

U.S.- China Relations

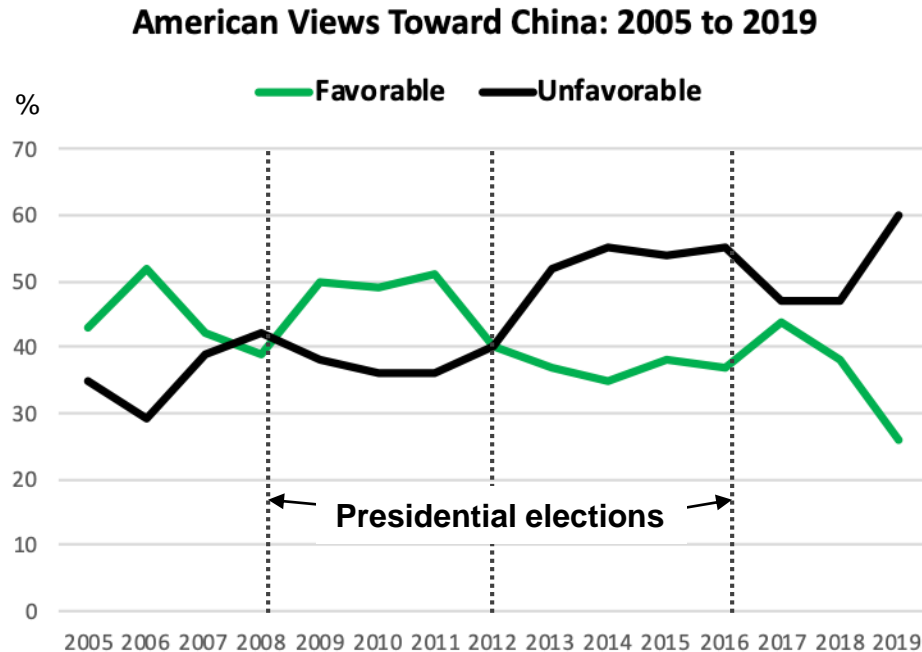
Unsustainable Codependency: From Trade War to Cold War?

Stephen S. Roach

American Economic Challenges Symposium
University of Wisconsin
October 11, 2019



From Washington to Main Street: The U.S. Turns on China

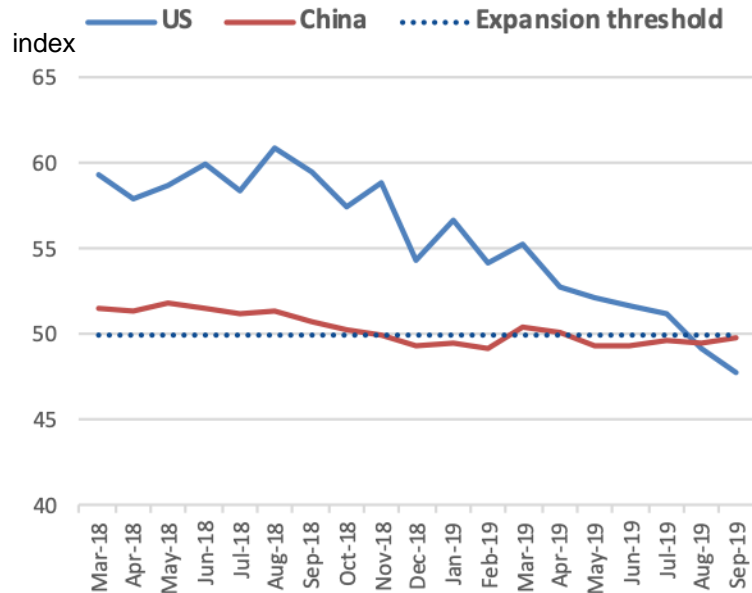


In the spring of 2019, fully 60% of Americans had an “unfavorable attitude” toward China — up 13 points from a year ago a record since the inception of this survey

