Unsustainable Codependency: From Trade War to Cold War?

Stephen S. Roach

American Economic Challenges Symposium
University of Wisconsin
October 11, 2019
In the spring of 2019, fully 60% of Americans had an “unfavorable attitude” toward China — up 13 points from a year ago — a record since the inception of this survey.

Source: Pew Research *Global Attitudes Survey* Aug 2019
Easy to Win a Trade War?

Purchasing Managers' Sentiment: Mar 2018 to Sep 2019

US and Chinese Equity Markets: Mar 1, 2018 to Sep 30, 2019

Source: National Association of Purchasing Management (US); National Bureau of Statistics (China); Bloomberg

Day 1 to Day 452:
- CSI 300: +13.4%
- S&P 500: +7.9%
U.S.-China Trade Deal?

The Framework: May 1, 2019

- **Bilateral**
  - Soybeans strategy: Multi-year narrowing of US-China trade imbalance

- **Structural**: 7 MOUs
  - Agriculture
  - Services
  - Technology
  - Intellectual property
  - Technology transfer
  - Non-tariff barriers
  - Currency

- **Implementation**
  - Codified by NPC legislation
  - Three-tier review process: monthly, quarterly, bi-annual
  - Enforcement mechanism
    - Tariffs remain in place
    - Unilateral US optionality
Breaking News:
A Deal!

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The Truce: Oct. 11, 2018

- Bilateral
  Soybeans “lite” strategy

- Structural
  - Currency
  - Intellectual property?

- Implementation
  Tariffs deferred:
  Oct 15: $250 bil
  Dec 15: $156 bil

What changed?
Breaking News: A Deal!

The Framework: May 2018

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  - Intellectual property?

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A Clash of Dreams

“Make = Manufacturing
America = “America First”
Great = Global Leadership
Again = Ahistorical

“We should adapt to and guide economic globalization.”
— Xi Jinping, World Economic Forum, Davos, Jan 17, 2017

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— Xi Jinping, World Economic Forum, Davos, Jan 17, 2017

“Protection will lead to great prosperity and strength.”
— Donald J. Trump, Inaugural address, Jan 20, 2017

The Battle for Global Supremacy
(Shares of world GDP based on purchasing power parity)

Source: International Monetary Fund
America’s Case for Conflict

Manufacturing Share of US Employment: 1939 to 2019

Jobs Share
Peak (1953) 16.3 m 32.4%
Latest (2019) 12.9 m 8.5%

US Goods Trade Deficit and China's Share: 1990 to 2019

Source: US Bureau of Labor Statistics and BEA
Trade as the Foil: Bilateral Blame Game

America’s Merchandise Trade Deficits with 102 Countries in 2018

Note: TOP 20 IN CAPS
Albania
Algeria
Andorra
Angola
Armenia
AUSTRIA (20)
Azerbaijan
Bangladesh
Belarus
Bosnia-Herzegovina
Botswana
Bulgaria
Burma
Cambodia
Cameroon
CANADA (10)
Chad
CHINA (1)
Christmas Island
Cocos Islands
Comoros
Congo (Brazzaville)
Cote d’ Ivoire
Czech Republic
Denmark
Ecuador
Equatorial Guinea
Estonia
Falkland Islands
Faroe Islands
Fiji
Finland
FRANCE (14)
Gabon
GERMANY (3)
Greece
Greenland
Heard and McDonald Islands
Hungary
INDIA (9)
INDONESIA (17)
IRAQ (18)
IRELAND (5)
Israel
ITALY (7)
JAPAN (4)
Jordan
Kazakhstan
Kenya
KOREA, SOUTH (13)
Laos
Latvia
Lesotho
Libya
Liechtenstein
Lithuania
Macedonia
Madagascar
Malawi
MALAYSIA (8)
Mauritius
MEXICO (2)
Moldova
Nauru
Nepal
New Zealand
Nicaragua
Nigeria
Norfolk Island
Norway
Pakistan
Papua New Guinea
Philippines
Poland
Portugal
Reunion
Romania
RUSSIA (16)
Rwanda
San Marino
SAUDI ARABIA (19)
Serbia
Slovakia
Slovenia
South Africa
Spain
Sri Lanka
St. Helena
Sweden
SWITZERLAND (12)
TAIWAN Prov. of China (15)
THAILAND (11)
Timor-Leste
Tokelau
Trinidad and Tobago
Tunisia
Turkey
Vatican City
Venezuela
VIETNAM (6)
West Bank
Zimbabwe

