**Prospects of Protectionism: Application of Prospect Theory’s S-shaped Value Function to the U.S.-China Trade War**

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**Abstract**

Protectionism is widely accepted by economists to be an inferior trade policy strategy in comparison to free trade policies. Despite this, the United States has threatened to utilize protectionism to induce better trade terms with its trade partners. This paper seeks to descriptively model the U.S.-China trade relationship through prospect theory to demonstrate points of leverage that exists in negotiations in the event of a trade war. Prospect theory’s S-shaped value function can help show differences in leverage between the two parties based on their gains and losses within their trade relationship that can provide insight in determining negotiation outcomes.

Keywords: Protectionism, Trade War, Prospect Theory, U.S.-China Trade Relationship

*"And these dummies say, 'Oh well, that’s a trade war.' Trade war? We’re losing $500 billion in trade with China. Who the hell cares if there’s a trade war?"*

*– Donald J. Trump at campaign rally in Lawrenceville, NJ, May 19, 2015.*

**Introduction**

The U.S.-China trade relationship’s status quo maintained a consistent pattern of trade flows for decades. The United States imports large quantities of merchandise goods from China, causing a massive merchandise trade deficit, measured at $375.5 billion in 2017 (Morrison, 2018). In addition to this trade imbalance, numerous trade issues culminated between both parties as well, with many trade issues left unresolved for years (Morrison, 2018). Neither the United States nor China wanted to risk disrupting its trade relationship, as their economies are largely interdependent and would lose the economic efficiency of free trade’s comparative advantage specialization. However, the surprise presidential election of Donald J. Trump, and implementation his “America First” protectionist trade policies threatens the stability of the US.-China trade relationship, risking a massive trade war between the two countries. During the 2016 election campaign trail, Trump frequently attacked China for its trade practices, claiming them to be unfair, with the United States “losing to China,” causing many different harms to the U.S. economic growth (see *Crippled America* for details*,* Trump, 2015 and Navarro and Ross, 2016). China expresses a different view of the trade relationship as one of “win-win cooperation,” warning the United States repeatedly that nobody wins in a trade war from the mutual economic loss both parties incur, while simultaneously signaling that China ready to defend its interests if necessary (Xi, 2017). Despite attempts at reconciliation through negotiation, the United States and China were unable to resolve their trade issues, resulting in a trade war starting on July 6th, 2018, when both parties implemented protective tariffs on $60 billion dollars with of goods (Morrison, 2018).

Economists acknowledge that trade is mutually beneficial to both parties due to the opportunity costs of production that can be achieved through specialization. There are only a handful of protectionist trade policies that economists validate, with the consensus amongst them being in heavily in support of free trade (Gilpin and Gilpin, 2001). In fact, over 1100 economists have written President Trump a letter informing him of such preference, warning him that the loss of comparative advantage through trade could have dire consequences for the United States economy (Rushe, 2018). However, the administration ignored these pleas. Instead the United States’ trade strategy is to utilize its protectionist trade policy as an inducement strategy to gain better trade deals in negotiation and alleviate their trade issues with China (Ross and Navarro, 2016; White House, 2017). This trade strategy is a risky gambit, and circumvents established norms governed by the World Trade Organization (WTO). In response, China has signaled it will retaliate with protectionism of its own in event the United States acts on their threats. Negotiations to reconcile trade issues failed, leading to a trade war, starting on July 6, 2018, from both parties implementing import tariffs on goods for roughly $60 billion dollars over intellectual property rights conflicts (Morrison, 2018).

The objective of this paper to answer the following question: Why does the Trump administration believe it has leverage to induce China into concessions? Our paper asserts the answer to this question lies in how the Trump administration perceives the United States’ leverage within economic relationships with its partners. As Trump (1987) himself has stated to “not make deals without [leverage]” in his own *Art of the Deal,* while also touting the United States’ economic leverage in *Crippled America,* we seek to investigate the dynamics of the U.S.-China trade relationships by focusing on leverage in the form of loss aversion, which arise from difference in perception of gains and losses in their trade relationship (Trump, 2015).

