

US-CHINA TRADE WAR: IMPACT OF COVID-19 PANDEMIC³

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ABSTRACT

The development of China's economy has led to increasing political and economic tensions between US-China. Increasing imports from China caused to raise trade deficit in the trade balance of the US. Imposed and mutual increasing tariffs made desperate relations between these countries. Afterwards, these turned into the trade and currency war. The impact of the trade and currency war between the United States and China on the economies of other countries makes these issues one of the most pressing issues. These two countries signed a trade agreement to adjust relations, reduce the deficit. The most important problem is also the Covid-19 outbreak because, after the trade deal, the pandemic both made invalid deal and changed the economic balance in the world. The weakened pandemic trade between the two countries thus reduced the US trade deficit. The deficit increased again in the second half of 2020 with an increase in imports of medical supplies as well as medical masks from China. China was able to overcome the pandemic easily and recovered its own economy. The main purpose of this study is to study the trade war between the United States and China and its main reasons, how the Covid-19 pandemic affects the trade war. Other goals of the research are to compare the economic performances of the United States and China with the pre-pandemic period, to determine what changes have taken place in the US and China's economies as a result of the pandemic, to analyze these changes.

Keywords: US-China trade; trade war; currency war; Covid-19 Pandemic.

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INTRODUCTION

Today, globalization and trade liberalization make economies more interdependent. Trade relations between the countries are growing, and this leads to an increase in trade disputes between countries worldwide.

The United States is the world's leader for their own economic performance, and it has trade relations with a lot of countries, especially advanced ones and regional associations. US international trade relations have grown steadily over the past decades. The United States is the largest importer and exporter of goods and services in the world. Until 2010, the countries with which the United States had the most economic ties were the United Kingdom, Canada, Mexico, and Japan, but this list has changed since 2010. China's development has also boosted US economic ties with China, and China has become the United States' largest trading partner. The US was anxious to own economic indicators which belong to economic relations with China so, it imposed tariffs and quotas on many imported goods from China. All of these caused increase tensions and trade disputes in the US-China economic relations (Steinbock, 2018; Kapustina et al., 2020). This movement by the United States triggered the trade war between these two great economic powers. As China responds, trade tensions increased, and a trade war caused damages to both economies. However, this movement by the United States was a disadvantage for the United States, as there was a large deficit in the US trade balance in economic relations with China.

The Covid-19, which unexpectedly spread around the world in early 2020, has had a major impact on the world economy. During the pandemic, international trade relations between world countries weakened. This also affected US-China economic relations and trade war. The economic downturns were observed in both the US economy and China's economy, too. China was soon able to take control of the situation, and it became an instance for other world countries with its economic, political, health reforms and strategic movements. However, the United States realized late the severity of the Covid-19 pandemic. When they began to take precaution to prevent the pandemic, the United States was already at the forefront of the world list. Currently, the United States is at the top of the world list with its number of Covid-19 patients. The pandemic is causing many health, economic and political problems in the United States, as in the rest of the world. Although in the first months of the Covid-19 pandemic US-China trade war had subsided and had been adhered to economic deals for a while, the trade war persists. The two countries have blamed each other for many things, and now the allegations spread of Covid-19 has been included on this list, too.

1. BACKGROUND OF THE UNITED STATES AND CHINA ECONOMIES

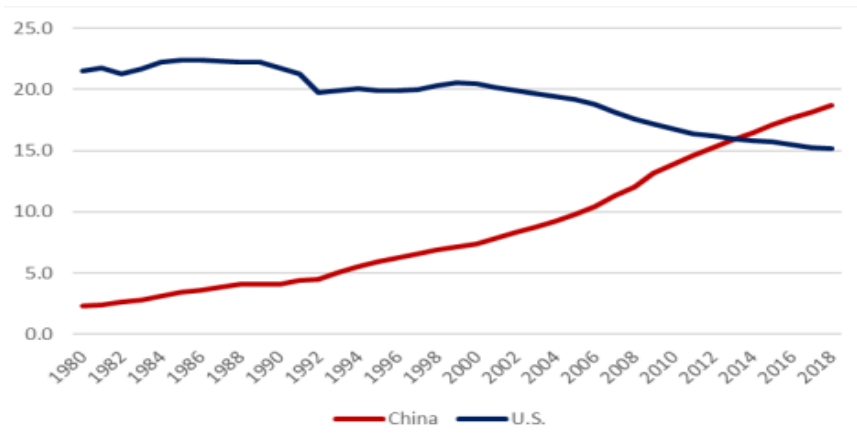
As in every country, the United States has a history of economic development with ups and downs. The Great Depression of 1929-1932, which caused great damage to the world economy and affected the economies of almost all countries, also had a great impact on the US economy. From 1929 to 1932, worldwide gross domestic product (GDP) fell by an estimated 15%. Compared to 2008-2009, the world's gross domestic product was 1% lower during the Great Depression (Lowenstein, 2015). Many measures and reforms have been taken in the United States to prevent the effects of the Great Depression. Although the consequences in many countries continued until World War II, the United States was more fortunate. President Franklin D. Roosevelt's reforms have an important role in ensuring economic development after