Source: US Department of Commerce (BEA)
## America's Macro Contradictions

<table>
<thead>
<tr>
<th>Theory</th>
<th>Practice: United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saving is essential for investment and economic growth</td>
<td>Net national saving rate: 2.4% of national income in 2018</td>
</tr>
<tr>
<td>Saving-short nations import surplus saving from abroad</td>
<td>Current account deficit: -2.4% of GDP in 2018</td>
</tr>
<tr>
<td>Imported saving leads to (multilateral) trade deficits</td>
<td>America’s 102 bilateral deficits in 2018</td>
</tr>
</tbody>
</table>

### America’s Imbalances are Likely to Get Worse

#### Net National Saving Rate

- **F’cst: 2019-25**
  - 2025: 1.7%

#### Current Account Deficit

- **2025**: -2.9%

Source: U.S. Department of Commerce (BEA); projections are based on CBO’s “Update to the Budget and Economic Outlook: 2019 to 2029,” Aug 21, 2019.
China’s Contradictions

<table>
<thead>
<tr>
<th>Strategic contradiction</th>
<th>Resolution</th>
<th>Tradeoff</th>
</tr>
</thead>
<tbody>
<tr>
<td>Structural rebalancing</td>
<td>Supply-side: Productivity</td>
<td>Demand-side: Consumer</td>
</tr>
<tr>
<td>Ownership transition</td>
<td>SOE Reforms</td>
<td>State vs. markets</td>
</tr>
<tr>
<td>Debt intensity</td>
<td>Deleveraging</td>
<td>Stability vs. growth</td>
</tr>
<tr>
<td>Middle-income trap</td>
<td>Imported to indigenous innovation</td>
<td>Trade conflicts</td>
</tr>
</tbody>
</table>

Easier to boost services and urbanization …

Urban share of Chinese population

Tertiary Share of Chinese GDP

… Than to increase personal consumption

Source: National Bureau of Statistics (China)
False Narrative: The USTR’s Case Against China

I. Case for inside forced tech transfer: Joint ventures
   TRANSFER YES, FORCED NO

II. Case for outside tech transfer: China’s “Going Out” policy
    UNSUPPORTED BY M&A TRANSACTIONS DATA

III. Illegal State support: Industrial policies
     CHINA IS HARDLY ALONE

IV. Cyberhacking allegations
    SERIOUS BUT DATED CHARGES


Flimsy Evidence
President Donald Trump
August 1, 2019

“Don’t let them tell you, the fact is … that China’s paying for those tariffs. Until such a time there is a deal, we will be taxing the hell out of China.”

Source: PIIE and US Department of Commerce
Tariffs: Then and Now

**Smoot-Hawley Tariff Act of 1930**
- Raised global tariffs by 20% on almost 900 imported items
- Focus: Protecting agriculture
- Economy was booming when legislation was drawn up
- Trade share of US GDP: 11%
- US: Surplus saver and creditor
- Not targeted at specific adversary; most US trading partners retaliated
- Deflation exacerbated the impact of tariffs


**Trump Tariffs: 2018**
- Proposed tariff increases of 25% on 1,333 Chinese imports
- Focus: Protecting manufacturing
- US economy has been in a subpar post-crisis recovery
- Trade share of US GDP: 28%
- US: Deficit saver and debtor
- US is far more vulnerable to a trade shock today than in 1930
- China singled out because of its huge bilateral trade deficit with the United States
- Deflation – unlikely
Structural Conflict: America’s Fears

- Technology and innovation as the means to economic prosperity
- US has been unrivaled as global technology leader post-World War II
- Ancient China’s technological prowess failed to accelerate after the 14th century
- Modern China’s push to indigenous innovation key to centenary 2049 growth objectives
- A zero-sum or win-win outcome for the US and China?