While some studies (Bollen and Rojas-Romagosa, 2018; Bouët and Laborde, 2017; Ha, 2017; Lai and Xia, 2016) show that the United States loses less GDP growth, roughly 4 times less, than China in the event of a trade war. There is more to leverage than just material considerations like GDP growth (Kirgis, 2014). If material considerations were all that mattered, the United States would maintain the current trade relationship status quo even though it is running a trade deficit, because the loss of comparative advantage relative to the status quo is significantly worse than implementing tariffs at all (Gilpin and Gilpin, 2001). Thus, we seek to utilize a model that can capture also psychological aspects within bargaining situations by utilizing prospect theory as a descriptive model to show why the Trump administration has leverage in trade negotiations and is utilizing protectionism as a strategy. Devised by Amos Tversky and Daniel Kahneman (1979) as a critique to Von Neumann-Morgernstern Expected Utility Theory, or rational choice theory, prospect theory utilizes an S-shaped value function with a neutral reference point, diminishing sensitivity, and loss aversion to describe human choice behavior, which rational choice theory has frequently failed to do successfully in various experiments.

Prospect theory has particularly strong modelling ability in negotiation situations. The S-shaped value function aspect of the theory is a powerful model because it accounts for the consideration of losses and gains, rather than only the possibility of gains (Tversky and Kahneman, 1979; 1986). This is an important aspect within negotiation models that rational actor models lack, because gains for one party are concessions for its counter party which often result into choice anomalies rationality assumptions cannot explain (Kahneman, 2011; Tversky and Kahneman, 1979, 1986, 1991). Several of the papers written by Tversky and Kahneman, also address aspects within bargaining situations. We argue that prospect theory can reveal points of leverage using its S-shaped value function, as a United States and China trade war is both a bargaining situation and a trade negotiation. The S-shaped value function models loss sensitivity relative to changes in wealth. If we use U.S.-China trade balance is utilized as a measure of wealth to establish the trade relationship’s status quo, we argue that the S-shaped value function is a proper model of the U.S.-China trade war, while other concepts from prospect theory can help explain the trade strategies of each respective party. This can help reveal why the United States is pursuing a protectionist trade policy, despite the great economic risks a trade war can cause for both the United States and China’s economies. Finally, in our concluding remarks, we conclude with some considerations that businesses should consider if their operations are within the scope of the U.S.-China trade relationship.

**Literature Review**

We provide a review of the literature related to prospect theory and other models of trade relationships; factors within negotiations; and a brief overview of the U.S.-China trade relationship. Trade relationships are essentially bargaining or negotiation situations over the fairness in exchanges between parties. Schelling (1980), and Bachetta et al. (2007) note that game theory can be utilized to model bargaining situations. Schelling (1980) particularly notes that game theory has weaknesses in modelling asymmetries. Bachetta et al. (2007) and Axelrod (2000) note that repeated prisoner dilemma games often model international trade cooperation but also acknowledge weaknesses in the model that occurs when both players defect. The defection/defection outcome in this model of international represents a trade war, but once this occurs within a round in the model’s iteration, all cooperation becomes impossible due to strategic assumptions in rationality and opponent’s behavior (Axelrod, 2000). These models also assume rationality according the Von-Neumann Morgenstern Expected Utility Theorem (1953). This theorem was critiqued by prospect theory as it has difficulty in modelling choice behavior in experiments, which often deviate from normative perceptions of a rational choice.

