Article

The Impact of the US–China Trade War on the European Union

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Abstract

Since April 2018, the USA and China have been engaged in a trade war. Because of the importance of these two countries in world trade, this dispute does affect not only the Chinese and American economies but also the entire world. Several studies have shown the impact of this dispute on different countries in Asia, but little was done to study the effect on European Union (EU) member states. The trade war between the USA and China should not let us forget the trade disputes between Washington and Brussels on one hand and EU–China trade differences on the other hand. This article will take stock of European policy towards the USA and China in this trade war; we will study the consequences of the US–China trade war on the exchanges between Europe and China and analyze the possible diversion created by this trade war for the European market.

Keywords

Trade war, EU, China, trade diversion

Introduction

Since the decision taken by the Trump administration to tax imports of Chinese solar panels and washing machines in January 2018, the trade war between the USA and China has only worsened with new custom barriers and boycott threats. Neither of the two powers will be able to emerge victorious from this dispute. Already, in the USA, the consequences are felt in certain sectors of activity, such as agriculture, particularly because of the Chinese decision to no longer import American soybeans. China is also starting to suffer from this trade dispute. Its relative economic slowdown is partly due to the trade war with the USA.[1]

Despite the threats to the US and Chinese economies, trade negotiations between the two powers do not seem to be progressing. President Trump's twitter diplomacy, recently illustrated by the announcement of additional tariffs of 10 percent on the US$300 billion worth of Chinese imports not yet taxed from September 2019, does not encourage a rapid resolution of trade negotiations between China and the USA.

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Consequences of War Trade on World Economy and Third Parties

Because of the importance of trade between the USA and China and their weights in the world economy, the consequences of this trade war are not limited only to the USA and China, but it is also likely that this dispute may provoke a possible global economic crisis today.

A Threat to World Growth

There is a consensus among world leaders and banks about the dangers of the current US–China trade war on the world economy. For former US Treasury Secretary Lawrence Summers, the world is at the most dangerous financial moment since 2009 (Yeung, 2019). The possible weakening of the Yuan could, among other things, raise China's borrowing costs and slow down the world economy. For Jean-Claude Juncker, the European Commission President, "The trade relations between China and the United States are difficult, they are contributing to the slowdown of the global economy" (Rampton, 2019). For the French bank "Société Générale" (Xu, 2018), the trade war between the USA and China might not lead to a global financial crisis but could impact the growth of Asian economies. This finding is shared by the IMF (2019); according to Ms. Christine Lagarde, the US–China trade war could reduce the level of global GDP by US$455 billion in 2020.

Trade War and Diversion: The Case of Vietnam

In a trade war, the two belligerents are economically impacted, as Chinese President Xi Jinping said in his speech at the 2017 Davos Forum: "No one can win a trade war," but the effects of a trade war on third parties are relatively difficult to measure. In their study on the impact of trade sanctions between the USA, China, and Mexico, Antoine Bouët and David Laborde (2017) note that all parties suffer from the new tariffs set up by the US administration.

Yet, it is commonly accepted that trade wars can be beneficial to some third parties, following the principle of diversion. According to this principle, to avoid and circumvent the new sanctions, companies seek to go through other countries. These third parties then see the development of certain activities targeted by the trade war. For example, according to a report by the Singapore-based DBS bank, the current trade war between China and the USA could create investment opportunities in the city-state (Seah, 2018). Vietnam was also seen at first, as a possible beneficiary of the Sino-US trade war; Huang (2018), CNBC, headlined in September "Vietnam could be a 'winner' from the US-China trade war."

To avoid taxes decided by Donald Trump, foreign and US importers alike have used Vietnamese companies, particularly in the textile sector. US imports of Vietnamese products thus increased by nearly 40 percent during the first 5 months of 2019 (Pierson, 2019). According to a study conducted by the Japanese bank Nomura (Subbaraman, Varma, & Loo, 2019), Vietnam was the first country to benefit from the trade war between the USA and China gaining almost 9 percent of GDP from trade diversion. However, the situation is complex, if large groups begin to relocate their production from China to Vietnam or are preparing to do so like Apple (Li & Cheng, 2019), it is more difficult, especially for Chinese small and medium enterprises (SMEs) to relocate their production in Vietnam. First, the country needs time to develop its production capacity, and must build new infrastructure, especially in logistics, to be able to meet the demand formulated by foreign companies. In addition, Vietnam is also not immune to new US taxes. Since December 2017, the USA has imposed taxes on steel imports from Vietnam.

