The Impact of the US-China Trade War on Import and Consumer Prices in The US And Their Economic Consequences.

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Abstract. This article examines the impact of the US-China trade war on import and consumer prices in the US and the economic consequences it brings. The analysis will first take an overview of the chronology of established tariffs before reviewing their effects on prices. By sourcing from data websites and analysing past articles, the author has concluded that the establishment of these protectionist tariffs has had a negative impact on inflation, driving up import and consumer prices. This is because of the rise in price upon import due to tariffs. The article then takes a turn to analyse how the rise in prices will affect the economy. The author will consider the economic impacts based on four main factors: inflation, employment, incentive, and wage. After thorough analysis, it is concluded that the US has 'sabotaged' its own economy with its tariffs, and it is highly encouraged for the US to take back tariffs to normalise trade.

Keywords: Trade war; import; consumer prices.

1. Introduction

The United States issued taxes on key worldwide imports, washing machines, solar panels, and raw commodities such as metals in 2018. Although these tariffs had no specific nation in mind and were designed to safeguard local sectors, many have theorised that these measures were designed with China in mind in order to stymie trade. Following that, the US hiked tariffs on dozens of Chinese products between 2018 and 2019, placing an extra 25% duty on $50 billion in Chinese imports and eventually targeted $350 billion in Chinese imports. [1] China retaliated with a series of tax waves targeting about $100 billion in US imports. [2] In January 2020, the two sides agreed on the phase one deal to cease additional tariff increases, while keeping the present rates until 2021. [3] It could be argued that the trade war is of great surprise when compared to past policies. The former mainly focuses on tariff reduction as opposed to implementing them. The trade war between the United States and China also came with various economic impacts on the US such that many have considered that the trade war was a major failure in US policymaking. [4] Tariffs boosted the expense for American firms that rely on Chinese imports ranging from consumer electronics to industrial gear. Due to higher income tax, the price of commodities rises for consumers. Consequently, this lessens the buying power of individuals which might in turn diminish domestic demand. For example, the trade war has significantly impacted the agriculture industry in the US. [5] China has placed retaliatory tariffs on major food exports including pork and soybeans. [6] As a result, demand for exports has decreased as people favoured exports from other countries and domestic goods. This has proved to be troublesome for American farmers. Furthermore, the trade war has disrupted established global supply lines, adding uncertainty to the economic climate. Companies were hesitant to commit to long-term investments and expansions because they were concerned about the future direction of trade policy. This concern reverberated across the industry, potentially slowing overall economic development, and further adding fluctuations in price. This might result in investors turning away from domestic firms because they are sceptical about the outlook of the industry. Manufacturing industries that rely on Chinese components were also impacted, as tariffs boosted manufacturing costs. The trade imbalance in the United States, which the trade war was intended to solve, experienced only minor improvement. However, this is only because imports were shifted from China to other nations rather than being cut. The US-China trade war has become a topic of great concern across a variety of industries which it has impacted. The war has generated many undesired consequences such as rising import prices, market uncertainty and inflation of goods and services. These are problems which should concern commoners and investors alike. Due to the profound effects on both the local and global economy, understanding its economic impact on the United States is of great significance for future investors and policymakers. By grasping the effects of the trade war on the economy will help determine future trade policies and develop solution to tackle the repercussions of the trade war. This article aims to investigate the economic impacts of the US-China trade war on the United States. This is done through the examinations of trade patterns, target industry of tariffs and changes in investment. Macro and micro perspectives will also be taken to determine the effects on overall GDP and individual behaviour. It will also analyse how they would affect the economy in the long run by accessing recent data and using models and theories to predict future outcomes. Finally, the article will attempt to find possible solutions which firms and the government should do to effectively tackle the consequences caused by the war.

