Flash Economics

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If the United States and China pursue a mercantilist strategy, can other countries (Brazil, Canada, India, the United Kingdom, Turkey, the European Union) cooperate and maintain free trade?

It is clear that the United States and China have adopted a mercantilist strategy, aiming either to eliminate their external deficit (United States) or to generate a massive external surplus (China). This strategy involves protectionism, industrial support, a preference for domestic production, and currency devaluation, among other measures.

The key question for other countries (Brazil, Canada, India, the United Kingdom, Turkey, and the European Union) is whether they can remain in a free-trade environment—benefiting from the gains of trade through specialization according to comparative advantages—or whether the deterioration of their external trade with the United States and China will force them to adopt a mercantilist strategy as well.

We believe that maintaining free trade is the better choice for these countries.

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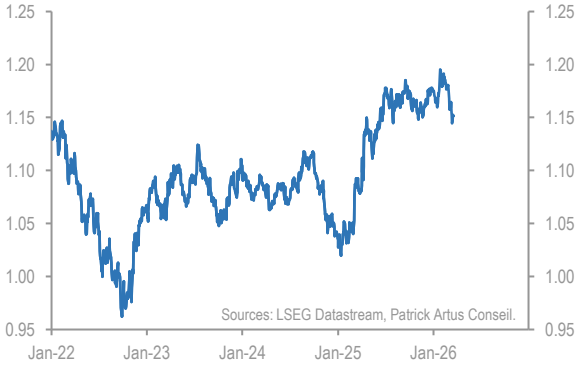
The United States and China are adopting a mercantilist strategy

1. The United States

The United States:

- Has implemented **tariffs** (an average rate of 17.5% on imports as of January 2026, according to the Yale Budget Lab);
- Requires other countries **to purchase American goods** (energy, military equipment, aircraft, etc..) **and to increase investment in the United States**;
- Practices domestic preference for U.S. products;
- **Seeks a depreciation of the dollar** (**Chart 1**).

Chart 1
Euro/dollar exchange rate (EUR 1 = USD...)



The objectives of this policy are:

- To **reindustrialize** the United States (**Charts 2A/B**);

Chart 2A
United States: Manufacturing production (2002.M1 = 100)

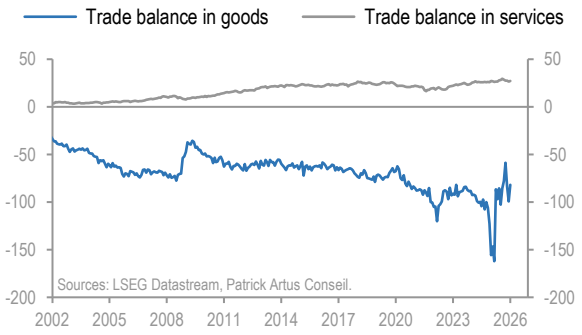


Chart 2B
United States: Real value added in manufacturing (as % of real GDP)



- To **eliminate the external trade deficit** (**Chart 3**) with the typical mercantilist view that the global economy is a zero-sum game, where one country's gain is another's loss.

Chart 3
United States: Trade balance in goods and services (monthly, USD bn)



2. China

China:

- In practice applies strong **protectionism**;
- Supports its industry through public subsidies;
- Invests heavily in digital industries, pharmaceuticals, automotive, electric batteries, wind, and solar energy, resulting in **production capacities exceeding domestic demand** (**Chart 4**), which can therefore be exported (**Chart 5**);

Chart 4
China: Capacity utilization for manufacturing (as %)

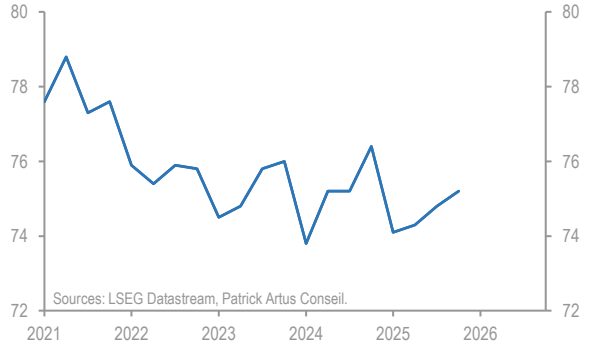
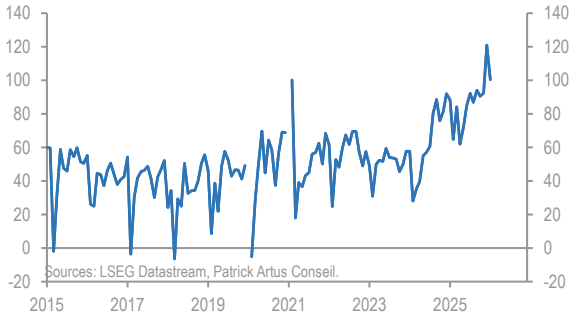


Chart 5
China: Exports of goods (in volume terms, Y/Y as %)



- Aims to generate a **massive external surplus** (**Chart 6**), which can be lent worldwide to strategic industries.