Washington justifies these taxes by the fact that most Vietnamese steel actually comes from China, South Korea, or Taiwan; and so, these three countries may avoid the antidumping measures put in place by Washington. Thus, several economists suggest that Vietnam could become the next target of Donald Trump. In June 2019, the US president, in an interview with Fox Business Channel, called Vietnam *almost the single worst abuser of everybody*, and wanted to force Hanoi to buy more US products as Vietnam's trade surplus with the USA reached almost US$40 billion in 2018. In July 2019, the US Department of Commerce announced some 456 percent duties on Vietnam steel imports using material from Taiwan or South Korea (Hutt, 2019).

A Global Trade War

Trade wars have been fought in the past, but the current trade war presents a unique dimension. Without going back to the rivalry between the British and Dutch empires of the seventeenth and eighteenth centuries or the commercial tensions between Japan and Western countries in the 1920s and 1930s (Stein, 1935/2011), several commercial wars have weakened the world economy for the last 40 years (Bac & Raff, 1997). However, the current trade war between the USA and China is different from the previous ones. First, the main protagonists are the world's two largest economic powers, and together accounted for nearly 40 percent of annual global wealth production in 2018.[2] The importance of the states in conflict could contradict John Conybeare (1988), an expert on the question of—commercial—wars who stated:

> It is also highly unlikely that U.S. trade policy alone could effect any major change in international political relationships.

Moreover, this dispute between the USA and China is not only about trade, but some of them have compared this trade war with the dispute between the USA and Japan during the 1980s. But in the case that interests us today, the speech that accompanies this trade dispute is much more martial. In late July 2019, at the Aspen Security Forum, John Rood, Undersecretary of Defense for Policy, warned that China could challenge global order (as constructed by the USA) (Elmer, 2019). In China's 10th defense white paper, published by Ministry of National Defense of the People's Republic of China (2019), Beijing points to the growing competition with the USA. This dispute is therefore not only motivated by economic reasons, but also parties involved could make decisions that would not be economically rational. According to Jack Ma, the founder of Alibaba conglomerate, the trade war between the two countries could last for decades (Kawase, 2018). We can also argue that this trade war is not limited to a single industry but is global in nature. It is not only about agricultural products or new technologies, such as the one that opposed the USA to Brazil in the late 1980s (Schoonmaker, 2002), but it also looks at every aspect of trade between the USA and China.

Furthermore, because of the complex nature of the US and Chinese economies (Atlas of Economic Complexity, 2017) and the variety of products covered by tariffs, this trade war directly and indirectly affects many Chinese, American, and foreign companies alike. It should also be noted, as we will see later in this article, that the current US–China trade is not the only trade dispute launched by the USA, but also that trade wars are likely to become the rule for the USA to attempt to solve its trade issues. Generally, states seek to resolve their trade disputes through international institutions such as the World Trade Organization (WTO); this was for example the case for the dispute between the USA and the European Union (EU) about the competition between Boeing and Airbus (Düsseldorf, 2015). Finally, the US–China trade war sets a bad example to settle dispute the hard way for other nations. We may argue that the US–China trade war has somewhat created the other trade war that has been shaking Asia since July 2019 pitting Japan against South Korea. The origins of this conflict are different from those of the Sino-US dispute, as the Japan–South Korea trade dispute is fueled by the legacy of World War II and the use of forced labor during the Japanese occupation of Korea (Johnson, 2019), but economic sanctions formulated by South Korea and Japan are reminiscent of the method used by Donald Trump.

Where Does the European Union Stand on the US–China Trade War?

Could the EU member states benefit directly or indirectly from the trade war between the USA and China, like Vietnam? The EU is the largest economy in the world. In spite of growing populism in Europe, the continent still promotes free trade. The EU disapproves the tariffs implemented by the USA and calls for a de-escalation between Beijing and Washington.

It is difficult to predict if the EU will benefit from the US–China trade war because of the unprecedent dimension of this dispute. However, some media and banks still argue that the US–China trade war may create opportunities for EU member states. According to a research conducted by the United Nations Conference on Trade and Development (UNCTAD, 2019), the EU exports would capture up to US$70 billion of the US–China bilateral trade. Among EU member states, Germany and France would be the most likely to benefit from this dispute according to Barclay. European companies may gain market share in China, thanks to trade substitution caused by tariffs (Smith, 2019). According to the bank's estimations, European exports to China may increase by 0.1 percent of GDP and the European car industry would be the biggest winner of this trade war. But this assumption proved not to be right, as China's car market has been suffering from slow growth since July 2018, hitting European carmakers; in early August 2019, France's Peugeot Société Anonyme (PSA) just announced to drop two auto plants in China (Sun & Frost, 2019).

