Chapter 4

# The Economic Policy of The Us-China Trade War

**Özgür Kanbir**[1]

**Abstract**

This chapter analyzes the political economy of the US-China trade war, arguing that it is a symptom of a deeper structural imbalance within the US economy rather than a conflict simply caused by China's rise. The central thesis is that the United States suffers from a chronic "low-savings/low-net-investment" paradox, a weakness that has persisted for decades. This structural issue has been masked and enabled by the "exorbitant privilege" of the US dollar's status as the global reserve currency, which allows the US to finance high consumption through persistent trade deficits. The chapter demonstrates that the massive trade deficit with China is a consequence of this dynamic—with China acting as "the world's factory" to meet US demand and recycling its dollar surplus back into the US financial system—not its root cause.

Through an analysis of long-term trade, savings, and investment data, the chapter shows that protectionist tariffs are a flawed policy. They fail to address the underlying savings-investment gap and instead impose costs directly on American consumers and producers via price increases. Furthermore, the chapter highlights the phenomenon of "trade diversion," where the deficit has not been eliminated but has merely shifted to other partners like Mexico and the European Union, proving the ineffectiveness of the tariffs. Ultimately, the chapter concludes that the trade war represents a painful acknowledgment that the dollar-centric global system has become unsustainable for the US itself, transforming the old adage "the dollar is our currency, but your problem" into a new reality where the dollar is now America's problem as well.

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## 1. Introduction

In the global economic arena of the 21st century, perhaps no competition has been as decisive as the tension between the United States and China. Headlines adorned with tariffs, mutual accusations, and this conflict dubbed the "trade war" are often presented in populist language as a simple story of lost jobs and massive trade deficits. So, if the issue is so straightforward, why is the world's most sophisticated economy taking steps that undermine the rules of the free trade system it established and has led for decades? Is this war truly a belated response to China's unstoppable rise, or is there a much deeper, structural crisis lurking behind the scenes, one rooted in the United States' own internal dynamics?

This section looks beyond the visible face of the conflict and examines the political economy of a deeper, structural transformation whose roots stretch back decades. Our fundamental argument is that the US-China trade war is a symptom rather than the disease itself. The underlying disease is a chronic problem of "low savings-low investment" in the US economy, which has persisted for half a century and has been masked by the "exorbitant privilege" conferred by the dollar's status as the global reserve currency. This privilege, which once provided the US with unlimited financing and consumption power, has gradually engendered policy complacency; it has become a "sweet poison" that erodes the country's real capital accumulation and long-term growth potential.

In this context, the massive trade deficits with China are not so much a cause of this structural imbalance as an inevitable consequence. While the US sustained its consumption-led growth model by borrowing in its own currency, China became the world's manufacturing hub to meet this demand and reinvested the resulting dollar surplus back into the US financial system, feeding the cycle. Therefore, the protectionist policies that began with the Trump administration and continue today are, in fact, doomed to failure. Rather than addressing the root cause of the disease, they target only the most visible symptom, the external deficit, but shift the cost back onto its own consumers and producers.

In this section, we will first examine the evolution of the post-World War II global economic order and the shifting power balances brought about by China's integration into this system from a historical perspective. We will then analyze foreign trade, global export shares, and external deficit data to question the empirical foundations of the arguments presented as the fundamental rationale for protectionist policies. The focus of the chapter will be to reveal how the US finances its external deficits and the key role of

the dollar's reserve currency status in this equation. Finally, by thoroughly examining the US economy's fundamental structural weaknesses in savings and investment tendencies, we will demonstrate with concrete data why trade wars are the wrong solution and the welfare loss they create.

This analysis aims to demonstrate, beyond populist narrative and short-term political maneuvers, that the US-China trade war is actually a painful reflection of a system created by the dollar's global hegemony that has become unsustainable, based on data and theoretical frameworks. For, as former Treasury Secretary John Connally once told his European counterparts, "The dollar is our currency, but your problem," has now become "The dollar is our currency and now our problem too."

## 2. Developments In the Global Economy After World War II

A new global economic system was established after World War II. European countries, which had been at war, acted under a vision of peace and developing economic relations, led by the United States. Over the next few decades, the trade volume and economic growth process created by this system generated great prosperity in the Western world. In particular, the Bretton Woods Conference in July 1944 led to the establishment of the International Monetary Fund (IMF) and the World Bank (WB), and the General Agreement on Tariffs and Trade (1947-GATT), which would become the World Trade Organization (WTO) in 1995, institutionalizing the capitalist world economy. The framework provided by these institutional structures has accelerated global trade volume and global economic growth. This development has been shaped primarily around the phenomenon of globalization. Parallel to these developments, the European Coal and Steel Community (ECSC) evolved into the European Community (EC) and subsequently the European Union (EU), resulting in the world's most successful regional integration.

With the end of World War II, the world transitioned to a bipolar order consisting of the Western Bloc (capitalist system) led by the United States and the Eastern Bloc (socialist system) led by the Soviet Union. The US sought to impose its new liberal ideas and free market economy on the world, becoming a hegemonic power that enabled European countries devastated by the war to return to a free market economy. In this vein, the Bretton Woods agreements of 1944 established a new monetary system based on a fixed exchange rate tied to the US dollar, and the Marshall Plan facilitated the re-entry of European states into the world market. The controlled nature of financial markets in the capitalist world increased the effectiveness of

national economic policies, ensured stable exchange rates and interest rates, and allowed inflation to remain at low levels. Direct investment and aid to developing countries played a role in their development and provided raw materials and labor to developed countries. However, it should be noted that the main economic policies of this period were based on *Keynesian economic* policies. Before 1980, Western economies were largely characterized by government-directed economic policies and widespread planning.

The oil crisis that began in the early 1970s, along with the emergence of stagflation in the Western world, paved the way for new approaches. Keynesian policies and welfare state practices began to be questioned. During this period, US President Nixon's decision to allow the dollar to float and OPEC's decision to raise oil prices were influential.

Starting in the 1980s, free market and liberalization policies found room for implementation. During this period, Keynesian policies began to be abandoned and supply-side economic policies were put into practice. *The debt crisis* in developing countries and the subsequent process of financial liberalization were events that influenced the internationalization process of this period. *Monetarist policies* began to be implemented during this period. Tight monetary policies, high interest rates, reduced government intervention, and privatizations became widespread. Developments in communication and information technology made financial liberalization inevitable and increased competition among countries to attract financial institutions. It has been observed that financial markets are among the fastest globalizing areas, with capital being instantly transferred from country to country through electronic intermediaries. However, this situation has played a destabilizing role in the world economy due to hot money flows chasing speculative gains (Eşkinat, 2016a, p. 74).

Newly industrialized countries such as the Asian Tigers (Japan, South Korea, Hong Kong, Taiwan, Singapore, Malaysia, Thailand, and Indonesia) have achieved great economic success by pursuing common policies such as export-led growth, high savings rates, state-led industrialization, and market targets (Eşkinat, 2016a, p. 68). China became the world's fastest-growing economy by implementing capitalism-based economic reforms in 1978 and introduced a new system called the "socialist market economy" (Eğilmez, 2020, p. 90). With the collapse of the Soviet Union in the early 1990s, the bipolar world order came to an end, leaving the US as the sole superpower. However, this situation also brought political and economic instability. Globalization gained momentum, and regional economic unions (EU, NAFTA, APEC) gained importance. The 1990s witnessed crises stemming

from debt problems, such as the Asian crisis, the Russian crisis, and the crises in Argentina, Brazil, and Mexico. The IMF intervened in these crises, attempting to stabilize global capitalism.

The 2008 Global Economic Crisis, which began in the US real estate sector and spread to the global financial system, has been the most serious problem faced by the capitalist system since 1929. The crisis resulted from the financial sector taking excessive risks and the bursting of the real estate price bubble. Following the crisis, economists' existing theories were questioned, and alternative approaches such as New Keynesian policies came to the fore (Eğilmez 2020: 154).

The global balance of power continued to shift from the West to the East. China's share of global GDP has increased, while that of the US and Europe has decreased. A group of countries known as *Emerging Markets* (BRIC countries, Mexico, Indonesia, Turkey, etc.) have rapidly approached the economic level of developed countries (Eğilmez, 2020, p. 188).

Today, the global economy is moving towards a structure dominated by Industry 4.0 in production and digital information in consumption. Environmental issues and sustainable development concepts have become important topics for the future of the global economy. Concerns have arisen about whether total global resources will be sufficient for future generations and the pressure of the growing population on resources.