We primarily utilize Tversky and Kahneman’s works on prospect theory (1979) and articles that refine the concept (Kahneman and Tversky 1979; 1986; 1991) and Kahneman’s book *Thinking, Fast and Slow* to establish our model. Their work is a critique of rational choice theory, which fails to consider that people are averse to losses, as “losses loom more than gains” which often causes reversals in preference in choices under risk (Tversky and Kahneman, 1991). Their model utilizes an asymmetric S-shaped value function, and a decision weighting function to explain choice behavior when people are subject to decision under risk. The S-shaped value function is formed by two domains, a convex domain in the upper part of the function, and a concave domain in the upper half of the function. Each domain corresponds to risk-seeking and risk-averse behavior, respectively, and has an asymmetric unique sensitivity to losses. Application of this S-shaped value function as a model will be further explained in the model section of our paper. Kahneman and Renshon (2009) utilize prospect theory’s model to show why there is a “hawkish bias” in international policy creation towards aggressive and risky-policies that can cause conflict over more cooperative policies. Those observations will be addressed in the concluding remarks, along with other aspects of prospect theory to show how this can assist businesses in formulating strategy.

Kirgis (2014), conducts a comprehensive research on the use of leverage in negotiation, and provides us definitions of leverage, which can be split into positive and negative categorizations. Leverage is defined by Kirgis (2014) as “all forms of power based on a party’s abilities to confer material benefits or impose material costs on a counter party,” and acknowledges that coercion is required to apply leverage, and that it plays a role in almost all negotiations, depending on social attitudes and context. He then provides Richard Shell’s (2003) categorical definitions of positive leverage: derived from a party’s ability to satisfy the counter parties interest; and negative leverage: derived from a party’s ability to impose costs on the counter party, if the counter refused to agree on a set of terms. Kirgis emphasizes the power of leverage in rooted in the consequences of an outcome, rather than game theory’s focus on an outcome probability. He also notes how psychological factors “routinely take precedence over material benefits.” One important aspect of Kirgis’ work is that he cites Shell’s real-life example using Donald Trump as example of effective use of negative and positive leverage as a bargaining tactic. We wish to show that Trump utilizes similar tactics in negotiation, all which revolve around utilizing leverage.

Salacuse (1998) notes some of these and other characteristics which can be attributed to differences in culture, identifying ten different ways culture can affect negotiation style. Amongst these stylistic pairs listed in the table below:

[Insert Table 1 about here]

While Salacuse categorizes these factors on a spectrum, we note that within these factor’s categorization there exists a dichotomy of characteristics. We use this to help establish differences between the United States and China’s qualitative negotiation aspects in a manner that is dichotomous so that we can apply proper domain assignment within our model. Nisbett (2004) notes that a dichotomy of thought exists between Western and Eastern thought, specifically examining differences in Chinese and Greek epistemologies to illustrate possible difference in thinking between American and Chinese thought. We consider this within the U.S.-China trade relationship’s modelling, as it helps us establish that we can assign mutual exclusive frames of thought, i.e. the risk-seeking and risk-averse frames, to the United States and China as a factor of cultural differences. Our model of prospect theory attributes framing as a function of wealth, but psychological considerations independent of wealth support our argument as well.

The different factors often make reaching agreement difficult and result from differences in cultural or occupational background and can be attributed to both the United States and China’s negotiating styles, as reflected by language in Trump’s (2015) *Crippled America,* a book describing his goals and policies published during his campaign for president,and Xi’s (2017) speech at the 2017 Davos World Economic Forum. Trump often uses language that implies unfairness in the status quo due wealth losses from trade with China, citing that “[United States’] competition with China right now is economic, and [the United States] has been losing the battle for a long time” (Trump 2015). This is a consistent theme within his policy advisors Ross and Navarro’s (2016) paper that outlines their trade negotiation strategy through protectionism. They note their goal is to utilize the threat of protectionism, which generates a GDP loss, to induce better terms of trade in negotiation. This strategy is risky because if agreement cannot be obtained, the United States risks losing a great amount of GDP in a trade war outcome, that could have been avoided by not implementing the protectionist policy in the first place.