2. Inflation

It is widely accepted that imposing tariffs on imported raw materials and goods necessary for the production process has an overall negative impact on the economy. This notion held true during the trade war as well. The introduction of tariffs has had a profound effect on various industries in the United States. Consequently, the increase in import prices of many goods made in China has led to significant hikes in consumer prices due to the rise in production costs. Manufacturers have predominantly shifted their focus to sourcing raw materials domestically, which, in the US, is more expensive compared to China. This section will delve into the successive waves of tariffs that were implemented, followed by an examination of their impact on import prices and subsequently on consumer prices. The trade war between the US and China witnessed the implementation of multiple rounds of tariffs on a wide range of goods. These tariffs were primarily aimed at protecting domestic industries and addressing concerns related to intellectual property theft and unfair trade practices. However, the consequences of these tariffs were far-reaching and had unintended negative consequences for the overall economy. One of the immediate effects of the tariffs was the increase in import prices of goods originating from China. As the cost of importing these goods rose, businesses had to bear the burden of higher production costs. Consequently, in order to maintain their profit margins, many companies passed on these increased costs to consumers in the form of higher prices. This resulted in a direct impact on consumer prices, leading to an overall increase in the cost of living for individuals and households. Moreover, the tariffs prompted a significant shift in sourcing strategies for manufacturers. Faced with higher import costs, many producers opted to rely more heavily on domestic suppliers for their raw material needs. However, the domestic supply of raw materials in the US often comes at a higher price compared to imports from China. This shift in sourcing patterns further contributed to increased production costs, which were eventually passed on to consumers. The impact of these tariffs on import prices and consumer prices cannot be understated. The rise in import prices directly affected businesses and consumers alike. Businesses faced higher costs, which in turn affected their competitiveness and profitability. Consumers, on the other hand, experienced an increase in the prices of goods, leading to reduced purchasing power and potentially impacting their overall standard of living. In conclusion, the imposition of tariffs on imported raw materials and goods during the trade war had a detrimental impact on the US economy. The subsequent increase in import prices of Chinese goods resulted in significant rises in consumer prices, as businesses passed on the higher production costs. Additionally, the shift towards domestic sourcing of raw materials, though intended to mitigate the impact of tariffs, further contributed to increased production costs. The overall consequence was an adverse effect on both businesses and consumers, highlighting the negative repercussions of tariffs on the economy [6].

3. Tariffs

Due to the abrupt establishment of various imposed tariffs from President Trump, whose election was unexpected and frowned upon by various firms and individuals, it is very unlikely that those tariffs were anticipated in the affected industries. [7] One of the most affected industries was steel which received tariffs nearing the start of the trade war. Over the course of one year from the introduction of Section 232 tariffs on steel, its import dropped from $2.8 billion in 2018 to $2.1 billion in 2019 [8] and the import price from China has risen from 3560 CNY/T to 4687 CNY/T during that time. [9] The effects of Trump's tariffs were also immediate because firms and producers have very little preparation as it is unexpected. This is supported by the experiment conducted by Fajgelbaum et al. (2019) which showed that there is little to no evidence to support the anticipatory effect of the pre-trends in those affected industries: the data sets shown are only to show the after-effects of the tariffs. After the investigation of China in 2018 which concluded that China has been involved in various 'malpractices' in trade and manipulation of subsidies, Trump imposed the Section 301 tariff to target Chinese products. The data below are sourced from Amiti et al. (2019). As of the present, a 25 percent tariff is still active on around $250 billion of Chinese imports and a 7.5 percent tariff on a further $112 billion. Including the Section 301 tariff, the tariffs in 2018 were implemented throughout the course of the year in six major stages, three from the US and three from China. Firstly, commencing from the end of 2017 and continuing into 2018, house appliances such as solar panels and washing machines accounting for $10 billion dollars in imports were the first set of products to be tariffed; solar panel import charges of 30% and washing machine import levies of 20%–50%. The second wave of tariffs was imposed in March regarding the import of raw materials with an emphasis on steel and aluminum. A 10% tax was imposed on imports of aluminum during this wave, while a 25% tariff was imposed on imports of steel. This round of tariffs cost approximately $18 billion in total. The third wave was the most expensive at $22 billion, targeting steel and aluminum but not directed at China. The three tariffs which can be seen in the latter half of the graph were directed specifically at China. The size of these tariffs was particularly immense. The first two waves of tariffs were both 25 percent with each accounting for $34 billion and $16 billion in cost respectively. The final wave targeted an additional $200 billion of Chinese imports at a tariff rate of 10 percent [10].

4. Import Prices

Tariffs, of its nature, are import taxes applied to shipments at the border before entry. Due to various tariffs implemented in the US, there is an inevitable increase in the product price being paid by US importers. The price change pattern during the tariff admission period was summarized in a report from the United States International Trade Commission. The report has examined the amount of imports by source country and the foreign export values using the Harmonized Tariff Schedule (HTS10) which sets out tariff rates of various goods imported into the US and compares that to imported cost at the border. The data displays US imports monthly and it shows the overall pattern of import price changes of various products. The x-axis shows the amount of time in months before and after the implementation of tariffs (at 0). Meanwhile, the y-axis shows the price fluctuations compared to the pre-tariff price (also at 0). It is quite clear that after tariffs are in effect, there is an upward growth in import prices. The black line which slopes down is the untreated or control variable to show that any changes are due to tariffs [5]. All products behaved by a deflationary trend prior to the tariffs and the trend continues for the unaffected products. However, products that were affected suffered a sudden jump in price during the month of the policy implementation. This increase in price, in fact, is not so much a surprise at all as it obeys the traditional model of inflationary effects of tariffs. Traditionally, a partial equilibrium model of import demand and export supply with a fully competitive market structure has been used to assess how tariffs affect prices and welfare. Naturally, as tariffs increase, import price increase. This reduces the demand of import and increases demand for domestic products. As a result, the decrease in imports climbs up the supply and demand curve of domestic goods and drives up the consumer prices.