Source: Pew Research *Global Attitudes Survey* Aug 2019

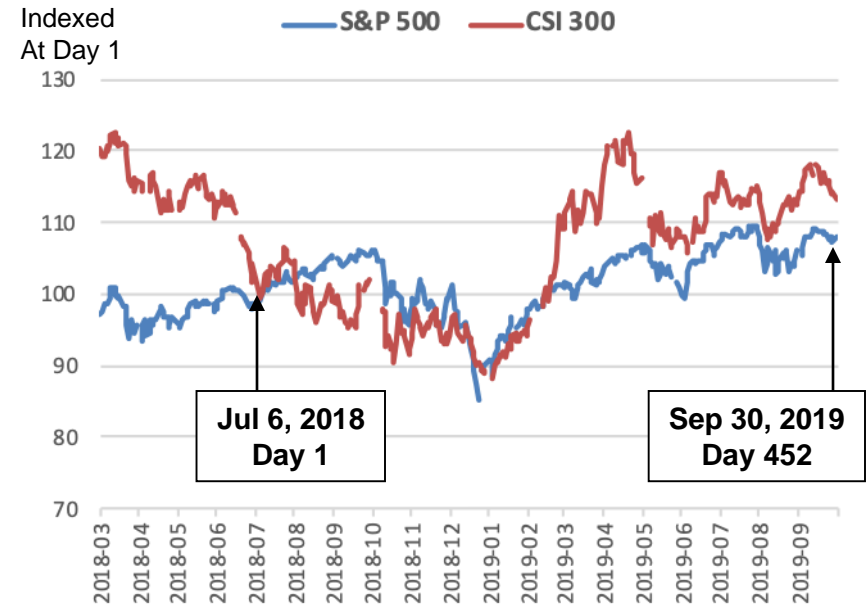
Easy to Win a Trade War?

Purchasing Managers' Sentiment:
Mar 2018 to Sep 2019



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

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



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

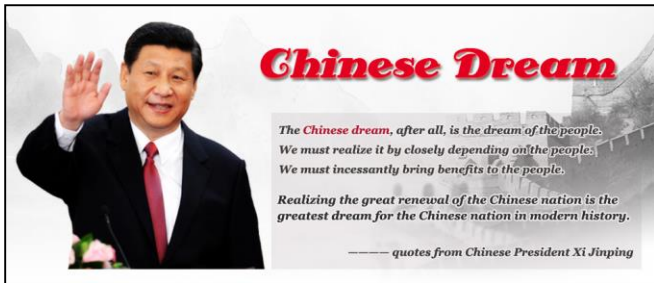
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A Clash of Dreams



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

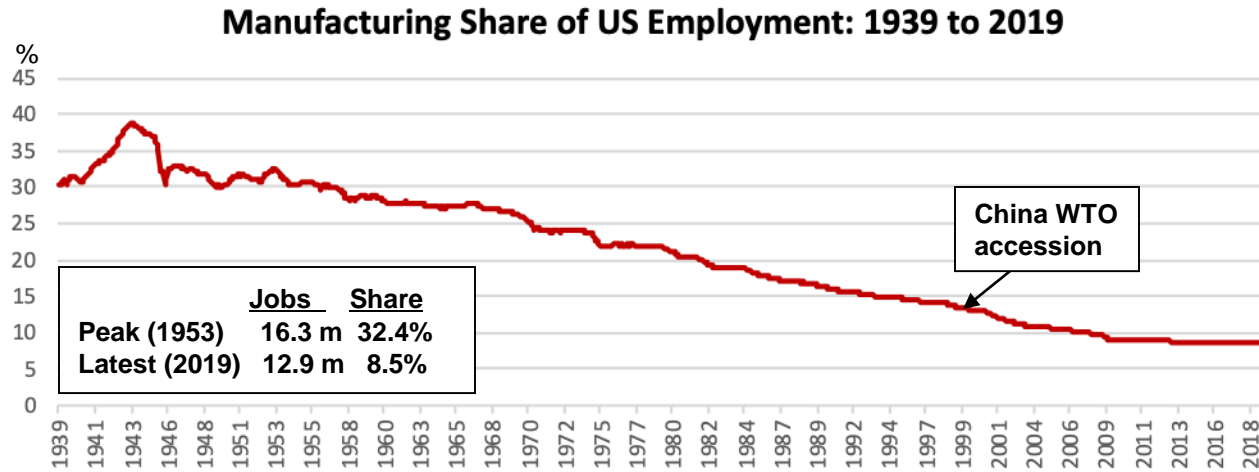


“Protection will lead to great prosperity and strength.”
— Donald J. Trump, Inaugural address, Jan 20, 2017



