods and services. This has happened before in China's disputes on goods and services offered by South Korea, Japan, or the Philippines, and it might happen again (NYT, 2018).

To conclude, the impact of the new import tariffs on the US companies, reflected in higher costs, diminished competitiveness and profit, lost jobs, efforts to redesign the supply chains and/or to relocate production in low-cost countries unaffected by the trade war, is not at all what the Trump administration intended (i.e. more orders for American companies located in the US, more jobs in the US domestic labour market, the return in the US of the American firms relocated in China and elsewhere etc.), but on the contrary.

**The American consumers** might not have felt a too strong impact from the first two rounds of tariff raises, which were focussed on the American companies and farms. Therefore, the impact on consumers was indirect, mild and objectively delayed. It was also additionally diluted by the fiscal and monetary measures taken in advance by the American administration: tax cuts for companies and gradual increases of the benchmark interest rate. The tax cuts have given a quite vigorous boost to the US economic growth, while the repeated interest rate increases have attracted dollars back into the American banks, contributing to the strengthening of the US currency. This has attenuated the potential decline of the American consumers' purchasing power due to rising prices.

As elsewhere, the American consumers have long benefitted from low inflation levels backed up by the abundance of cheap goods imported from China. However, the higher tariffs levied on Chinese imports may generate an inflation leap, especially when more consumer goods will be targeted. As compared to the first two rounds, the third round of tariff increases (of September 2018, worth USD 200 billion) included more consumer goods (47%) and the increase was deliberately moderate, to only 10%, specifically to protect American consumers. But it also provided for potential further tariff increases, to 25%, in case US-China negotiations fail<sup>15</sup>. If tariffs on the consumer goods imported from China do reach 25%, the impact on the the American consumers will be direct and considerably stronger than before.

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<sup>15</sup> Following a three months truce (January to March 31, 2019) agreed by the end of 2018 with the purpose of gaining time for negotiations, the expected US-China deal didn't materialize and, on May 10<sup>th</sup>, 2019, the US Administration did increase the import tariffs again, to 25%, for the USD 200 billion third tranche of Chinese imports. In retaliation, the



It is worth mentioning here that a dollar that became stronger, as described above, as well as a RMB (yuan) that is currently depreciating are expected to trigger developments contrary to president's Trump intentions when he decided to change tariffs: a stronger dollar will discourage American exports, while a declining yuan will stimulate the Chinese ones and that will negatively impact the hoped-for rebalancing of the Balance of Trade. The US trade deficit with China will not decline, but on the contrary, it might grow.

**The American economy.** Trade policy is not the adequate tool for the American trade deficit correction, which results from a structural problem of the US economy and, as such, it needs different solutions. The root cause of the US sizeable trade deficit (with China and with other 101 economies of the world), is the low propensity to saving of the American population, coupled with the American society's high propensity to consumption and investments. American yearly domestic investments systematically overtop annual savings and, as such, to make ends meet, the US needs to attract capital from other sources, year by year, perpetuating and aggravating its trade deficit.

On this topic, Joseph E. Stiglitz, a Nobel prize laureate in economics, says: "... *macroeconomics always prevails: if the United State's domestic investments continue to exceed its savings, it will have to import and have a large trade deficit. Worse, because of the tax cuts enacted at the end of last year, the US fiscal deficit is reaching new records – recently projected to exceed \$1 trillion by 2020 – which means that the trade deficit will surely increase, whatever the outcome of the trade war.*" Also, he adds that „*The „best” outcome of Trump's narrow focus on trade deficit with China would be improvement in the bilateral balance, matched by an increase of an equal amount in the deficit with some other country (or countries).*” (Stiglitz, 2018)

Trade surpluses and deficits are not the equivalent of surpluses and deficits in a company's balance sheet, as the Trump administration seems to treat them. The deficit is not necessarily a loss, and the surplus is not profit. For the USD 375 billion paid to China in 2017 for imports in excess of the amount cashed from China for their exports, the US received goods of equivalent value which, on the one hand, met the demand of the American companies, upheld their production, competitiveness and profits, and helped increase the amounts collected for the state budget by taxation, while, on the other hand, they met the American population's demand for affordable consumption goods, contributing to a low inflation, higher purchasing power and better living standards. Nevertheless, by increasing the import taxes all these advantages disappear: the American companies will have to adjust, making suboptimal choices that will impair their performances (at least in the shorter run), while the American population will face rising inflation and diminishing purchasing power.