Chart 6
China: Trade balance in goods (Monthly data, in USD bn)



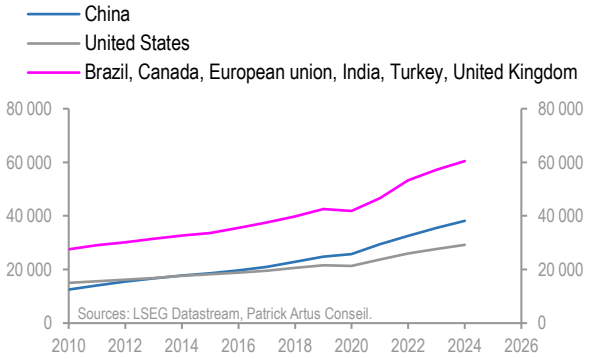
The issue for other countries

We now turn to other major economies: **Brazil, Canada, India, the United Kingdom, Turkey, and the European Union**. The key question for these countries is:

- Can they remain in a **free-trade regime**, specializing according to their comparative advantages?
- Or is **the deterioration of their trade with the United States and China** so severe that they will be forced to adopt a mercantilist policy themselves (protectionism, industrial support, currency depreciation) to sustain domestic production?

First, consider the size of this group of countries (**Chart 7**).

Chart 7
GDP (bn USD , PPP)



This group is very large—significantly larger than either the United States or China.

Next, **consider the weight of the U.S. and China in their exports** (**Charts 8A/B**) and **the weight of trade among these countries** (**Charts 9A/B**).

Chart 8A
Exports to China and the United States
(as % of total exports)

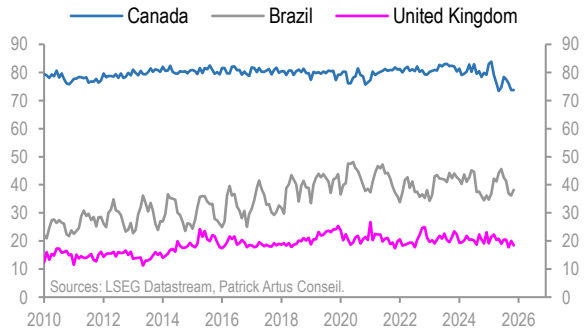


Chart 8B
Exports to China and the United States
(as % of total exports)

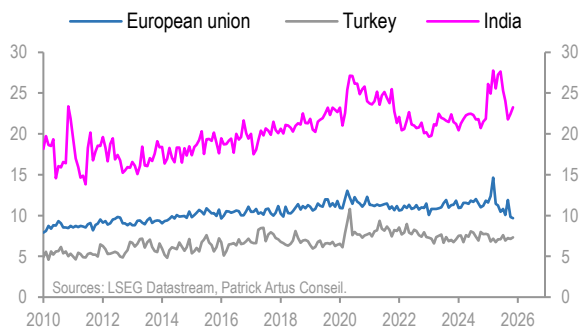


Chart 9A
Exports to Brazil, Canada, European union, India,
Turkey and United Kingdom (as % of total exports)

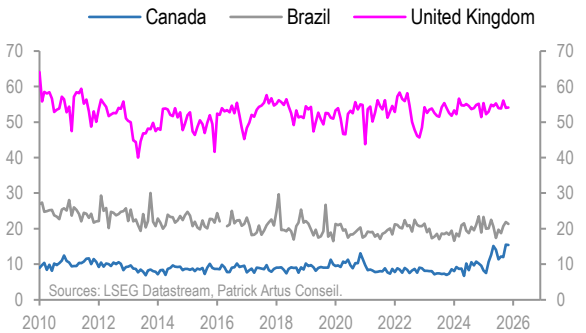
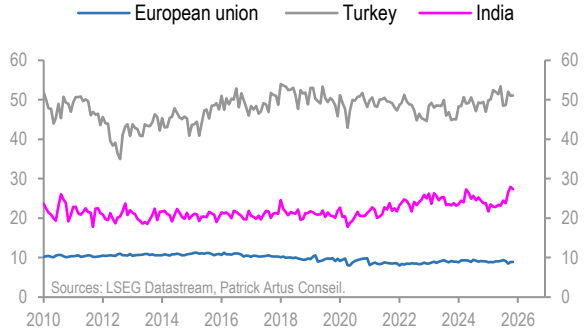


Chart 9B
Exports to Brazil, Canada, European union, India,
Turkey and United Kingdom (as % of total exports)



For Canada and Brazil, exports to the United States and China are larger than exports to the other countries in this group. However, for the United Kingdom, the European Union, Turkey, and India, exports to the U.S. and China are smaller than trade within the group.

When examining the main comparative advantages of these six countries, **it is striking that they are diversified and relatively similar** (**Table 1**).