Source: International Monetary Fund

America's Case for Conflict



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

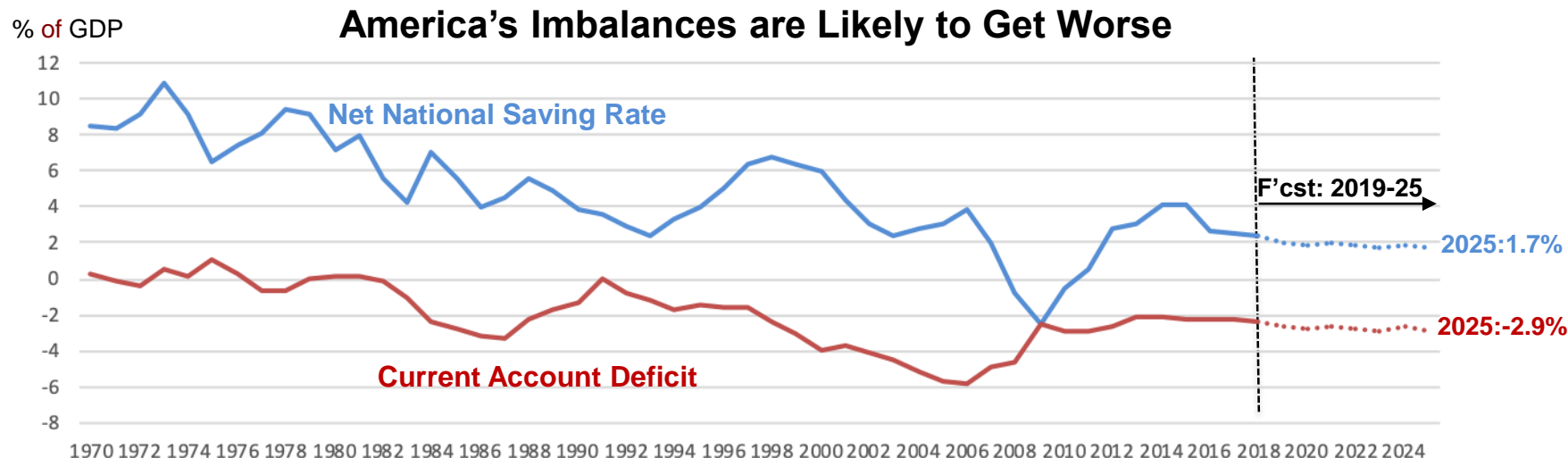
Note: TOP 20 IN CAPS

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

Source: US Department of Commerce (BEA)

