

US-China Trade War

Cooperation, and not War, is Key to Mutual Prosperity

There is room for cooperation between the US and Chinese institutions and businesses to bring about advances in healthcare and related products and services. The US has been carrying out regular joint space exploration missions with Russia for decades. There is no reason why China cannot form a closer partnership with the US on this front. In short, there are many areas of cooperation where both the US and China can mutually benefit.

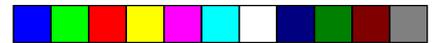


Andrew Leung

President Trump figures that a trade war against China is easy to win. China imports \$150 bn of goods from America while exports to it some \$500 bn. Given that, it would not be a surprise if Beijing runs out of retaliatory tariffs of equivalent size soon and thus would force it to buckle to the US demands. But then international trade has become much more interconnected and interdependent now than ever before. Statistics vouch for that. According to a study of the

Petersen Institute for International Economics, 85% of the Chinese products hit by initial Trump tariffs are machinery and components used by manufacturers in the US. Substitutes may be available, but are likely to cost more and may not suit the requirements of timeliness, scale or compatibility, as some researchers point out. Many other US industrial products are likewise affected by disruption in the global supply and value chain, of which China is an integral part. Further, as far as con-





sumer goods are concerned, Americans will struggle to cope, not just with increased costs of substitutes but their availability. Day-to-day difficulties without Chinese consumer goods are well illustrated in a 2008 real-life case-study by an award-winning journalist.

China, down but not out!

At the same time, it can be said China is not exactly running out of retaliatory ammunition. Trump's commonly-touted trade deficit with China ignores America's \$38.5 bn trade surplus with China in services. As services account for the bulk of the US economy and trade in services is growing much faster than trade in goods, if pushed to a corner, Xi Jinping's government may well put pressure on American banking, professional, logistics and other service businesses in China. Additionally, China also holds nearly a fifth (19%, to be precise) or about \$1.2 tn of US treasuries. While they remain a relatively secure investment, over the last few years, especially 2014 onwards, foreign appetites including Japan's and China's have begun to plateau, courtesy a few better investment alternatives. While it is not feasible to dump US treasuries without hurting itself massively, China may well decrease its holding gradually. Much of the slack can be offset by other investors but in an era of rising US interest rates, this redress may be limited, putting pressure on the US economy. The extra funds released may be invested in China's much-needed social provision or in China's Belt and Road initiative to avoid upward pressure on the Renminbi.

Notwithstanding new discoveries, China continues to retain a stranglehold (90% of global supply) over rare earth metals. These are vital to a variety of industrial applications in sectors including healthcare, energy, communications, electronics, nuclear and defence. Decreasing or withholding supply to US companies could cause massive disruptions.

So far, however, China has been

careful to stay on the right side of international rules, keeping retaliations reactive, measured, proportionate, and targeted, aiming at President Trump's support base in the agricultural homeland. The world's second largest and Asia's top economy appears to be in a much better position, than what Trump & Co. could be assuming, to weather this storm. America accounts for 19% of China's total exports and their value added represents only 3% of China's economy, which has in the recent past increasingly shifted to services and domestic consumption.

Nevertheless, market economists reckon that every \$100 bn of imports affected by tariffs would reduce around 0.5% of global trade, with direct impact on China's economic growth of 0.1-0.3 percentage points, and a broadly simi-

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lar percentage impact on US growth. That means a full-blown tariffs of \$500 bn would shave-off anything from 0.5 to 1.5% of China's growth. But Washington too will not remain unaffected. In fact, as the Trump Administration is also engaged in similar tariff war with America's other trading partners such as Canada, Japan and Europe, the corresponding impact on its own economy is likely to be relatively much larger compared to Beijing. And it is also likely to hurt more US jobs than it helps.

Beneath the US-China tit-for-tat, however, lies a good deal of common ground between the two countries. America wants China to stop pressuring US businesses to share or transfer intellectual property, to improve market access and the level-playing field, and to import more American products. These demands are bipartisan and similar concerns are shared by the European Union. On the other hand, the recent near-death by US sanctions of China's IT conglomerate ZTE is a

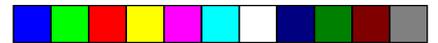
wakeup call for China to fast-track development of its own core semiconductor chip technology, even as China built what was the world's fastest supercomputer in 2016 without US chips. To realize the "China Dream" of an innovative, more mature and moderately well-off economy, the nation needs to promote home-grown innovation, press on with opening-up, and stimulate growth of domestic consumption. These national imperatives happen to tally largely with what Trump wants.