According to EIU<sup>16</sup>, the US-China trade war will impinge especially on the US, and its outcomes will burden mainly the American citizens. They will have to bear a higher inflation, raised by 1.5 p.p., as compared to its previous level, before the trade war outburst (Warner, 2018). Also, according to a preliminary prediction by Kirill Borusyak, from Princeton University, and by professor Xavier Jaravel, from London School of Economics, the new tariffs introduced by both the US and China will lead to additional monthly costs of USD 127, for each American family (Bryan, Gal & Chang, 2018).

Most economists also expect an additional cost materialized in lost jobs and in slowing economic growth. It is difficult, for now, to estimate the potential job loss, but only for the first tariff increases enacted on steel (to 25%) and Aluminium (to 10%), which had been supposed to salvage 30,000 American jobs in those two industries, it seems that the rising import tariffs will, instead, generate the loss of 432.700 jobs in a diversity of downstream industries: from a relatively low number of lost jobs in the fields of transport by pipes, food, chemicals and wood processing, to machinery and equipment, automotive and auto parts (about 10,000 lost jobs, by each), communications, metal components and financial services (15,000 lost jobs each), to construction (60,000), trade and distribution (about 100,000) and a large range of services (180,000-200,000).

As the propensity for saving is chronically low in the US, but still strong in China, the trade imbalance between the two might persist for many years on. Until now, in opposition with president Trump's expectations, but in keeping with the predictions made by numerous economists, the trade deficit with China has been prone to rising. A survey by the *National Association of Business Economics*, carried out in August 2018, when many of the tariffs were still unchanged, showed that 91% of the economists interviewed about the consequences of increased import tariffs, thought that these will injure American economy and that other rising

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Chinese Ministry of Finance announced that, starting June 1<sup>st</sup>, 2019, they will also increase import tariffs to 25%, on 2,493 American products (Heeb, 2019).

<sup>16</sup> Economist Intelligence Unit

tariffs rounds should be abandoned. Obviously, the American administration didn't take these opinions into account and US import tariffs continued to be driven up. We expect that this trend will continue.

Still, the solution for the bilateral trade imbalance is not a return to protectionism. Structural imbalances should be corrected by fiscal policies and other means that address the American low savings and the Chinese low consumption. However, if stimulating consumption in China might seem easier to accomplish because it is, to a certain extent, a natural trend, stimulating savings in consumerist US, at the expense of high consumption, might prove extremely challenging, unpopular and very risky for politicians, discouraging, as such, even the idea of any attempts in this direction.

According to Jeffrey D. Sachs (2018) Donald Trump's „... *misbegotten trade wars*” and his policy on Iran will undermine the international use of the American dollar, already rivalled by the euro and, to a lower but increasing extent, by the yuan. In his opinion president Trump's „*ill-conceived*” international economic policies will hasten the end of the US dollar's world dominance and particularly the trade war will weaken China's growth only in the short run, but it „... *will bolster China's determination to escape from its continued partial dependency on US finances and trade, and lead the Chinese authorities to double down on military build-up, heavy investments in cutting-edge technologies and the creation of a renminbi-based global payments system as an alternative to the dollar system.*”

As none of these signals have been considered, the American economy will increasingly feel the negative consequences of the trade war. This is, in fact, the main reason why the IMF October 2018 outlook revises downwards its forecasts on growth rates for 2018, from 2.9% to 2.5% in the US, from 6.6% to 6.2% in China and from 3.9% to 3.7% globally (Ward, 2018).