But other studies show that, on the contrary, the trade war between the USA and China has negative consequences on the European economy and in particular on European companies present in China. In September 2018, the European Union Chamber of Commerce in China (2018) published a report based on a survey conducted among European companies in China. According to this study, nearly 54 percent of European companies in China considered US tariffs on Chinese goods negatively, and 42.9 percent of these companies said China's tariffs on American imports negatively affected their activities. Only 4.2 percent of them approved of these tariffs. According to this study, three quarters of European companies in China did not intend to change their mode of operation despite the US and Chinese tariffs.

In the Business Confidence Survey 2019, published by the European Union Chamber of Commerce in China (2019) in May 2019, the US–China trade war ranks fourth among the issues identified by European companies in China (after the slowdown in Chinese growth, the slowing of the global economy and the rising cost of labor in China).[3] These tariffs are therefore not an opportunity for European companies present in China.

European Union's Independent Position in the US–China Trade War

In Europe, most leaders called upon the USA and China for negotiations and warned that this trade war may disrupt economic growth in Europe and in the world. For Dutch minister of foreign affairs, Stef Blok, "Nobody has an interest in a trade war and free trade is crucial for the Netherlands" (Pieters, 2019). This position is shared by every EU member.

The USA and European Union's Common Concerns Regarding China

Washington and Brussels share some concerns about China's trade policy. First of all, the USA and the EU both have a large trade deficit with China (US$419 billion for the USA and €185 billion for the EU in 2018). However, within the EU, the situation varies from one state to another. According to Eurostat, in 2018, Germany had a trade surplus with China, while France, Italy, or Spain suffered from a trade deficit. This difference does not allow the EU to formulate a common policy on the issue of trade with China.

Both the USA and the EU express some concerns about China's state-owned companies and fair competition and are asking for reciprocity in trade. Although China is further opening its market to foreign companies, it is still denied the "market economy" status at the WTO by both the USA and the EU. Washington and Brussels have also complained about possible breach of intellectual property rights by Chinese companies.

Furthermore, the USA and the EU feel challenged by world growing interest for China's Belt and Road Initiative (BRI). Whereas Washington has rejected this program, the EU has mixed perceptions about the BRI, as several EU members chose to join China's initiative. Moreover, the EU–Asia connectivity plan developed jointly with Japan does not stand as an alternative to the BRI, but as a complementary project. Although the European Commission described China as a systemic rival (European Commission, 2019), the EU is looking for developing cooperation with China.

The European Union, Another Target of the "America First" Strategy

It is difficult for the EU to side with the USA on the trade war with China, since Brussels is also the target of US sanctions or threats of sanctions. From April 2018, the USA has started to impose a 25 percent tax on steel and 10 percent tax on aluminum from the EU. Since then, the Trump administration had threatened the EU with new taxes. The car industry is particularly at risk. In August 2018, Trump said at a campaign rally:

> We're going to put a 25 percent tax on every car that comes into the United States from the European Union. (Ewing, Swanson, & Rich, 2018)

In May 2019, the US administration postponed decision on (European) car tariffs for 180 days. But, in August 2019, President Trump repeated his threat to impose tariffs on European cars, although he then stated he was only "kidding" (Reuters, 2019). The Trump administration also threatened to increase tariffs on French wines[4] and other symbolical European products.

European companies may also face further sanctions from the US administration for trading with Iran. In May 2018, Trump decided to pull out of the Joint Comprehensive Plan of Action (JCPA). Although European nations remain committed to maintaining the Iran nuclear deal, several European companies decided to leave from the Iranian market for fear of US sanctions. For example, in August 2018, France's Total officially left its gas project in Iran, for the benefit of China's CNPC.

Finally, the USA and the EU are also divided on the Huawei case. For Trump, Huawei poses a threat to the national security of the USA. After targeting the Chinese company ZTE, the US administration pointed to the possible dangers posed by Huawei, and in August 2018, US agencies were no longer allowed to use equipment made by Huawei. Washington decided to ban US networks from Huawei equipment. In February 2019, the US State Office officially discouraged European allies from using Huawei equipment in their 5G rollout. However, Europeans chose to ignore US pressure for Huawei ban but were planning for more coordination among EU members regarding security risks. Europeans are still concerned about Huawei's technology dominance, but contrary to the USA, Europe has become heavily dependent on Huawei for 4G development and 5G rollout. A Huawei ban would strongly affect the future development of 5G in Europe. Furthermore, although Washington is considering Huawei a possible national security threat, President Trump declared that sanctions against Huawei could still be lifted as part of a trade deal with China (Phelan, 2019). However, the US pressure on European countries to ban Huawei has not ceased. In August 2019, John Bolton, US National Security Adviser, strongly advised UK Premier to back US position on Huawei, despite Huawei agreeing to fully abide by all UK security regulations. The "America First" policy is a strong deterrent against a shared US–EU position on trade with China.

