

Trade war between the USA and China: Who gains? Who loses? Does Malaysia stand a chance to benefit?

Introduction

‘Whatever affects one directly, affects all indirectly¹.’ The validity of this quote has been reaffirmed by the developments of the US-China trade war, which have exhibited profoundly far-reaching impacts from Canada to Southeast Asia. After President Trump’s announcement of the first unilateral tariff on US\$50 billion worth of Chinese imports in June 2018 (Figure 1, \$34 billion and \$16 billion effective in July and August respectively), China’s Ministry of Commerce accused the USA of launching a ‘trade war’. A ‘trade war’ is defined as a situation where a nation imposes tariffs or quotas on foreign imports, and foreign countries retaliate using similar forms of trade protectionism².

The situation has escalated significantly such that a mutually beneficial trade deal now seems far from reach. In view of the worsening tensions of the US-China trade war, it is of paramount importance that we understand the impact of this conflict on the global economy as well as those on our homeland Malaysia. As the resolution of the trade war depends on who blinks first, this leads to the important question of: who is enduring the greater losses in this trade war. Additionally, as Malaysia is a manufacturing hub like China, it leads us to ponder whether Malaysia has anything to gain from the ongoing trade conflict.

¹ Martin Luther King, Jr., “Remaining Awake Through a Great Revolution”.

² James Chen. “What is a Trade War?”. *Investopedia*.

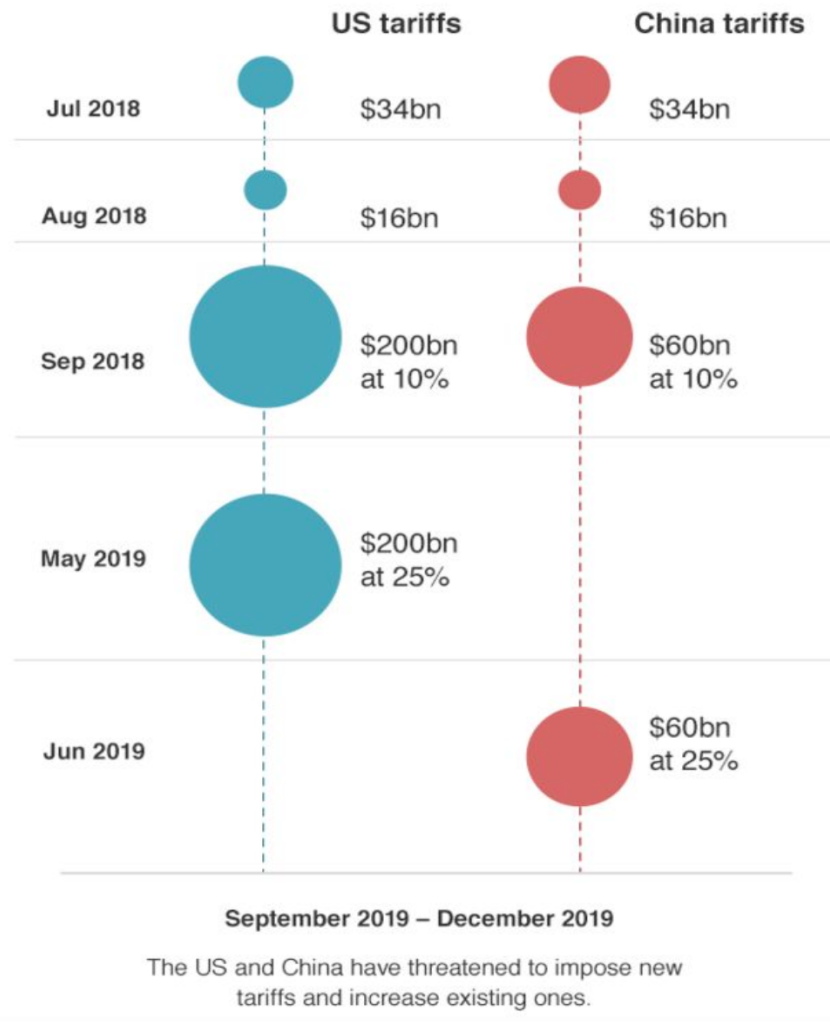


Figure 1³ (10% US tariff in Sept 2018 was raised in May 2019 for the same basket of goods)
(10% China tariff in Sept 2018 was raised in June 2019 for the same basket of goods)