### 3.2 China

As a very large and diversified economy, in which the government promptly intervenes every time it senses risks, China is relatively immune to the external disturbances. Empirical evidence demonstrate that in the recent 40 years any developments involving foreign markets - from the natural fluctuations of foreign trade, to disruptive events, such as the economic crises -, have exerted a limited influence on China's economic growth and have never driven the growth rates in the negative zone. Additionally, as China has made significant progress in its endeavour of switching from the investment and export-driven development model to a consumption-led one, its dependency on foreign demand and markets, even on the American one which is the largest, has decreased considerably: while the weight of China's exports into its GDP has declined from 37% (in 2007), to 18% (in 2017) (Roach, 2018), its dependence on the exports to the US fell more briskly, by almost 53%, from 7.2% of its GDP, to only 3.4%, during the same time-frame (Lau, 2018).

**The Chinese producers** do feel, undoubtedly, the impact of the trade war, but, most probably, comparatively less than the American ones, if we also consider – besides the above mentioned factors - the still high proportion of the *processing trade* in the Chinese foreign commercial exchanges (33% in 2014). While processing trade was pervasive before the year 2000, at present, the traditional commercial exchanges are dominant (54% in 2014) and the main actors are: (i) Chinese POEs (23.1% of the overall foreign trade) and (ii) SOEs (12.5%), (iii) foreign companies with operating units located in China (9.2%), (iv) foreign-invested joint ventures (6.2%), (v) others (2.8%) (Bawoo, 2017). In this section we will briefly look only at the companies with whole Chinese capital, either SOEs, POEs, large or SMEs<sup>17</sup>.

**Large SOEs** exporting goods to the US are usually very powerful companies that benefit from permanent state support in every respect (favourable regulation, cheap financing, subsidies, support for outbound investments and RDI, strategic guidance and every other elements of the *national champions* industrial policy tool-kit). **Large Chinese POEs** – such as Huawei, or Alibaba - enjoy, broadly, almost the same regimen, but the active governmental support is more discrete. In principle, both SOEs and POEs, which are all implementing and promoting abroad the Chinese government's interests and strategies, have gained, in time, both enough economic strength of their own, and sustained protection and help from the Chinese state, to not be badly hurt in the trade war. However, companies in the high technology (HT) fields are still dependant on imports and technology from the US and other economically advanced economies and, therefore, still quite

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<sup>17</sup> Small and Medium Enterprises.

vulnerable, in spite of their high ranking in international hierarchies (as the recent case of ZTE has demonstrated<sup>18</sup>).

Following the outburst of the trade war, foreign orders to China have started declining and the predictions for 2018 are that the export decline will inflict losses amounting to USD 22 billion on Chinese exporters and will generate unemployment, mainly on the East coast (Zhang, 2018). Some industries will be hurt more than others. Among the most affected ones will be those already burdened by overcapacity, such as the steel and aluminium industries, for which the new US tariffs rose to 25% and 10%, respectively, driving exports down by 53% since March (Hao, 2018). Another relevant example is that of the Chinese car industry and market: the Chinese car market, which is the largest in the world, declined in 2018 for the first time in 26 years, the industry's stocks have also fallen significantly, some of the companies postponed their investment plans and revised downwards the outlook on their annual results. All these developments triggered the authorities' intervention through fiscal policies, primarily tax cuts of 50% on new car acquisitions.

However, the **Chinese SMEs** are the ones prone to suffer the most, as the consequences of the trade war will add to the adverse effects generated by some of the on-going domestic reforms, such as those in finance and banking. For instance, one side-effect of the government's efforts to reign credit and to contain *shadow banking* was that the SMEs – which, as a rule, were not accepted for lending by the big state banks -, started to face increasing funding shortage and, because of that, to lose orders, market shares, profit and jobs. They are also losing competitiveness, due to the increasing costs of labour and of the other inputs, and are forced to function with very thin margins. Against such a backdrop, the consequences of the trade war added more pressure and roughened their fight for survival (Lee A., 2018). In response, some of the Chinese SMEs speeded-up upgrading, investing in automation and robots, while the government instructed the state banks to start giving them loans. The government also implemented a range of other supporting policies: fiscal policy (tax cuts on certain acquisitions, to stimulate domestic sales), monetary policy (four successive RRR<sup>19</sup> cuts, to increase money supply) and customs policy (tariff cuts for 1300 items imported from other countries than the US, to stimulate trade substitution and domestic consumption).

