China

Learning from Mistakes and Deficiencies

Despite US pressure on China to give it up, the latter is likely to persist with its industrial upgrading plan, "Made in China 2025", perhaps no longer making a song and dance about it.

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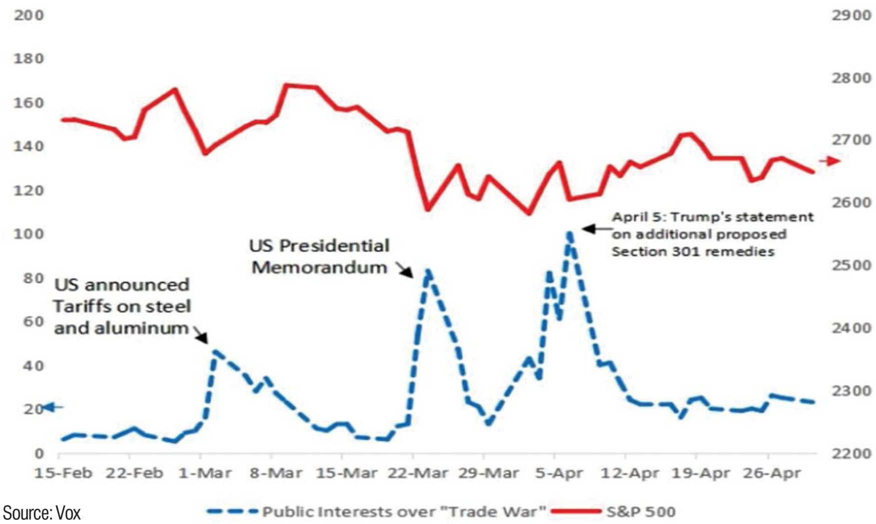
US-China trade war

At the time of writing this article, the trade talks have suddenly collapsed. The original expectation was that the latest talks in Washington were meant just to dot the i's and cross the t's. Instead, a couple of days before the Chinese delegation started this supposedly "final" trip, President Trump exploded by lapping massive tariff hikes (to 25%) on $200 bn of Chinese goods effective a few days later. He also threatened to impose similar tariffs on all remaining Chinese exports, depending on developments. The accusation was that at the last minute, China backtracked on their earlier promises by deleting commitments to enact laws to codify China's concessions.

After some initial silence, the Chinese delegation proceeded with the original talks in Washington anyway, just to show good faith. But no one was naïve enough to believe that a final deal could be struck during this trip under these circumstances.

The reality was that China was massively put off by America's increasingly imperial attitude in these negotiations. Negotiating with a loaded gun

The Economic Costs of the US-China Trade War



Source: Vox

pointed at its head reminds China of its past "century of humiliations" at the hand of foreign aggressors. This historical demon aside, it dawned on China that the negotiation appeared a total surrender, without getting any meaningful benefit in return. The American side insisted that tariffs would remain regardless of any Chinese concessions, just to make sure that China would actually deliver.

This was extremely embarrassing for China, not to mention President Xi, even as President Trump keeps on calling him a close friend.

China has announced retaliatory tariffs aimed carefully at 5,000 American products worth $60 bn. Naturally, China would run out of reciprocal tariffs as American exports are a fraction of China's. But there is no lack of non-tariff levers against American commercial interests. Massive orders of soybeans or Boeing aircraft could be cancelled or delayed. Regulatory hurdles could be erected. Even some US treasuries could be dumped to rattle Wall Street.

What is more, the initial tariffs targeted China's high tech products. The wider the tariff net, the more household goods, parts and components will be caught. This will inflict a lot of pain to US consumers, importers and US homeland manufacturers.

Additionally, the longer the impasse continues, the more anxious President Trump is likely to become. The prize of a solid "win" against China would become elusive as the presidential campaign draws near.

