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Article

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Intereconomics

Suggested Citation: Plummer, Michael G. (2019) : The US-China Trade War and Its Implications for Europe, Intereconomics, ISSN 1613-964X, Springer, Heidelberg, Vol. 54, Iss. 3, pp. 195-196, <https://doi.org/10.1007/s10272-019-0822-3>

This Version is available at:

<https://hdl.handle.net/10419/213216>

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The US-China Trade War and Its Implications for Europe

At present, Europe is transfixed by Brexit and its potential consequences, but it is not the only threat that European leaders are currently grappling with: the US-China trade war and its influence on the global trading system are also of concern, with the potential for short-term disruption and a medium/long-term threat to the global system. As this system has been to no small degree responsible for European prosperity in the post-war era and future growth will be predicated on a vibrant global marketplace, the current risks need to be taken very seriously. But does the US-China spat really threaten Europe? And might there be a positive side to it? What can Europe do to counter any negative spillovers?

Certainly, the sheer size of the US and Chinese economies ensures that the stakes are high. Together they constitute almost two-fifths of global GDP.¹ Most economic forecasters are sounding the alarm; for example, in May 2019, the Organisation for Economic Cooperation and Development (OECD)² warns that uncertainties associated with trade disputes between the United States and its partner countries are already negatively affecting growth and global business investment, which it now projects will rise by only 1.7% in 2019 and 2020, down by half (3.5%) from the 2017-2018 period. The breakdown in US-China negotiations in early May is already negatively impacting stock markets in the US. The escalation of tariffs on \$200 billion of US imports from China, and \$60 billion of Chinese imports from the United States, with threats of more to come from both sides, have significant potential to disrupt global growth.

The United States and Europe worked together diligently to build the liberal global system of governance in place today, and key European economies continue to participate with the US in like-minded economic organizations such as the OECD, the G-7 and the G-20. The US is also Europe's most important trade and investment partner, as well as a critical strategic ally. Hence, the inward-looking instincts of the 'America First' Trump Administration, including its skepticism regarding many of the global institutions that the US and Europe created, constitute a first-order threat to Europe. This is true with or without any US-China trade war. The decision to impose tariffs on steel and aluminum imports to the US based on national security considerations – currently being challenged in the World Trade Organization (WTO) – is causing global disruption in those sectors and downstream industries. Similar tariffs on automobiles, a key export of the EU to the US,³ are also being threatened. The US-China trade war flows from this new, muscular approach to US trade policy but is of second order concern to Europe.

Indeed, the Chinese policies that are being attacked by the US are equally unpopular in Europe. Criticisms regarding theft of intellectual property in general and trade secrets in particular are often aired in the European press and in laments of governments and the private sector, as are complaints regarding the treatment of the foreign affiliates of its multinationals. Alleged unfair trading practices of the Chinese government and its state-owned enterprises (SOEs) are a long-standing European grievance. Apprehensions regarding security risks are also shared; both the US and the UK have expressed strong concerns about Huawei.

Moreover, the competitiveness of American and Chinese firms is obviously suffering the most in this trade war and Europe could stand to gain from trade diversion benefits. For example, UNC-

- 1 The World Bank: World Development Indicators: Structure of output, available at <http://wdi.worldbank.org/table/4.2>.
- 2 OECD: OECD Economic Outlook, Volume 2019 Issue 1: Preliminary version, No. 105, Paris 2019, OECD Publishing.
- 3 Eurostat: EU-United States most traded goods, available at https://ec.europa.eu/eurostat/statistics-explained/index.php/USA-EU_-_international_trade_in_goods_statistics#EU-United_States_most_traded_goods.

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TAD estimates that EU exports would be the chief beneficiary of an escalated US-China trade war, with the EU capturing \$70 billion (\$50 billion of Chinese exports to the United States and \$20 billion of US exports to China).⁴ Alicia Garcia-Herrero uses a partial-equilibrium model and calculates even larger gains for Europe, given the complementarity of EU and US-China exports.⁵ These are not large figures relative to the \$20 trillion EU economy and would likely be temporary, but they could be significant at the sectoral and country levels.

With the breakdown in talks this month, it is unclear when negotiations will recommence. Both sides have strong economic incentives to make a deal but each government is currently boxed into a political corner and neither side wants to appear weak. Arriving at an accord this year would be important given the upcoming US elections in 2020. The US government is demanding concessions related to intellectual property, forced technology transfer, non-tariff barriers, agricultural purchases, services and enforcement, with the latter topic proving to be particularly sticky in recent negotiations.⁶ Most of these areas would have a positive spill-over effect on Europe and European firms would gain along with Americans. Agricultural purchases may be a different story: trade might be diverted away from European agricultural exports to China in favor of American exports. But overall effects would be relatively small for Europe.

In short, the big threat to the EU is not the direct impact of a US-China trade war per se, troubling though it may be. Certainly the US-China trade conflict has affected markets well beyond trade; conflict creates uncertainty, which weighs on confidence in the future and, hence, investment. But the bigger longer-term problem relates to the health and integrity of the global system.

What can be done to strengthen the system? The EU is already stepping up to the plate in the Asia-Pacific. For example, the US devoted eight years of intense negotiations to create a comprehensive, 'gold standard' trade agreement called the Trans-Pacific Partnership (TPP), which was signed by its 12 Member States in February 2016. However, President Trump pulled out of the TPP immediately upon taking office. Yet, the remaining 11 TPP countries have moved forward anyway and the resulting Comprehensive and Progressive Agreement on Trans-Pacific Partnership (CPTPP) went into effect on 30 December 2018. The CPTPP is remarkably similar to the TPP. Importantly, at least five other Asian economies (Indonesia, Korea, the Philippines, Thailand and Taiwan) have expressed interest in joining the CPTPP, and China is currently studying the possibility of membership. Particularly in its expanded version, the CPTPP might well deliver the type of global leadership that the architects originally intended – without the US.

Europe is also being pro-active with the Asia-Pacific: it has already concluded bilateral agreements with Canada, Chile, Colombia, Japan, Korea, Mexico, Peru and Singapore, and has negotiations underway with India, New Zealand, the Philippines, Thailand and Vietnam. A major study by the Centre for European Policy Studies (CEPS) and the World Trade Institute (WTI) considers the potential of an EU-China FTA and shows that there could be potentially large effects.

In sum, while US-China trade friction has created uncertainties and Europe will no doubt face some direct costs, the bigger threat comes from the new inward-looking approach of the US government. What will happen in the future is unclear. But what is obvious is that the rapid transformation of the global economy over past decades is demanding new, shared leadership. The EU needs to work with its Asia-Pacific partners, as well as the US, in order to update trade rules, reduce border impediments and lay the groundwork for a prosperous 21st century global marketplace.

4 UNCTAD: Key Statistics and Trends in Trade Policy 2018, New York and Geneva 2019, United Nations Conference on Trade and Development, available at https://unctad.org/en/PublicationsLibrary/ditctab2019d1_en.pdf.

5 A. Garcia-Herrero: US-China trade war: What's in it for Europe?, Bruegel, 23 August 2018, available at <http://bruegel.org/2018/08/us-china-trade-war-whats-in-it-for-europe/>.

6 See, for example, U.S., China Schedule more Talks, World Trade On-Line, 29 April 2019.