the Great Depression. As a result of Roosevelt's reforms, the United States differed greatly from other countries in terms of GDP in World War II. Of course, the United States had many advantages in World War II, most importantly its military and economic power and geographical position. In late 1943 and early 1944, at the peak of the United States' war effort, it was manufacturing almost as many munitions as all of its allies and enemies combined (Rockoff, 2005).

If we compare the economies of the United States and China during the Second World War, we can see that the United States is a world leader in terms of GDP, with many advantages, both economically and militarily, but China is not in its current position. However, how did China manage to reach its current position, becoming the world's second-largest economy?

China's economy was in recession during and after World War II, and the country had faced famine. This was due to the wrong reforms implemented by Mao Zedong, who was in power from 1943 to 1976. The foundation of the modern model of economic development of the People's Republic of China was laid during the reign of Deng Xiaoping, who came to power in 1978. He carried out some economic reforms related to the development of China's economy. The most important of these reforms was the Four Modernizations because Deng was able to achieve his aims in the economy, scientific and technological development, agriculture, and national defence with this reform (Mason, 1984).

Figure 1. US and China's GDP (PPP Basis) as a Share of Global Total: 1980-2018 (%)



Source: IMF, World Economic Outlook, April 2019.

One of the new reforms and realized basically as a mercantilist endeavour was called the Open Door Policy. The Open Door policy entails two main policy shifts: opening geographic regions to foreign investment and opening unique institutions across the country. The main goal of this policy was to stimulate China's export via the encouragement of the FDI and a decrease in dependence on bank loans. Foreign direct investment (FDI) is more flexible than bank lending, and it can also be used to expand manufacturing capacity and boost infrastructure. As a consequence of this policy, FDI has increased significantly, established free trade and state support, particular state-controlled institutions (Galbraith and Lu, 2000).

Another factor that drives the development of China's economy was joining the membership WTO. in 2001. This step has helped both developments of China and the World Economy. A developing export market and eliminating investment restrictions have caused China's capital growth. By joining the WTO, China has accepted all the accession requirements and agreements

set by the WTO. After that, China gained extensive trade relations with other members of the WTO. This event led to the liberalization of trade, an increase in exports and imports of China's products, a reduction in state-owned enterprises and an increase in privatization in the country.

In 2001 at its WTO accession, China's GDP stood at 1.33 trillion USD, while in 2014, it topped 10 trillion USD, increasing by nearly 8 times and ranking the second globally (Yuan, 2016).

2. RISING TRADE TENSIONS IN THE UNITED STATES AND CHINA ECONOMIC RELATIONS

After joining to WTO, the rapid development of the China's economy has made it one of the largest partners of the United States. The growing trade ties, the withdrawal of the United States from the Trans-Pacific Partnership, which maintains a balance in relations with China, have led to many trade disputes between the two countries.

Table 1. Share of US Merchandise Trade with Major Trading Partners
(as a share of US total trade, exports, and imports of merchandise)

Trading Partner	2000			2017		
	Total Trade	Exports	Imports	Total Trade	Exports	Imports
European Union	19.24	21.13	18.03	18.45	18.33	18.53
China	5.78	2.08	8.14	16.27	8.39	21.44
Canada	20.46	22.81	18.96	15.03	18.21	12.94
Mexico	12.32	14.18	11.13	14.40	15.70	13.55
Japan	10.53	8.20	12.01	5.28	4.40	5.86
Germany	4.39	3.75	4.79	4.39	3.47	5.00
United Kingdom	4.24	5.28	3.59	2.82	3.64	2.27