The American market remains a major and difficult to replace market for the Chinese companies, irrespective of their size, economic power or type of ownership. That is why, under the circumstances, they will do everything in their power to keep their US market shares, trying to restructure, cut costs, raise productivity and quality, but also by finding ways to avoid the new American import tariffs, such as: (i) by re-routing deliveries through third countries that enjoy lower, or no tariffs on US imports; (ii) by totally or partially relocating their activities in neighbouring countries which, besides enjoying better customs regimen for their exports to the US, can also offer cost advantages that China no longer has.

**The Chinese consumers** will probably face a mildly higher inflation, some job losses and even a dent of their trust, reflected in an increased cautiousness towards spending. Chinese population is still massively, although not predominantly, rural. Their consumption is still quite frugal, traditional and oriented towards Chinese-made goods and, as such, they are not directly affected by the US import decline. As compared to them, city dwellers and the affluent, especially the young, are much more interested in western (luxury) goods (mainly cars, electronics, cosmetics and fashion), as well as in travelling abroad, but they are ready to boycott the US exporters if required.

Chinese consumers will not feel a direct impact of the trade war with the US, but they will probably suffer its indirect effects if the economy keeps slowing further, the macroeconomic evolution worsens and especially if they happen to become unemployed. Generally, the trade war is not on the news and most of the population is not even aware of it.

**The Chinese economy** is the main target of the protectionist measures adopted by the US, during president's Trump first mandate. The US-China trade war has contributed to slowing China's economic growth and it might obstruct for a while China's advancement, but it will not reverse it. It might also have contributed to some adjustments in the Chinese domestic policies agenda, postponing some of the reforms and implementing others, but it surely has also strengthened the resolution of both the authorities and the population

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<sup>18</sup> In April 2018, at president's Trump order, the US export of semiconductors to ZTE was interrupted and in about one month the company was on the brink of collapse. Only following the dialogue of the two presidents deliveries were resumed and the company saved.

<sup>19</sup> Rate of Required Reserves

to accelerate their country's technological development, economic advancement and the Chinese economy's uncoupling from the US, turning it into an increasingly powerful rival of the US.

According to the IMF, in the most severe scenario, during the first two years of trade war China might lose just 1.6 p.p. of its economic growth rate, because much of the impact will be neutralized by the public policies implemented by the government with a view to stimulating the economy and giving growth a boost. The IMF forecasts a slower and declining economic growth rate of 6.6% in 2018 and 6.2% in 2019 (WEO, 2018). On the other hand, a report of September 2018 by JP Morgan Chase predicted that, in case the US will decide to levy 25% duties on all Chinese imports and China will retaliate, China could lose 5.5 million jobs (Fahad, 2019).

The new international context created by the trade war accelerates the economic adjustments in China by both market-triggered processes (GVCs restructuring, relocations, industrial upgrading, trade diversion or trade flows re-routing etc.) and state-initiated policies. The Chinese government not only answers to the US assault with similar tariff and non-tariff measures, but it also devises and implements active policies able to attenuate both the negative impact of the trade war on its domestic economy (by stabilizing investments, encouraging consumption, more firmly supporting RDI, the private sector and SMEs, by monitoring credit, debt and unemployment etc.) and on China's international relations (by stimulating Chinese imports, promising more open markets, opening new industries to foreign investments, promising to eradicate forced technology transfers and strengthen IPRs etc.).

### 3.3 Third countries

A trade war involving the two largest economies of the world (1<sup>st</sup> - USA; 2<sup>nd</sup> - China by GDP), and, at the same time, the largest commercial powers on earth (1<sup>st</sup> - China; 2<sup>nd</sup> - USA by total exports and total trade) which are tightly linked through the innumerable GVCs and IPNs of their companies, could not unroll without impacting on the other countries and on the world economy functioning as a whole. Among the most affected third countries, which could also have a significant role to play in the newly created context of the US-China trade war, there are, on the one hand,

- (i) their neighbouring countries and/or those integrated into the same regional/global value chains as the US and/or China, especially the countries in S.E. Asia, and, on the other hand,
- (ii) the other major trade partners of each of the two - in this case, the European Union, which is the most important trade partner for both the US and China.

