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

In the words of David Ricardo "It is quite as important to the happiness of mankind, that our enjoyments should be increased by the better distribution of labour, by each country producing those commodities for which by its situation, its climate, and its other natural or artificial advantages, it is adapted, and by their exchanging them for the commodities of other countries, as that they should be augmented by a rise in the rate of profits." However, faced in a situation where the second largest economy has a stronger trade advantage over the largest economy, protectionism measures sets in to prolong global economic and technological dominance. Hence it can be said that the trade war is an act of coercion by the U.S. through the impositions of tariffs forcing China to make changes towards what the U.S. claims as "unfair trade advantage" whereas China merely reacts to this by absorbing the tariffs, pouring more money to the U.S. which subsequently causes the U.S. currency to rise, contributing to the growing trade deficit widely complained by the U.S. government.

According to the President Of The United States, the U.S. is likely to gain from the ongoing trade war between the USA and China[1]. President Trump claims that raising tariff rates would bring back money to the U.S., making it a great opportunity for the U.S. by stimulating greater domestic production and consumption. While this could lead to expenditure switching effect taking place, where U.S. firms will be able to benefit from the lack of foreign competition, it goes against the principle of comparative advantage as mentioned by David Ricardo. Therefore, this viewpoint can be said to be flawed as it assumes that the U.S., a capital intensive economy, is able to produce the same amount of consumer goods at a lower cost as compared to China which has a larger work force and lower unit costs. President Trump's claim that China has been stealing jobs from the U.S. can also be argued to be false as he makes the assumption that a job is a physical unit which can be transferred or stolen at will when in reality a job is an opportunity created by market forces to fulfill the demands of the market.[2]

As the U.S. is the major market for Chinese goods making up 19% of total exports, while US exports to China only represent approximately 8% of total US exports, China is more likely to incur a greater loss from the trade war. However, the decline in share of exports of goods and services within the total Chinese GDP show that China has been transitioning away from being dependent on trade[3]. This is further evidenced as the rate of growth of China's real GDP declined by 0.4% from 2017Q4 to 2018Q4 (Figure 1). While it may be the lowest rate of growth of China's real GDP since the outbreak of the global financial crisis, it indicates that the impact of the increase in tariff rates are relatively small in real terms. Despite this, the uncertainty that it has created and the negative influence it has have also affected the real economy (Figure 2). At the time of writing, the Shanghai Stock Exchange lost 8%, Shenzhen lost 12% while the Standard & Poor 500 index gained 12%. China may also experience a slowdown in technological growth as they are prevented from acquiring high end US technologies as seen in the ban in sales of U.S components to giant Chines telecommunications company ZTE Corporation and also the ban from the usage of Huawei by government officials.