Measuring European Union–China Exchanges Since the USA–China War Trade

While it is difficult to measure the economic impact of the Sino-US trade war on the EU, we can still consider whether the weakening of relations between China and the USA benefits the EU. For this purpose, we propose to use some indicators to measure exchanges, including trade, FDI, universities exchanges, and visitors.

Increasing Trade Between European Union and China

First, we must notice that imports from China to USA rose by 6.8 percent in 2018 in spite of tariffs, and US exports to China decreased by 7.5 percent (US Census Bureau, 2019). It means that US trade deficit with China continues to grow in 2018. Actually, US trade deficit with China hits highest level in history at US$419,527 million, it represents nearly half of total US trade deficit (47.9%).

Meanwhile, both EU imports and exports from and to China continue to rise. EU imports from China grew by 5 percent from 2017 to 2018, while EU exports to China increased by 6.2 percent.

Although it is difficult to state that EU exports to China supersede US exports, we can note that the US–China trade war did not negatively affect the overall EU–China exchanges.

Comparison Between China's Direct Investment in the USA and in the European Union

One of the major outcomes of the US–China trade war is the sharp drop of China's direct investment in the USA to the lowest level since 2011. China's direct investment in the USA in 2018 was worth only US$4.8 billion, down from US$29 billion in 2017 and US$46 billion in 2016. This low level of investment results mainly from Beijing's deleveraging campaign to prioritize the domestic market over foreign acquisition. The Rhodium Group (Hanemann, Gao, & Lysenko, 2019) also noticed some asset divestitures conducted by Chinese companies in the USA to reduce their debts level. However, this trend must be qualified insofar as about one-third of these divestitures were carried out by Chinese HNA group, a heavily indebted consortium that had developed acquisitions abroad.[5] So, these divestitures may not directly result from the US–China trade war. The USA is not an exception, China's direct investment in the EU did also decrease in 2018. China's direct investment in the EU represented €17.3 billion in 2018

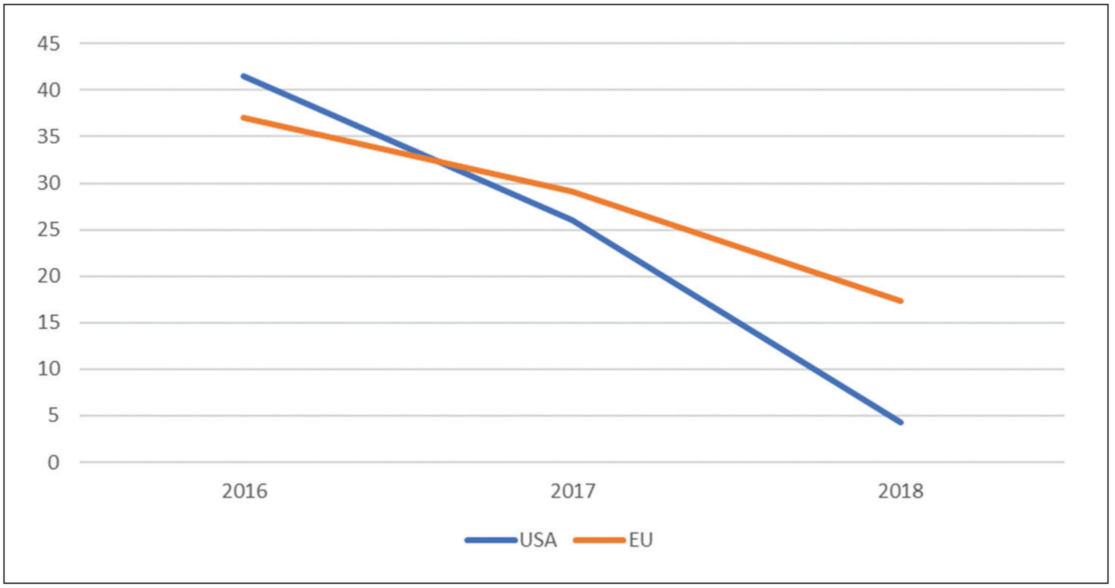

Figure 1. China's Direct Investment in the USA and European Union (€billion)

Source: Data compiled by author on basis of statistics provided by Rhodium Group.

down from €29.1 billion in 2017 and €37 billion in 2016 (Hanemann, Huotari, & Kratz, 2019). There is a growing concern in Europe, especially in Germany and France about Chinese acquisition of critical technologies that may further reduce the China's direct investment in Europe.