For all these countries, the US-China trade war can generate great challenges and risks, but also extraordinary opportunities.

**3.3.1 The South-East Asian countries** are, in their great majority, developing and emerging economies, whose companies are involved in the regional supply and production chains built around China thanks to their cost advantages. At the same time, other numerous companies headquartered in the highly developed economies of Asia (Japan, South Korea, Singapore, Hong Kong, Taiwan), Europe (the EU Member States) and the US, are also integral to the Asian regional value chains (RVCs), mainly due to their technological superiority and outstanding RDI capabilities.

In the second half of 2018, the Asian companies have come to experience the consequences of the trade war and, consequently, to adopt different strategies of response.

First, an increasingly consistent trend among the exporters to the US located in China, is represented by the relocations of their production facilities to the neighbouring South East Asian countries, with a view to capitalizing on both their cost advantages or technological prowess, and on their lack of obstructions to the US market access. Many of these companies – either totally Chinese, or foreign invested – had already been under the pressure of the rising production costs in China and of the increasingly thinner profit margins that they had to practice, so that, when the new import tariffs were introduced on both bilateral trade flows, they had sufficiently compelling reasons to decide to move their facilities elsewhere. With development, China ceased to be a cheap production place. Depending on the complexity of the work involved, Vietnam, Thailand, India, Bangladesh, Pakistan, the Philippines and even some Eastern European countries have become the favourite destinations of these companies for the relocation of labour-intensive activities, while Taiwan, Hong Kong, South Korea and Japan are chosen for the relocation of the capital-and-technology-intensive industries.

Secondly, a distinctive group of companies among the exporters to the US located in China is that of the companies that dependent on American imports (mainly electronic components) to function, which now

have to cope with higher tariffs on both their import of components and on their exports of final goods. These companies are currently searching for other suppliers in Asia, especially in Taiwan, South Korea and Japan. According to some surveys, even 30% of the American companies working in China and using American inputs are now trying to find new sources of components in the region and new locations for their facilities outside China (Kawase, 2018). It is interesting to notice that both the facility relocations and the GVCs restructuring by changing suppliers happen much more rapidly in the HT industries, than in the labour-intensive ones. It is also worth highlighting that, from the point of view of the receptor countries, the trade war has beneficial outcomes, creating unexpected opportunities for them to receive foreign investments, to benefit from additional job creation, product diversification and a boost to their GDP growth.

Thirdly, among the Chinese exporters to the large American consumer goods trading networks (such as Walmart, Macy's etc.), which used to have their suppliers located mostly in China (e.g. Li&Fung), the acquisitions from China are now drastically declining while new suppliers of garments are searched for in Bangladesh, Vietnam, India, Pakistan and the Philippones and suppliers of footwear are looked for in Vietnam, India, Indonesia and Europe.

Finally, the the trade war impact is also felt at the level of the transport, forwarding and logistics companies. Their new orders decline and routes change according to trade diversion. For instance, as a consequence of lower maritime traffic, COSCO Shipping Holdings, the third largest maritime company in the world, gave up transports on one of the maritime routes that used to connect China and the US, which had become unprofitable.

Speaking about the trade war impact on the S.E. Asian economies, one of the most affected one could be South Korea, which depends on China for 25% of its exports and on the US for 12%. According to a report by KITA<sup>20</sup>, in the worst case scenario, of a total trade war, in which China's exports (which include South Korean components) fall dramatically, this country could register a 6.4% drop in exports, which is the equivalent of USD 36.7 billion (Lee J.-h., 2018b).