“China has targeted America’s industries of the future ... if China successfully captures these emerging industries, America will have no economic future.”
— Peter Navarro June 2018
Structural Conflict: China’s Fears

China’s Per Capita GDP as % of US
(based on constant dollar PPP)

Avoiding the “middle-Income trap”

- China is at a precarious threshold
- Mean reversion or systemic failure?
- From “catching up” to self-sustaining development
- From imported to indigenous innovation
- Stymied by growing possibility of a tech war with the United States

Source: IMF WEO database
China’s Push to Indigenous Innovation

E-commerce Portion of Total Retail Sales

Life Sciences Share of Global IPO Market

Consumer Fintech Adoption: 2019

Source: US Commerce Dept, Statista, Forrester Research; Life Science Competitiveness Indicators 2018; and EY Fintech Adoption Index 2019
China’s AI Strategy: At the Frontier

“China’s New Generation AI Development Plan”
PRC State Council (Jul 2017)

**Goals (RMB)**

<table>
<thead>
<tr>
<th></th>
<th>Al Core</th>
<th>Al Related</th>
<th>Global Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>150 bil</td>
<td>1 trl</td>
<td>In line with ROW</td>
</tr>
<tr>
<td>2025</td>
<td>400</td>
<td>5</td>
<td>World leading</td>
</tr>
<tr>
<td>2030</td>
<td>1000</td>
<td>10</td>
<td>Primary global AI center</td>
</tr>
</tbody>
</table>

Robot Density: 2016

Installed industrial robots per 10,000 employees in the manufacturing sector

Will Humans Go the Way of Horses?
Rise of the Machine: 1910 to 1960

Yale JACkson Institute For Global Affairs
From Trade War to Hot War? Perils of the Thucydides Trap

**Chinese vs. U.S. GDP: 1890 to 2018**
(Ratio based on purchasing power parity)

**History of Major Power Conflicts:**
War in 12 of 16 cases

<table>
<thead>
<tr>
<th>Period</th>
<th>Ruling power</th>
<th>Rising power</th>
<th>Outcome</th>
</tr>
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<tbody>
<tr>
<td>16th c</td>
<td>France</td>
<td>Hapsburgs</td>
<td>War</td>
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<tr>
<td>16-17th</td>
<td>Hapsburgs</td>
<td>Ottoman</td>
<td>War</td>
</tr>
<tr>
<td>17th</td>
<td>Hapsburgs</td>
<td>Sweden</td>
<td>War</td>
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<tr>
<td>17th</td>
<td>Dutch Rep</td>
<td>England</td>
<td>War</td>
</tr>
<tr>
<td>17-18th</td>
<td>France</td>
<td>Great Brit</td>
<td>War</td>
</tr>
<tr>
<td>18-19th</td>
<td>UK</td>
<td>France</td>
<td>War</td>
</tr>
<tr>
<td>19th</td>
<td>UK, France</td>
<td>Russia</td>
<td>War</td>
</tr>
<tr>
<td>19th</td>
<td>France</td>
<td>Germany</td>
<td>War</td>
</tr>
<tr>
<td>19-20th</td>
<td>Rus, China</td>
<td>Japan</td>
<td>War</td>
</tr>
<tr>
<td>20th</td>
<td>UK</td>
<td>US</td>
<td>No war</td>
</tr>
<tr>
<td>20th</td>
<td>Rus, UK, Fr</td>
<td>Germany</td>
<td>WWI</td>
</tr>
<tr>
<td>20th</td>
<td>USSR, UK, Fr</td>
<td>Germany</td>
<td>WWII</td>
</tr>
<tr>
<td>20th</td>
<td>US</td>
<td>Japan</td>
<td>WWII</td>
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<tr>
<td>20th</td>
<td>USSR</td>
<td>Japan</td>
<td>No war</td>
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<td>20th</td>
<td>US</td>
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<td>UK, Fr</td>
<td>Germany</td>
<td>No war</td>
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Source: Angus Maddison, *The World Economy: A Millennial Perspective*, OECD (2011); IMF *World Economic Outlook* database; Graham Allison, Belfer Center, Harvard University
From Trade War to Cold War 2.0?