On the other hand, China expresses a more risk-averse view of the trade relationship. Although it acknowledges that it runs a massive merchandise surplus, China has signaled it is willing to work with the United States to mitigate some of the negative effects from this trade asymmetry (Morrison, 2018). Additionally, President Xi (2017) used express the benefits of the relationship that both sides enjoy from trade in his Speech at the World Economic in Davos, which occurred days prior to Trump’s inauguration. In this speech, he articulated the risks a protectionist strategy could generate for the global economy, note that “nobody wins in a trade war” as both sides suffer economic losses from loss of comparative advantage (Xi, 2017). Although negotiations and summits have occurred since then, not much has changed on the position of either party in the trade relationship. We use Morrison, (2018) and Wong and Koty (2018) to provide an outline of current events that occurred in the U.S.-China Trade relationship’s history. Morrison (2018) also provides a substantial overview of trade issues and problems with the relationship using the most recent data available. In this relationship, the United States frequently threatened China with protectionist measures, mostly tariffs, while China signaled it would retaliate in the event of protectionist initiated by the United States, instead attempting to emphasize the benefits each side enjoys from trade, which would be lost once both side reciprocated with protectionist tariffs (see Wong and Koty, 2018). Economic data also substantiates that there are asymmetries in the status quo between the United States and China. The historical balance of trade data consistently reports a deficit of trade for the United States and trade surplus to China due to the nature of trade flows between both parties every year since trade relations renormalized in 1985 according to the U.S. Census Bureau (Morrison, 2018).

We utilize synthesize these concepts to create a descriptive model of the U.S.-China trade relationship through prospect theory. The language used by Trump (2015) and Xi (2017) align with our argument that each party views the trade status quo differently in terms of gains and losses from their trader relationship. The deficit and surplus that each party has in the trade balance suggests that this difference in language issued in these statements results from differences in sensitivity a trade loss or trade gain corresponds to within the S-shaped value function. The United States behaves in a manner that reflects their losing position in the trade status quo, while China’s behavior reflects the opposite. China signally of retaliation to the United States’ policy corresponds to risk-averse behavior, while the United States’ pursuit of protectionism corresponds to risk-seeking behavior. The following section will illustrate how this difference can illustrate an asymmetric difference in loss sensitivity that can explain why the United States and China are behavior in the manner described.

**Model**

**Prospect Theory:**

Prospect theory is a critique of Von Neumann-Morgenstern Expected Utility Theory that descriptively explains decision-making under risk through psychological experiments (Tversky and Kahneman, 1979). The theory acknowledges several psychological considerations that affect choice outcomes such as: framing effects, certainty and pseudo-certainty, status quo bias, reference dependence, fairness, and loss aversion. Prospect theory describes these effects by using two functions to model choices under risk: an S-shaped value function and a decision weighting function. The models are applied in a two-phase process: a framing and editing phase, and evaluation phase (Tversky and Kahneman, 1986). The first phase of framing an editing frames the “effective acts, contingencies, and outcomes” of a choice problem (Tversky and Kahneman, 1986). Framing effects, according to Tversky and Kahneman (1986) are “controlled by the manner in which the choice problem is presented as well as by norms, habits and expectancies of the decisionmaker.” The second phase of evaluation then judges these framed prospects, detecting dominance or by comparing their values.

The S-shaped value function is designed to model “the essential part” of the prospect theory. It asserts that individuals are sensitive to reference dependent changes in wealth rather than the final state of outcomes (Kahneman 2011; Tversky and Kahneman 1979, 1986, 1991). The function obtains it shape from its concave domain corresponding to the positive quadrant for gains, and its convex domain corresponding to the negative quadrant for losses, with a neutral reference point at the origin where the convex and concave domains join. Material values of wealth are plotted on the x-axis, and psychological value is plotted on the y-axis to form the model below:

[Insert figure 1 about here]