Negative effects of the trade war

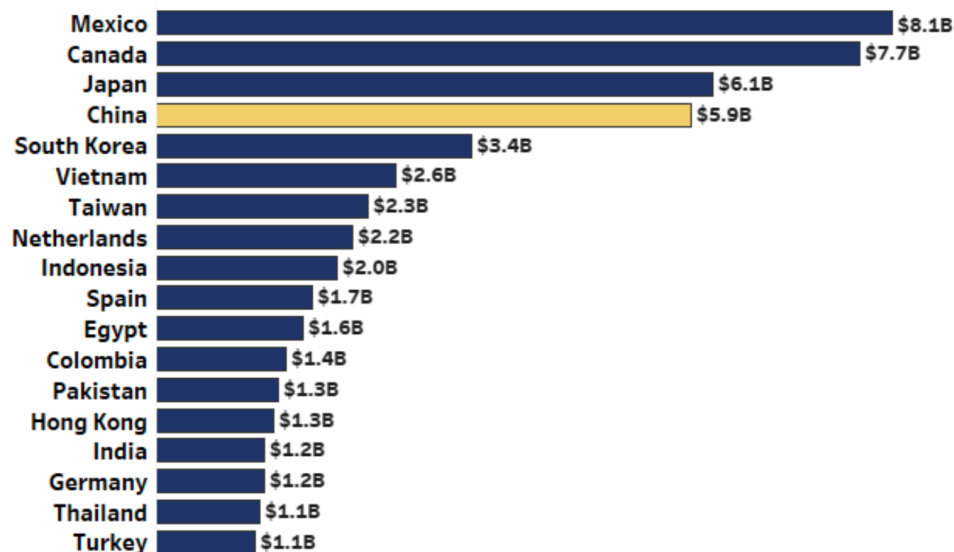
For American consumers, the ongoing tariff war reduces their disposable income. The tariffs rates as of August 2019 are estimated to burden each household with an annual cost of US\$1000. These tariffs have a regressive effect on low-income households, particularly because the September 2019 tariffs apply to tradable consumer goods, and this exacerbates social inequalities in the country. In addition, the higher price levels brought by the tariff war dampens consumer spending. The 8.6 points decline of The Consumer Sentiment Index⁴ in August 2019 — the largest monthly decline since December 2012 — suggests that aggregate demand will remain tepid despite the upcoming holiday season.

³ “Trade war: US hits China with new wave of tariffs”. *BBC Business*

⁴ Richard Curtin. “Survey of Consumers, University of Michigan”

Moreover, USA's export-driven agriculture industry has been hard-hit by a reduction in its exports to China. The USA's lobster exports fell by over 80% between 2018 and 2019, while its soybean exports to China fell by two-thirds in the same period. To make matters worse, China discontinued all purchases of US agricultural products in August, which meant that US farmers lost their 4th largest export market (Figure 2). In accordance with economic theory, the fall in demand for US farm products has led to falling prices, resulting in declining incomes and poor financial stability for US farmers. Inevitably, producers who are unable to survive will lose their livelihoods, in line with estimates that 1.1 million American jobs supported by US exports to China could be jeopardised by the trade war⁵.

Top markets for U.S. farm products



SOURCE: Census, 2018 exports



Figure 27

Even giant US multinational companies (MNCs) have suffered tremendous losses due to the trade war. American MNCs now face tariffs on component parts and finished products produced in China, which hikes up their costs. This, coupled with lower sales in China due to higher (post-tariff) prices, has eroded the profits of these MNCs. To quantify, US technological companies have lost US\$ 10 billion as of August 2019. As a result, firms are likely to reduce their capital expenditure, which will impede future growth and compromise the dynamic efficiency of the economy. This could surmount to a loss of US\$ 1 trillion for the US economy in the coming decade, if the trade war remains unresolved.