America's Macro Contradictions

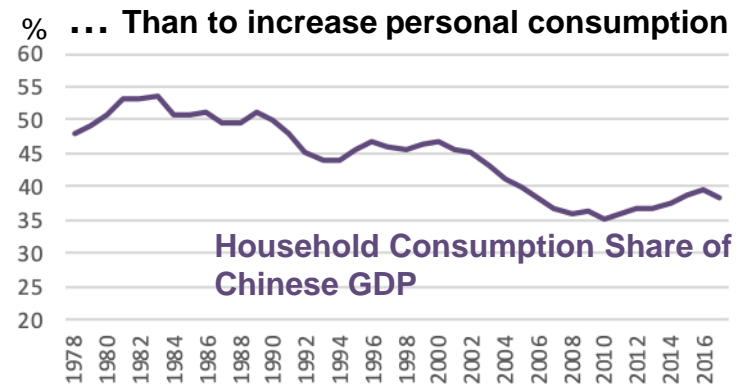
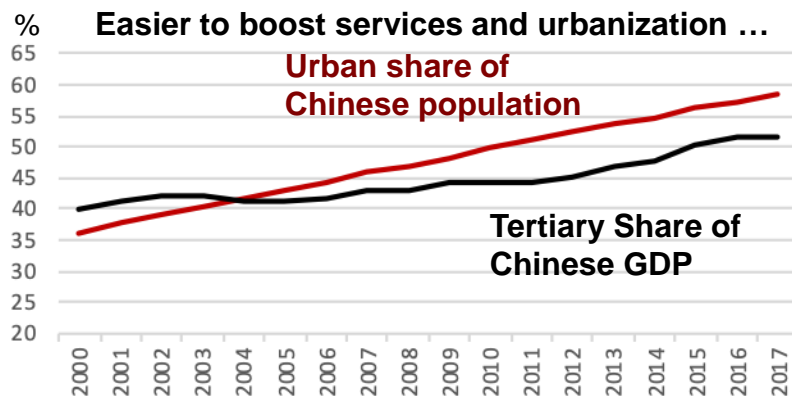
Theory	Practice: United States
Saving is essential for investment and economic growth	Net national saving rate: 2.4% of national income in 2018
Saving-short nations import surplus saving from abroad	Current account deficit: -2.4% of GDP in 2018
Imported saving leads to (multilateral) trade deficits	America's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



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

Strategic contradiction	Resolution	Tradeoff
Structural rebalancing	Supply-side: Productivity	Demand-side: Consumer
Ownership transition	SOE Reforms	State vs. markets
Debt intensity	Deleveraging	Stability vs. growth
Middle-income trap	Imported to indigenous innovation	Trade conflicts



Source: National Bureau of Statistics (China)

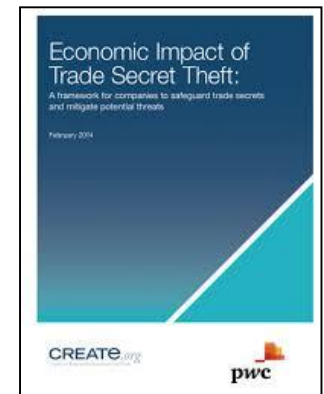
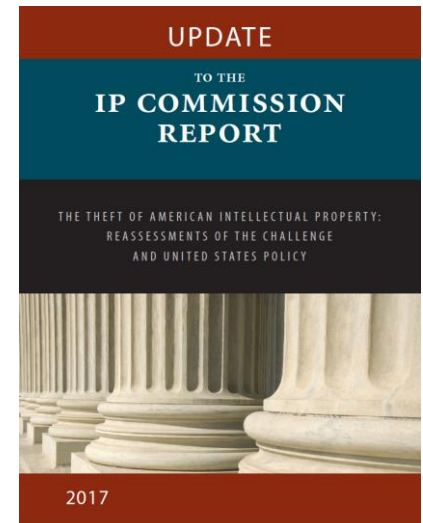
False Narrative: The USTR's Case Against China

USTR, "Findings of the Investigation into China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation Under Section 301 of the Trade Act of 1974," March 22, 2018