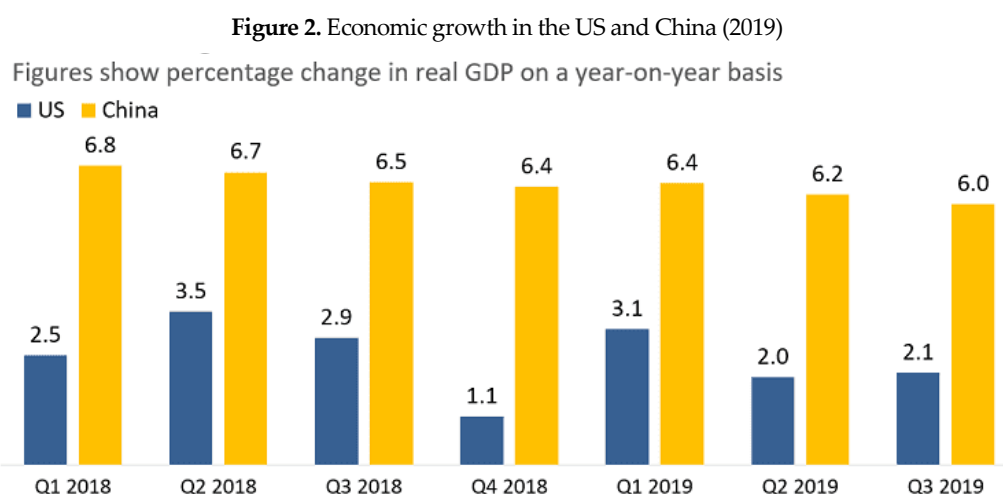
Source: CRS calculations with data from the US Department of Commerce, Bureau of Economic Analysis

This table demonstrates how imports and exports of the United States have changed from 2000 to 2017. In 2000, the largest trading partner of the United States was Canada. But in 2017, China was the largest goods importer of the US. According to table 1, in 2017, the share of the US imports from China is higher than the share of exports to China. This leads to a trade deficit in the trade balance of the United States. The US trade deficit has increased from \$ 103.1 billion in 2002 to \$375.6 billion in 2017. The trade deficit of the United States has increased further to US\$419.2 billion in 2018 in trade relations with China (Reuters, 2019).

In recent years, China has gained many achievements in the artificial intelligence and telecommunications technology sectors. Therefore, the majority of imported China's goods to the US are electrical machinery, technological and technical equipment. These nuances worried the United States, so in 2018, the president of the United States, Donald Trump, accused China of intellectual property theft and imposed very high tariffs on many goods imported from China to reduce the trade deficit. This was the first step in the trade war between the United States and China. President Trump's tariffs policy had targeted to encourage consumers to buy American products by making imported goods more expensive. This new trade policy agenda also emphasized the issue of protection of US intellectual property rights. President Trump imposed 25% tariffs on steel imports and 10% on aluminium from all suppliers in April 2018. From now on, China imposed further to 25% tariffs on 128 American products such as soybeans and airplanes (Reuters, 2020).

Both the United States and China impose additional tariffs and quotas for each other and third countries. China is also responding to US restrictions by devaluing the Yuan. The devaluation of the Yuan is boosting US consumers' interest in China's goods because now they can buy more China's goods than American goods. Overall, by January 2020, The US has imposed tariffs on more than \$360 billion of China's goods, and China has retaliated with tariffs on more than \$110 billion of US products (BBC, 2020).

In the first half of 2019, US tariffs triggered 25 per cent export loss, inflicting a US\$35 billion blow to China's exports in the US market for tariffed goods (UNCTAD, 2020). This trade war slowed down both the US economy and China's economy during the two years.



Source: The US Bureau of Economic Analysis, National Bureau of Statistics of China.

2019 can be considered the tensest year between China and the United States. Sales of one of China's companies Huawei are growing and suddenly surpassed the world leaders in this field, from a small company in China to a global company. Huawei became the second company in the world after Apple in the first half of 2019, surpassing Samsung. Following the incident, the United States imposed sanctions on some foreign companies. Although it did not say whether it was directly against Huawei, most of the products on the list were Huawei products. The US sanctions have affected Huawei's sales in the second half of 2019. That year, the United States has increased tariffs on China's products by 30%. Yuan was devaluated to 7.17 against the dollar, this was the lowest level of Yuan in a decade.