Restructuring the Chinese economy

There is also the confidence that China's economy is stabilizing. Consumption now accounts for 60% of China's economy, up from 45% a decade ago. Unaffected by US tariffs, domestic consumption is booming.

According to eMarketer's recent worldwide retail and e-commerce forecast, China is poised to become the world's top retail market in 2019, surpassing the US by more than $100 bn. This year, China's total retail sales are expected to grow 7.5% to $5.636 tn, compared to estimated US retail growth of 3.3%, reaching $5.529 tn. Growth rates are slowing for both countries, but China's growth rate will exceed that of the US through 2022.

While the stabilization of China's economy is partly helped by economic stimulus, such robust growth in private consumption suggests innate strengths. Naturally, domestic consumption impacts less on the global economy, especially when most consumer purchases are made in China. Nevertheless, Chinese millennial professionals are staunch supporters of foreign-branded accessories or local brands with a "cool" twist. There is also massive demand from mass consumers for safer and more reliable foreign-branded milk powder and cosmetics.

In any case, most Chinese consumers look for and purchase products online. With China's some 400 million middle-class consumers on the prowl, there are plenty of opportunities for the imaginative and enterprising from foreign countries.

Services account for a much larger proportion of China's economy than manufacturing. However, China's manufacturing output is larger than that of the US, Germany and South Korea combined. All this gives Beijing the confidence that China can outlast the current Trump administration by playing a longer game in the trade talks.

Despite US pressure on China to give it up, China is likely to persist with its industrial upgrading plan "Made in China 2025", perhaps no longer making a song and dance about it.

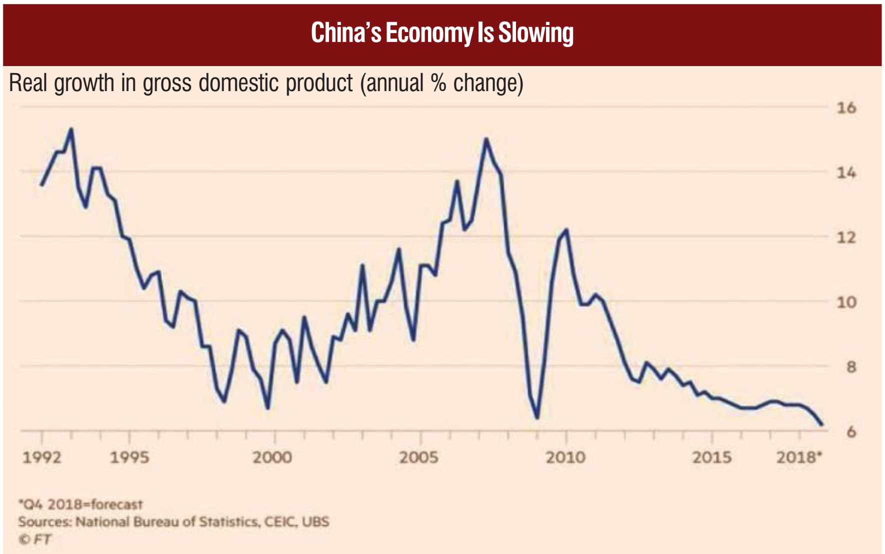
So watch out for business opportunities connected with the plan's component parts—new information technology, numerical control tools, aerospace equipment, high-tech ships, railway equipment, energy saving, new materials, medical devices, agricultural machinery, and power equipment.

China's economy is moving from energy-intensive to technology-intensive model, from quantity to quality. The old model relying on cheap labor and commodities has passed its sell-by date.

Energy intensity per unit GDP has steadily decreased over recent decades. Sustained improvement is on track to realize the target reduction by 2020 of 15% since 2015 and 44% since 2005. As China is the world's largest commodity customer, this paradigm shift has huge implications for global commodity prices. However, some caution is in order as this is offset by rising commodity demands from other emerging economies.

China is now the world's largest car market. The global car industry is undergoing a paradigm shift towards hybrids and electric models. The next Detroit is likely to be in China, but the cars will be "green".