US real estate sector, especially on the West coast, may also suffer from the US–China trade war. In spite of tight capital control carried out by Beijing, Chinese middle-class is used to heavily investing in the US real estate sector; China has become the largest foreign buyer of the US residential real estate since 2014. In 2018, one-fourth of the total foreign investment in US residential real estate was conducted by Chinese private investors. But according to US National Association of Realtors, the volume of transactions performed by Chinese declined by more than 50 percent in 2019 (Olick, 2019). This is caused mainly by Chinese tighter regulations on investment abroad.

In Europe, Chinese private investors are especially interested in golden visa programs offered by Portugal and Greece that give them an EU residence permit; they do also invest in the UK, the main destination of Chinese investors in real estate in Europe, in Germany, and France to give to their children access to top foreign universities. According to Juwai (2019), a Chinese real estate consulting company, the European market will continue to attract Chinese buyers for the next years because of the stability of the European market.

More Chinese Tourists Visiting Europe

With regard to tourism, we can note that for the first time in 2018, the number of Chinese visitors to the USA decreased by about 6 percent and fell below 3 million visitors, according to the US Department of Commerce International Trade Administration Industry and Analysis (2019). Chinese visitors rank fifth in the USA after Canadians, Mexicans, British, and Japanese. Nevertheless, Chinese visitors' spending in the USA are quite stable (+3%). They are among the foreign visitors who spend the most during their stay with an average budget of US$6,700. But the US hospitality sector fears that the US–China trade war would shift Chinese tourists away from the USA. We can also notice that the Chinese embassy in the USA sends warning to potential Chinese visitors about the possible dangers they face during their stay in the USA (shootings, high costs of medical care, etc.) (Mai, 2018).

On the contrary, the EU is still an attractive destination for Chinese visitors. In 2018, the number of Chinese visitors to the EU increased by 5.1 percent according to the European Travel Commission. However, this good result may not be the direct consequence of the US–China trade war, but the outcome of the 2018 EU–China Tourism Year and the dedicated actions that were part of this event.

European Universities as an Alternative to US Universities

We would like also to draw attention to the evolution of number of Chinese students in both the USA and EU since the beginning of the US–China trade war. American universities still remain the first foreign destination for Chinese students who make up to one-third of international students in the USA. Although many US universities still heavily rely on Chinese student's enrolment fees (Musgrave, 2019), many Chinese students do not feel welcome anymore in the USA and are searching for other places to study. The US administration once considered a possible ban on student visas for Chinese nationals to tackle espionage (Sevasopulo & Mitchell, 2018). Although this harsh decision was not taken, Republicans are still searching for tightening visas for Chinese students (Zengerle, 2019). In 2019, for the first time, the number of Chinese students in the USA declined by 2 percent. However, this may not be entirely due to the trade war, as the US universities are becoming less attractive to foreign students regardless of their nationality. The number of foreign students in US universities declined by 2.7 percent between March 2018 and March 2019 (US Department of Homeland Security's Student and Exchange Visitor Information System, 2019).

Although we were not able to find data for every EU member regarding the enrolment of Chinese students for the academic year 2018–2019, we notice that Chinese students also make up to one-third of international students in European universities and represent the largest non-EU contingent in most European universities. It seems that British universities are the ones that benefit the most from the US–China trade war, as applications from Chinese students to study at UK universities have gone up 30 percent since 2018 (Weale, 2019); this surge may also be partly due to the weaker pound that makes studying in the UK less expensive than previously. Germany is still an attractive destination for Chinese students with 36,915 Chinese students in 2018, up 5.5 percent from 2017 (ICEF, 2019). But actually, English-speaking countries or universities offering degrees in English are the most likely to benefits from the US–China trade war (Xīndōngfāng qiántú chūguó, 2019).

Policy Implications for European Union and China

The US–China trade is a major threat for global economy, it poses both challenges and opportunities to third countries, including European countries. Because of the possible impact of this commercial war on the European economy, the EU must further develop its own policy regarding the tensions between two of its main trade partners and seize the opportunities offered by this crisis.