According to these indicators in figure 3, Yuan devalued further to its record level in 2019, compared to other years. Throughout history, China has devalued its currency to ensure its economic growth, regulate economic relations with other countries, and develop trade. The devaluation in 2019 and 2020 is due solely to tariffs and sanctions imposed by the United States on China's products and companies, as well as US-China trade relations in general. This is because the tariffs imposed by the United States have reduced sales of China's goods, as well as large China's companies. He caused them great damage. The devaluation of currency, the Yuan, has boosted consumer interest in China's goods. Currency devaluation impacted significantly on both the United States and China, other countries with which China has trade ties.

Figure 3: Yuan against US Dollar (2021)

Source: *tradingeconomics.com*

The US-China trade war is hampering the development of the global economy, directly or indirectly affecting many countries. But there are also countries that have benefited from the trade war, such as Vietnam, Taiwan, Mexico, Chile, Malaysia, Hong Kong and South Korea. Vietnam is the country that has benefited the most from the US-China conflict. Due to this trade war, the Vietnamese economy grew by 7.9%. It gained US\$6.4 billion from the end of 2017 to the end of 2019 (Schacht, 2020).

3. THE COVID-19 PANDEMIC EFFECTS ON US-CHINA TRADE AND CURRENCY WARS

As a prime theme of Trump's presidency, the issue of economic relations with China emerged. President Trump has specifically accused China of intellectual property theft, coerced technology, currency manipulation and state subsidies on several occasions. One of the driving forces, which caused the trade war was China's ability to become the world's main leader in the artificial intelligence and technology sector in a very short period.

After all these tensions, in December 2019, both China and the United States signed a "phase one" trade agreement to slow down the trade war and resolve disputes by mutual consent. That trade deal was about Intellectual Property rights and forced technology transfer and to reduce the trade deficit. According to 'Phase One' of the trade agreement, from July 2018 to November 2019, the US and China agreed to reduce some of the tariffs each side had levied concerning the other. Also, the US agreed to exclude China's goods from the tariff list and to reduce tariffs on \$160 billion worth of China's products from 15 per cent to 7.5 per cent. In the meantime, China has committed to rising US imports of services and consumer goods by \$200 billion over the next two years (Muhammad and Smith, 2020).

The Covid-19 pandemic, which began to spread from China's city of Wuhan in December 2019, is a major blow to the entire world economy, as well as to the leading forces in the economy. According to some economists, this pandemic is the worst global crisis in the world economy since World War II. According to some, the damage caused by the pandemic to the world economy and international trade relations is a mixture of the Great Depression of 1929-1933 and the Global Crisis of 2008-2009.

It would be more accurate to mention three different nuances related to the impact of the Covid-19 epidemic on the world economy.

1. The spreading of the Covid-19 in China. The effects of the pandemic on China's economy and its international trade relations. The disruption of global supply chains in China. The weakening of China's economy.
2. Influence on Europe and the United States. The influence of the pandemic on the US and European markets. Thus, the collapse of global stock markets.
3. The impact of the pandemic on developing countries and their economies, like India and Brazil.

The occurrence of the pandemic a month after the signing of the bilateral trade deal between the United States and China increased the uncertainty of the contract.

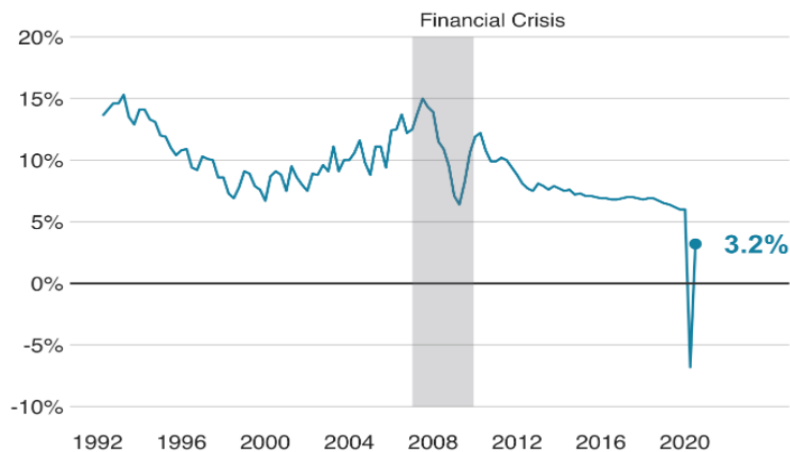
The pandemic was declared in China. Firstly in the first quarter of 2020, China faced an economic downturn due to the pandemic. So, China proposed to follow the commitments of the existing trade agreement to the US. China moves to eliminate restrictions, and weakened trade tensions with the US attempted the exemption of tariffs from 79 American products. But, the Trump administration rejected all suggestions from China. Even, Trump Administration accused of concealing important information about the Covid-19 pandemic, which could have prevented it from rapidly spreading in the rest of the world. President Trump threatened to adopt trade measures against China through the imposition of higher tariffs on China's goods as a punishment for the spread of the pandemic. On May 14 2020, the Trump administration decided to ban China's Company, Huawei, from using US software and hardware in strategic semiconductor processes. This was a violation of the trade agreement by Trump. After that, new agreements can be signed with the consent of both parties, or a new phase of the trade war can begin. The prolongation of the trade war during the pandemic does not benefit any country. Due to the effects of the pandemic, the global economy is weakening, and global economic growth is declining (Chen et al., 2020).