⁵ US-China Business Council. "2019 State Export Report"

Meanwhile, China is suffering from an economic downturn as well. Its economic growth cooled down to a 17-year low (6.2%) in Q2 of 2019. This can be partially attributed to the fall in China's exports as US tariffs reduced the price competitiveness of Chinese goods in the USA. As the volatile tariff situation has given rise to greater business uncertainty, this resulted in low credit demand in China, as businesses chose to delay decision-making and investment. Additionally, the trend of MNCs exiting China in order to side-step US tariffs has caused foreign direct investment (FDI) in the nation's free-trade zone to plunge from a 13.5 % growth in 2017 to a 3.5% fall in 2018. These factors show that the trade war contributed to China's falling aggregate demand, which has led to the economic downturn.

As a consequence of the trade war, China's major import partners have been experiencing a contraction in export demand. Export-oriented countries in Southeast Asia — including Thailand and Singapore — have seen a decline in their volume of exports due to the adverse effects of the trade war on market confidence. This is reflected by the falling figures in the forecasted economic growth of the aforementioned nations for 2018-2019 (Figure 3).

Economic growth forecast for ASEAN5 and India

(year-on-year change, in percent)

	2019				'20	'18	'19	'20	'21
	Q1	Q2	Q3	Q4	Q1				
ASEAN5	4.1	4.2 (4.4)	4.5 (4.7)	4.6 (4.8)	4.4	4.8	4.3 (4.6)	4.5 (4.6)	4.7 (4.8)
Indonesia	5.1	5.1 (5.0)	5.1 (5.2)	5.1 (5.3)	5.1	5.2	5.1 (5.2)	5.3 (5.3)	5.6 (5.4)
Malaysia	4.5	4.4 (4.5)	4.4 (4.5)	4.4 (4.5)	4.3	4.7	4.4 (4.5)	4.4 (4.5)	4.7 (4.9)
Philippines	5.6	5.9 (6.3)	6.3 (6.3)	6.5 (6.5)	6.3	6.2	6.2 (6.4)	6.5 (6.5)	6.5 (6.8)
Singapore	1.2	1.6 (2.1)	2.0 (2.6)	2.4 (3.0)	2.2	3.1	1.8 (2.4)	2.1 (2.4)	2.4 (2.8)
Thailand	2.8	2.7 (3.4)	3.7 (4.1)	3.7 (3.9)	3.5	4.1	3.3 (3.7)	3.3 (3.7)	3.4 (3.8)
India	5.8	6.2 (6.6)	6.8 (7.1)	7.2 (7.4)	7.5	6.8	6.9 (7.1)	7.2 (7.2)	7.4 (7.2)

Forecasts for 2019 onward; figures in parentheses represent average forecasts as of the previous survey in March 2019; annual figures for India are those of fiscal year (April-March)

Source: JCER/Nikkei Consensus Survey, Nikkei/NQN Survey, Haver Analytics

Figure 3⁶

In the long run, a prolonged trade war would disrupt the global supply chain, as is already reflected in the scurried movement of US firms out of China. The high trade barriers such as tariffs distort price signals and comparative advantage, which acts as a disincentive to specialisation. This would lead to a permanent reduction in global output and economic welfare.

⁶ Kiyoshi Kusaka. "US-China trade war will hit ASEAN economy harder". *Nikkei Asian Review*.

Possible beneficiaries of the trade war

One of the indirect consequences of the trade war is greater market access for MNCs in China. In a bid to coax foreign investors from exiting China, Beijing has accelerated the opening of its services, agriculture, mining, manufacturing and financial services sectors in its 2019 Negative Lists and Encouraged Catalogue. The newfound market access will provide opportunities for the expansion of MNCs such as JPMorgan Chase and Goldman Sachs in China. This will benefit the MNCs in terms of wider market reach and potentially higher profits. Globally, the economy may enjoy higher efficiency and increased international trade.