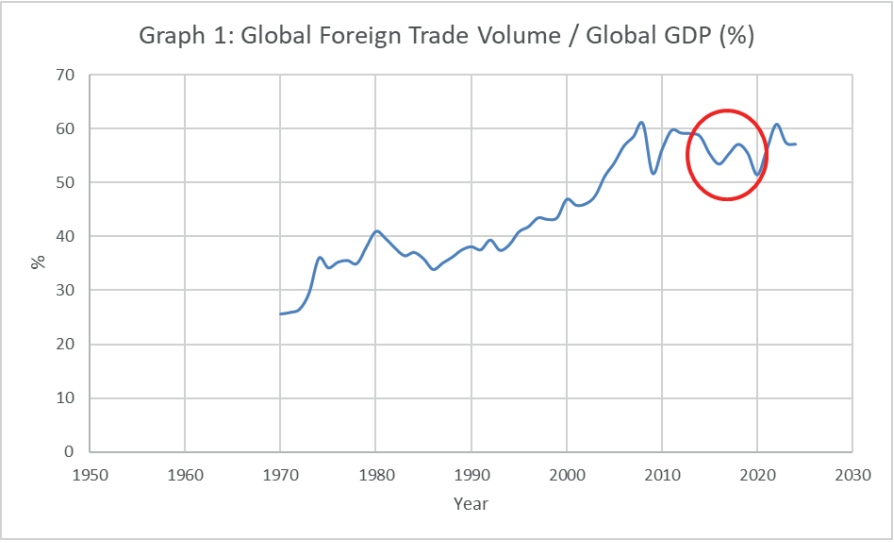
After World War II, international political economy transformed into a bipolar system. After 1991, it evolved into a unipolar system based on US hegemony. However, since the 2000s, we have seen a weakening of US hegemonic power. The emergence of China and Russia as global economic powers is transforming the international political economic structure. The new international economic structure has become quite complex. This structure includes technological advances, financial liberalization, the reduction of poverty, increasing international integration, global crises, regional wars, income inequalities, and environmental problems.

When we evaluate this period in terms of global economic growth and the upward trend in global trade volume, a more detailed picture emerges. An important development emerged in the 1970s, with international trade continuing to grow faster than national production. This trend continued with general stability until the 2008 crisis. After 2008, new developments affecting global economic development and prosperity emerged. The global economic crisis, the increase in geopolitical and geoeconomic risks, the intensification of regional wars, the protectionist policies that began during

Trump's first term, and the 2020 Covid-19 pandemic have shown that this new era is a challenging period in terms of the course of globalization.

### 2.1. Developments in Global Trade and Global Production

World trade grew at an average annual rate of 6.6 percent between 1948 and 1966 and 9.2 percent between 1966 and 1973. During this period, the UK's share of world trade declined, while the EU and Japan's trade activity increased. The share of industrializing countries in world trade rose to between 25 percent and 30 percent in the 1950s (Eşkinat, 2016b, p. 170).

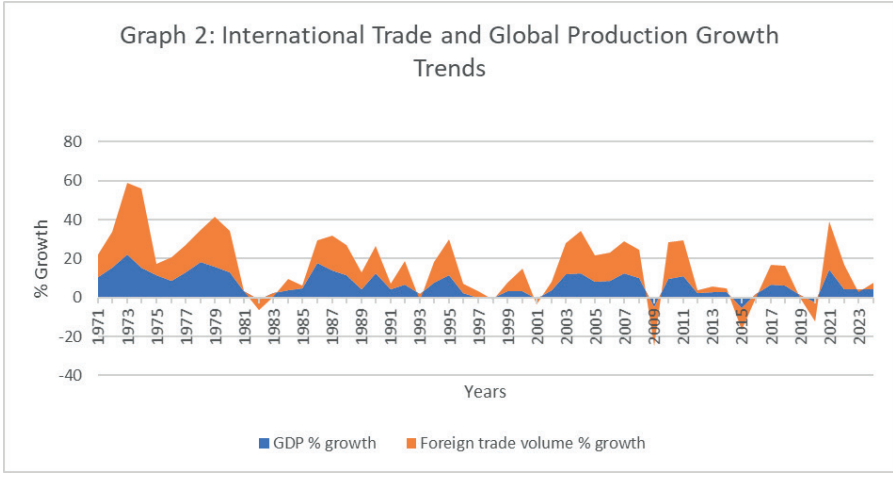



***Source: Prepared by the author using data from The World Bank, world development indicator .***

Graph 1 shows the ratio of global foreign trade volume (imports + exports) to Gross Domestic Product (GDP). The most important feature of this graph is that it clearly shows the course of the globalization process. The fact that foreign trade's share in world production has increased to this level shows us the extent of integration achieved through globalization. Until the 1970s, the volume of foreign trade was around 20 percent of global GDP, but after this period, it increased rapidly, reaching 60 percent in 2008. This development took place in an environment supported by both wars and institutional developments in the global system. The 1990s marked the beginning of a new era, accelerating the momentum in global trade volume. The collapse of the socialist system and the integration of transition

countries into the global system led to a significant increase in global trade volume. After the 2008 global economic crisis, global foreign trade volume remained in the 50-60 percent range. This trend over the last fifteen years indicates that a new era of globalization has begun. Globalization appears to have reached a certain saturation point. This secular shift has been dubbed 'slowbalization'.[2] The impact of the protectionist policies implemented during Trump's first term, as seen in the period marked by the highlighted period (2009–2013), led to a decline in global trade volume. Between 2017 and 2020, there was a significant decline of approximately 7-8 points in the share of global trade in the world economy. This means that the global economy has become more "insular" and international trade has slowed down.

Supply chain disruptions during the COVID-19 pandemic, layered on top of these policies, further increased the fragility of the global trading system.




***Source: Prepared by the author using data from The World Bank, world development indicator .***

Graph 2 compares global GDP growth rates with the growth rate of international trade volume. Outside of global economic crises, during normal economic periods, the growth of international trade volume has always exceeded global production growth.

2 The new era in which globalization has slowed but not stopped.

Trade volume growth is both faster and more volatile than GDP growth in the long term. It declines more sharply during contractions and rises more rapidly during expansions. This is consistent with theoretical analyses (Eaton et al., 2016). Until 2008, the elasticity of international trade to GDP generally remained above 1. However, it declined structurally after 2008, marking the beginning of the slowbalization era (Constantinescu et al., 2015; World Trade Organization, 2023). The sharp decline observed during the 2009 global crisis and the 2020 pandemic, followed by rapid recovery patterns, confirms trade's extreme sensitivity to the cycle (Baldwin, 2009; Eaton et al., 2016; World Trade Organization, 2022).

A significant portion of the items that make up trade are investment and durable consumer goods; the income elasticity of these items is greater than 1. Small changes in the cycle translate into large fluctuations in trade (Bussière et al., 2013). Therefore, the graph shows that trade has sharper peaks and troughs compared to GDP (IMF, 2016).

Increased vertical specialization in the 1990s and 2000s led to the same final product crossing multiple borders. The increase in added value resulting from small changes in production, combined with international trade, led to growth (Baldwin, 2016; Hummels et al., 2001). The slowdown in the deepening of *global value chains* (GVCs) after 2008 explains the decline in elasticity observed in the graph (Constantinescu et al., 2015). *Containerization,* information technology, and multilateral/bilateral agreements reduced effective trade costs in the late 1980s and 2000s. Conversely, increasing variety and economies of scale have made trade grow faster than GDP (Hummels, 2007; Krugman, 1979). Rising protectionism and geopolitical uncertainties in the 2010s have weakened this effect (IMF, 2016; World Trade Organization, 2023).

During crises, trade finance tightens and dollar tightening suppresses external demand; this channel is evident in the sharp decline seen in 2008–09 (Amiti & Weinstein, 2011; Chor & Manova, 2012). The sharp decline in 2009 and the recovery in 2010, as seen in Graph 2, are also consistent with this mechanism.

Demand shocks are amplified and passed up the supply chain. The collapse due to stock depletion before the pandemic, followed by a surge in 2021 due to stock replenishment and pent-up demand, is a typical example of this effect (Lee et al., 1997; World Trade Organization, 2023).

Open economy models predict that real exchange rate movements affect trade volume; however, the large fluctuations in the graph are explained

not by the exchange rate alone, but by the structural and financial factors mentioned above (Dornbusch, 1976; IMF, 2016). In the mid-1990s and early 2000s, trade growth significantly exceeded GDP growth thanks to the expansion of GVC and low trade costs (Baldwin, 2016; Hummels, 2007; Hummels et al., 2001). In the 2009 period, however, the Great Trade Collapse occurred, and international trade via credit, logistics, and GVC channels contracted much more sharply than production. The slowdown in trade volume during the 2012–2019 period, which occurred at a rate close to GDP, stemmed from a permanent decline in elasticity (Constantinescu et al., 2015; IMF, 2016). In the 2020–2021 period, the Covid-19 pandemic collapse and base effect led to a rapid rebound supported by inventory replenishment.

In the medium term, the growth of goods trade does not appear likely to be significantly higher than GDP. Considering the new protectionist tendencies initiated by Trump in his second term, this effect may be observed in the short and medium term. Unless the share of trade in services (especially digital services) increases, the "trade turbo effect" similar to that seen in the 2000s will remain limited (Baldwin, 2016; IMF, 2016; World Trade Organization, 2023).

## 3. Are There Economic Reasons for The U.S. Turning to Protectionism?

During his first term, Trump imposed tariffs on Chinese iron and steel products on March 8, 2018, to protect domestic producers and industries. New tariffs (International Emergency Economic Powers Act-IEEPA) were announced on April 2, 2025, declared "*Independence* Day." Following the ensuing shock and stock market decline, the tariff implementation was suspended. However, new tariffs came into effect on August 7, 2025. The newly implemented tariffs raised the US average effective tariff rate above 17 percent (Yale University, 2025). This rate is the highest seen since 1935.

