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Past, Present, and Future: Research on the Influence of International Competition and Collaboration Relationship between US and China

Yutao Wang*

Pepperdine University, Malibu, California, USA

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ABSTRACT

"America has no permanent friends or enemies, only interests", by Henry Kissinger. US and China have become the usual pattern of new international trade as the top two economic entities since 2010. After former President Trump took over the chair, the trade conflict between the US and other countries, especially China, has been sharpened to increase domestic employment. A new era of international competition on the economy has grown invincibly in a brutal way.

This paper states and analyzes the economic development and historical interactions between China and the US, standing from China's perspective. Four-time periods are introduced in the paper for China's progressing procedure: 1949-1978 pre-opening, 1979-2000 post-opening, 2001-2016 WTO period and focusing on the 2017-2021 deterioration. The methodology starting from industrial structure, trade deficit, monetary and fiscal policy. The key questions include; why China has faster growth, why the US tries to restrict China's development, and its effective influence.

The paper's conclusion lies in the comprehensive prediction of the future economic relationship between China and the United States in the ongoing 50 years, yields to the world trade habits and potential international economic system revolution, demonstrated from three sectors: economic structure change and technical restrictions.

1. Introduction

Kerry Liu (2020) had summarized the integral Chinese policies response before 2020 to the trade war with the US in his research, in which he concluded that the Chinese government had changed its policy focus from demand stimulus to supply stimulus that much more effective than traditional pattern under the pressure of high tariffs, while started reforming institution to focus more on quality development. As for COVID-19 relative analysis, this paper has introduced the results from Miguel Faria-e-Castro (2020) and Luca Fornaro and Martin Wolf (2020), which quantified the effects of the Coronavirus Aid, Relief and Economic Security Act of 2020 in the US, the $2 trillion package by White House on Mar 27, 2020. Meanwhile, the package involving transfers is seemingly useful, and unconditional transfer could be the least costly speaking of implementation.

2. Relationship before China-US Trade War

2.1 Pre-Opening Stage (1949-1978)

After establishing the People's Republic of China on Oct 10, 1949, the economic communication between Chi-

**Corresponding Author:*
Yutao Wang,
Male, Master in Finance(2021);
Pepperdine University, Malibu, California, USA;
E-mail: karl.yutao.wang@foxmail.com.

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na (PRC) and the US has been unofficially started as the signal of WWII's termination. However, the founded of the PRC was also the starting point of ongoing China's internal conflict. From 1949 to 1960, China (PRC) was incredibly intimate with the Soviet Union due to the ideology's similarity to communism. The 5-year loan equivalent to $500 million to China (PRC) took up 14.3% of the entire government expenditure, contributing tremendously to the reconstruction of infrastructure and industry, including the weapons used against the US during the Korean and Vietnam War. As a KMT supporter during the domestic cold war standing for capitalism, the US shut down almost all communication channels with China (PRC). Even though the formal diplomatic relationship was not framed during this period, a negligible amount of private transactions and investments has been active despite the Cold War's miniature between the CCP in mainland and KMT in Taiwan. However, the investment and lending from the Soviet Union to China (PRC) has dramatically become the trigger of contradiction between them and also the initial point of changing attitude to the US.

2.2 Post-Opening Stage (1979-2000)

After the relationship breakdown between China and the Soviet Union in the 1960s for territory conflicts and other factors, things went different after 1972. When former US President Richard Nixon officially visit Beijing months after Henry Kissinger's secret meeting as the pioneer for the breakthrough of China-US relationship, China attempted to get in touch with the US proactively. However, due to a 10-year misleading extremely progressive strategy, China has suffered from a massive recession, so that the transactions with all other countries were almost shut down. Otherwise, the initial time of China-US diplomacy could be advanced for up to 10 years. At the turning point of 1972, the total trade amount was about only $13 million. However, in 1979, of official claim of diplomatic relationship establish, the bilateral trade amount increased to $1 billion, 80 times more than seven years ago. When the time came to the night before China entering WTO, the number went up to $74.5 billion, meaning an average annual increase rate of an incredible 24%. It is a well-deserved and well-known honeymoon period between China and the US.