The most significant positive spillover effect of the US-China trade war is trade diversion, as both China and USA increase sourcing from third countries. The European Union expects an increase in its exports to China, as China seeks import substitutes for US-produced aircraft equipment, passenger cars, industrial machinery etc. This would amount to additional export revenue of 1.5 billion Euros per year due to the September 2019 wave of tariffs. On the other hand, ASEAN nations have already enjoyed a 14% rise in exports from China, in particular due to increased demand for its furniture and semiconductors. Vietnam has been the biggest beneficiary of trade diversion (Figure 4), as its relatively low labour costs and geographical proximity to China has made it a haven for US MNCs during the tariff war. Moreover, Vietnam has the capacity to manufacture a similar range of goods to China, namely E&E goods, textiles and machinery, which allows it to benefit from trade diversion.

The USA's competitors in agriculture have also benefited from a rise in export demand. China has opted to purchase greater amounts of Brazilian soybean to substitute those of the US, leading to a sharp rise in Brazil's soybean premium in April 2019 (Figure 5). Meanwhile, China's tariffs gave Canada's lobster industry an immediate 25% advantage over the USA. Fresh lobster shipments to China from Canada were increased by 1.5 folds between 2017 and 2018. As a result, Canada's lobster exports have risen and prices have increased accordingly. In both instances, trade diversion unexpectedly boosted the agricultural industries of third countries, which benefits local producers in the form of higher incomes and increased job opportunities.