Table 1: Comparative advantages (2023)

United Kingdom		Turkey	
Category	**Contribution to the trade balance (in thousandths of the country's GDP)**	**Category**	**Contribution to the trade balance (in thousandths of the country's GDP)**
Financial serv.	28,7	Travel serv.	36,8
Oth. business serv.	27,9	Transport serv.	17,8
Telecom. & info. serv.	11,6	Knitwear	10,2
Insurance serv.	6,8	Clothing	7,6
Aeronautics	5,0	Commercial vehicles	6,4
Licensing (IP serv.)	3,6	Carpets	4,6
Beverages	0,8	Cereal products	3,5
Transport serv.	0,8	Furniture	3,5
Paints	0,8	Domestic electrical appliances	3,3
Iron ores	0,7	Metallic structures	3,3

Canada		India	
Category	**Contribution to the trade balance (in thousandths of the country's GDP)**	**Category**	**Contribution to the trade balance (in thousandths of the country's GDP)**
Crude oil	41,6	Telecom. & info. serv.	40,0
Natural gas	6,0	Refined petroleum pr.	11,6
Cereals	4,7	Oth. business serv.	9,0
Non-ferrous metals	4,4	Pharmaceuticals	6,6
Coals	4,3	Cereals	3,4
Iron ores	3,8	Cars and cycles	2,8
Aeronautics	3,8	Meat and fish	2,8
Telecom. & info. serv.	3,8	Clothing	2,3
Meat and fish	3,5	Carpets	2,1
Non-edible agricultural pr.	3,2	Knitwear	2,0

Brazil	
Category	**Contribution to the trade balance (in thousandths of the country's GDP)**
Edible agricultural pr. (excl. cereals)	27,8
Crude oil	14,7
Iron ores	14,4
Meat and fish	8,4
Sugar	7,0
Cereals	5,6
Animal food	5,0
Paper	4,7
Iron and steel	3,0
Non ferrous ores	2,7

Germany		France	
Category	**Contribution to the trade balance (in thousandths of the country's GDP)**	**Category**	**Contribution to the trade balance (in thousandths of the country's GDP)**
Cars and cycles	19,3	Aeronautics	13,2
Pharmaceuticals	8,3	Toiletries	7,9
Specialized machines	7,5	Travel serv.	7,2
Engines	6,1	Beverages	5,9
Plastic articles	5,3	Oth. business serv.	5,4
Precision instruments	5,2	Financial serv.	4,7
Licensing (IP serv.)	4,7	Cereals	2,7
Miscell. hardware	4,6	Transport serv.	2,7
Vehicles components	4,2	Electricity	2,5
Construction equipment	3,1	Maintenance serv.	2,1

Spain		Italy	
Category	**Contribution to the trade balance (in thousandths of the country's GDP)**	**Category**	**Contribution to the trade balance (in thousandths of the country's GDP)**
Travel serv.	37,6	Travel serv.	10,2
Cars and cycles	9,8	Miscell. hardware	8,5
Edible agricultural pr. (excl. cereals)	6,3	Specialized machines	8,2
Transport serv.	5,9	Leather	7,4
Telecom. & info. serv.	5,4	Engines	7,4
Oth. business serv.	5,2	Pharmaceuticals	4,9
Ceramics	2,8	Beverages	4,8
Commercial vehicles	2,8	Refined petroleum pr.	4,3
Financial serv.	2,6	Preserved fruits	4,0
Other services n.i.e.	2,6	Furniture	3,9

Source: CEPII

Almost all have comparative advantages in:

- Industrial machinery;
- Agricultural products;
- Automobiles;
- Pharmaceuticals.

Several countries also have comparative advantages in:

- Financial services;
- Tourism;
- Telecommunications services.

Thus, **free trade among these countries would primarily promote intra-industry trade** (trade in similar but differentiated products) rather than inter-industry trade.

Summary: how should other countries respond if the U.S. and China adopt a mercantilist strategy?

It is clear that the United States and China are currently pursuing a mercantilist strategy (protectionism, support for production and exports, currency depreciation, and a focus on improving external trade balances). The question for other countries (Brazil, Canada, India, the United Kingdom, Turkey, and the European Union) is whether they should:

- Remain in free trade, benefiting from the associated gains, or
- Respond to the deterioration of their trade with the U.S. and China by adopting a mercantilist strategy themselves.

Our analysis shows that:

- The combined size of these six countries/regions is very large;
- For four of the six countries, trade with the U.S. and China is smaller than trade within the group;
- The production structures of these six countries are similar, facilitating intra-industry trade but not inter-industry trade.

Overall, maintaining free trade among these countries—regardless of the policies adopted by the U.S. and China—appears superior to adopting a mercantilist strategy.

Moreover, the United States cannot fully exit certain global value chains in which its firms are integrated (semiconductors, pharmaceuticals, aerospace), which limits the effectiveness of its mercantilist strategy.

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