The tariffs have a two-tiered structure. A base tariff of 10 percent was applied to countries with no trade deficit and not subject to sanctions. On top of this, rates ranging from 11 percent to 50 percent were applied to countries with a trade deficit. Additional customs duties have been imposed, particularly on China (34 percent), Canada (35 percent), Mexico (30 percent), and EU countries (15 percent). Trump justified this measure by citing the need to increase domestic production, create jobs for Americans, and pay off the national debt. The reason for selecting specific countries other than China, particularly Canada, Mexico, and the EU, is the phenomenon of *trade diversion*, which we explain below.

At first glance, these measures are reminiscent of the negative consequences of the Smoot-Hawley tariffs of 1930 for the US. The Hawley-Smoot Tariff Act of 1930 exacerbated the effects of the Great Depression and plunged global trade into unprecedented difficulties.

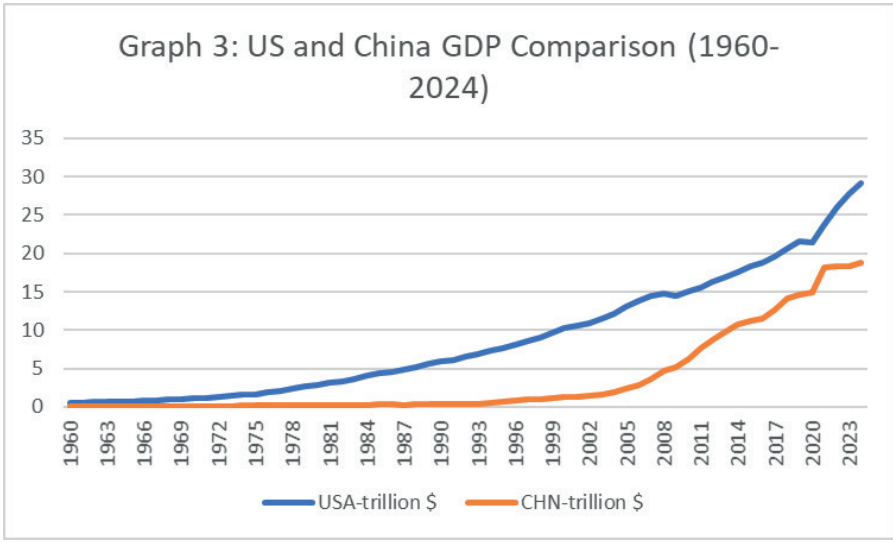
However, US foreign trade policy underwent a transformation, particularly after World War II, shifting towards reciprocity and the establishment of GATT. In the second half of the 20th century, especially in the 1980s, Japan became the primary target as the trade deficit rose rapidly and protectionism resurfaced. After the Cold War (1989), US trade policy focused on promoting free trade and globalization, and the WTO was established in 1995.

Under the Trump administration, however, fundamental changes have taken place under the *America First* principle, such as withdrawing from the Trans-Pacific Partnership and launching a trade war against China. Past conflicts (for example, with Japan over automobiles and semiconductors) have generally resulted in concessions from Japan, such as voluntary export restrictions to smooth over the issues. In some cases, such as the 2002 Steel War, the US withdrew tariffs in response to the European Union's threat of retaliation. However, the current China-US Trade War appears unique in terms of its scope and content. The new war is taking place in the context of globalization, strong Foreign Direct Investment (FDI) flows, and technological competition, unlike traditional trade conflicts (Guoyong and Ding 2021).

Economic relations between the United States (US) and China can be described as an "economic nationalism and competition-focused trade war," which began under the Donald Trump administration and continues under the Joe Biden administration. This period represents a break from the Open Door Globalism strategy the US had pursued for decades, in response to China's rise and the contradictions brought about by globalization.

Traditionally, the US grand strategy was based on an open door policy aimed at economic and extraterritorial expansion. This policy promoted a liberal world order that supported American hegemony and enabled the opening of global markets. However, under the Trump administration, this globalization-focused approach transformed into economic nationalism, a reaction against globalization fraught with internal and external contradictions. This transformation began very rapidly, particularly during Trump's second term, as of 2025.

Between 2000 and 2024, the Chinese economy grew approximately fifteenfold, reaching $18.7 trillion from $1.2 trillion, becoming the world's second-largest economy and rising to a position of global leadership in manufacturing, technology, and science (The World Bank, 2025).




***Source: Created by the author using World Bank data.***

Assuming the current trend continues until 2024, Under a naïve linear trend extrapolation (not a forecast), we estimate when China will catch up with the US GDP. Based on the GDP values compiled from the World Bank dataset, the equations obtained from linear regression analysis are as follows:

China GDP Trend: $GDP\_CHN(Year) = (3.116 \times 10^{11}) * Year - (6.162 \times 10^{14})$

US GDP Trend: $GDP\_USA(Year) = (4.018 \times 10^{11}) * Year - (7.925 \times 10^{14})$

By equating these two equations and finding the intersection year, we estimate that by the end of 2032, China's GDP will catch up with the US. The GDP value at the intersection year will be approximately $34.6 trillion.

Populist narrative and the "America First" Approach: Trump's policies were supported by populist narrative reflecting mottos such as Make America First Again, similar to those of figures such as Buchanan, who ran for president in 1996 (Buchanan, 1990). This rhetoric centered on the idea that global elites had "betrayed" American workers and industry and that international trade had hollowed out the "middle class America." The

decline of American industry (deindustrialization) and the problems created by foreign competition formed the basis of this populist narrative.

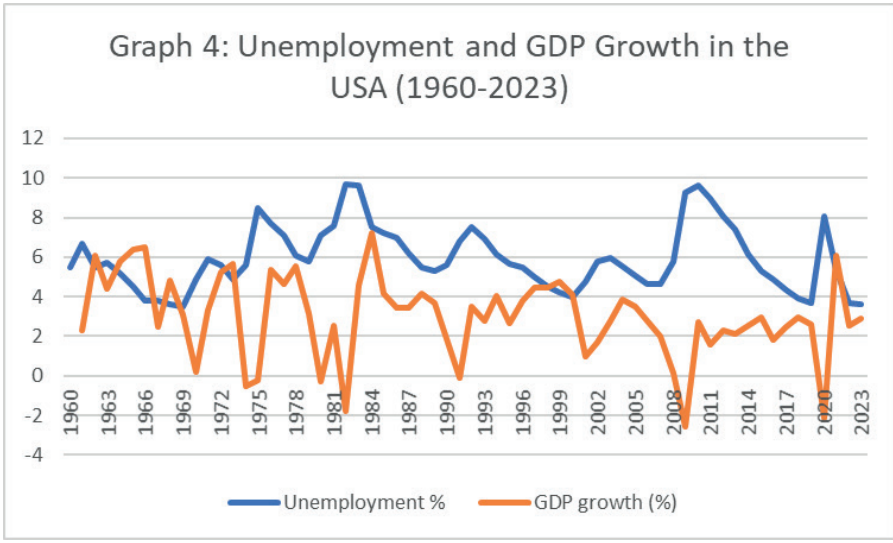
This tension manifested itself in concrete steps such as increasing tariffs and moving production chains away from China ("reshoring" and "decoupling"). The goal was to revive US economic growth and force other countries to comply with US-preferred policies.

The U.S. trade deficit with China has been highlighted as a major source of this tension. The U.S. has viewed China's industrial policies, such as "Made in China 2025," and its state-supported development model as a threat to American industry and competitiveness. Concerns that China is exploiting the advantages it has gained through globalization have been effectively articulated in the US for the past twenty years. The criticisms expressed in these publications are as follows :

- China is creating negative effects on American production and employment.
- By pegging its currency, the yuan (renminbi), to the dollar at a fixed rate and keeping its value low (manipulating it), China provides a profitable subsidy to Chinese exporters while imposing a heavy tax on U.S. exports. This is the fundamental cause of the chronic U.S. trade deficit and the slowdown in economic growth.
- China's "Communist-style state capitalism" completely disregards the principles of free trade. It is dismantling US industries one by one, based on labor. This has resulted in the loss of millions of US manufacturing jobs.
- China is seizing critical global resources (energy, minerals) using "checkbook diplomacy" (low-interest loans in exchange for infrastructure), primarily in Africa and Latin America.
- China generally does business with corrupt regimes without imposing moral conditions such as human rights or transparency.

While some of the criticisms here are valid, it is necessary to approach the criticisms regarding production and employment with caution. First, the average unemployment rate in the US over the last sixty-four years is 5.9 percent. Again, for the same period, the average growth rate is 3 percent. These rates are 5.8 percent and 2.1 percent respectively since China joined the World Trade Organization in 2001. All other things being equal, there is no evidence to suggest that international trade with China has had a negative

impact on unemployment figures in the US. However, the downward trend in long-term growth rates is noteworthy.




***Source: Created by the author using World Bank data.***

As shown in Graph 4, periods of rising unemployment in the US coincide with periods of economic crisis. Outside of these periods, the unemployment rate fluctuates at levels very close to the natural rate of unemployment (4-4.5 percent).