Areas of cooperation

In March, Premier Li Keqiang pledged that any mandatory transfer of foreign technology in the manufacturing sector would be forbidden. Next month, China's central bank, the People's Bank of China, announced a series of measures to enable foreign businesses to compete on an equal footing in the securities, fund management, futures and life insurance sectors, allowing majority foreign ownership. This is seen as a harbinger of diffusing the escalating trade war. Further, China has the world's largest recoverable shale gas reserves. However, full commercial exploitation is hampered by adverse topography, lack of advanced fracking technologies and concerns over related water intensity and soil pollution. American shale businesses can be invited to help. China also stands to benefit by importing more American natural gas as a cleaner substitute for coal, which accounts for 60% of the country's energy mix. More American branded consumer products too can be imported, providing greater choice for China's exploding consumer market.

While the Trump administration is wary of China's "Made in China 2025" state-backed technology drive, China's less restrictive regulations on data-mining for genetic and other human science research makes the country attractive to relevant American enterprises including pharmaceuticals. There is room for cooperation between the US and Chinese institutions and businesses to bring about advances in





How US-China relations have changed over time



1784

A US ship named Empress of China arrives in southern Pearl River Delta to trade for Chinese spices, tea and milk.



1989

After the Tiananmen Square crackdown on June 4, the US imposes sanctions on China, banning US financing of China-related projects and blocking exports to Chinese military and police entities.



1994

First intellectual property rights dispute breaks out, and takes two years to resolve.



2001

China joins the World Trade Organisation after US President Bill Clinton pledged support two years earlier and established permanent normalization of trade.



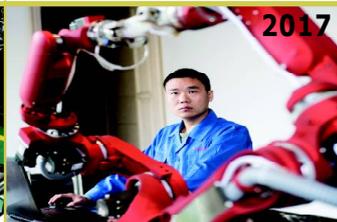
2004

US files first ever WTO complaint against China.



2009

US President Barack Obama enacts a 35% tariff on Chinese tyres.



2017

Under US President Donald Trump, the US looks into charges of Chinese intellectual property theft and China's steel and aluminium exports amid dumping claims.



2018

US imposes 25% tariffs on more than 800 Chinese goods, worth \$50 bn.

Source: South China Morning Post

healthcare and related products and services. The US has been carrying out regular joint space exploration missions with Russia for decades. There is no reason why China cannot form a closer partnership with the US on this front. In short, there are many areas of cooperation where both the US and China can mutually benefit.

All this, and much more, can be negotiated for a US-China bilateral trade and investment agreement which addresses America's legitimate concerns, paving the way for a more mutually beneficial relationship.

Avoiding the 'Thucydides Trap'

However, a likely barrier is a widespread worry, if not paranoia, that an illiberal China is usurping American leadership of the world order. Several books such as *Destined for War: Can America and China escape Thucydides's Trap?*, and, *All Measures Short of War: The Contest for the Twenty-First Century and the Future of American Power* discuss about the great power rivalry and potential war, besides it has also been a part of debates and innumerable columns. The latest US national security

strategy names China a revisionist strategic competitor that threatens US national interests.

To counter those concerns, it is pertinent that rather than empty re-assurances, China shows that it remains a staunch supporter of the rule-based international order, which is now under strain with Trump's "America First" unilateralism. Already, there are signs that China is toning down its rhetoric of trade war and national triumphalism. But more can be done to change negative perceptions. In the South China Sea, for example, China can explore the possibility of joint development of energy resources and fisheries with rival territorial claimants. At home, China can afford to loosen more space for freedom of expression. It can promote a more vibrant civil society, including poverty relief and humanitarian projects overseas, working as necessary with the United Nations. What is more, President Xi could nudge President Trump into taking a leadership role in ongoing negotiations for Free Trade Area of the Asia-Pacific (FTAAP), which includes both China and the US. This would show that China continues to embrace free and fair international trade, but it

harbours no wish to displace the US as leader in the Asia-Pacific.

With a comprehensive US-China bilateral trade and investment agreement answering America's demands, much of the trade war tension could be diffused. As a staunch defender of the liberal order which has served the world well, China would be well placed to realize its dream of national renaissance.

That said, it would be unrealistic to expect an early, happy ending to the current spat between Beijing and Washington. It is unlikely. For, until the full pain on US businesses and consumers kicks in and America's mid-term elections in the autumn happen, President Trump, in all likelihood, would continue to tighten the screws on China, while the latter has to continue with measured retaliations. That means the world must, therefore, brace for a long, hot summer!

(The author is a prominent international China specialist with a 38-year career in many senior government positions in Hong Kong. He holds PMD from the prestigious Harvard Business School.)

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