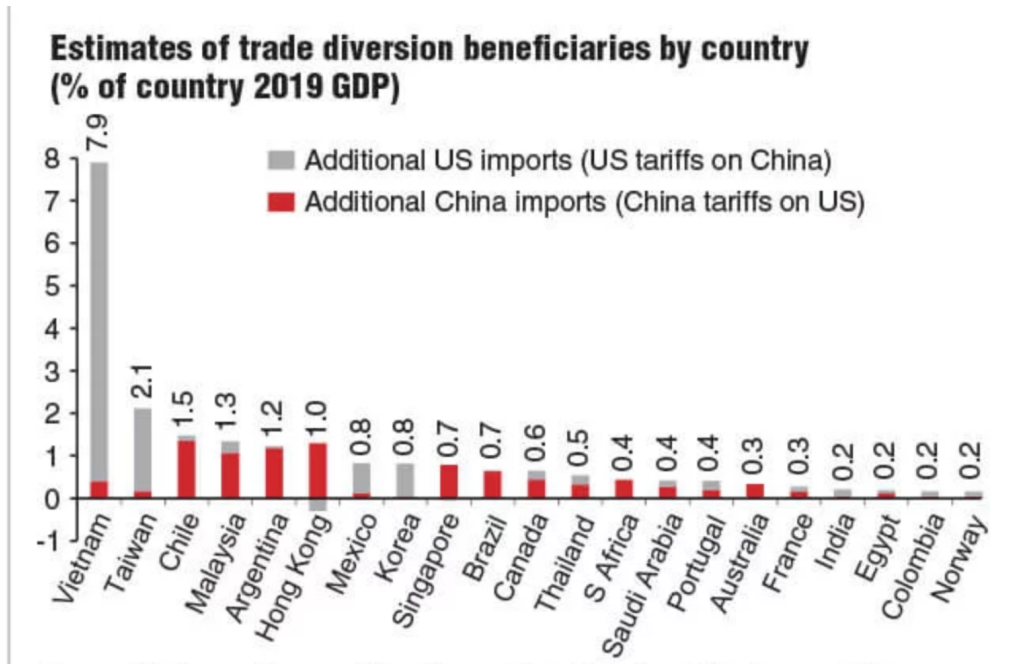


Figure 47

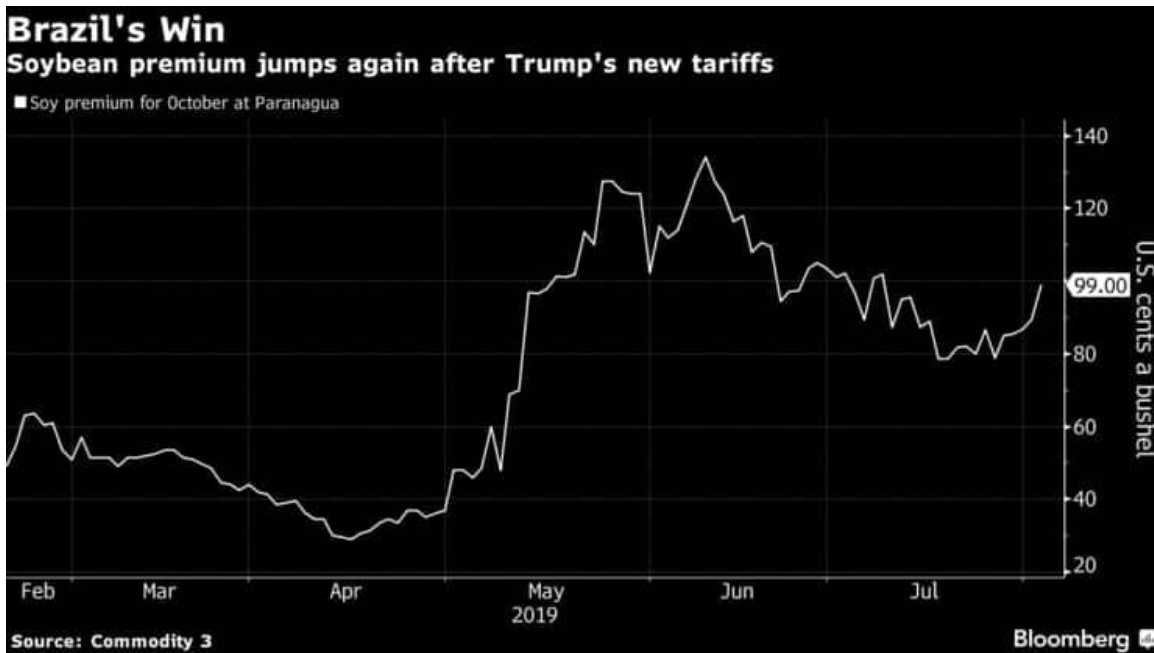


Figure 58

⁷ Chester Tay. "Malaysia the 4th biggest beneficiary of trade diversion - Nomura". *The Edge Markets*.

⁸ Almeida, Niu and Cang. "China Ramps Up Brazil Soybean Imports, Rebuffing U.S. crops". *Bloomberg News*.

How Malaysia is affected by the trade war

Malaysia is the proud recipient of the world's 4th biggest share of trade diversion due to the trade war (Figure 4), largely accredited to a substantial increase in its exports to China. To enumerate, Malaysia's exports of waste and scrap alloy, natural gas and benzole to China have been on the rise since the start of the trade war. Furthermore, the recent escalation in trade tensions suggest that China may reduce its imports of other US-made products and seek import substitutes. Considering that Malaysia manufactures E&E equipment, mineral fuels, industrial machinery and plastics (like the USA), Malaysia may be able to capitalise on this and increase its exports to China in the near future.

At the same time, another unexpected gain from the trade war is the rise in Malaysia's foreign direct investment (FDI). FDI into Malaysia's manufacturing industry surged by 127% in Q1 of 2019 compared to the previous year. This could be attributed to the trend of American MNCs shifting operations from China to Southeast Asia, owing to Malaysia's manufacturing capabilities for solar panels, medical apparatus and E&E equipment — goods which the US heavily imported from China. In the long haul, this means Malaysia will be able to attain greater economic output and higher exports, which would improve our balance of trade and economic growth. However, Malaysia has only received a modest share of trade diversion (Figure 4, 1.3% of Malaysia's GDP) compared to Vietnam and Taiwan, which may be the result of Malaysia's waning comparative advantage.

On the other hand, the trade war may also drag down Malaysia's export-reliant economy. A prolonged tariff war is a negative sum game, which will cause the global demand and output to shrink. Consequently, Malaysia will experience a fall in exports which would lead to lower aggregate demand and lower GDP growth. This is especially true since Malaysia's exports constitute around 67.6% of its GDP (2016).