2.3 After Entering WTO (2001-2016)

After the Yinhe incident in 1993, Third Taiwan Strait Crisis in 1996, and the Belgrade embassy bombing event in 1999, the US-China relationship was no longer intimate as 20 years before. Also, even though the US's imports continued to grow, it was dramatically declined due to numerous and comprehensive protests in China, hitting the floor in 1999. However, as China's diplomatic behavior, the US side only received verbal complaints from the Chinese government. Hence, despite the minority of resistance to China's Socialism, the voice from the US remained relatively positive regarding China, which built the foundation for the later assistance to join WTO.

On Dec 11, 2000, China formally 're-entered' WTO for a seat. However, there was a meeting between China and the US 1 year before the WTO meeting from Nov 10 to Nov 15, 1999. In the agreement signed in Beijing, the US admits China's identity as a WTO member and promised assistance for the entry, indicating that the relationship of economic partner was still ongoing. Just one year later, the shocking Sept 11 Attacks broke out and deviated both China and the US's attention from competition to the anti-terrorism. China positively supported the US anti-terrorism wars in Afghanistan and joined relevant action in the UN to maintain global safety. Since the influence of terrorism, the conflict between the two countries was eased for a while.

Starting from 2009, the US president's replacement has signaled a new stage of China-US diplomatic relationship. Different from the uncompromising attitude of republicans like Bush Jr., Barack Obama treated China issues more peacefully. In 2014, the bilateral trade balance arrived at $5.5 trillion, touching the ceiling of the current increase rate of international trade amount between the US and China.

Nonetheless, the US-China relationship was gradually worsening because of several global contradictions like the THAAD system in South Korea and South China Sea Arbitration, setting up a fuze for future deterioration.

3. Deterioration (2017-2020)

3.1 Introduction

Since the beginning of 2018, several economically-influential events have caused significant fluctuation or, more precisely, destruction in the largest economy groups. Two crucial incidents are still ongoing: the all-out trade war proposed by the United States and the pandemic of COVID-19. In response to economic phenomenons brought by trade war and virus, governments from 2 of the largest and also most special economies, China and the US, have been attracting massive attention from researchers, policymakers, companies, and investors inclusively. Subsequently, this report will mainly focus on fiscal policies from these two top economic entities.

Effectively on Jul 6, 2018, US President Donald Trump

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announced that tariffs would be increased to 25 percent on a reduced 818 products (from 1,334) while other new 284 products are under consideration. After a four-month break over the period from Dec 2018 to April 2019, on May 10, 2019, the trade war between the two countries stepped into the second stage. Starting from that moment, total US tariffs hit the maximum of $550 billion while total Chinese tariffs to US products also reached $185 billion ceiling as a response. Afterward, under the wide-spreaded COVID-19, two countries are attempting to mitigate the conflicting situation with the signal of Phase One Agreement.

According to the Liu (2020) and his previous results, the background behind the China-US trade war is complicated and considered to have consisted of three aspects: First, from the perspective of US policymakers and executives, there exist suspicious unfair operations levied by China, including but not limited to: China's cyber economic espionage against US companies; invalid protection to the intellectual property rights; anti-innovation and duplicate encouraging policies; avoid of WTO duties; abuse of policies supporting specific industries; the intervention of currency value (Morrison, 2018). Second, from the US government's aspect, the China-US trade war is the superficiality of US protection to the imports relevant domestic industries. Besides, this unilateralism was also performed as renegotiation or unauthorized quit of WTO. Third, China's fast development was challenging the US's dominant position and suspected to impact the capitalist market and western order (De Graaff & Apeldoorn, 2018).

After two massive shocks from a trade war, COVID-19, known as Coronavirus, spread out with an exponential speed, which could be traced back to Dec 31, 2019, when the first cluster of pneumonia cases was reported in Wuhan. Starting from Jan 20, 2020, China's central government required a complete lockdown in Wuhan and crowded regions then continuously nationwide quarantine in other areas, which caused a severe supply shortage to the economy by forcing the secondary industries to shut down with the reason of shortage of labor force. After the introduction for China-US trade war, this paper will then summarize and analyze the policies implemented by the Chinese government in response to the trade war and the widespread COVID-19.

3.2 Trade War

After the initial proposition of 'global safeguard tariffs' towards all countries except Canada, also acknowledged as the unveiling of trade war or the first stage, CPC Politburo meeting has decided to accelerate the reform of institution to supply-side structure, increasing the production capacity and quality of relevant industries, which was the first secret confrontation between US and China.