5. Consumer prices

The prices addressed above show the prices paid when arriving in the US and before distribution. These are the prices that the country faces. The following discusses the changes in prices that consumers face. These prices are the ones which ultimately affect the economy. The increase in the price of imported goods from China and other parts of the world is sure to affect consumer prices in stores. However, consumer prices of different goods are affected in different ways. After a thorough investigation, it has been established that the increase in the consumer price of targeted goods is not as vigorous as expected. This concludes that retailers have absorbed some of the higher costs caused by tariffs. The tariffs imposed by the United States have targeted a range of goods as discussed above and the two most significant categories are premade goods and raw materials. The imports of premade products were predominantly targeted by the first wave of tariffs. Due to the imposition of these tariffs, there has been a significant decrease in the number of imports which is particularly obvious with solar panels and washing machines. In response, there has also been a price surge to such an extent that a complete tariff pass-through has been translated into the consumer price. This is demonstrated in the paper from Flaaen et al. (2020) which analysed the consumer price of the washing machines during the phase of washing machine tariffs and compared that to other house appliances. During that they found no evidence of incomplete tariff pass-through but a complete pass-through. The price of a washing machine has increase by 125 percent from the pre-tariff price. The second and third waves of tariffs targeted the steel and aluminium industry in Canada, Mexico, and the EU. Canada and Mexico are two of the largest exporters of steel to the US, with 6,970,000 NT and 4,760,000 NT in 2020 respectively and the tariffs have significantly decreased their imports to the US. Although this has encouraged more domestic steel production due to the additional import tax, this has also increased the price of steel. US firms have made the choice of importing steel from abroad due to the lower cost. When this advantage has decreased, it has changed the behaviour of firms to use domestic steel which is more expensive. Thus, an increase in material price also increases the retail price of goods. Furthermore, an increase in demand for domestic steel also created more jobs in the manufacturing industry and has raised employment costs which translates to higher retail prices. It is shown that the Section 232 tariffs would result in an increase of around $2.4 billion in aggregate income in the steel industry but would also cause an increase of $5.6 billion in costs for steel consumers; for every job created, there will be a cost of $650,000 [3]. However, there was incomplete pass-through to the consumer price and the increase in prices was not as sudden as anticipated, given the complete pass-through in the prices of imported goods. [4] This could be because firms have attempted to avoid the consequences of the tariffs to lessen their industrial impacts. For example, research has shown that firms have anticipated the implementation of tariffs. As a result, they rapidly increased their purchase ahead of the tariffs and seldom purchased from tariffed countries after that. [5] Following that, as the purchased goods eventually run out and supply decreases below demand, the price gradually increases, and they will have to buy tariffed goods. In addition, other firms sought to purchase goods from other countries with slightly higher prices but were not affected by the tariff. This would also explain the gradual increase in consumer prices [6].

6. Conclusion

After conducting a comprehensive analysis of the impact of tariffs on prices, it is crucial to examine how the subsequent increase in prices will ultimately affect the economy. Tariffs have the potential to diminish US output through various mechanisms. One key mechanism is the pass-through of tariffs to manufacturers and consumers in the form of increased pricing. When tariffs are imposed, they can raise the cost of components and materials, thereby increasing the price of goods manufactured using those inputs. This, in turn, reduces private-sector production and leads to decreased earnings for both capital owners and labor. The increased prices resulting from tariffs also have an adverse effect on the after-tax value of both labor and capital income. As consumer prices rise, the purchasing power of individuals and businesses diminishes, which can incentivize them to work and invest less. This reduction in economic activity is driven by the fact that higher prices erode the returns on both labor and capital. Furthermore, the imposition of tariffs can have implications for the value of the U.S. dollar. In response to tariffs, the U.S. dollar may strengthen, which can counteract any potential price increases for American consumers. However, a stronger dollar can make it more challenging for exporters to sell their products on the international market. This, in turn, reduces the profits of exporters and leads to decreased U.S. production and earnings for both employees and capital owners. As a result, there are diminished incentives for employment and investment, ultimately leading to a smaller economy. In summary, the consequences of tariffs on the economy extend beyond the immediate impact on prices. The increase in prices due to tariffs can reduce private-sector production, diminish earnings for both labor and capital, and discourage individuals and businesses from working and investing. Additionally, the potential strengthening of the U.S. dollar in response to tariffs can impede export competitiveness, leading to decreased production and earnings. These factors collectively contribute to a smaller economy with reduced incentives for employment and investment. It is essential to consider these broader economic implications when evaluating the effects of tariffs.

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