Another such example could be that of Singapore, which is a huge regional transboarding hub extremely dependent on foreign trade. In Singapore, 9 of 10 handled containers have a foreign destination, and many of the components coming from various countries and heading for China stop there for some intermediate operations. That is why the potential traffic decline generated by the US-China trade war could lead to a significant GDP drop of 0.8 p.p. in 2018 and 1.5 p.p. in 2019. Similarly, other S.E.Asian countries that have developed as export hubs, such as South Korea, Malaysia and Taiwan could lose up to 0.6% of their GDP, in 2018 (Vaswani, 2018).

All these examples show just one thing: that in a trade war almost everybody loses. With the exception of a few developing economies which may unexpectedly be in the situation of receiving the investors chased away from other countries by the consequences of the trade war, all the other countries are losing in the long-term, even after the trade hostilities have ceased. The trade war itself is disruptive, generating powerful shocks, uncertainty, losses, but, in their turn, the solutions that companies are resorting to in their fight to survive, are disruptive too, and also suboptimal, expensive and difficult to implement. Both relocations and GVCs restructuring are very difficult moves, that imply high costs and, at least initially, until the learning processes roll on and the cooperation mechanisms between links run in, they generate inefficiencies. Additionally, even after such a conflict is finally closed, long-term scars, that cannot heal, still persist in the guise of mutual distrust, reservedness and suspicion, which will incur further costs: those of the cooperation deals which, against this backdrop, will no longer happen.

**3.3.2 The European Union** didn't have a very good start in its relationship with the Trump administration, but the tensions have subsided once the American president has fully focussed on China. Until the negotiations for a US-EU free trade agreement (FTA) are finalized, the US-China trade war opens a window of opportunity that should be capitalized on (Wolff, 2018). As it is under the trade war pressure, China needs good relations with the EU and, as such, it might become more flexible and ready to conclude the negotiations on the EU-China bilateral investment treaty (BIT) that have stalled for quite long. It might be a proper moment to solve the negotiation blockages on the question of reciprocity in investments, or the technology and IPR transfers, issues that are also among the techy themes which president Trump also insists on.

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<sup>20</sup> Korean International Trade Association

The European companies that have developed productive and trade activities in both the US and China are broadly facing the same challenges as the similar firms from other regions that we have already looked at, above. Still an interesting example worth highlighting is that of the German companies in the car industry (Daimler Benz, BMW) which have assembling facilities in the US, where they build cars for both the American domestic market and for various export markets, China included. A significant part of the components assembled by the American units come from the European value chains that integrate the production of numerous Central and Eastern European factories, including many from Romania. By potentially enacting and charging higher duties on the European imported car parts, the US could give a serious blow to these intermediate goods manufacturers. Having the imports of EU components into the US market made more expensive and then facing again heightened Chinese duties for the US-assembled German cars exported to China, could create huge problems to both the German companies and their numerous European suppliers, but also to the American assemblers and their staff. Fortunately, this is only a hypothesis which, hopefully, will not become reality, once the US-EU negotiations have already resumed.

Moreover, an interesting additional aspect of this example, which highlights once more the absurd of any trade war, is that the Chinese car company Geely, that has recently become one of the new co-owners of Daimler Benz, as well as its largest investor<sup>21</sup>, will see its commercial interests and profits harmed by the protectionist measures enacted by its own Chinese state, which will be charging higher duties on the US exports of Daimler cars to China.

According to a research by Bruegel<sup>22</sup> (Garcia-Herrero, 2018), the US-China trade war may generate immediate commercial opportunities for third economies such as that of the EU (e.g. import substitution of US agricultural products in Chinese market and of some consumption goods in the American one), but also, more importantly, it may offer the opportunity of obtaining certain concessions that China was not previously willing to give, as regards: the opening up of its economy to EU imports and investments, under reciprocity terms; giving subsidies up; reaching some common ground on questions regarding Chinese takeovers of HT companies in Europe at subsidized prices that neutralize any competition, with the purpose of getting access to their technologies and RDI capabilities etc.