As the decline in export demand due to the tariff war and the possible boost in demand due to trade diversion act in opposing directions, the overall effect on Malaysia's economic outlook is uncertain. There is a lot of unpredictability surrounding when and how much new foreign investment will materialise to Malaysia's advantage, which makes it difficult to forecast the long-term impact of the trade war on Malaysia. Nevertheless, Bank Negara Malaysia predicts that on a net-net basis, Malaysia's gains from trade diversion are insufficient to offset the negative impact of the trade war. In other words, Malaysia has nothing to gain from a prolonged trade conflict.

Conclusion

By and large, it is clear that there are no winners in the US-China trade war for the long run. As of September 2019, the USA and China have both been hurt by lower exports, business uncertainty and weak consumer sentiments. Consequently, the global economy as a whole has subtracted about 0.3% of its GDP in the short run¹⁷ and the adverse effects of the trade war on the global economic climate will worsen as the conflict becomes prolonged.

Nonetheless, countries which produce import substitutes to those of China and the USA, have been able to derive a short-term boost in economic growth. Malaysia is among these beneficiaries, however a lack of comparative advantage has impeded Malaysia's ability to attract trade diversion. At the very least, Malaysia has been spared of any major economic setbacks as of today, however, further prolongation or escalation in the trade dispute may weigh down Malaysia's export-driven growth and reverse our fortunes in this trade war.

(1986 words)

Bibliography

- Almeida I., Niu S. and Cang A. “China Ramps Up Brazil Soybean Imports, Rebuffing U.S. crops”. *Bloomberg News*, August 16, 2019. Retrieved from <https://www.bloomberg.com/news/articles/2019-08-16/china-ramps-up-brazil-soy-imports-as-u-s-trade-war-worsens>
- Cerutti E., Gopinath G. and Mohommad A. “The Impact of US-China Trade Tensions”. *IMF Blogs*, May 23, 2019. Retrieved from <https://blogs.imf.org/2019/05/23/the-impact-of-us-china-trade-tensions/>
- Chen, James. “What is a Trade War?”. *Investopedia*, August 21, 2019. Retrieved from <https://www.investopedia.com/terms/t/trade-war.asp>
- China Imports from United States. Retrieved from <https://tradingeconomics.com/china/imports/united-states>
- Curtin, Richard. “Survey of Consumers, University of Michigan”. August, 2019. Retrieved from the official website of the Survey of Consumers, University of Michigan <http://www.sca.isr.umich.edu/>
- Franck, Thomas. “Morgan Stanley: Risk of a global recession is ‘high and rising’”. *CNBC*, August 21, 2019. Retrieved from <https://www.cnbc.com/2019/08/21/morgan-stanley-risk-of-a-global-recession-is-high-and-rising.html>
- Harada, Issaku. “US overtaken by Southeast Asia as China’s No. 2 trading partner”. *Nikkei Asian Review*, July 13, 2019. Retrieved from <https://asia.nikkei.com/Economy/Trade-war/US-overtaken-by-Southeast-Asia-as-China-s-No.-2-trade-partner>
- Kearns, Jeff and Pickert, Reade. “Exports, Imports, Both Plummet as U.S. Trade Deficit Narrows”. *Bloomberg*, June 6, 2019. Retrieved from <https://www.bloomberg.com/news/articles/2019-06-06/u-s-trade-deficit-narrows-as-exports-imports-both-plummet>
- Kusaka, Kiyoshi. “US-China trade war will hit ASEAN economy harder”. *Nikkei Asian Review*, July 9, 2019. Retrieved from <https://asia.nikkei.com/Economy/US-China-trade-war-will-hit-ASEAN-economy-harder>
- Lee, Amanda. “China’s free trade zones fail to shine despite Beijing’s desire to lure global investors”. *South China Morning Post*, August 22, 2019. Retrieved from <https://www.scmp.com/economy/china-economy/article/3023921/chinas-free-trade-zones-fail-shine-despite-beijings-desire>
- Leswing, Kif. “The trade war has already cost electronics companies \$10 billion and it gets worse on 1 Sept”. *CNBC*, August 31, 2019. Retrieved from <https://www.cnbc.com/2019/08/31/the-trade-war-has-already-cost-electronics-companies-10-billion.html>
- Malaysia Exports to China. Retrieved from <https://tradingeconomics.com/malaysia/exports/china>
- Pandey, Ashutosh. “US-China trade war — The unlikely European winners”. *Dw Business*, August 13, 2019. Retrieved from <https://www.dw.com/en/us-china-trade-war-the-unlikely-european-winners/a-50009418>

