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What's at stake in the tariff negotiations between the US and China

May 22, 2018 3.29pm AEST



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Whether or not China and the US are successful in negotiating out of a trade war and restoring the integrated global economy, there will still be strategic tensions between the nations. THOMAS PETER / AAP

The United States and China have put on hold plans to place tariffs on exports, in an effort to avoid a trade war. Our analysis shows just how important these negotiations are, with the impact of trade wars adversely affecting both economies and others like Australia.

The threat of a trade war started when US President Donald Trump announced 25% tariffs on Chinese imported electronics, aerospace products, and machinery. China retaliated hours later and announced 25% tariffs on US exports to China.

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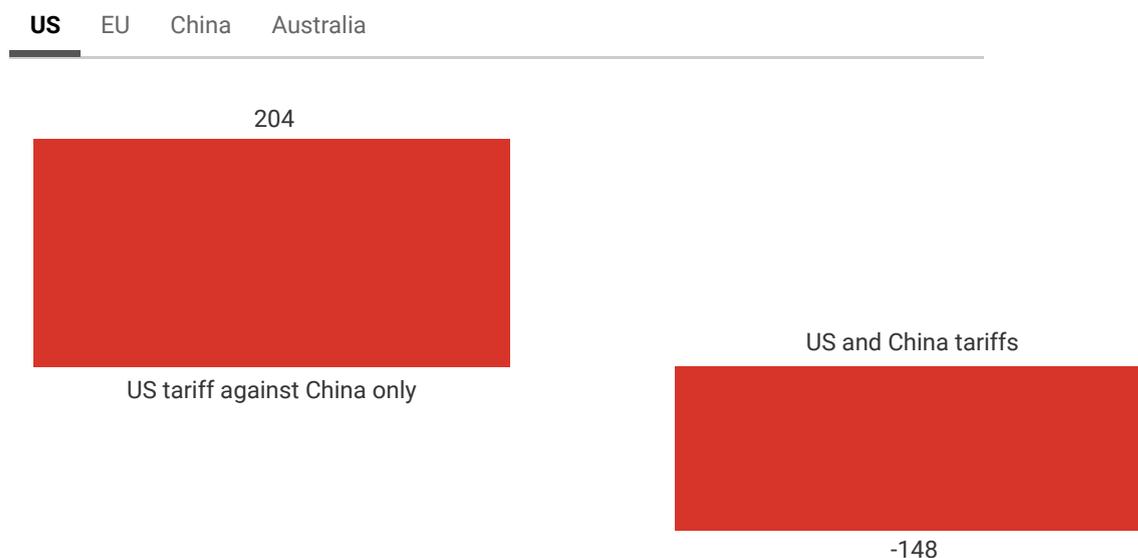
Now both sides are agreeing to take “measures to substantially reduce the United States trade deficit in goods with China” and to work on expanding trade and protecting intellectual property.

We modelled a number of scenarios showing all increases in US or Chinese protection would cause international trade, and the global economy more generally, to shrink. We also find interest rates would rise everywhere and the Australian dollar would depreciate.

China and US trade would then fall by between a quarter and a third, depending on whether the tariffs are hiked unilaterally or bilaterally. Australia’s lucrative exports to China would also fall as US demand for China’s goods fall and China requires smaller quantities of Australian goods to produce them.

Because Australia is a small, open economy that is strongly influenced by developments abroad, the impacts of rising protectionism can be as large here as they are in the US and China.

Effects on incomes of 25% US tariff on imports from China, with and without retaliation (US\$)



Real disposable income per capita in US\$

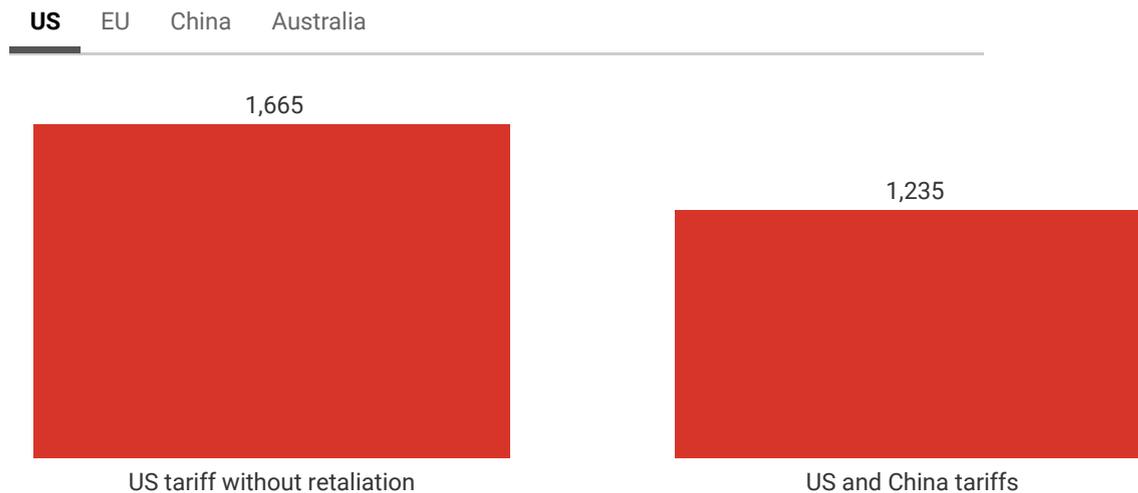
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We found if US imposed tariffs but there was no retaliation abroad, the rise in tariff revenue would provide relief for the US economy and that this would raise the after-tax incomes of Americans even though US GDP would fall. However, we found after-tax incomes would fall everywhere else.

If China retaliated to the tariffs, all countries and regions would suffer losses, with Australia’s net loss among the largest, in per capita terms. The effects on China would be the largest, relative to their current disposable income. Because China would suffer the largest proportional loss of welfare, their government would have the strongest incentive to negotiate.

We expect any initial effects of tariffs on both sides to be slight, in small part this is because it will cause trade to be diverted to and through other countries. Because trade is likely to leak around the new protectionist barriers, the US and China could choose to impose the protection on imports from all countries.

Effects on incomes of 25% US tariff on all countries' imports, with and without retaliation from China (US\$)



Real disposable income per capita in US\$

If this were the case global losses would be very much larger, and they would be borne primarily by third countries, including Europe and Australia.

One possible silver lining of this scenario for central banks would be inflation in the advanced economies like Australia, causing interest rates to rise. This would take pressure off the central banks, which have been struggling to prevent costly deflation.

While the US President continues to bring up a trade deficit with China as a concern, most economists agree that trade imbalances depend most on differences in saving rates.

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The US is threatened by the continuing rapid expansion of the Chinese economy and because US firms have to relinquish intellectual property in order to enter the large and growing Chinese market. The US also fears China's move toward more sophisticated manufacturing and services under the "Made in China 2025" plan.

Whether or not China and the US are successful in negotiating out of a trade war and restoring the integrated global economy, there will still be strategic tensions between the nations. These will create political pressure for stronger trade interventions in the future and will place countries like Australia at risk of substantial economic losses.



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Trade

Economics

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trade deficit

Donald Trump

Tariffs

Trade wars