Table 1. Timeline for China's Fiscal Policies before Jul. 16, 2018

Apr 2, 2018	China levied tariffs (ranging from 15% - 25%) on 128 products in total, including foods and metals.
Apr 4, 2018	China announced 25% tariffs on 106 products in total, including foods, chemicals, and electronic devices.
Apr 17, 2018	China announced anti-dumping duties of 178.6% on imports of sorghum from the US.
May 18, 2018	China's Commerce Ministry announced that China would stop tariffs on US sorghum.
May 20, 2018	China agreed to armistice also to buy more US goods.
Jun 16, 2018	China adjusted the tariff list to 545 products while announced a second round tariff, including 114 products.

On Jul. 31, 2018, 25 days after the trade war announcement from the House as the signal of the second stage of trade war, the CPC Politburo meeting reached a internally consensus in stabilizing employment, finance, foreign trade, foreign investment, and market expectations. Primary fiscal policies proposed during this period were taxation adjustment. First, China's Ministry of Commerce was asked to take the proactive fiscal policy, then proposed external tariffs to massive amounts of specific US goods including foods, agricultural products, medical equipment, chemicals, and machinery ranging from 5% to 25%. In contrast, to stimulate export to compensate for the trade loss between the US, China has increased the export tax rebate rate while reducing the export processing days since Nov 1, 2018.

Based on the official number given by US Trade Representative Office, since 1985, the trade deficit with China has been continuously increasing, excluding two special moment: 2009 and 2019, among which 2009 was recognized by the recession by the 2008 financial crisis when domestic demand was sharply declined along with the import. According to Liu (2020), China's trade balance should be unaffected by the increased two-sided tariffs. However, after 2018, the trade balance between China and the US fell back to about five years ago, 2014. However, when noticing net import, the decline on it is not such vast as Trade balance, which is about three years backward. Since it has been only one year after the tariff levied, there is not enough evidence to indicate its influence in the long run, but it shows China's exports tax rebate policy effectively promotes export from China to the US.

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Table 2. US Trade Balance with China ($ million). Source: United States Census Bureau

2013	2014	2015	2016	2017	2018	2019
-318,684	-344,818	-367,328	-346,825	-375,423	-419,527	-345,617

The Chinese government revised the taxation in several other fields, mainly including value-added tax cut (starting from May 1, 2018) and personal income tax cut (starting from Oct 1, 2018). Even though the growth rate of personal income tax reduced from 21.7% before the cut to 14.2%, the personal income tax return was executed at the beginning of 2020, so as a tax policy, personal income tax was playing a role in stabilizing the market expects more than stabilizing finance or employment in 2019.

Generally speaking, China's tax policies effectively enhanced economic growth under tariff pressure by relieving the expense financial burden for companies while stimulating consumption.

Unlike the first two-stage, After Sept 11, 2019, the trade war between the Big Two has been ushering in the dawn: China's Tariff Commission unveiled two tariff exemption goods from the US, including most manufacturing products, which would be valid for one year. This first compromised policy has enlightened the future.

On Jan 15, 2020, Phase One Deal, recognized as the truce sign, was signed by both China and the US, agreeing to roll back tariffs, expand international trade, and adjust clauses of intellectual properties and currency practices.

The temporary exemption lists would preserve valid for only one year, and the earliest one would be expired in September 2020. Even though the situation is right at a turning point currently, it is still unpredictable where the relationship between the two largest economies will head for.

The trade war has generated an extensive shock to both the Chinese and US economies and their community. As the most intuitive influence brought from the trade war, there were two strong appreciation trends of Chinese RMB after the trade war breakout and then followed by an instant depreciation. According to the record on Macro trends and Trading Economics, even though the overall exchange rate tends to be the same number based on the current number as a percentage of initial data at the beginning of the trade war, it has been severely fluctuating within the past three years. The highest depreciation of RMB exceeded -10% from January 2018 to September 2019. As another new trend, an apparent appreciation is recognizable, starting from the explosion of COVID. Besides, As illustrated, the US unemployment rate did not suffer much because of a trade war, since it continued decreasing from 4% after July 2017 till the pandemic and experienced an incredible lift to the maximum of 15% (Fig ure 2). Compared with the US, the urban unemployment rate of China was about to be the same as the US before the point, but later jumped from approximately from 4% to 5% owing to the trade war, while another climbing of 1% happened after the pandemic, where the ceiling resulted from the nationwide lockdown and quarantine during the pandemic period. However, one point that should be mentioned here is that the reported unemployment rate varies from different channels (Fig.2 & Fig. 3), showing opposite trends. Feng (2015) argued that China's official unemployment rate was calculated by a preliminary survey surrounding to urban area, and the real unemployment rate is about to be double or triple of the official records. Since the authorized absolute number was generally given around 10 million on average in 2018, we may estimate 30 million unemployed people as real data (or approximately 3.75% in total labor force), which was close to the given data.