- 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

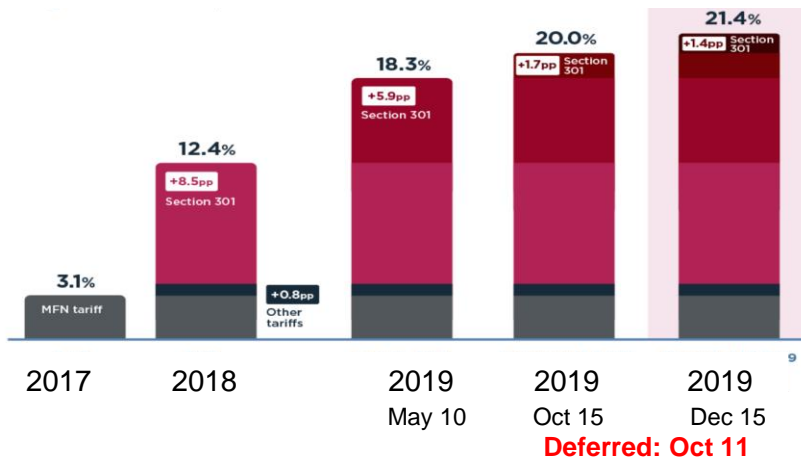


Flimsy Evidence

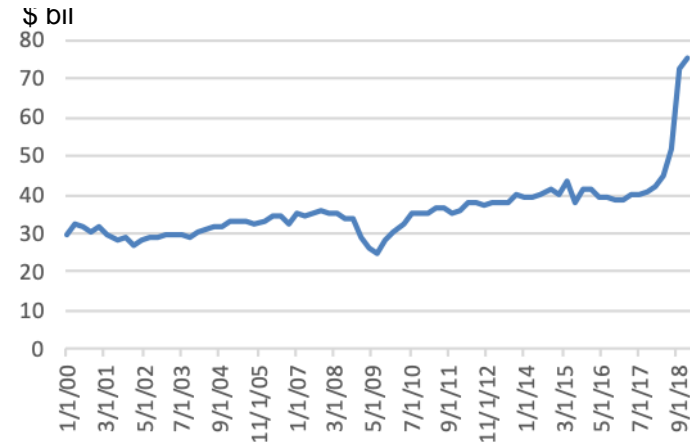


Trump's Tariffs

Average Tariff Rate on US Imports from China



U.S. Tariff Revenue



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

Source: Douglas A. Irwin, *Peddling Protectionism: Smoot-Hawley and the Great Depression*, 2011.

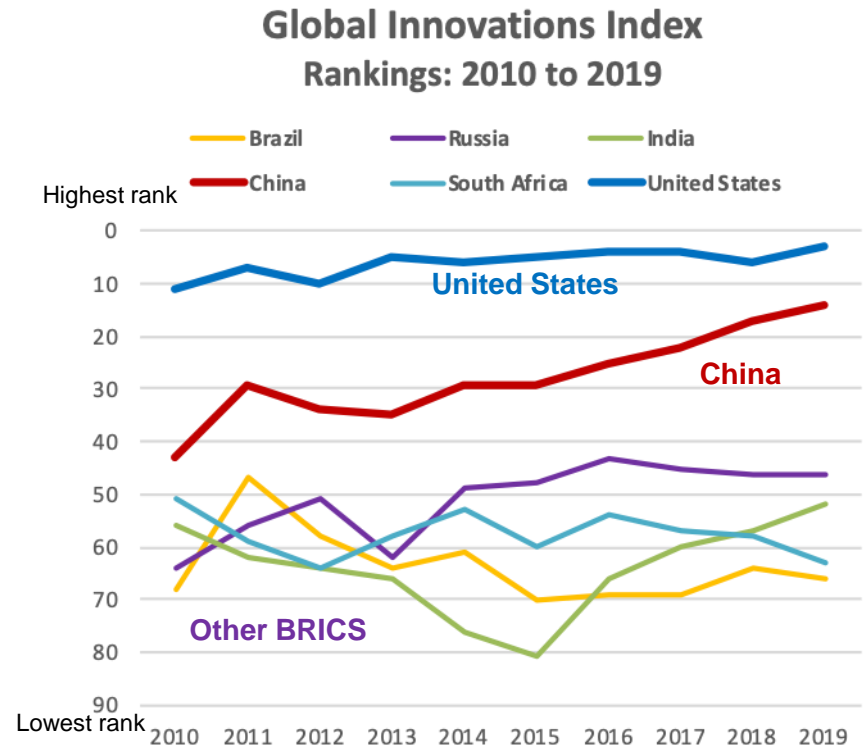


Trump Tariffs: 2018

- 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?