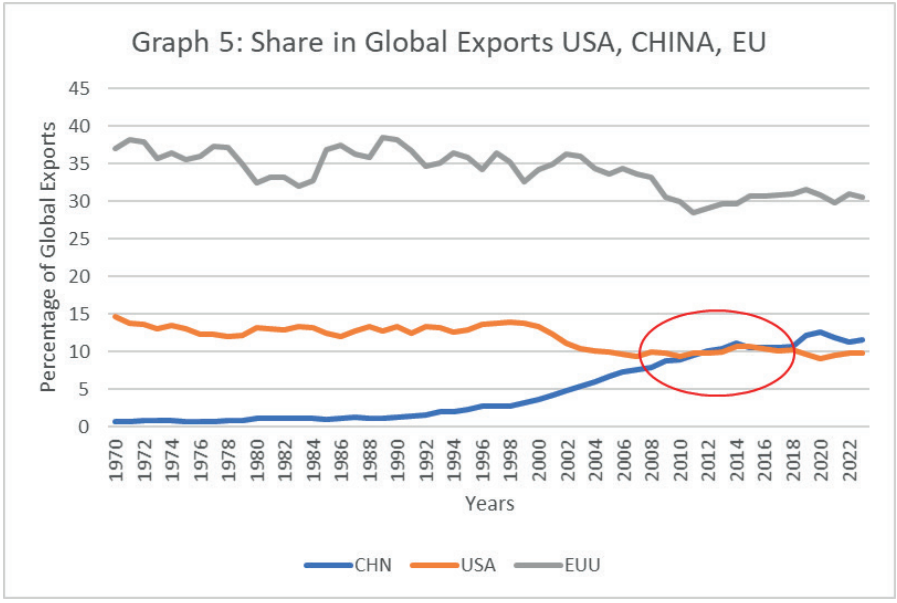
Therefore, in light of long-term unemployment data, we can say that protectionist policies have no justification in terms of unemployment and creating new employment opportunities.

To understand the economic rationale behind the protectionist measures initiated during Trump's first and second terms, analyzing the long-term international trade indicators of the US economy can provide insight.

### 3.1. Global Trade and External Deficits

Looking at the long-term performance of the most important actors in global exports provides an important data set for understanding developments in the current period. Graph 3 shows the share of the United States (US), China, and the European Union (EU), the three key actors in the world economy, in global goods exports between 1970 and 2022. This half-century period is a segment in which the tectonic shifts in global

economic power balances can be most clearly observed. The graph strikingly reveals the extraordinary rise of China as a manufacturing and export giant, in contrast to the relative decline of the US, the leader of the post-World War II Bretton Woods system, and industrialized Europe.




***Source: The World Bank, 2025 Created by the author using data from .***

The change in the export shares of the three main actors in the graph can be interpreted as a reflection of different economic models and different stages of globalization.

Graph 5 shows that the EU, which had a share of approximately 35-40 percent of global exports in the 1970s, struggled to maintain this share throughout the period. The downward trend, which became particularly apparent in the early 2000s, can be explained by several key factors. First, the maturing of EU economies and their shift towards deindustrialization, placing greater emphasis on the service sector. Second, internal shocks such as the 2008 Global Financial Crisis and the subsequent Eurozone Debt Crisis negatively impacted economic growth within the bloc and, consequently, export performance (Eichengreen, 2010). Third, and most importantly, new players such as China, with their low-cost and high-volume production, have aggressively entered global markets. Despite this, the EU has maintained its position as the world's largest integrated market and its strength in high

value-added products, thereby sustaining its leading position in global exports for a long time.

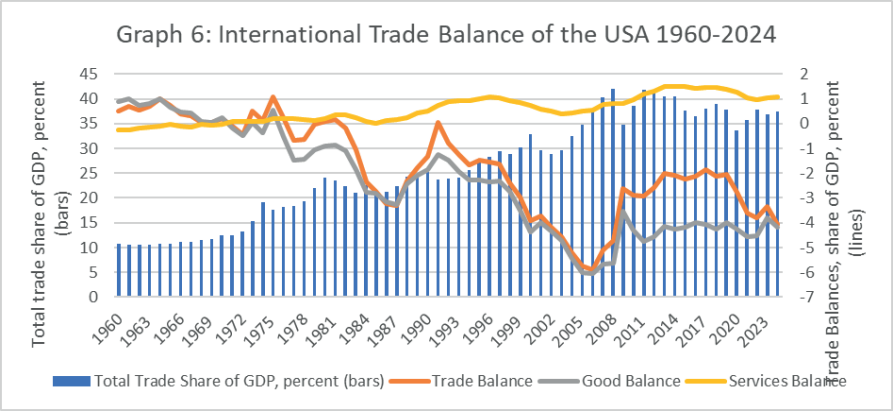
The US share of exports remained relatively stable at around 10-15 percent from the 1970s to the early 2000s. During this period, the US maintained its leadership in technology, finance, and high value-added industrial products. However, since the early 2000s, there has been a noticeable decline in the US share. The fundamental dynamic behind this decline is the process known as "The Great Convergence" (Baldwin, 2016), a new phase of globalization that enables information technologies to fragment supply chains. American multinational corporations have reduced their costs by moving labor-intensive stages of their production processes to countries such as China, which has led to a decline in the share of US goods exports. The 2008 Global Financial Crisis accelerated this decline by dealing a blow to the US economy (Tooze, 2018).

The most striking story in Graph 5 undoubtedly belongs to China. With a share of global exports close to zero in the 1970s, China began a slow rise in the 1980s with its economic reforms and opening-up policies. The real turning point, however, came with China's accession to the World Trade Organization (WTO) in 2001. This membership ensured China's full integration into global markets and elevated it to the position of "the world's factory." The sharp rise in the graph after 2001 is clear evidence of this. The state-led capitalism model, massive infrastructure investments, low labor costs, and export-oriented industrialization strategy have pushed China's export share to record levels (Naughton, 2018).

The period marked by the red circle in the graph, 2009-2013, is a symbolic turning point in global economic history. During this period, China's share of global exports caught up with and then surpassed that of the United States. It is no coincidence that this crossover occurred immediately after the 2008 Global Financial Crisis. While the crisis deeply shook developed economies such as the US and the EU, the Chinese economy recovered rapidly and continued to grow thanks to the massive stimulus package implemented by the Chinese government. This event is considered one of the most concrete indicators of the shift in global economic power from the West to the East. China's rise has not been limited to low-tech products; over time, it has expanded into high-tech fields such as telecommunications (e.g., Huawei), renewable energy, and electric vehicles, becoming a serious competitor for the US and the EU (Naughton, 2018).

The structure of global trade has fundamentally changed over the past 50 years. The world export market, initially dominated by the EU and the US,

has been reshaped by China's unprecedented rise. This process highlights the dynamics of globalization, the transformation in the international division of labor, and the success or failure of national economic strategies. The EU's relative loss of share, the decline of US manufacturing, and China's seemingly unstoppable rise constitute the macroeconomic reality underpinning today's trade wars, technological competition, and efforts to restructure supply chains. This picture clearly shows that the global economic order of the 21st century will be determined by the complex competition and cooperation relationships between these three actors. Indeed, the 2008 crisis changed the world (Tooze, 2018), and information technologies have taken globalization to a new phase (Baldwin, 2016).




***Source: The World Bank, 2025 data obtained and compiled by the author.***

Total trade volume, which was approximately 10 percent of GDP in the 1960s, reached 30 percent in the 2000s and has recently approached 40 percent. This trend demonstrates how policies aimed at reducing trade barriers (such as GATT and later the WTO) and technology (container shipping, communications, etc.) have increased global trade since the post-World War II period. The US economy has become much more integrated with the world economy over time.

The US has consistently run a surplus in services trade since the 1970s. This surplus has hovered around 1-1.5 percent of GDP. This reflects the US's global competitive strength in high value-added service sectors such as finance, technology, education, healthcare, and intellectual property. However, the goods balance shows the opposite trend. Goods trade, which was in balance until the mid-1970s, has been running a continuous and

growing deficit since then. This deficit is the main determinant of the overall trade deficit (orange line).

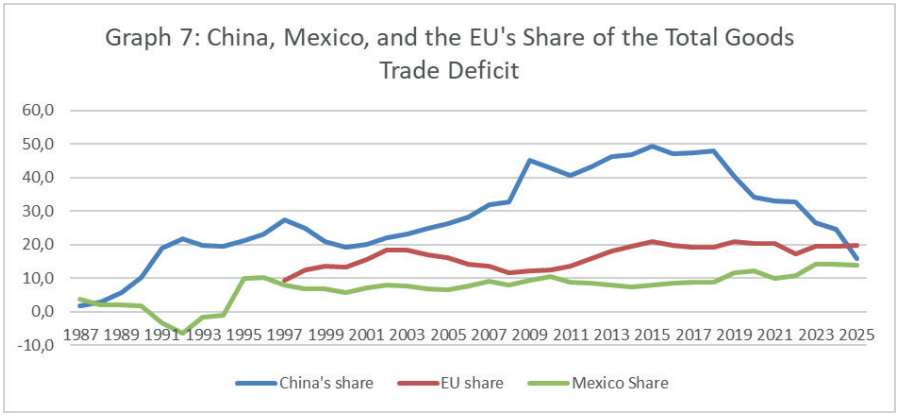
The mid-1960s and mid-1970s represent a turning point. The US trade balance has generally been in surplus or close to balance. However, this situation changed permanently in the mid-1970s, and a period of trade deficits began. There are several fundamental reasons behind this change. These are the collapse of the Bretton Woods System, oil shocks, and the rise of new industrial powers such as the EU and Japan.