Figure 1. RMB-Dollar Exchange Rate during Trade War

Source: Macrotrends

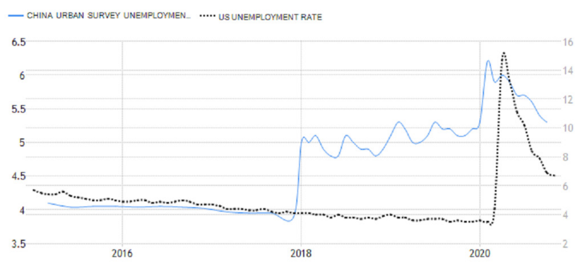

Figure 2. Unemployment Rate during Trade War (%)

Source: Trading Economics

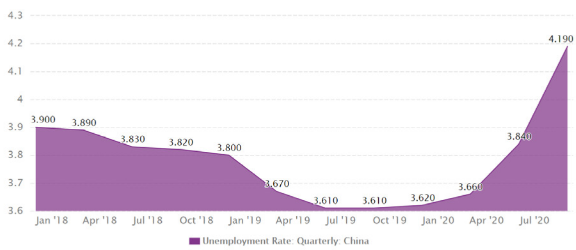

Figure 2. China's Unemployment Rate during Trade War (%)

Source: CEIC

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3.3 COVID-19 Influence

To compensate for the capital loss during the quarantine period, similar to the US, China has mainly implemented a package of 2.5% of GDP (or RMB 2.7 trillion) up to Apr 23, 2020, in addition to the existing 1.2% of GDP fiscal measures or financial plans, including increasing spending on pandemic prevention and control; increasing production of medical equipment; increasing expenditure on unemployment insurance; tax relief and waived social security contributions. As a result of rising government spending, China's daily capacity, up to Apr 8, 2020, reached 3.4 million, 1.5 million as KN95 mask and medical protective suit, respectively. As a

Miguel Faria e Castro (2020) argued that a fixed intervention package of 3.7% of total GDP to increase unemployment insurance benefits is the most effective method to maintain a certain level of dynamic equilibrium between household income and borrower consumption. Surprisingly, the Chinese government's total spending exactly equals 3.7%, and the only difference from the theoretical value is that the Chinese government did not only take unemployment insurance into account. As intuitive evidence of the effect of the 3.7% of GDP spending, the output growth of industries was -1.1% in March 2020, compared to -13.5% loss during Jan and Feb 2020. Meanwhile, the export growth in March was -6.6% while the previous predicted value from Reuters is -14%, which was consisted of more medical equipment than other days, including ventilator, thermometer, etc. All those numbers are showing an optimistic recovery for the Chinese economy. However, since the US has made the same decision to expand government spending with little success instead, the rehabilitation of the Chinese economy might be more attributed to other perspectives, saying effective execution of lockdown and self-isolation. However, this paper would no conduct further discussion on administrative issues.

4. Future (2021-)

4.1 Short Run

Since the US government's stated significant purpose is to eliminate the trade deficit between China, this paper employed a simple framework of bilateral current account model within one period, starting from the open economy model. To simplify, I assume there are only two countries in this system, ignoring info and other asymmetries.

Firstly, in the standard open economy model, we have the output Y as the sum of consumption C, government expenditure G, investment I (ignored because research is based on the government perspective), and net export NX, which is equivalent to trade balance TB since there are only two countries in the system:

$$Y = C + G + TB \tag{1}$$

Time is discrete and noted by t as year. Then the utility is a function of consumption C_t and C_{t+1}, assuming the contribution of each is represented by logarithm owing to diminishing marginal effect, and the government's primary target is to maximize the following utility function:

$$\max_{C_t, C_{t+1}} U = \ln C_t + \ln C_{t+1} \tag{2}$$

Meanwhile, considering the revised intertemporal budget constraint (IBC) for the utility function, as the present value of consumption equals the present value of output, with the discount of interest rate r:

$$C_t + G_t + \frac{C_{t+1} + G_{t+1}}{1+r} = Y_t + \frac{Y_{t+1}}{1+r} \qquad \text{IBC (3)}$$

