

TRADE WAR PERSPECTIVE

Recent tariff announcements by both the US and Chinese governments have increased investor fears of an expanded trade war. Free trade is a good thing, and while trade deficits themselves are not a reason for a trade war, eliminating tariffs altogether would still not ensure that those deficits would go away. The United States' trade deficit with China is due in part to China's higher tariffs on imports and attempting to eliminate these are worth the effort.

Forty years ago, China's economy was in the dark ages. In the early 80's, they began to implement capitalistic principles such as property rights, open markets, and free wages. As advances in technology were adopted, economic growth began to take off. Eventually, China began to lose respect for intellectual property by stealing the work of companies located abroad. Years of disregard for others' intellectual property rights have complicated the economic and diplomatic landscape.

The Boat

President Reagan once said that we are all in the same "trade" boat, metaphorically speaking. If someone shoots a hole in the boat, it doesn't make sense for us to retaliate by shooting another hole in it, as eventually the boat will sink. The moral of the story is that too much protectionism does much more harm than good.

However, the increase in new tariffs are not enough to sink the economy into a recession. The simple math is \$100 billion in tariffs spread across over \$14 trillion of consumer spending, which results in a small impact. The alternative is to allow China to continue to abuse or ignore intellectual property rights by stealing from others. For virtually all involved, this alternative is neither acceptable nor palatable.

The numbers reveal China would end up the loser in a long-term trade war with the U.S. Last year the U.S. exported \$180 billion in goods and services to China (0.9% of U.S. GDP) while China exported \$559 billion to the U.S. (4.6% of their GDP). The U.S. holds significant leverage in both economic strength and alternative supply chains, meaning an extended trade war would inflict significant long-term damage to China's economy.

It is highly unlikely that these facts are unknown by Chinese officials. China's long-standing disregard for the intellectual property rights of its trade partners may leave them more isolated than they want to believe. China needs the U.S. (and the west) for their economy to continue to grow, meaning a full-blown trade war is unlikely to happen.