- Rapoza, Kenneth. "Europe Joins U.S. Companies Moving Out of China". *Forbes*, July 16, 2019. Retrieved from <https://www.forbes.com/sites/kenrapoza/2019/07/16/europe-joins-us-companies-moving-out-of-china/#546eb3f215bf>
- Reeves, Scott. "Maine turns to Canada after losing China lobster market". *China Daily Global*, May 27, 2019. Retrieved from <http://global.chinadaily.com.cn/a/201905/27/WS5ceb3c68a3104842260bde39.html>
- Rooney, Kate. "China confirms it is suspending agricultural product purchases in response to Trump's new tariffs". *CNBC*, August 5, 2019. Retrieved from <https://www.cnbc.com/2019/08/05/china-confirms-it-is-suspending-agricultural-product-purchases-in-response-to-trumps-new-tariffs.html>
- Rosen D.H., Gloudeman L. and Narayanan B.G. "Assessing the costs of tariffs on the U.S. ICT industry". *The U.S. Chamber of Commerce*, 2019. Retrieved from https://rhg.com/wp-content/uploads/2019/03/RHG_AssessingCostsofTariffson-USICTIndustry.pdf
- Tan, Huileng. "US soybean farmers are working new markets now that exports to China have tanked". *CNBC*, August 7, 2019. Retrieved from <https://www.cnbc.com/2019/08/08/us-china-trade-war-soybean-farmers-are-working-new-markets.html>
- Tay, Chester. "Malaysia the 4th biggest beneficiary of trade diversion - Nomura". *The Edge Markets*, June 4, 2019. Retrieved from theedgemarkets.com/article/msia-4th-biggest-beneficiary-trade-diversion---nomura
- "Trade war: US hits China with new wave of tariffs". *BBC Business*, September 2, 2019. Retrieved from <https://www.bbc.com/news/business-49505781>
- US-China Business Council, The. "2019 State Export Report". July 29, 2019. Retrieved from <https://www.uschina.org/reports/2019-state-export-report>
- Whittle, Patrick. "How China's tariffs are affecting U.S. lobster exports". *Boston News*, August 26, 2019. Retrieved from <https://www.boston.com/news/national-news/2019/08/26/how-chinas-tariffs-are-affecting-u-s-lobster-exports>
- Xinhua. "China-ASEAN trade continues to boom amid global slowdown, uncertainties". *China Daily*, July 23, 2019. Retrieved from <http://www.chinadaily.com.cn/a/201907/23/WS5d367792a310d8305640082a.html>
- Yao, Kevin and Patton, Dominique. "China pledges to expand financial market opening as U.S. trade delegation arrives". *Reuters*, March 28, 2019. Retrieved from <https://www.reuters.com/article/us-china-boao/china-pledges-to-expand-financial-market-opening-as-u-s-trade-delegation-arrives-idUSKCN1R9076>
- Yao, Kevin and Wu, Huizhong. "China's economy worsens in July, industrial growth at 17 year low as trade war escalates". *Reuters*, August 14, 2019. Retrieved from <https://www.reuters.com/article/us-china-economy-activity/chinas-economy-worsens-in-july-industrial-growth-at-17-year-low-as-trade-war-escalates-idUSKCN1V404X>
- Ye, Zhang Zoey. "China's 2019 Negative Lists and Encouraged Catalogue for Foreign Investment". *China Briefing*, July 10, 2019. Retrieved from <https://www.china-briefing.com/news/chinas-2019-negative-lists-encouraged-catalogue-foreign-investment/>