The twin deficits phenomenon emerged in the 1980s. The graph shows that the trade deficit (orange and gray lines) deepened significantly in the mid-1980s. Supply-side policies implemented during the Reagan administration (tax cuts and increased defense spending) led to a massive budget deficit. Rising interest rates to finance the budget deficit made the US dollar excessively valuable. The valuable dollar made US exports more expensive while making imports cheaper, resulting in a much higher trade deficit.

The most dramatic deterioration in the graph is seen in the late 1990s and 2000s. The Dot-com Bubble in the late 1990s and the strong domestic demand that followed in the early 2000s were another factor driving imports. This period marked both a peak in globalization and the emergence of China's influence. The trade deficit reached a historic low in 2006, approaching -6 percent of GDP.

Looking at the main reasons for this, we first see China's accession to the World Trade Organization in 2001. This event was a turning point for the global economy. China's massive and low-cost production capacity became fully integrated into the world trading system. From this period onwards, US companies largely shifted their production to China. This flooded the US market with cheap Chinese imports. This situation pushed the goods trade deficit between the US and China to record levels.

Graph 6 shows a sharp contraction (improvement) in the trade deficit during 2008-2009. This does not mean that the US economy experienced a structural improvement. On the contrary, due to the economic crisis, household and corporate consumption and investment demand in the US contracted, and imports were slashed. This is a classic example of how a crisis can temporarily "improve" the trade balance. During the post-crisis recovery process, the deficit began to widen again.




***Source: Data sourced from the U.S. Census Bureau, 2025, and compiled by the author.***

While the US had a $367 billion goods trade deficit with China in 2015, this graph was $295 billion in 2024. As shown in Graph 7, since 2015, China's share of the US's total goods trade deficit has declined, while its total deficit with the rest of the world has increased, as seen in the previous Graph 6. This shows that the trade deficit has not disappeared, but has only shifted geographically. The main actors filling the gap left by China in this shift have been the European Union and Mexico.

China's share of the US total goods trade deficit was 49.3 percent in 2015, but this ratio has steadily declined to 24.5 percent in 2024. The US total goods trade deficit was approximately -$745 billion in 2015, but rose significantly to approximately -$1.205 trillion in 2024.

As the US's total deficit increased while China's share decreased, the trade deficit with other countries or regions must have increased. At this stage, the EU and Mexico stand out.

The U.S. goods trade deficit with the EU was approximately -$156 billion in 2015, rising to approximately -$236 billion in 2024. This represents an increase of approximately $80 billion.

The most striking increase has been in foreign trade with Mexico. The US goods trade deficit with Mexico was approximately -$60 billion in 2015, but exceeded -$171 billion in 2024. This represents an increase of more than $111 billion and makes Mexico one of the biggest winners of the declining US trade deficit with China.

*Table1 : Change in the U.S. Trade Deficit (2015 vs. 2024)*

| Country/Region | Trade Balance 2015 (Millions $) | Trade Balance 2024 (Millions $) | Change in Deficit (Millions $) |
|---|---|---|---|
| **China** | -367,328 | -295,515 | +71,813 (Deficit Decreased) |
| **European Union** | -155,900 | -235,874 | -79,974 (Deficit Increased) |
| **Mexico** | -59,973 | -171,491 | -111,518 (Increased) |
| **Canada** | -15,450 | -61,978 | -46,528 (Increased) |
| **World Total** | -745,483 | -1,204,719 | -459,236 (Net Increase) |

***Source: Compiled from USA Census Bureau 2025 data and calculated by the author. Negative values indicate the US trade deficit.***

Trade data clearly shows the phenomenon of *trade diversion* that emerged as a result of the US-China trade wars, which accelerated in 2018. The tariffs imposed by the US on products imported from China have forced importers and manufacturers to restructure their supply chains. These companies have reduced production in China and shifted production and supply to other countries such as Mexico, the European Union, and even Vietnam, which are not affected by the tariffs.

According to this analysis, although the US trade deficit with China has decreased, it has not disappeared; on the contrary, it has grown further and shifted to other countries, particularly Canada and Mexico due to their geographical proximity and trade agreements (The United States-Mexico-Canada Agreement - USMCA), as well as European Union countries with strong manufacturing infrastructure. Considering the new situation revealed by this picture, it is evident that the U.S.'s foreign trade deficits have not decreased.

### 3.2. How Does the US Finance Its Trade Deficits?

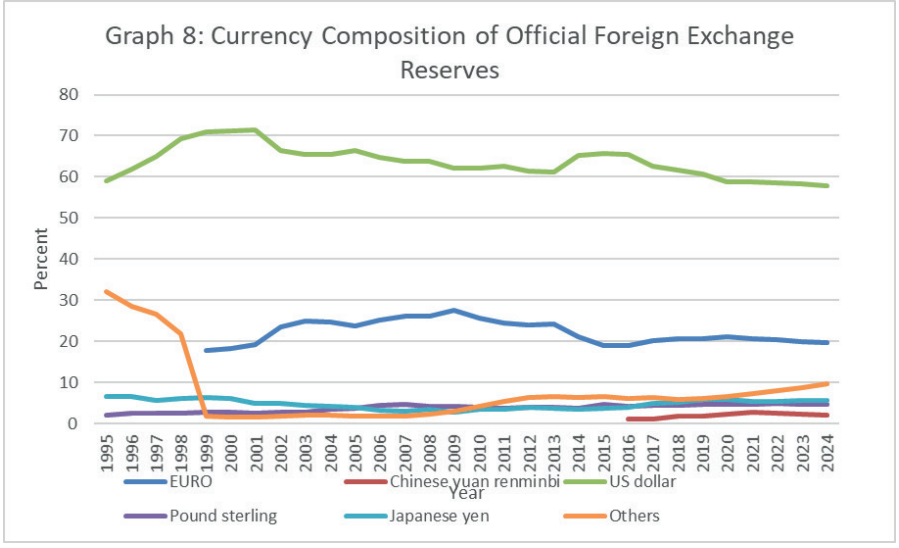
The US trade balance graph shows that the country has had a chronic external deficit problem since the 1970s, primarily stemming from trade in goods. This deficit has been deeply affected by structural transformations such as the collapse of the Bretton Woods system, the "twin deficits" of the 1980s, and the rise of China as a global manufacturing center, as well as cyclical shocks such as the 2008 crisis and the COVID-19 pandemic. In contrast, the US's strong competitive advantage in the services sector creates

a consistent surplus in services trade, which partially offsets this deficit but is insufficient to close it. Therefore, the US finances its trade deficit by running a surplus in the capital and financial account.

The U.S. closes the gap created by purchasing goods and services from the rest of the world by attracting investment from the rest of the world. Foreigners purchase assets in the U.S. rather than goods from the U.S. The main reasons for this capital flow to the United States are listed below.

### 3.2.1. The Status of the Dollar as a Reserve Currency

The US dollar's status as a reserve currency is the most important factor in this regard. The US dollar is the primary currency for global trade and finance. Central banks of other countries hold large amounts of dollars in their reserves to facilitate international trade and maintain the stability of their own currencies. These central banks purchase U.S. Treasury bonds, the safest and most liquid asset, to invest these dollars (Eichergreen, 2011). This situation provides the U.S. with an "exorbitant privilege"; that is, the U.S. can borrow in its own currency to import goods and services. The rest of the world's constant demand for dollars enables the US to easily finance its deficits.




***Source: IMF, 2025 Created by the author using data from .***

Global reserves, which stood at $1.4 trillion in 1995, peaked at $12.9 trillion in the 2021-2022 period. There are two main reasons for this

approximately ninefold increase. The first is the 1997 Asian Financial Crisis. During the crisis, Asian countries with insufficient reserves turned to a policy of "prudent reserve accumulation" to protect themselves against similar shocks in the future. Second, the impact of export-driven growth models came into play. A mercantilist approach is at work here. Many developing countries, particularly China, purchased foreign currency (especially dollars) from the market to keep their currencies competitive against the dollar, which led to a rapid increase in their reserves (Aizenman & Lee, 2007).

The most dominant and most debated trend in Graph 8 is the position of the US dollar within the global reserve currency system. Looking at the data, the US dollar still accounts for approximately 58 percent of global reserves, giving it an overwhelming advantage. This situation demonstrates that the dollar continues to enjoy its "exorbitant privilege" (Eichengreen, 2011). The main reasons for this privilege can be listed as: US Treasury bonds being the world's deepest and most liquid financial market, the dollar being the billing currency in global trade (especially for commodities such as oil), and the inertia (network effect) brought about by the system (Gopinath & Stein, 2021). When examining this trend in detail at , we infer that this hegemony has been slowly eroding (Arslanalp et al., 2022). The dollar's share, which was around 71 percent in the early 2000s, has now fallen to 58 percent. This 13-point drop is the clearest evidence of a quiet but determined search for diversification in the global system. Central banks do not want to put all their eggs in one basket. The euro and yuan have gained as the dollar has lost ground.