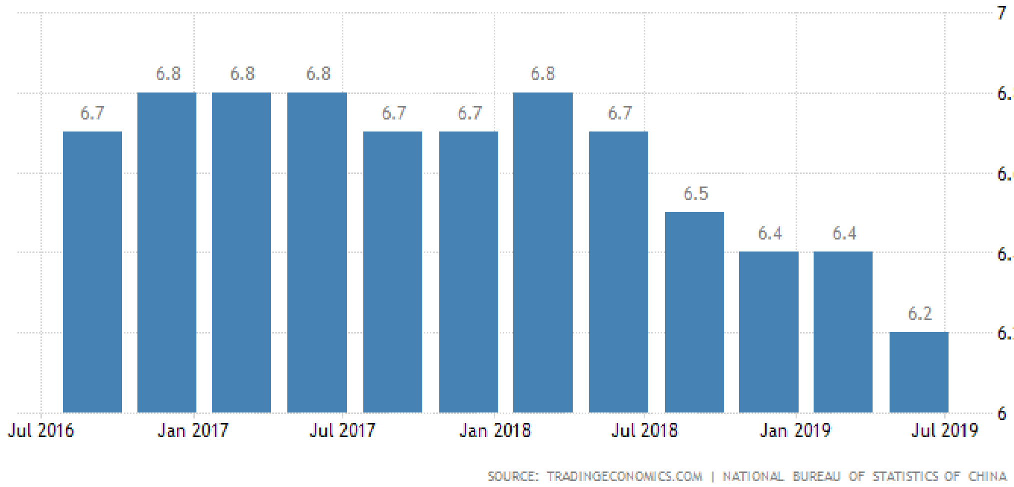

Figure 1

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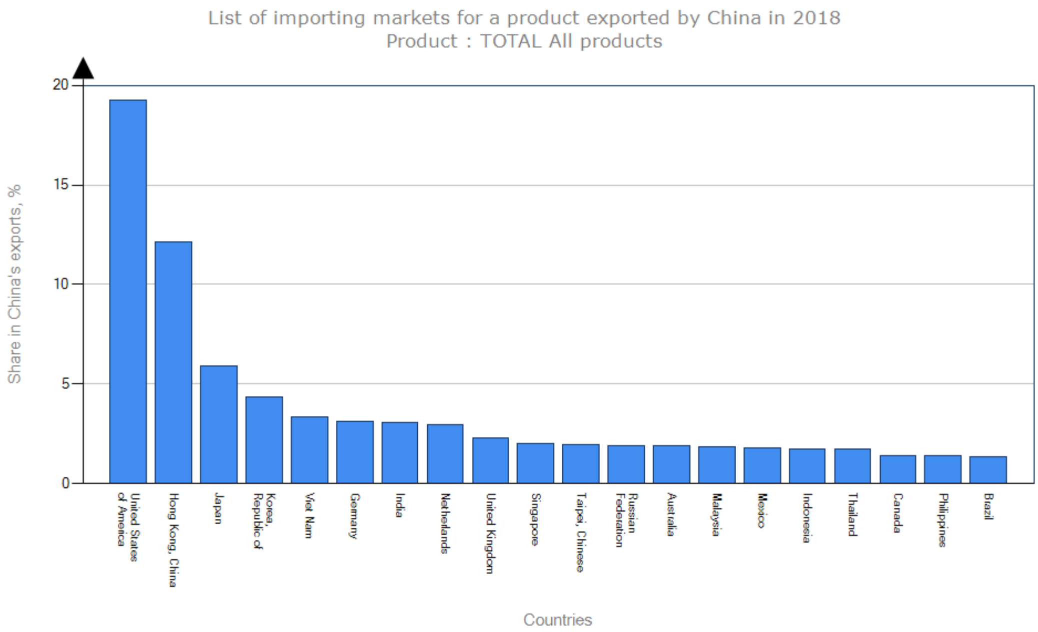
[1] https://twitter.com/realdonaldtrump/status/1164914959131848705?lang=en

[2] https://twitter.com/realdonaldtrump/status/1158407058519207936?lang=en

[3] https://data.worldbank.org/indicator/NE.EXP.GNFS.ZS?end=2018&locations=CN&start=2006



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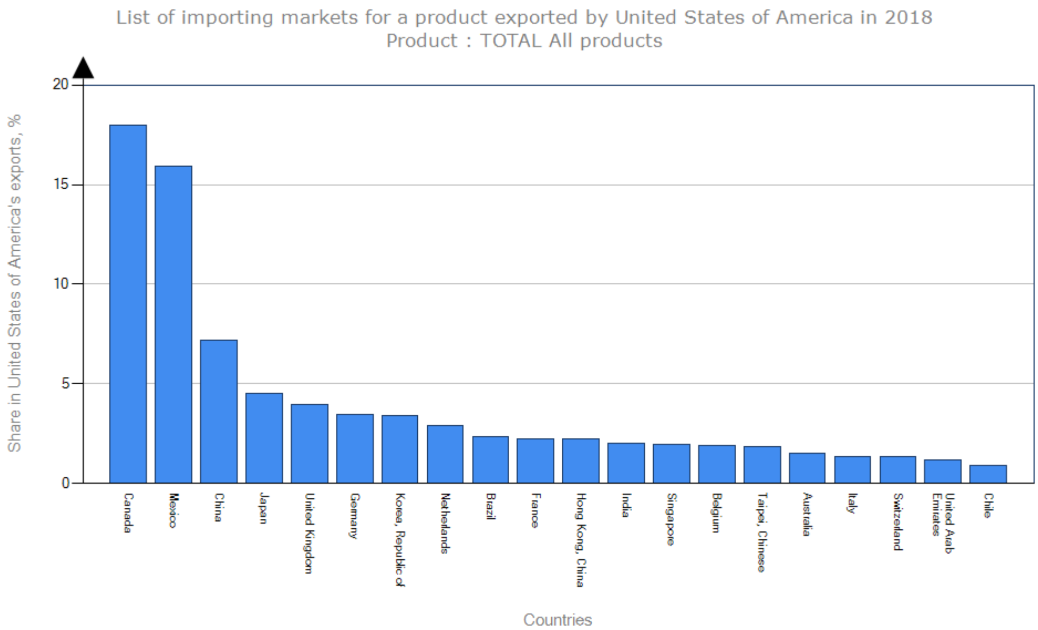

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Figure 2

U.S. consumers and businesses are also likely to lose from the trade war as tariffs are borne by businesses through lower profit margins and by consumers at higher prices. Economists at the New York Fed found that the Chinese Exporters did not reduce their prices; hence the U.S. domestic prices have risen together with the tariffs levied that year. Basic economic theory tells us that increase in tariff rates would bring about proportionally higher deadweight losses as consumers are forced to pay higher prices or seek out for cheaper but less efficient producers from other countries. Hence the gains from tariff revenue is likely to be short lived as US enterprises stop purchasing imports from China and forced to shift their supply chains to other cheaper sources. The study conducted shows that in November 2018, importers were paying a monthly cost of $3.0 billion in tax payments and an additional $1.4 billion in deadweight loss, this amounted to a total of $4.4 billion every month and $52.8 billion every year. Of this cost, $282 were flowing to government revenue as part of the tariff increase, which in theory could be rebated back to the consumers, as seen in the $28 billion relief made through July 2019 to help farmers, however the deadweight losses accounted for an additional $132 per annum which was in excess of the government revenue collected from tariffs.

