REGIONAL IMPLICATIONS

TO: POTUS
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INTRODUCTION

A trade war between the world's two largest economies would have negative impacts on other active trade participants and key allies such as Japan, South Korea and the European Union. Both Japan and South Korea are skeptical of America's decision to impose tough tariffs on Chinese goods. In this sense, we do not have support from our allies, which places us at an isolated position. Without a strong united front, the United States cannot win a trade war easily. Furthermore, the trade war potentially places Chinese President Xi Jinping at a strategic high ground for clear-headed policies regarding the global trading climate, and China as the protector of global free trade system. This is in contrast with the Trump administration, whose "American First" policy has led to perception of the US as an irresponsible breaker of WTO's established rules and a potential threat to the international free trade system.

IMPACT OF TRADE WAR ON US PARTNERS AND ALLIES

JAPAN

Japan could be hit by the cross-fire of a US-China Trade War. The trade war could affect Japanese companies who set up factories in China. If China retaliates, Japanese investors who export grain from US subsidiaries could also be hurt. A great number of Japanese companies export parts to China to be assembled and sent to the United States. In this case, Japan could be impacted if US-bound shipments from China decline because of the trade war. Once the United States imposes tariff on Chinese products, Japanese manufacturers whose production bases are located in China could be the major victims of cross-fire. Sony, Panasonic, Hitachi Ltd and Nidec Corps all have production lines in China. If these tariffs are imposed, imposed some Japanese products manufactured in China might fall under their scope.

Retaliatory Chinese tariffs on soybeans would hurt the interest of Japanese companies such as Marubeni Corp, Mitsui & Co. and Mitsubishi, whose US subsidiaries export soybeans to China. Japan also worries that the trade war might strengthen the yen which would be a negative signal for Japanese companies. Strengthening of the yen would be bad because foreign goods would then cost less and prices would decline, something that would be incredibly damaging to an economy already gripped by economic stagnation and deflation.

According to Japan's Minister of Economy, Trade, and Industry Hiroshige Seko, countermeasures would not help solve trade issues but would only hurt both countries' interests and have a negative impact on the global trade system. Seko also urges President Trump to solve the trade deficit and IPR issues within the system of WTO, rather than through unilateral action. Based on the tone of minister Seko, we can assume that Japan wishes to avoid and would be hurt by a US-China trade war, given they have so many production bases in China as well as investments in both US and China. A trade war is definitely undesirable to Japan.

Japan and China both agreed that a trade war would severely damage the world economy in a high-level economic dialogue in April 2018. Japanese Foreign Minister Taro Kono claimed that a trade war would have large impacts on the prosperity of international economy no matter who brought it about. Meanwhile, Japan also shows their interest in the China-led one belt one road project on a case-by-case basis if international standards are made. Last year, China and Japan also agreed to set aside disputes and seek to improve cooperation between the two largest economies in Asia. All the signs indicate that the China-Japan relationship has been closer in recent years and Japan may turn against the US and its protectionist policies if a trade war is to break out.

SOUTH KOREA

Since the beginning of the trade conflict late last year, the South Korean stock market KOSPI has become quite sensitive to the issue, shrinking every time rhetoric intensified and expanding when tensions die. This phenomenon indicates that the trade war might directly impact Korea's economy as well.

Last year South Korea's exports to China were worth an estimated $142.1 billion and accounted for 24.8% of their total exports. South Korea's export to the US are estimated at US$ 68.6 billion, accounting for 12% of its entire exports. The total exports to both China and US account for 36.8% of South Korea's entire exports. If the 10 percent tariff hike is actualized by the US, EU, and China, Korea's International Trade Association estimates that the country's exports could drop by as much as $40 billion. Therefore, the trade war between China and US would affect South Korea's exports and even hinder its future economic development.

Almost 70% of South Korea's exports to China are intermediate products required to be further processed by China. Finished products would be shipped to other countries. For instance, the televisions that China exports to the US market are made in China but the screens and other core components are provided by South Korea. Thus, when China benefits from the trade deficit with US-China bilateral trade, South Korea benefits from the process as well. In 2017 the trade deficit between South Korea and China was $44.26 billion. If the trade war continues, China and the United States would impose at least 10 percent tariffs, which would decrease overall international trade by 6 percent. In that case, South Korea's exports would fall 6.4 percent in which Korea would lose US$ 36.7 billion. Nevertheless, some Chinese cell phone makers (Huawei, Xiaomi) compete directly with Korean cell phone makers (Samsung, LG) in American and European markets. So American tariffs on Chinese goods might boost the sale of some South Korean products such as smartphones.

The issue that South Korean officials are concerned the most about is the exchange rate. They worry that the United States may take certain measures to increase the exchange rate of the RMB to the USD in order to reduce the trade deficit. Then Korea might be requested to increase their exchange rate, too. Therefore, Seoul believes that the trade war would impact South Korea's exports. Even if both sides reach a compromise, Korea's interest are still at risk.

TAIWAN AND MALAYSIA

Taiwan and Malaysia would also negatively be affected by a US-China trade war, as the economies of these two countries largely depend upon exports. This includes machinery to the US and China as well a lot of intermediate goods to China for final assembly and exportation to the United States. Solid-state drive and monitor manufacturers such as Lite-On and Foxconn, both explicitly listed in the list of increased tariffs, would be forced to pay more to export hardware parts to China for assembly and also have to pay more to ship their final products to the US. Increased tariffs might push Taiwanese and Malaysian companies to shift production to other countries and potentially also find new export markets with lower trade barriers.