Creating Diversion

In Asia, several countries, including Vietnam, have tried to take advantage from this commercial conflict by attracting investors in industries that suffer from US tariffs in China. For obvious labor costs reasons, European nations cannot benefit from industries relocating their production from China to third countries in order to avoid US tariffs. However, European companies may take advantage from China's disaffection with US products and services. In this article, we saw that several US economic sectors including real estate, tourism, and education were hit by the US–China trade war. In Europe, the same industries only saw a limited increase due to the US–China trade war. A more coordinated and structured answer from the European industries could possibly result in more activities from Chinese clients. As the US–China trade war is not fading away, EU business sectors need to develop adequate campaigns to further attract Chinese visitors, students, and investors who are no longer willing to conduct their projects in the USA, and thus divert trade from USA to the EU.

Fostering the European Union–China Partnership

As China and the EU are both the targets of US trade sanctions, more coordination is required between the two blocks to promote free trade. Beijing and Brussels have repeatedly claimed their willingness to fight against protectionism and support multilateralism. At the last EU–China summit in April 2019, in their joint statement, Donald Tusk, Jean-Claude Juncker, and Li Keqiang reaffirmed their commitment to cooperate on World Trade Organization reforms (European External Action Service, 2019).

Although, supporting the China–EU dialog has been a prime concern for Beijing and Brussels, less attention was given to the EU–China relations because of the US–China trade war. For China's diplomacy, settling the trade war with the USA has been a number one priority; this caused Brussels to feel left out by China as argued by Wen dy Wu (2019). In the current context, the USA is defining the agenda of both China and the EU. A stronger cooperation between Beijing and Brussels and the launch of joint projects may enable China and the EU to take back control of their agenda.

Settling Trade Disputes Between the European Union and China

As mentioned earlier in this article, the EU has formulated some concerns about China's trade policies. Like the USA, the EU suffers from a strong trade deficit vis-a-vis China. A crucial point is the continuation of negotiation between Europe and China. The current US–China trade war is causing resentment on both sides, and a possible trade resolution would hardly bring trust and confidence back between Washington and Beijing (Dollar, Petri, & Plummer, 2019). Although the EU and China have trade differences, the approach adopted by Washington is not the one to be favored to settle their disputes, as it brings instability to the world and creates distrust between partners.

Conclusions

The US–China trade war is a major disruption in world trade, and its impact is not limited to China and the USA. Because of the diversion principle, some emerging economies, such as Vietnam, may benefit from this trade war by seizing some short-term opportunities. But this trade war poses a threat to most countries and creates instability that may prevent investors from conducting projects abroad.

The EU, the third major economic region along China and the USA, called parties to negotiate. Although the EU shares with the USA some concerns about China, it is also a target of US sanctions. It is still difficult to analyze the impact of the US–China trade war on the EU, because of the complexity of European economies, and measure the trade diversion cause by the trade war to European companies. However, based on our findings regarding China's outward direct investment, outbound tourism, and students in the USA and Europe, it seems that till today, the US–China trade war has benefited very little to European economic sectors opened to noninstitutional, private consumers in tourism, residential real estate, and education. Chinese companies seem not to favor European countries over the USA for investment, but China's direct investment deceleration in the EU is slower than in the USA. However, most companies, US, Chinese, and European, alike are expecting the end of the US–China trade war to conduct new major projects.

Although this article does not deal directly with this issue, we may suppose that the current Brexit crisis may have prevented the EU from formulating an ad hoc policy that would take advantage of the US–China trade war.

Finally, a trade deal between the USA and China would not solve every issue regarding US–China trade relations. Tensions may persist over decades as China is challenging US economic power. However, the EU–China relationship may deepen as China continues to open its economy to foreign investors.

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Notes

1. According to World Bank, for the second quarter of 2019, China's economic growth rate was 6.2 percent, its lowest rate since 1992.
2. That is 24.14 percent for the USA and 15.82 percent for China. Data collected by the author from International Monetary Fund.
3. One may argue that the US–China trade war is also a factor of the first three challenges identified by European companies.
4. In July 2019, President Trump threatened wine tariffs in retaliation over French law targeting US tech giants.
5. HNA divestitures in the USA include the sale of Ingram Micro (pending), Hilton worldwide (completed), Hilton Grand Vacations (completed), Park Hotels & Resorts (completed), 245 Park Avenue (completed), and Vista Tower (pending). Most of HNA acquisitions were made in 2016 and 2017.

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