As utility function is bowed-inward, so both of the function would have the same marginal rate as C_{t+1} in the form of C_t at the maximized point. Hence, by equating partial derivation of (2) and (3), we have:

$$\frac{MU_{C_t}}{MU_{C_{t+1}}} = \frac{MY_{C_t}}{MY_{C_{t+1}}} \Rightarrow \frac{\partial U / \partial C_t}{\partial U / \partial C_{t+1}} = \frac{1}{1/(1+r)}$$

$$\Rightarrow \frac{C_{t+1}}{C_t} = 1 + r \Rightarrow C_{t+1} = (1+r)C_t \qquad \text{(Euler Equation)}$$

Hence, we obtained the optimized relationship between consumption C_tC_{t+1} and with the variable of interest rate r. However, the interest rate is not a direct data, so we plug the Euler Equation back into IBC (3), yielding the optimized number of C^*_t and C^*_{t+1} when considering maximizing the utility function:

$$C_t + G_t + C_t + \frac{G_{t+1}}{1+r} = Y_t + \frac{Y_{t+1}}{1+r} \Rightarrow$$

$$C_t^* = \frac{1}{2}\left(Y_t + \frac{Y_{t+1}}{1+r} - G_t - \frac{G_{t+1}}{1+r}\right)$$

$$C_{t+1}^* = \frac{1}{2}(1+r)\left(Y_t + \frac{Y_{t+1}}{1+r} - G_t - \frac{G_{t+1}}{1+r}\right)$$

Therefore, we may calculate the Trade balance for both US and China from (1):

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$$TB_t = Y_t - C_t - G_t = Y_t - \frac{1}{2}\left(Y_t + \frac{Y_{t+1}}{1+r} - G_t - \frac{G_{t+1}}{1+r}\right) - G_t$$
$$= \frac{1}{2}\left(Y_t - G_t - \frac{Y_{t+1} - G_{t+1}}{1+r}\right) \quad (4)$$

$$TB_{t+1} = Y_{t+1} - C_{t+1} - G_{t+1} = Y_{t+1} - \frac{1}{2}(1+r)\left(Y_t + \frac{Y_{t+1}}{1+r} - G_t - \frac{G_{t+1}}{1+r}\right) - G_{t+1}$$
$$= \frac{1}{2}(1+r)\left(\frac{Y_{t+1} - G_{t+1}}{1+r} - Y_t - G_t\right) \quad (5)$$

Being aware that the trade balance will sum up to zero in a two-country system, while keeping effective interest rate constant because of the assumption as no extra premium in different investment (otherwise the international investment could be biased directly to one country). Besides, define the difference of government expenditure between the US and China as $\Delta G = G^{US} - G^{CN}$:

$$TB_t^{CN} + TB_t^{US} = 0 \Rightarrow r = \frac{Y_{t+1}^{US} - Y_{t+1}^{CN} - \Delta G_{t+1}}{Y_t^{US} - Y_t^{CN} - \Delta G_t} - 1 \quad (6)$$

Since the difference of output is also a straight-line function of $\Delta G = G^{US} - G^{CN}$, we may consider to integrate and then delete the output variable Y in both denominator and numerator. Noticing Y = C + G + TB, we know Y has a strong and significant positive linear relationship with G. So we could define: $Y^{US} - Y^{CN} = (\alpha + 1) \cdot \Delta G + k$, where *a*+1 is a positive constants, plugging into (4), we may have an equation of r by ΔG:

$$r = \frac{\alpha \bullet \Delta G_{t+1} + k_{t+1}}{\alpha \bullet \Delta G_t + k_t} - 1 \quad (7)$$

Since it is a simple closed model with two countries, the interest rate r is equivalent to the GDP growth rate.

As Luca Fornaro and Martin Wolf stated in their essay in March 2020, they provided a pessimistic opinion that intensive policies should be introduced based on current increasingly expanding victims under pandemic. However, R&D of specific vaccines has been gaining positive results. According to a study of 365000 patients in the UK, there is a rapid decay of antibody of COVID-19 after three months, which suggests the failure of community immune strategy in England and the severity of unstoppable virus diffusion in the US with the current known number of 15 million. Hence, the US government needs to increase expenditure further on stimulating supply, especially on medical facilities, noticing that the medical supplies would be in shortage soon. Meanwhile, China is returning to average capacity and even exceed the domestic supplies, which means the government could slow down the stimulus in case of the old issue of overcapacity. Hence, it is convinced that the US government would spend more than China government with an increasing speed in the short run to compensate for the harmful effects of COVID-19.