China's economic potential, the pre-virus economic situation, and technological discoveries make it easier to fight the pandemic. It has fought against the virus by high economic costs, medical equipment, severely principles at the earliest stage. China summarized "four early" that is early detection, early reporting, early quarantine, early treatment, and it could take control over the pandemic (Yong, 2020). China's scientists, their special principles, medical-technological equipment, 5G and other high-tech methods have an important role in China's fighting against the virus.

In March 2020, the World Health Organization announced the seriousness of the virus to the world. China was already in a period of economic growth when the situation in other countries began to deteriorate. As it emerged from the quarantine, China's economy continued to expand more strongly than expected.

China's economy began to recover in the second half of 2020 following a record economic downturn and grew 3.2%. China's ability to rebuild its economy and slowly cope with the pandemic has been moral to other countries.

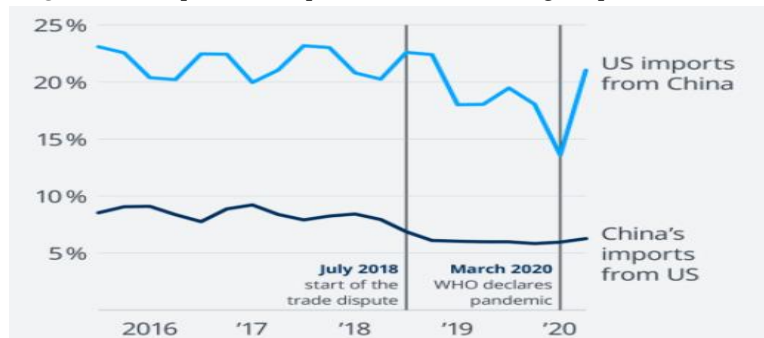
Figure 4. Recovery of China's economy, GDP. (2020)



Source: National Bureau of Statistics of China.

During the pandemic, US-China economic ties weakened due to a number of reasons, including closed borders, quarantine, and the cessation of production in many enterprises of both countries. The suspension of imports and exports with China for a period was also reflected in the US trade deficit. However, with China's economy recovering from the second quarter of 2020, it has been able to provide for the needs of countries such as the United States. The increased imports from China are related to more imports of health suppliers and equipment, medical face masks. For instance, imports of face masks from China to the United States have increased more than 10-fold. (figure 5)

Figure 5: US imports and exports from China during the pandemic (2020)



Source: ITC trade map.

<https://www.dw.com/en/the-real-winners-of-the-us-china-trade-dispute/a-55420269>

China was the only country in the world that was able to recover its economy at an unexpected time and with unpredictable results. In the second quarter of 2020, the world's largest economic power, the United States, was still fighting the Covid-19. However, the United States couldn't take control of the situation in the country. The number of infected was constantly growing. Lack of anti-virus precautions and lack of seriousness against the virus aggravated the situation in the country. The fact that there were more private hospitals in the country than public ones meant that not everyone could pay for treatment. This was one of the factors complicating the attempt to prevent the spread of the virus. The United States still ranks first in the number of infections. The total number of infections is very high compared to China.

The US economy plummeted in the spring at a record pace, but in the quarter that is just ending, it is poised to swing to a record rise. According to, The Commerce Department, the US's Real GDP has fallen at a rate of 31.4% in the April-June quarter. However, we cannot say that this is a consequence of the pandemic for the US economy.