Existential Fears

China’s Perspective
- US containment strategy
- Tariffs and trade war
- Clash of two systems

America’s Perspective
- Bilateral MAGA imperatives
- Innovation and prosperity
- Global hegemony

Cold War with USSR (1947 to 1991)
- Soviet threat after WWII
- USSR and US 2.1%/yr. per capita GDP growth
- Over 1985-91: Soviet growth fell by 1.1%/yr.
- Postwar strength of US economy

Fading Strength

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<tr>
<td>Real GDP growth</td>
<td>3.5%</td>
<td>2.3%</td>
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<td>Net national saving rate</td>
<td>8.8%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Productivity growth</td>
<td>2.2%</td>
<td>1.1%</td>
</tr>
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Source: Cornell, INSEAD, and WIPO, Global Innovation Index 2019; US Department of Commerce and US Bureau of Labor Statistics
Lasting Resolution:
From Art of the Deal to Wisdom of the Compromise

- **Market access: Bilateral Investment Treaty (BIT)**
  - Eliminate foreign ownership caps
  - Addresses JVs and forced technology transfer
  - US play on consumer-led Chinese rebalancing
  - CFIUS import restrictions lifted
  - BIT tally: China (145); US (42); Global (~3000)

- **Saving: From Unbalanced to Rebalanced**
  - US needs more
    - Budget deficits and subpar domestic saving
    - Multilateral fix for bilateral trade tensions
  - China needs less
    - Surplus saving to saving absorption
    - Funds social safety net and boosts consumption

- **Cyber: Battleground of the Information Age**
  - From bilateral to global
  - Paris-Accord-like cyber attack targets
  - WTO-like dispute and enforcement mechanism

- **US-China Dialogue: From reactive to proactive engagement**
  - From episodic to ongoing
  - From S&ED-type framework to a permanent secretariat
**From Codependence to Interdependence**

**Codependence**: The unhealthy relationship
- Expect partner to serve your needs
- Loss of a sense of self
- Leads to frictions, imbalances
- Reactive: Denial and the blame game
- Unsustainable – the break-up
- Fixation on relationship risks

**Interdependence**: The healthy relationship
- Partners responsibly satisfy their own needs
- Maintain self identities
- Appreciate mutual benefits of partnership
- Constructive interactions
- Sustainable – strategic partners?
- Appreciation of relationship opportunities

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**The Ultimate Producer and the Ultimate Consumer**

<table>
<thead>
<tr>
<th>Year</th>
<th>United States</th>
<th>China</th>
</tr>
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<tbody>
<tr>
<td>1978</td>
<td>70</td>
<td>30</td>
</tr>
<tr>
<td>1980</td>
<td>65</td>
<td>20</td>
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<td>1982</td>
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<tr>
<td>2016</td>
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</tbody>
</table>

Source: World Bank Development Indicators
Global Consequences

The Two Most Important Economies in the World

Contributions to Global GDP Growth:

- **US and China**
  - 1980s: 32%
  - 1990s: 39%
  - 2000-07: 34%
  - 2008-18: 44%

- **Rest of the World**
  - 1980s: 68%
  - 1990s: 61%
  - 2000-07: 66%
  - 2008-18: 56%

Source: IMF World Economic Outlook (Apr 2019)