The S-shaped value function model has three characteristics. First, evaluation is reference dependent by a neutral reference point. Prospects that are better than the reference point are gains and correspond to concave domain, while worse prospects are losses, and correspond to the convex domain. Second, diminishing sensitivity, or when marginal value of gains and losses decreases with size, applies to sensory and evaluation of changes in wealth rather than final states of wealth. Third, loss aversion is constant throughout the function, meaning that when losses are gains are compared “losses loom larger than gains” (Tversky and Kahneman, 1986). Thus, the slope of convex curve is steeper than the concave curve along the S-shaped value function, which is consistently supported by empirical evidence (Tversky and Kahneman, 1979, 1986, 1991). These characteristics gives the S-shaped value function its asymmetric nonlinear shape. This difference in slopes between the convex and concave domain model asymmetry in negotiations because gains are enjoyed at the expense of the other side’s concessions (Kahneman 2011; Tversky and Kahneman, 1986).

The decision weighting function is a nonlinear asymmetric function acknowledges a tendency for people to assign a “decision weights” to outcomes that are different from probabilities. It is primarily shaped by probability interpretations such as certainty, possibility and pseudo-certainty effects. The nonlinear curve of the function’s decision weight relative to probability function’s linear curve in respect to outcomes models the tendency of humans to overweigh small probabilities, and under weigh large probabilities. The purpose of this function in prospect theory is to illustrate asymmetry and loss aversion in response to threats as Kahneman states: “you pay attention to a threat, you worry – and the decision weights reflect how much you worry and because of the possibility effect, the worry is not proportional to the probability to of the threat” (Kahneman, 2011).

To determine points of leverage, we shall use primarily utilize prospect theory’s S-shaped value function as a point of analysis in determining loss sensitivity as a function of negotiation leverage. Concepts derived from the decision weighting function will be discussed in the conclusion. Utilizing this function in *Thinking, Fast and Slow,* Kahneman (2011) makes two claims about prospect theory, “which some readers may view as contradictory:”

* In mixed gambles, where both a gain and a loss are possible, loss aversion causes extremely risk-averse choices.
* In bad choices, where a sure loss is compared to a larger loss that is merely probable, diminishing sensitivity causes risk-seeking.

However, there is no contradiction, which is explained by comparing the slopes of the curves in their respective domains under the effects of loss aversion (Kahneman, 2011). The deviation between points along the curve’s slope represents a measure of sensitivity to certain outcomes. In the first example is a prospect where gain and loss outcomes are possible, diminishing sensitivity causes the deviation from the gain, or an upward movement along the concave slope, to be lower relative to the deviation from the loss, or downward movement along the slope, especially if that movement along the slope enters the convex domain where the negative slope is steeper. This observation holds true even when examining purely from the domain concave domain of gains, only intensifying sensitivity towards risk-aversion. The second example differs because of the certainty of loss in one outcome, which requires us to examine this choice within the convex domain. Diminishing sensitivity of a loss compared to an even greater loss causes the deviation from one loss to the other be lower relative to the deviation from the certain loss to the possible gain, due to the convex nature of the curve’s slope in the domain of losses. Thus, under the certainty effect, concavity corresponds to risk-aversion, and convexity corresponds to risk-seeking.

**Prospect Theory Applied to the U.S.-China Trade Relationship:**

We utilize prospect theory to model the U.S.-China trade relationship as an asymmetric two-party negotiation scenario. To model this trade relationship, we first treat wealth as a function of the trade balance in dollar terms. The neutral reference point is set to zero, and represents a fully balanced trade relationship. Total trade between the United States and China was measured at $505.5 billion dollars in 2017 (Morrison, 2018). The trade deficit of the United States and the trade surplus of China was measured at $375.5 billion dollars in 2017. Each value as a function of wealth corresponds either the concave or convex domain respectively and is assigned accordingly. Therefore, China corresponds to the concave domain, while the United States corresponds to the convex domain along the S-shaped value function, respectively. This establishes the U.S.-China trade relationship’s status quo within the parameters of our model. We assume *ceteris paribus* certainty of this status quo as characteristics unique to country’s trade specialization cause the trade balance to maintain this consistent pattern throughout their relationship’s status quo (Morrison, 2018).