Therefore, we may suppose ΔG should be increasingly boosted, considering the marginal growth rate of interest rate:

$$-\frac{Mr_{\Delta G_t}}{Mr_{\Delta G_{t+1}}} = -\frac{\partial r / \partial \Delta G_t}{\partial r / \partial \Delta G_{t+1}} = -\frac{(\alpha \bullet \Delta G_{t+1} + k_{t+1}) \bullet \alpha / (\alpha \bullet \Delta G_t + k_t)^2}{\alpha / (\alpha \bullet \Delta G_t + k_t)}$$
$$= -\frac{\alpha \bullet \Delta G_{t+1} + k_{t+1}}{\alpha \bullet \Delta G_t + k_t} < 0$$

Hence, we may conclude that the interest rate would increase positively as a discount factor for economic growth in this simple model, which indicated that the GDP will still keep growing based on US expansionary fiscal policy.

More significantly, noticing in equation (5), the trade balance between China and the US is positively related to interest rate r. Predictably, the trade balance would increase without relevant policies implemented as the interest rate growing, or the trade deficit of the US would be widened further.

Conclusively, there might be more conflicts with the trading policies in response to this situation, so the relationship between the US and China would continue to deteriorate in the short run from an economic perspective. And currently, after the president Biden took over the seat, as a representation of the hardline, he put more focus on other aspects but not economy, since we could see the Phase One Contract is still expanding. Anyway, this worsen trend would be somewhat mitigated by utilizing political and diplomatic intervention, but the contradiction between US and China is still going to rebound in recent years by another format.

4.2 Long Run

The relative advantage of each region always determines all spontaneous collaborations between countries. For instance, the US has always been obtaining capital, represented by the advances in productive tools and comprehensive technologies, which generate massive added-value during manufacture. In contrast, most underdeveloped and developing countries' relative advantage is labor, land, and resource expenses based on the GDP and CPI as salaries. Therefore, when China needed progress in necessary infrastructure and eliminated absolute poverty, the US could be the best strategic friend to

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exchange capital and labor force resources, which could be proved by the honeymoon period between the 1980s and 2000s. However, after China's initial capital accumulative period in the past 40 years, the labor force and land became more expensive, while the Chinese industry began to seek and create added-value by individual manufacture. The profiting room of the US in China was minified step by step. Currently, the US capital investment is proceeding to move out of China to surrounding regions like Southeast Asia and India, signaling the next generation of competition between China and the US: technological race.

Like the Arms race between the US and Soviet Union, the new-gen of technological race is unstoppable and accelerated. However, the difference between those two types of race is the goal and economic effect: Arms race focused on strengthening military force as preparation for incoming WWIII, which laid a substantial financial burden on trainee, maintenance, and surplus arms stock. In contrast, any technological progress would lift productivity then adapt a positive effect on the supply-side, increasing GDP and living standard synchronously.

According to the estimation and simulation, the total Chinese GDP will exceed the US in 2030. However, along with the destruction of pandemic, the time would probably come earlier, up to 5 years, saying that the global economic structure has an opportunity to be rebuilt, which is also the turning point of the relationship between the US and China: Either a positive change or a war in small scale, probably around Taiwan as the current global central issue. The situation tends to become more intense based on US and China's recent policies targeting Taiwan regions.

Afterward, assuming the conflict at the turning point did not devastate both countries' economies, the technological race would continue till 2035, China's 15-year blueprint called 'China Standards 2035'. Around this particular time, the triadic patent, or the officially acknowledged patent hold by China, would reach the same level as the US, indicating that the real balance between those two top entities so that the technological collaboration could take the majority of interactions but not just unidirectional capital input.

As another factor, the world is never a game with two countries. In recent days, India was also growing with increasing speed. Similarly to China, it is estimated that Indian GDP would also exceed the US around 2035. As the US and China face the third challenger to them, the contradiction between these two countries would be reduced. Unlike the cold war times, China's triple polarization, India and the US would become much more stable for many years after 2035.

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