The U.S. Tariffs' Costs

2018 Tariffs	Tax payments	Deadweight loss	Total cost to consumers
Monthly cost	$3.0 billion	$1.4 billion	$4.4 billion
Annual cost	$36.0 billion	$16.8 billion	$52.8 billion
Per household annual cost	$282	$132	$414
Additional 15% Tariff on $200 Billion			
Monthly cost	$2.245 billion	$6.594 billion	$8.84 billion
Annual cost	$26.942 billion	$79.132 billion	$106.074 billion
Per household annual cost	$211	$620	$831

Notes: The upper panel is drawn from analysis of six waves of U.S. tariffs in 2018 in Amiti, Redding, and Weinstein, "The Impact of the 2018 Trade War on U.S. Prices and Welfare," National Bureau of Economic Research w25672 (2019). Per household numbers are calculated based on 127.6 million households in the United States in 2018. The lower panel is forecast based on the elasticities in the aforementioned study.

The USA and China trade war may also have detrimental effects towards the Malaysian economy due to its nature being a small and open economy with high dependence on trade where exports make up 69% of GDP[4]. In addition, Malaysia has a high degree of exposure to the Chinese economy as it is the main importing market for Malaysian exports. However we may benefit from the trade diversion as both countries look for safer countries to relocate their production lines. According to Bank Islam Malaysia Bhd chief economist Mohd Afzanizam Abdul Rashid, Malaysia would benefit from US import substitution in respect of semiconductors and also China import substitution in terms of natural gas. Yet, Malaysia has been put into Monitoring List by the US Treasury Department and one of the criteria is bilateral trade surplus balance with the US of a minimum of $US 20 million, hence it may be a potential target for the U.S. if they deem that the trade surplus is wealth robbed from the U.S.. Malaysia may also benefit as high tariffs on Chinese goods have the potential to generate trade and investment spill-overs in Malaysia's trade as investments shift away from China to avoid the negative impacts of the tariffs. For example, Hong Kong based Internet of things device maker Kayamatics and US Semiconductor Company Micron has said that it plans to set up production lines in Malaysia.[5]

A report published by the financial holding company Nomura stated that Vietnam is the largest beneficiary from the trade war, gaining 7.9% of GDP from trade diversion, where the trade diversion is mostly additional U.S. imports. In Vietnam, some Chinese companies are starting to shift supply chain in China to Vietnam. For example, GoerTek, the Shandong based manufacturer of Apple's Airpods, announced it would move production to Vietnam, citing that the trade war as the reason behind this decision. While it could be said that Vietnam would benefit from the influx in Chinese firms invested in Vietnam's tech sector, South Korea's Samsung, which assembles most of its smartphones in the country is already Vietnam's largest foreign investor, therefore it is unclear of how much added value Vietnam would get. The influx of Chinese investments could also negatively impact Vietnam's economy if the US decided to impose tariffs on Vietnamese exports suspected of having Chinese origins. The increase in Chinese labours will also increase the salary of workers as the minimum wage in China tend to be well below the minimum wage in Vietnam, where in Vietnam the minimum wage ranges from US$120 to US$170 while in Guangdong, China the minimum wage is $315. Without an increase in productivity, any increase in wage demands would only translate to increased costs towards the economy.

Having weighed up the pros and cons of the trade war, some would argue that the war was never driven by economic reason rather it was for political gain. As political populism wins over sound economic policy, President Trump may be using China to solidify his electoral base in his presidential re-election campaign. By painting the false image of the US being exploited by China, President Trump is able to justify his raises in tariffs and falling trade deficits as a win towards the U.S. economy. President Trump also stated that if the democrats were to win next year's election, America would be ripped off[6], further proving that President Trump is wielding the war as an election weapon.

To conclude, the trade war is a war created by the U.S., fought by the U.S. against the U.S. with a rippling effect towards the global economy and nobody wins. As the outcome of the trade war is a lose-lose for both nations and all parties involved where exporters will lose from a fall in the volume of exports while importers lose from paying higher prices, it is in both nations best interests to end the trade war immediately. Yet, political reasons deters this from happening as President Trump would have to declare a victory in the trade war whereas President Xi would have to justify China being an economic superpower by not giving in to U.S. pressure, hence it is unlikely that the war will end any time soon. If both countries were to compete in a friendlier way by opening up trade barriers, a higher level of innovation and efficiency would be achieved, leading to a net welfare gain. To quote David Ricardo, "Under a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each. This pursuit of individual advantage is admirably connected with the universal good of the whole."

(1621 words)

[4] https://data.worldbank.org/indicator/NE.EXP.GNFS.ZS?end=2018&locations=MY&start=2006

[5] https://www.thestar.com.my/business/business-news/2019/02/25/malaysia-in-need-of-growth-story

[6] https://twitter.com/realdonaldtrump/status/1127337211777757191?lang=en

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