[Insert Figure 2 about here]

Both parties have the capability to implement protectionist trade policies unilaterally (e.g. ad valorem import tariffs), to coerce or induce the other to change terms of trade from the status quo. The choice to implement such a policy is a mixed prospect because it can generate a possible gain in terms of trade, but at risk of substantial economic losses in the event of a trade war. Protectionist trade policies threaten a loss of wealth because import tariffs increase costs of business for the counterparty, affecting their net-export value in GDP calculations. If both parties impose import tariffs a trade war occurs, which sacrifices efficiency gains from comparative advantage specialization that can only occur through cooperation on trade terms. While there are situations where it may be reasonable to utilize protectionism to punish unfair behavior within a cooperative relationship, it is not certain that such an action will induce a policy change. Some measures may be ignored by the counterparty because their sensitivity to the loss those measure create is inadequate. Thus, we treat protectionist policies as a mixed prospect to induce change within a trade relationship’s status quo. Success is dependent on what a party’s subjective loss sensitivity is relative to their counterparty’s in the status quo. As noted previously, risk-seeking frame corresponds to the convex domain and risk-aversion corresponds to concave domain. The convex domain is less sensitive to loss than the concave domain, implying that the party is risk-seeking because it has less to lose than the other party, as indicated by our S-shaped value function model, having an edge in the battle of attrition. Thus, we define leverage as considerations of material and psychological loss sensitivity that correspond to the prospect theory’s S-shaped value function. A point of leverage exists if one party is less sensitive to loss than the other. This can be determined through our model by analyzing the convex and concave domains within the S-shaped value function, as the risk-seeking and risk-averse frames uniquely correspond to asymmetric sensitivities to loss.

Therefore, prospect theory’s S-shaped value function implies that: China should behave in a manner associated with risk-averse behavior because of its trade surplus, making it more sensitive to loss as its trade position corresponds to the concave domain along the S-shaped value function; and the United States should behave in a manner associated with risk-seeking behavior because of its trade deficit, making it less sensitive to loss as its trade position corresponds to the convex domain along the S-shaped value function. As these each correspond to unique sensitivities, we conclude that in the event that both sides incur loss from a trade war, the United States will be less sensitive than China in its ability to tolerate a loss in a battle of attrition. While this implies that the United States can “win” the trade war it initiated with China, and demonstrates a leverage point in negotiation, the aspect of loss aversion offers other considerations that complicate this negotiation situation. Leverage does exist if psychological and material considerations are accounted for that could explain the Trump administration’s consistent position to utilize protectionism in the U.S.-China trade war, but this perspective is only one way of analyzing leverage, which could be changed by differences in framing of the trade relationship.

**Concluding Remarks**

We utilized prospect theory’s S-shaped value function to the U.S.-China trade relationship. Our model assigns the United States’ to the convex domain, because of its deficit, and China to the concave domain, because of its surplus, as a function of the trade balance within their trade relationship. This implies that the United States has less to lose relative to China when presented with a risky prospect can generate a greater loss or a possible gain, i.e. the possibility of a trade war versus the possibility of inducing trade terms. Thus, the United States becomes more risk-seeking when the characteristic of loss aversion is applied to the negotiation scenario, which explains the preference the United States now has towards protectionist trade policies. This on the other hand, also makes China more risk-averse than the United States, which explains why China is not issuing threats of protectionism except in the case of retaliation. Therefore, prospect theory provides a sufficient explanation to why the Trump administration is utilizing protectionism, which typical models of economic analysis in trade fail to do.