Overall, China and the US trade war weakened somewhat in 2020. Although trade relations have weakened at the beginning of the year, given information by China's national Bureau, US-China trade relations have grown quickly in the third quarter of 2020. The pandemic has affected and continues to affect not only the trade war but also the economic relations, economic, political and health conditions of all countries worldwide. Although some economies can cope with the pandemic, the situation is critical in many countries. As the United States and China are strong economies in the world, the impact of the pandemic has been felt more in these countries. In 2020, the visible changes in the US and China's economies have also affected many sectors of the economy. It has reduced the country's imports, exports, the level of production and investments. In such a situation, it is in the interest of both countries to ensure their own economic growth, which is reflected in the US-China trade war. In early this year, the United States blamed China for the spread of the virus, but China was the fastest-growing country and helped other countries about it.

Figure 6: China and US (2020) (FX vs Daily new Covid-19 active cases differential)



Source: Bloomberg Professional.

<https://www.cmegroup.com/education/featured-reports/covid-19s-influence-on-exchange-rates.html>

The impact of the pandemic on China's economy has changed many indicators, both in the economy and trade. The decline in imports and exports was a major disadvantage for trade. This situation of trade has affected many areas, such as the economy. Most importantly, exchange rate dynamics approached unexpected results again. The main reason for this was the decline in foreign investment into the country. When active patients were declining in China, and the number of patients was high in the United States, China's economic ties with the United States began to grow again. The period when the pandemic first began to spread, in early 2020, was the devaluation of the Yuan against the dollar to 7.10. However, the peak of the devaluation was in June-July during 2020. In June, the dollar was 7.16 Yuan. As a result of the recovery of the economy after June, the value of the Yuan against the dollar also rose from June until October to 6.75. China earned about 6% from this. The dependence of the devaluation of the Yuan against the dollar on the number of active patients can be seen in the graph below.

Although the pandemic slowed down the trade war between the United States and China for a while, it led to an escalation of the currency war. When China took advantage of the situation to re-devalue its currency to make a profit, the United States was taking steps to reduce the number of active Covid-19 patients so that the country could return to its previous state. In this situation, the main reason for the growing role of China's currency on the global scale was the emphasis on e-RMB. Using its e-currency, China has been able to ensure digitally the development of areas that weakened due to the pandemic. China's move has boosted e-banking, e-commerce, e-marketing. Of course, China's digital currency cannot suddenly become important in international trade. Because, for internationalization, a digital currency must overcome many difficulties like people's habits of use, the rate of use of the dollar around the world. The increase in the role of e-RMB in the international market meant the decrease in the role of the dollar, which is the most widely used in the world trade market. This can be considered as another stage of the currency war.

The Covid-19 pandemic, a global problem of 2020, has affected the development of the world economy, trade relations significantly. Changings, Recessions in the United States and China's economies changed trade and currency wars' directions, caused to begin of the wars to another level. In 2021, we can observe how the Covid-19 pandemic has impacted the US and China's economies and the pandemic results for these economies. In the first quarter of 2021, 18.3% growth has been observed in China's economy over the same period of last year. This is proof that China can easily overcome the pandemic by showing record growth.

CONCLUSION

The main goal of the countries during the pandemic was to fight the against Covid-19 pandemic and restore their economies to their previous situation. We cannot say anything exactly about the consequences of the pandemic for a trade war because the effects of the pandemic are still ongoing. So far, the pandemic has affected many countries, changed all conditions in global trade.

Both the US and China's economy weakened due to the pandemic at the beginning of 2020. Pandemic changed the direction of the trade war between China and the United States. Disputes that the parties tried to delay have resurfaced. The United States has blamed China for the Covid-19 pandemic. In the first half of 2020, trade relations, the level of economic growth, production and investment of both countries completely weakened. In the second half of the year, China's potential made it easier to overcome the pandemic. China's economic recovery has led to all other countries' economic growth. Increased exports of medical supplies from China have boosted foreign trade with the United States. Although the US deficit declined at the beginning of the year, this later led to a growing trade deficit again in the trade balance of the United States. The devaluation of the China's Yuan has prompted the United States to accuse China of currency manipulation and to rekindle tensions. E-commerce, e-education, e-bank, e-marketing, digital currency operations have developed.

In short, although the pandemic has reduced trade disputes between the United States and China, the trade war is still going on. As a result, the pandemic has weakened both the US and China's economies, along with the rest of the world economy, in the first half of 2020. In the second half of 2020 and the first quarter of 2021, countries began to overcome the pandemic and fix problems, which appeared due to the pandemic. China's economy developed record level of

18.3% by compare last year's same period. Although China was the first country to overcome the virus and has developed such, the pandemic period is characterized by low economic growth and high unemployment in the whole world economy.

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