When it was launched in 1999, the euro was expected to be a serious competitor to the dollar, and initially it lived up to this expectation (Chinn & Frankel, 2008). Its share peaked at nearly 28 percent in 2009. However, the Eurozone Debt Crisis (Greece, Spain, etc.) that followed immediately thereafter severely damaged the Euro's perception as a "safe haven." Since then, the Euro's share has fluctuated, settling at around 20 percent. This shows that the Euro has not yet fully realized its potential as a global reserve currency.

The Chinese Yuan (Renminbi), moreover, is gaining strength as a new reserve currency. Included in the graph in 2016, the Yuan had a modest start. Its share began at around 1 percent and has now settled in the 2-2.5 percent range. This small percentage should not be misleading. Considering that China is the world's largest trading nation and its efforts to internationalize the Yuan (its inclusion in the SDR basket, digital Yuan trials, swap lines), this rise can be seen as the beginning of a long-term trend (Prasad, 2016).

However, the biggest obstacles to the Yuan becoming a fully global reserve currency are China's continued capital controls and the fact that its financial markets are not as transparent and liquid as those in the US.

The "Others" line in Chart 8 tells perhaps one of the most interesting stories. This category includes currencies such as the Australian Dollar, Canadian Dollar, and Swiss Franc. The share of this category has risen from around 2-3 percent in the early 2000s to nearly 10 percent today. This is a " stealth diversification" strategy, showing that central banks are turning not only to the dollar, euro, or yuan, but also to the currencies of smaller economies that are seen as reliable and stable. This is extremely rational behavior in terms of risk management (Arslanalp et al., 2022).

The overall picture revealed by this graph can be summarized as follows:

a. The Dollar's Dominance Persists but Is Weakening: The international monetary system remains dollar-centric, but its strength is diminishing.

b. The Transition to a Multipolar Monetary System is Underway: The world is slowly evolving towards a "multipolar" reserve currency system, where multiple currencies play significant roles, rather than a system where a single rival to the dollar emerges.

c. Trust and Liquidity Are Key Priorities: A currency's reserve status depends not only on the economic size of the country but also on global trust in the depth of its financial markets, the rule of law, and its institutional structures. Levelling-off of the euro's share and the obstacles facing the yuan underscore this reality.

The next decade will reveal how the balances in this picture will be shaped by trade policies, geopolitical tensions, technological developments (digital currencies), and global debt dynamics.

### 3.2.2. High Demand for US Assets

Foreign investors (individuals, companies, and governments) have a high demand for US assets for various reasons. These can be listed as follows:

U.S. Treasury Securities: They are considered the world's safest financial asset. During periods of global economic uncertainty, investors turn to U.S. government bonds, which they view as a "safe haven." This lowers the U.S. government's borrowing costs and facilitates deficit financing (U.S. Department of the Treasury, 2024)

Foreign Direct Investment (FDI): Foreign companies make direct investments by establishing factories, acquiring companies, or launching

new operations in the U.S. The U.S.'s large and wealthy market, stable legal infrastructure, and skilled workforce make it attractive for such investments. Between 2000 and 2023, net foreign direct capital inflows to the U.S. reached approximately 1.7 percent of GDP. This value averaged 0.7 percent between 1970 and 1999. Therefore, since the 2000s, the US has pursued more successful policies in attracting foreign capital inflows compared to the previous period. However, since 2015, there has been a relative decline in capital inflows (The World Bank, 2025).

Portfolio Investments: Foreigners purchase shares of companies listed on U.S. stock exchanges and private sector bonds. The U.S.'s deep, liquid, and transparent financial markets serve as a global hub for such investments.

### 3.2.3. Economic and Political Stability

Compared to many other countries, the U.S. is perceived as having strong property rights, a predictable legal system, and political stability. This leads global capital to favor the U.S. for long-term investments. Investors are largely confident that their assets in the U.S. will not be arbitrarily nationalized or lose value.

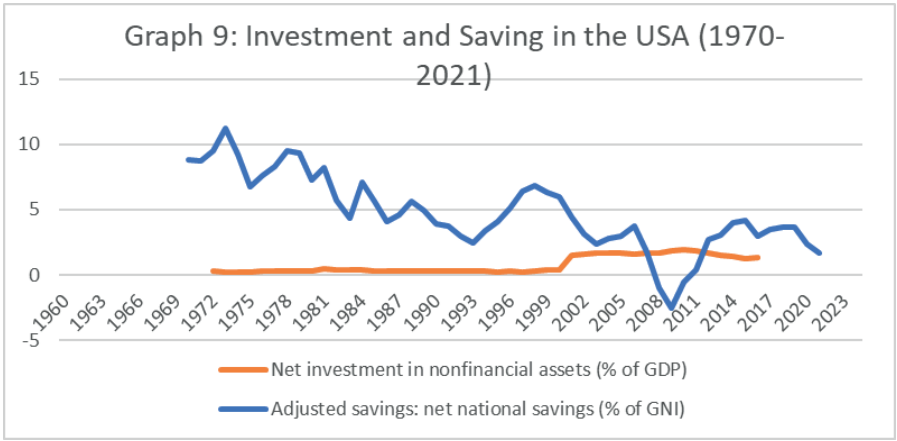
In short, the United States does not "close" its trade deficit; instead, it finances it by continuously attracting capital from the rest of the world thanks to the dollar's status as a global reserve currency, the reliability of U.S. assets, and the depth of the U.S. economy. This is similar to the United States issuing a kind of "debt instrument" (bonds, stocks, etc.) for the goods it consumes. As long as the rest of the world is willing to hold these securities, this system can continue.

In light of this data, it is clear that the US has no problem financing its trade deficits. On the contrary, the US can easily finance its external deficits and at the same time have the opportunity to import in a way that increases consumer welfare. It should also be noted that the US's seigniorage revenues make a significant contribution here.

## 3.3. The Fundamental Problem: Investment and Savings in the United States

One of the fundamental problems of the United States in this context, which is not very prominent and is not discussed, is its savings and investment trends. Over the last half-century, the U.S. economy has undergone a structural transformation. In particular, there have been significant declines in savings behavior and real capital accumulation. The dollar's status as the global reserve currency, the advantage of seigniorage income, and the ability

to easily import goods with its own currency to increase consumer welfare have come at a cost to the United States.




***Source: The World Bank, 2025 data obtained and compiled by the author.***

Graph 9 shows the trend of two key macroeconomic indicators of the US economy between 1970 and 2021: "Adjusted Net National Savings" as a percentage of Gross National Income (GNI) and "Net Investment in Non-Financial Assets" as a percentage of Gross Domestic Product (GDP). These two indicators are vital for understanding an economy's long-term growth capacity, capital accumulation rate, and sustainability.

"Adjusted Net National Savings," shown by the blue line, is a more comprehensive indicator than standard savings measurements. This metric aims to measure a country's "real" wealth accumulation rate by subtracting depreciation of fixed capital, adding education expenditures, and deducting the damage caused by the depletion of natural resources (energy, minerals, forests) and carbon dioxide emissions (World Bank, 2021).

Graph 9 clearly shows that the US adjusted net national savings rate has entered a long-term downward trend, starting from levels above 10 percent in the 1970s. Various structural factors underlie this decline. Increasing public debt (negative public savings), declining household savings rates, and demographic changes are among the main reasons for this trend.

The most dramatic break in this curve occurred during and after the 2008 Global Financial Crisis (GFC). The fall of the savings rate below zero during the crisis shows that the US economy not only consumed its existing capital and natural resources that year, but also ate into its future prosperity. This

situation is directly related to the massive wealth loss caused by the crisis and the large budget deficits (negative savings) incurred by the government to stimulate the economy (Tooze, 2018). Although there was a recovery in the post-crisis period, savings rates remained well below their historical peaks.

The orange line, "Net Investment in Non-Financial Assets," represents the net addition to an economy's physical capital stock, such as factories, machinery, and infrastructure. This is calculated by subtracting depreciation (the wear and tear on capital) from gross investment.

One of the most striking findings shown in Graph 9 is that the net investment rate in the US remained extremely low, almost at zero, from the 1970s to the early 2000s. This indicates that new investments made by the US economy during this 30-year period were only sufficient to offset the depreciation of the existing capital stock. This is an important sign that the country's infrastructure and production capacity are aging.

This chronic low level of investment aligns with the "Secular Stagnation" thesis, which was brought back into the spotlight by Lawrence Summers (Summers, 2014). According to this thesis, in developed economies, the desired level of investment falls below the desired level of savings due to factors such as demographic reasons, income inequality, and technological changes. This situation leads to low interest rates, slow growth, and asset bubbles. The low net investment rate in the graph can be interpreted as a decline in profitable investment opportunities in the US economy or as companies directing their profits toward financial activities such as share buybacks rather than real investments.

The fundamental macroeconomic identity states that a country's savings (S) finance domestic investment (I) and net foreign investment (current account surplus) ($S = I + CA$). The large gap between the savings and investment curves in the graph may initially suggest that the US has a large current account surplus. However, this is misleading, as the US has been a country with a chronic current account deficit for decades. The reason for this contradiction is that the "adjusted savings" metric in the graph differs from the standard national accounting definition.