Loss aversion the effect it can play in decision-making is a key factor in analyzing how each side’s interpretation of gains and losses within the trade status quo affects their policy. This can support arguments for leverage, but a jump to such conclusions is neglectful to other effects loss aversion can have within negotiations. First, Kahneman (2011) and Tversky and Kahneman (1986, 1991) note that loss aversion makes agreements more difficult to obtain because of the asymmetric nature of gains and losses, and that gains for one party come at the country party’s concessions. Second, Kahneman and Renshon (2009) note that risk-seeking parties have a reluctance to settle. Third, endowment towards a certain position can cause parties to reject favorable outcomes (Kahneman and Renshon, 2009; Tversky and Kahneman, 1991). This essentially supports the conclusion that while the United States has leverage over China, utilizing this leverage to generate an agreement is very difficult, and is unlikely to generate immediate results.

With these general considerations in mind, business should prepare for the losses which tariffs may generate to their individual operations, and should also be pessimistic that this trade war can be resolved quickly. Our loss sensitivity is an immaterial consideration unless both parties are engaged in a trade war because they do not feel the real effects of the economic losses. In absence of this real sensitivity to economic loss, the threats of protectionism and promises to compromise are not effective in determining winners and losers within a trade conflicts until the consequences of such behavior materialize as dilemmas that must be resolved through establishing fairness and cooperation in a negotiations. Furthermore, the model also implies that either continuation or escalation of the trade war is more likely than its resolution, as the loss aversion, and risk-seeking behavior of the United States makes agreement difficult. The trade war has only escalated since the July 6th tariffs were implemented by the United States and China, with the United States imposing additional tariffs on $200 billion worth of goods on September 24, 2018, while China retaliated with additional tariffs on $60 billion with of goods. While a truce was obtained on December 2, 2018 to cease escalation of tariffs of 90-days was agreed upon by the United States and China, tariffs are still not completely off the table, with both sides incurring more wealth losses from these tariffs as deadlock persists. The escalation of tariffs and continuation of trade negotiations provides weak evidence that prospect theory is an appropriate model that can be applied to the U.S.-China trade relationship. However, stronger evidence to empirically validate this model’s usefulness in establishing leverage needs to be provided to truly declare that prospect theory is a descriptive model. To accomplish this, we intend to analyze statements for language that implies framing effects towards risk-seeking and risk-averse behavior through a revealed preference procedure (Wakker, 2008). If a party exhibits behavior corresponds to the convex or concave domain respectively, which was determined by their position in the trade status quo, we argue that prospect theory can be utilized as a descriptive model of behavior, as supported by the actual trade policies each respective country implements, and position it articulates within this trade negotiation as a function of either risk-seeking or risk-averse behavior respectively. Words are often useful and powerful frames that can cause variance in choice preference. By analyzing the meaning of words within the context of the U.S.-China trade relationship that imply how the status quo is framed to them we can show that a preference towards risk-seeking and risk-averse trade policies exists. If these revealed preferences appropriately corresponds to the model’s convex and concave domains, risk-seeking framing for the convex domain and risk-averse framing to the concave domain, just as the trade deficit and surplus assignment does this could provide sufficient evidence that prospect theory is a valid model for understanding prospects of utilizing protectionism by showing the leverage the party suffering losses has when it threatens such policies. Thus, the insight we suggest for businesses would be valid in how they should adjust their strategic planning in response to a country’s choice of trade policy.

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**Table 1.**

**The Impact of Culture on Negotiation:**

|  |  |
| --- | --- |
| **Negotiation Factors:** | **Range of Cultural Responses:** |
|  | |
| Goal | Contract or Relationship |
| Attitudes | Win/Lose or Win/Win |
| Risk-taking | High or Low |
| Emotionalism | High or Low |
| Agreement Form | Specific or General |
| Team Organization | One Leader or Consensus |
| Communication Style | Direct or Indirect |
| Time Sensitivity | High or Low |
| Agreement Building | Bottom Up or Top Down |

From Salacuse (2018).

**Figure 1**

**S-shaped Value Function**

Psychological Value

Wealth

**Figure 2**

**S-shaped Value Function Model of U.S-China Trade Relationship**

Psychological Value

U.S.-China Trade Balance

$505.5 Billion

-$505.5 Billion

$375.5 Billion

-$375.5 Billion

U.S.

China