Thanks to climate change and the green revolution, the Age of Oil is beginning to draw to an end. Already, gas has exceeded oil in total global consump-



tion, while the proportion of renewables is steadily rising, though unlikely to displace coal. As former Saudi oil minister Sheik Yamani famously said, the Stone Age ended, not for lack of stones. So the analogy may apply to oil. There are still plenty of stones, but gone are the days of their prehistoric dominance.

The Belt and Road initiative

The US and a number of other countries, including India, have a negative attitude towards China's flagship national initiative. Let us examine its objectives and progress so far, including perceptions of "debt trap" diplomacy and corruption, and whether it is a project of "national vanity".

First of all, it must be recognized that infrastructure matters hugely for national development and regional integration. A typical example is land-locked Central Asia, where mineral-rich countries are economically backward for lack of transport infrastructural connectivity with the outside world. According to many pieces of research, there is a massive infrastructural deficit across the globe, including ports, highways, bridges, power plants, dams as well as schools and hospitals. Most of these deficiencies are shunned by purely private investors.

To China, the initiative's objectives are tenfold. They are to:

(1) Realize the China dream of global renaissance, part of China's "Two Centenary Goals", including the objective of becoming a modern and powerful socialist country by 2049;
(2) Reinforce China's global connectivity—policy, infrastructure, trade, finance and people-to-people;
(3) Meet global infrastructural deficiencies;
(4) Assist in developing countries' national development;
(5) Break free from America's Asia-Pacific containment of China;
(6) Expand China's international trade and markets;
(7) Accelerate the internationalization of the Renminbi;
(8) Make good use of China's excess capacity;
(9) Redress China's regional economic disparities; and
(10) Include an Arctic Silk Road around Eurasia.

The Belt and Road already covers over 65% of world population, representing over 40% of world GDP. Potential investment is estimated at $5 tn, many times the post-war Marshal Plan ($120 bn in today's prices). The initiative is backed by China's Silk Road Fund, the Asia Infrastructure Investment Bank (AIIB) and the New Development Bank (the BRICS Bank).

Up to now, 173 deals have been signed with 125 countries and 29 international institutions, including 26 in Asia, 24 in Europe, 14 in the Middle East and 3 in Africa. These include 16 central and eastern European countries. Recently, Italy and Switzerland have joined, while the European Union has expressed a cautious willingness to cooperate.

With 1,800 projects underway, the initiative is nowhere near conclusion, particularly in Africa, where China's footprint is almost ubiquitous. It is thus likely to be a work in progress for many decades, if not stretching beyond mid-century. There is a widespread worry about debt sustainability. By nature, most of the hosts are backward, less developed countries where indebtedness is common. According to a recent survey by the Washington-based Center for Global Development headed by Larry Summers, only 8 out of 68 B&R borrowers are debt-distressed. A majority of B&R countries are more likely to avoid problems of debt distress thanks to B&R projects.

Nevertheless, for the initiative to be sustainable, China is beginning to learn from mistakes and deficiencies. There is now more emphasis on corporate governance, corruption avoidance, as well as partnership with a wider range of stakeholders. These include advanced countries such as Japan and those in Western Europe as well as multilateral organizations like the World Bank and the United Nations Development Program.

It is early days yet and a long learning curve. But in a world of growing disruptions and confrontations, including the raging US-China trade war, the Belt and Road offers China at least a meaningful counterweight. As for business opportunities for host and other countries, think about the railroad in Wild West days. Where there is infrastructural connectivity, business will flock, including real estate, commerce, services and myriad other possibilities. All part of the Belt and Road, Port Hambantota of Sri Lanka is a poster child for alleged "debt trap", while Port Piraeus of Greece has turned from a sleepy affair to one of the busiest and most profitable in Europe. The taste of the pudding, after all, is in the eating. ■

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