Global Economy

The US-China Trade War: The New Normal

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The ever-escalating trade war between the U.S. and China has become a "new normal" in the international trade scene. Since January 2018, the U.S. average import tariffs on Chinese goods have risen from 3 to 23 percent. Meanwhile, China's retaliatory import tariffs on U.S. goods rose from 7 to 24 percent.

Although the U.S. has long been advocating for a rule-based multilateral trading system, ad-hoc policies aimed to influence trade balances are not unusual. For example, in the 1980s, the Reagan administration forced Japan to adopt a voluntary export restraint (VER) of automobiles amid worries of persistent trade deficits. The VER did not help to reduce the trade deficit and was obsolete in the 1990s. However, probably due to its simplicity, the idea of shrinking trade deficits by singling out a top trade partner still attracts the Trump administration.

Intuitively, two factors jointly shape a country's trade balance: (1) the structure of imports and exports, and (2) the openness to trade. The first factor is captured by the ratio of the trade balance to total trade value. That is, $(exports - imports)/(exports + imports)$. This ratio lies between -1 and 1, with a positive value indicating more exports than imports. If trading with China had significantly hurt the economy, as President Trump claimed, this ratio should have a decreasing trend after 2001, when China joined the WTO. However, the data does not support his argument: The ratio was -0.18 in 2001 and -0.15 in 2018. In other words, increasing foreign trade with China has not affected the U.S. import/export structure.

The second factor uses the ratio of total foreign trade value to the gross domestic product as an indicator of trade openness. This ratio increased from 0.22 in 2001 to 0.27 in 2018. That is, the U.S. economy is 20 percent more open than in 2001. Therefore, given the robust trade structure, the growing openness to trade seems to be the underlying driver for widening trade deficits, and the only way to lower them is by systemically cutting trade links. Obviously, autarky is not a viable option for a global power like the U.S.

In a nutshell, a comprehensive trade deal between the U.S. and China is unlikely. From the U.S. side, President Trump demands a dramatic "win" of lower trade deficits, which is impossible without heading for autarky. From the Chinese side, the "Made in China 2025" plan has revealed their ambition to move up in the global value chain. In the long run, such a strategy will reduce their exports of final (consumer) goods. However, in the short run, in light of tremendous political uncertainties in the U.S., Beijing may choose to wait and negotiate after the upcoming presidential election.

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