EUROPE

Europe has the potential to lose a lot from the trade war, as many European companies are already invested in Chinese supply chains and production centers. While strategic maneuvering can perhaps allow them to capitalize from a US-China trade war by superseding US high tech exports to China, there are certain products and services it would unlikely be able to provide. European countries such as Germany, Spain, and Denmark are poised to gain if China decided to purchase European aircraft over Americans ones. Furthermore, increased tariffs on American alcoholic spirits mean that French wineries will stand to gain from a 25 percent duty on Californian wine, as would Scotland, which is the second largest whiskey exporter to China after the United States. However, it is improbable for the EU to be able to cooperative to this degree, as it is not completely unified. Some European countries are more willing to follow the United States than others, and some will be completing unwilling. There remains a potential that increased US protectionism will push EU to side with China in a trade war, as the EU has already expressed its dissatisfaction with US trade policy by filing a complaint with the WTO about the United State's proposed steel and aluminum tariffs.

SOUTH AMERICA

Brazil & Argentina: China has become the largest importer of soybeans in the world and the U.S is currently China's second largest supplier. Under the auspices of a trade war, the U.S is facing a 25% tariff on exporting soybeans. South American producers could mostly fill the gap, according to Chinese Vice Finance Minister Zhu Guangyao. Brazil may be the prime beneficiary in this sector, as Brazil is already China's top supplier of soybeans, while China is Brazil's overall top trading partner and also an increasingly important foreign investor. In 2017, the U.S. sold 32.9 million tons of soybeans to China, second after the 50.93 million tons sold by Brazil.

Argentina, the world's third-largest soybean exporter, is similarly well-positioned. Soybean meal represents 17.5 percent of Argentina's total exports. Though Argentina and Brazil currently cannot supplant American soy exports altogether, they have the potential to do so if trade conflicts between US and China escalate. Both Argentina and Brazil are currently benefiting from rising soybean prices in the wake of a US-China trade war. However, Brazil's agriculture minister Blairo Maggi fears that higher Chinese demand for soybeans might increase local prices so much that it hampers the competitiveness of not only the soybean sector, but also the meat, poultry, and dairy sectors of these countries, which often use soy as feed for chicken, cows, and pigs.

Paraguay and Uruguay: The immense Chinese market, which imports a whopping 60 percent of the world's soy exports, will likely look for further alternatives in Latin America, including smaller soybean exporters like Paraguay and Uruguay.

CONSEQUENCES OF A TRADE WAR ON THE INTERNATIONAL ECONOMY & TRADE SYSTEMS

Impact on the WTO and Other Free Trade Regimes

A full-scale US-China trade war initiated through tariffs would be a "complete violation of WTO rules," per Matt Gold, former WTO deputy trade representative under President Obama. This action would undermine the legitimacy of the WTO and other international trade agreements. The United States, like other member nations, has violated WTO rules in the past, so launching a trade war of this magnitude might be the breaking point that encourages other countries to settle their own trade grievances with the United States and ignite a wider conflict. Even if the United States offers exemptions from new tariffs to certain strategic allies, countries that do not receive these exemptions will become resentful and likely retaliate. Such behavior against the United States has already begun: India recently submitted a WTO complaint over steel and aluminum tariffs while Russia, Turkey, and Japan—three non-exempted states—have warned the United States they will retaliate by imposing tariffs on American goods altogether worth $1.45 billion. Coupled with European and Chinese claims, the United States can potentially face as much as $3.5 billion in new tariffs, a number that might balloon further if other countries retaliate as well.

If worse comes to worst and the United States pulls out of the WTO, it would not just deprive the United States of a mass global export market, but it would also lead to an outright collapse of the organization and usher in an era of uncertainty for the global economy. Trade regimes like the WTO not only facilitate global trade, but also prevent unfair and coercive trade agreements from being established unilaterally. If its presence is missing, it might embolden China to fill the vacuum with its own trade regime that unfairly benefits Chinese trading practices and has little regard for intellectual property rights or human rights. On the contrary, pressure from the United States and other member nations might force the WTO to update and improve their rules to match the modern global environment. President Trump has called the WTO a "disaster" and "very unfair" to the United States, especially in regards to intellectual property rights violations by the Chinese. Conversely, China and other notorious violators of IPRs have argued that the integration of TRIPS into the WTO has stifled economic and social growth in developing countries and only serves to further concentrate wealth in the hands of already rich and developed nations.

Damage to the Global Economy

Though the WTO currently projects that the global economic growth rate will be a healthy four percent next year, a trade war between United States and China might lead to a decline of global economic growth. In 2017, global trade increased by 4.7%, which is the greatest growth rate in the past six years. However, the OECD estimated that import tariffs throughout the European Union, China, and the United States could reduce global GDP by 1.4 percent and global trade by as much as 6 percent. These numbers do not account for the impact of import tariffs adopted by other nations so the actual rate of reduction might be far greater. The damage of a US-China trade war to the global economy and its expansion depend on the items and categories included in the trade war. The escalatory nature of the trade war signifies that more and more products may fall under the scope of not only new tariffs, but also other retaliatory trade measures that will decelerate global economic growth. If this happens the damage will not only affect China and the U.S., but also the worldwide economy.