The "excessive privilege" that the dollar has gained from being a reserve currency has shaped the behavior patterns of the US economy. Easy and cheap financing opportunities have weakened the savings discipline of both households and the public sector. This situation is linked to trade deficits through the fundamental macroeconomic identity $S - I = CA$ (National Savings - Domestic Investment = Current Account). When the U.S.'s

national savings (S) are lower than its domestic investment (I), the current account (CA) must be negative mathematically. This negative balance, i.e., the current account deficit, manifests itself largely through the country importing more goods and services than it exports, i.e., the trade deficit.

The main conclusion comes from reading these two trends together. First, the US is experiencing a low savings and low investment paradox. The US has both a low "real" savings rate and a low net real investment rate. This becomes more meaningful when combined with Ben Bernanke's "Global Saving Glut" thesis (Bernanke, 2005). According to this thesis, high savings in Asian economies, particularly China, flowed into the US, lowering interest rates and enabling the US to finance its consumption and public spending despite its low savings rate. However, as the graph shows, this foreign capital inflow did not translate into strong real investment growth in the US. Instead, it largely financed consumption and financial assets such as the housing market, paving the way for the 2008 crisis.

Second, long-term growth potential is eroding. According to the Solow growth model, a country's capital accumulation rate (investment rate) is one of the key factors determining per capita income levels. A net investment rate hovering near zero for decades means that the economy cannot deepen its capital stock and thus weakens its long-term growth potential.

Graph 9 highlights the deep structural challenges facing the US economy over the past 50 years. On the one hand, there has been a steady erosion in adjusted net national savings, which indicate the country's capacity to build future prosperity. Furthermore, there has been a chronic stagnation in real capital investment, which increases the economy's production capacity and productivity. The 2008 Global Financial Crisis demonstrated how destructive the combination of these two weaknesses can be. Graph 9 provides strong evidence that the U.S. economy has entered an environment of low growth, low interest rates, and low investment, defined as a "Secular Stagnation," and highlights the need for the country to prioritize capital accumulation and sustainable savings policies for its long-term economic health.

Is this situation a result of growing trade deficits with China, particularly after 2001, or is it a reflection of the easy financing conditions afforded by the dollar's status as the global reserve currency?

The answer to this question provides clear evidence as to whether Trump's policies are right or wrong for the US as of 2025. Let us be clear that the fundamental cause of the structural weakness mentioned above is not trade

deficits, but the dollar's status as the global reserve currency. Trade deficits are a consequence and symptom of this situation.

This analysis reveals that the two factors in question are in a "chicken-and-egg" relationship, but that the fundamental and permissive factor in this dynamic is the "*excessively privileged*" position of the US dollar in the international monetary system. In 1971, US Treasury Secretary John Connaly responded to complaints about the negative effects of US economic policies on other countries during a meeting with his European counterparts in Rome by saying, "*The dollar is our currency, but it's your problem.*" (Eichengreen, 2011; . However, today we can say that *the dollar* has become *the US's problem as well*.

The most fundamental mechanism underlying the US's decades-long model of low national savings and high consumption is the situation described as the "exorbitant privilege" (exorbitant privilege) by French Finance Minister Valéry Giscard d'Estaing, which stems from the dollar being the world's primary reserve currency (Eichengreen, 2011, p. 4). This privilege provides the US with two significant economic advantages that no other country possesses:

- Constant Global Demand: Central banks around the world need large amounts of dollars to finance international trade, pay their foreign debts, and hold reserves as a store of value. This creates constant demand for financial assets issued by the US, particularly US Treasury bonds, which are considered the world's safest assets, thereby suppressing interest rates.
- Low Borrowing Costs: This strong global demand for U.S. assets allows the U.S. government and private sector to borrow at much lower interest rates compared to other countries. This enables the US to sustainably finance its massive budget deficits (negative public savings) and current account deficits (a reflection of low national savings) without triggering a balance of payments crisis. As Eichengreen (2011) points out, while other countries facing deficits of similar magnitude typically experience sharp currency devaluations and interest rate shocks, the US is largely exempt from this mechanism.

In the 2000s, massive savings surpluses generated by export-oriented Asian economies such as China and oil-exporting countries flowed into the US in search of safe havens for investment. This capital inflow further lowered interest rates in the US and enabled it to finance consumption and the housing market despite its low savings rates. This symbiotic relationship

has been defined as a modern system centered on the US, in which Asian economies export capital to the US to sustain export-driven growth, giving rise to the "*Bretton Woods II*" hypothesis (Dooley et al., 2003). In this system, China reinvests the dollars it earns by selling goods to the US into US Treasury bonds; this keeps US interest rates low and strengthens the dollar. Naturally, it also encourages the US to import more from China. Therefore, the trade deficit with China is more a consequence than a cause of this global imbalance system.

Moreover, seigniorage revenue is the key concept that explains how this system works in favor of the US. In its narrow sense, seigniorage is the difference between the nominal value of money and its production cost, but its actual meaning in the international context is much broader. The "international seigniorage" gained by the US consists of real economic advantages stemming from the dollar's reserve currency status (Eichengreen, 2011). These advantages are as follows:

- Real Resource Transfer: The US can obtain real goods and services (imports) in exchange for financial assets (Treasury bonds) denominated in its own currency, which are merely promises of future debt repayment and carry low interest rates.
- Exemption from Exchange Rate Risk: The US does not bear any exchange rate risk because it borrows in its own currency. When other countries borrow in foreign currencies, the depreciation of their national currencies increases their debt burdens, but the US is exempt from this risk.

The low savings and investment rates observed in Graph 9 are not a consequence of the US running trade deficits. On the contrary, the "excessive privilege" afforded by the dollar's status as the global reserve currency is the fundamental and enabling reason that has allowed the US to sustain low national savings rates and high consumption levels for decades. An inevitable consequence of this structural situation and its reflection in the international arena is the chronic trade deficits, financed by the "Global Savings Surplus," particularly with countries such as China. Therefore, trade deficits are not the disease itself, but rather a symptom of a deeper macroeconomic imbalance created by the dollar's unique role in the global system.

The other side of the coin is the investments made by US companies in China and other countries that offer cost advantages. In this context, the US is a country that exports significant amounts of capital. Between 1990 and 2023, on average, there has been a net foreign direct investment outflow

equivalent to 1.67 percent of US GDP. This rate was 0.57 percent between the 1970s and 1990. Therefore, US companies have largely turned to net capital exports in the new era of globalization after 1990. Between 2021 and 2024, the amount of net foreign direct investment outflow from the US averaged $388 billion annually (The World Bank, 2025).

Numerous multinational enterprises (MNEs) have used China as a production base and export platform. Approximately 60 percent of China's exports to the US originate from foreign-owned enterprises. Due to the prevalence of contract manufacturing, some American companies also produce their products in China and export them to the US. Many U.S. technology companies depend on manufacturing facilities in China for the final assembly of their products. For example, 90 percent of the iPhones sold worldwide by U.S. technology giant Apple are assembled in China (Aytekin, 2025). This situation involves trade between a U.S. company (Apple) and its subsidiary or contracted manufacturer in China (e.g., Foxconn), which is a type of intra-company or related-party trade. However, the start of the trade war has begun to shift the direction of cost-focused investments by U.S. companies (Guoyong & Ding, 2021).

## 4. The Cost of Protectionism

In this new era, led by the US and beginning in 2025, what are the potential effects that customs tariffs on global trade have created so far and will create in the near future? It is possible to answer this question in the context of recent outcomes and economic theory.

The cost of the tariffs imposed by the Trump administration starting in March 2018 has largely been borne not by Chinese exporters, but by US importers and ultimately US consumers and producers. Contrary to the administration's claim that "China will pay these tariffs," economic data from the trade wars that began in 2017 show that the tariffs have effectively created increased costs within the U.S. economy. Tariffs have increased prices since 2018, reducing economic output and employment. Historical evidence that tariffs raise prices and reduce economic growth supports the potential impact of the 2025 tariffs on consumers.

Analyses show that the tariffs of the 2018-2019 trade war were largely borne by consumers of goods imported into the US through higher prices. For example, it was found that after tariffs were imposed on washing machines, washing machine prices increased by $86 per unit and dryer prices increased by $92 per unit, resulting in a total cost increase for consumers exceeding $1.5 billion (York & Durante, 2025).

### 4.1. Price Impact Mechanism: Nearly Full "Pass-Through"

Economic analyses have revealed that Chinese exporters did not significantly reduce the dollar prices of the products they sold to the US after the tariffs were imposed. This indicates that the "pass-through" rate was close to 100 percent, meaning that a 25 percent tariff directly increased the cost of the product entering US ports by 25 percent. One of the most fundamental studies on this topic concluded that the cost of the 2018 tariffs was "fully borne by American firms and consumers" and that no statistically significant decline in Chinese firms' export prices was observed (Amiti et al., 2019).