Starting from the US and the EU export structures to China, which are quite similar<sup>23</sup>, and presuming that the US will not hit the EU in the manner it did with China, the cited above study comes to the conclusion that the EU *motor vehicle* producers, followed by the *chemicals* and the *machinery and equipment* ones, would gain the most in the US market, while in the Chinese market, the EU companies that will benefit the most will be those in *aviation*, which would have practically no rivals. Also, starting with the third round of tariff hikes for Chinese imports worth USD 200 billion, enacted by the US, the EU consumer goods manufacturers could take the opportunity to replace at least partially the Chinese exports to the American market. Another important conclusion of this research is that the EU could benefit more by substituting Chinese exports on the US markets (earning up to USD 69 billion more, in the bilateral trade with the US), than by replacing the American exports to China (for additional amounts of up to USD 32 billion). In other words, the EU companies could profit more from the tariff sanctions enacted by the US on China, than by the tariffs charged in retaliation by China, on the US.

In paralel, other reports warn that under the US-China trade war, the euro zone will have a modest economic growth in 2018, easy to be neutralized in case of further escalation of the hostilities. According to a recurring survey by Reuters among 44 economists, the current trade war presents a clear risk of incurring the euro zone growth decline to 2.1% in 2018 and to 1.8% in 2019, while the inflation rate could remain flat, at 1.7 in both years (Reuters, 2018).

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<sup>21</sup> In 2018, the Chinese group Zhejiang Geely Holding Co. which includes Geely Auto and owns the Swedish Volvo Cars and Vorvo Trucks (partially), acquired, for USD 9 billion, 10% of Daimler Benz (which owns Mercedes Benz and Dailer Truck). Daimler Benz sold a record 600 000 cars and SUVs to China in 2017, double the number sold in the US (Bloomberg, 2018).

<sup>22</sup> Bruegel is a European think tank head-quartered in Brussels.

<sup>23</sup> The main 5 groups of goods exported by US to China are: (1) chemicals; (2) transport equipment; (3) motor vehicles; (4) machinery and equipment; (5) medical instruments, while the main 5 groups of goods exported by the EU to China are: (1) motor vehicles; (2) machinery and equipment; (3) chemicals; (4) medical instruments and (5) transport equipment).

## 4. Conclusions

As any other trade wars, the US-China one will not have real winners, whatever the speeches of the two presidents caught in this fight will be, after reaching an agreement. This trade war has disrupted considerably not only the two economies directly involved in it, but the whole world, and not for a few months, but for very long term, most probably measurable in decades. It has incurred losses both to the two countries and to their partners, and it will keep generating quantifiable, as well as - potentially even more important - unquantifiable costs. It has already brought forth and it will continue to generate outcomes that are contrary to those expected by its initiator, president Donald Trump, and the American people will probably pay most of the price of this adventure, started on the wrong assumptions and approached with the wrong instruments. The US-China trade war has sowed the seeds of long-term uncertainty and distrust among countries, it has relativized principles, it has contributed to the undermining of the institutional architecture that has sustained the world peace and the world's path to prosperity in the postwar decades, in spite of all its imperfections, failures, imbalances and the inequity that has persisted.

Under the leadership of president Trump, the return to protectionism of the country that has for so long promoted liberalism, multilateralism and globalization, in parallel with president's Xi rhetoric - not exactly justified by facts - on openness, international cooperation and the support of other developing nations by way of investments, picture the image of a world that is losing its landmarks, it infringes on its principles and it defies its institutions, sliding towards populism, isolationism and confrontation.

The encounter of the two largest economies of the world is only at surface a trade war. In its deeper layers, it is a fierce fight for economic, technological and military domination, a fight between two different models of development, governance, political system and type of social relations. And it is also a confrontation of prides, of not only the two leaders, but of two grand nations: one that is coming from a unique past, of thousands of years of greatness, and is thirsty to regain its glorious status, and another one, which, in just a couple of centuries has built up itself, it has rebuilt and modernized the postwar world and it earned, and is still firmly keeping, the reins of power.

In the recent half of a century the US and China have managed to weave an increasingly strong and complex bilateral relationship that was a guarantee of global stability and peace. Gradually, but steadily, this tight relationship is now loosening and changing into a new, fundamentally different one, that takes shape right now, under our very eyes.

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