Increased costs for importers have been passed on directly to retail prices throughout the supply chain. This has occurred in two ways. First, there is a direct impact. The retail prices of Chinese-origin products subject to customs duties (e.g., washing machines, furniture, luggage) have increased significantly. Second, there are indirect effects. Domestic US producers or importers from other countries have tended to raise their own prices as competition pressure has eased due to Chinese competitors losing their price advantage. Estimates of the decline in market revenue understate the total impact Americans will face, as these estimates exclude loss of choice and higher prices for substitute goods. In general, tariffs are trade barriers that raise prices and reduce the current quantity of goods and services available to U.S. businesses and consumers. Tariffs can be passed on to producers and consumers in the form of higher prices. Increases in consumer prices can reduce the after-tax value of both labor and capital, encouraging Americans to work and invest less, which leads to a decline in economic output. In 2026, Section 232 tariffs will reduce after-tax income by an average of 0.3 percent, while IEEPA tariffs will reduce after-tax income by an average of 1.1 percent (York & Durante, 2025).

### 4.2. Impact on Households

On the other hand, the cost impact on households also translates to a tax increase. All applied and planned tariffs correspond to an average tax increase of $1,300 per US household in 2025 and $1,600 in 2026. These effects directly reduce household purchasing power (York & Durante, 2025). Indeed, the Congressional Budget Office stated that the initial tariffs implemented in 2017 reduced the average U.S. household's annual real income by approximately $1,277 due to both higher prices and the reduction in economic efficiency caused by the tariffs (Congressional Budget Office, 2020). Similarly, analyses model that the tariffs will reduce US GDP

by 0.8 percent over a long term such as 2025-2034. They model that it will suppress wage increases and lead to job losses (York & Durante, 2025).

### 4.3.Impact on Producer and Intermediate Goods Prices

Tariffs target not only final consumer goods but also critical intermediate goods such as steel, aluminum, and various machine parts used by US manufacturers in their production processes. This has raised raw material prices within the US, particularly due to tariffs imposed on metals such as steel and aluminum. The 2018–2019 experience showed a negative impact on employment and production in the targeted sectors (Flaaen & Pierce, 2019). This led to a moderate slowdown in GDP but a more pronounced slowdown in trade.

This increase in costs has negatively impacted the competitiveness of manufacturers in sectors such as automotive, construction, white goods, and machinery manufacturing. With rising raw material costs, US manufacturers have found themselves at a disadvantage against their international competitors in both the domestic market and export markets. The impact of Section 232 (steel and aluminum) and Section 301 (Chinese goods) tariffs imposed by the US-on-US manufacturers has varied between sectors that received direct protection and industries that use these products as inputs. When examined by sector, Section 232 tariffs have mitigated the damage to the steel industry caused by global overcapacity and encouraged approximately $22 billion in new capital expenditure by increasing the sector's capacity utilization rate (81 percent in 2021). Similarly, Section 232 tariffs have helped stabilize the primary aluminum industry, with approximately $5.2 billion in investments announced in the sector since 2018. On the other hand, Section 301 tariffs have reduced imports from China and increased domestic gross production in directly affected sectors such as Semiconductors, Apparel Manufacturing, and Motor Vehicle Parts (with some sectors estimated to have seen increases of up to 6.4 percent in 2021). However, downstream industries that heavily use steel and aluminum as inputs have been negatively affected by rising input costs; studies estimate that most of these industries have experienced a decline in domestic production (up to 2.77 percent in Cutlery and Hand Tool Manufacturing), and downstream domestic prices have increased by an average of 0.2 percent. Therefore, according to the USA Trade Commission report, the tariffs under Sections 232 and 301 have increased input costs for US producers (DeFilippo & Powers, 2023). Some experts also argue that the protectionist policies implemented after 2017 have caused more harm than good to US producers (Lovely & Liang, 2019).

### 4.4. Overall Economic Impact and Magnitude of Tax Increases:

The tariffs Trump implemented in 2025 will rank as the largest tax increase since 1993. These tariffs will increase federal tax revenues by $171.3 billion in 2025. If all IEEPA tariffs remain in effect, the applied tariff rate will rise to 18.9 percent, and the effective tariff rate will rise to 11.6 percent—the highest average rate seen since 1943. Therefore, the 2025 tariffs will not only directly increase household costs but also cause consumers to pay higher prices and have fewer product choices (York & Durante, 2025).

### 4.5. Global Welfare Loss

According to Classical Economic Theory, trade wars are events that reduce a country's welfare for three main reasons: 1) Tariffs make imported goods more expensive and reduce consumers' purchasing power, 2) The production costs of domestic producers who use imported goods as intermediate goods increase, and this cost is passed on to consumers, 3) Retaliatory measures reduce external demand for domestic products and decrease production.

### 4.6. Decline in Global Trade Volume:

The ratio of global trade to GDP peaked in 2017-2018. During this period, the ratio was around 59-60 percent. This is close to the peak before the 2008 Global Financial Crisis and is an indicator of post-crisis recovery. By 2020, however, this ratio had declined to around 52-53 percent, particularly due to a sharp drop in the first half of the year. Between 2017 and 2020, there was a significant decline of approximately 7-8 points in the share of global trade in the world economy. This means that the global economy has become more "insular" and international trade has slowed down. We anticipate that this trend will continue in the coming period with new customs tariffs. The slowbalization process that began with the policies of 2017 will continue in 2025 and beyond.

### 4.7. Investment Diversion:

Trade wars have led to a new restructuring in the global semiconductor value chain, with a "factory-building race" beginning among East Asian economies in particular. The special tariffs imposed by the trade war may encourage MNEs to relocate their production facilities or export bases from high-tariff countries to low-tariff countries, motivated by "tariff jumping/hopping." This situation has caused potential investments to shift from China to a third country. It is seen as a reflection of the tariffs and protectionist policies that began during the Trump era and continued under the Biden

administration. The policies have encouraged US companies to shift their supply chains from China to other countries seen as "friends and allies."

### 4.8. Diversification of the Supply Chain

Due to increasing risks in recent years, US companies have begun to shift part of their production to countries such as Vietnam and India. However, China still plays a central role thanks to its complex production processes and massive infrastructure (Aytekin, 2025).

Even if some multinational companies move the final product assembly outside of China, they continue to source the raw materials and intermediate parts used in production from China. This again demonstrates trade within the companies' own supply chains.

Some divestments have resulted from the combined effect of high production costs caused by rising wages and land prices, and higher tariffs caused by the trade war.

A survey of more than 200 American MNEs operating in China showed that 60 percent of companies would adjust their strategies due to the trade war, 50 percent would seek new supply partners, and 25 percent would shift their investments to other countries. There are concrete examples, such as Nintendo, Google, HP, and Dell, showing that US companies (or large MNEs manufacturing in China) are shifting from China to other East/Southeast Asian countries to avoid tariffs and restructure their cost structures. It is noted that US companies initially used China as a major production and export platform due to its cost advantage, but as part of this strategy, investments and production have begun to shift to other Asian countries such as Vietnam, Malaysia, and Taiwan due to the Trade War and increasing tariffs (Guoyong & Ding, 2021).

## 5. Conclusion

The analysis conducted throughout this section reveals that the US-China trade war, the most debated economic conflict of the 21st century, is an expression of a much deeper and more structural malaise beyond populist rhetoric and headlines. Our fundamental conclusion is that protectionist policies and tariffs represent a misguided treatment based on a flawed diagnosis, targeting not the disease itself but only its most visible symptom: the massive trade deficit. The real issue underlying this conflict is not so much China's rise as the structural weakness of the US economy over the past half-century, masked by the "exorbitant privilege" conferred by the dollar's status as the global reserve currency.

As we have demonstrated with data, this "exorbitant privilege" has given the US the unique power to borrow in its own currency to import goods and services from around the world, but on the flip side, it has created a chronic "chronic low-savings/low-net-investment equilibrium" paradox. Easy financing opportunities have led both households and the public sector to prefer consumption over savings and financial speculation over real investment. According to the basic macroeconomic identity (S - I = CA), this structure, in which domestic savings fall below domestic investment, mathematically necessitates a current account deficit. In this equation, China, in its role as "the world's factory," has become an actor that meets this structural consumption demand of the US and feeds this symbiotic cycle, called "Bretton Woods II," by reinvesting its dollar surplus in US Treasury bonds. Therefore, the trade deficit with China is not so much a cause of this system as an inevitable consequence.

In this context, the results of the tariffs imposed since 2018 and escalated in 2025 have, as we theoretically expected, pointed to failure. The cost of the tariffs has been borne not by Chinese exporters, but directly by American consumers and producers using intermediate goods through price increases. More importantly, these policies have not reduced the US's overall trade deficit; on the contrary, they have caused the deficit to shift geographically to other partners such as Mexico and the European Union through the phenomenon of "trade diversion," and even to increase overall. Rather than solving the fundamental structural problems of the U.S. economy, protectionism has disrupted global supply chains, led to a loss of global prosperity, and accelerated the slowdown in global trade, known as "slowbalization."

Ultimately, the US-China trade war signals the end of an era. This is not just a competition between two economic superpowers, but also a historic turning point where the sustainability of the dollar-centered global financial architecture and the asymmetric advantages it brings are being questioned. The coming period will show whether the US will confront these structural weaknesses and develop policies to strengthen its real economy by increasing savings and investment rates. For, as the analysis reveals, the words once arrogantly uttered by former US Treasury Secretary John Connally to his European counterparts, "The dollar is our currency, but your problem," have now become the reality that "The dollar is our currency and now our problem too." The trade war is nothing more than a noisy confession of this painful truth.

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