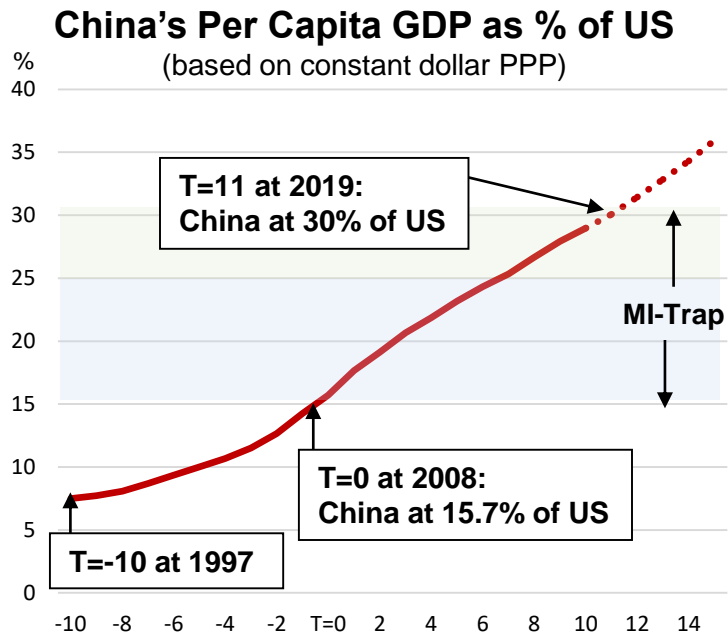


Source: Cornell, INSEAD, and WIPO, *Global Innovation Index 2019*

“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



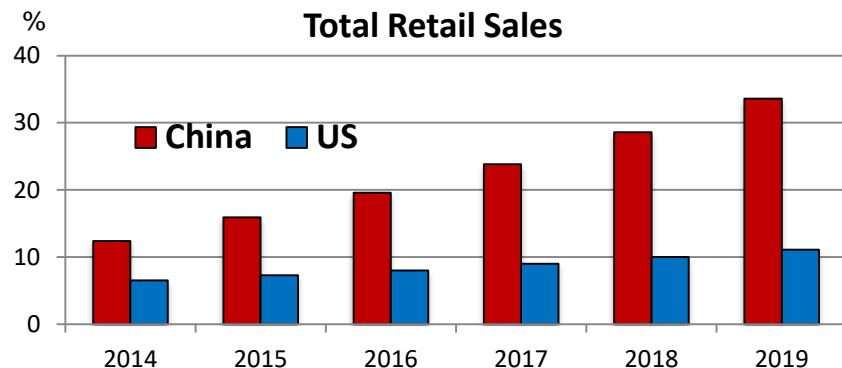
Source: IMF WEO database

Avoiding the “middle-Income trap”

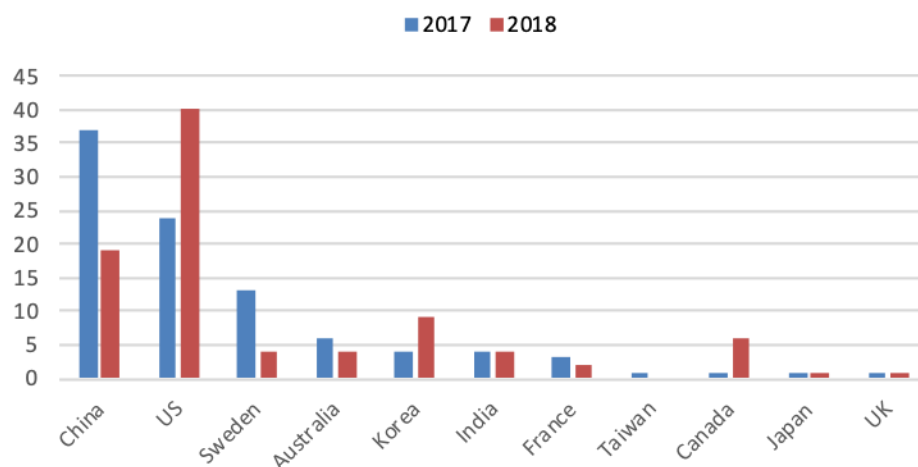
- China is at a precarious threshold
- Mean reversion or systemic failure?
- From “catching up” to self-sustaining development
- From imported to indigenous innovation
- Stymied by growing possibility of a tech war with the United States

China's Push to Indigenous Innovation

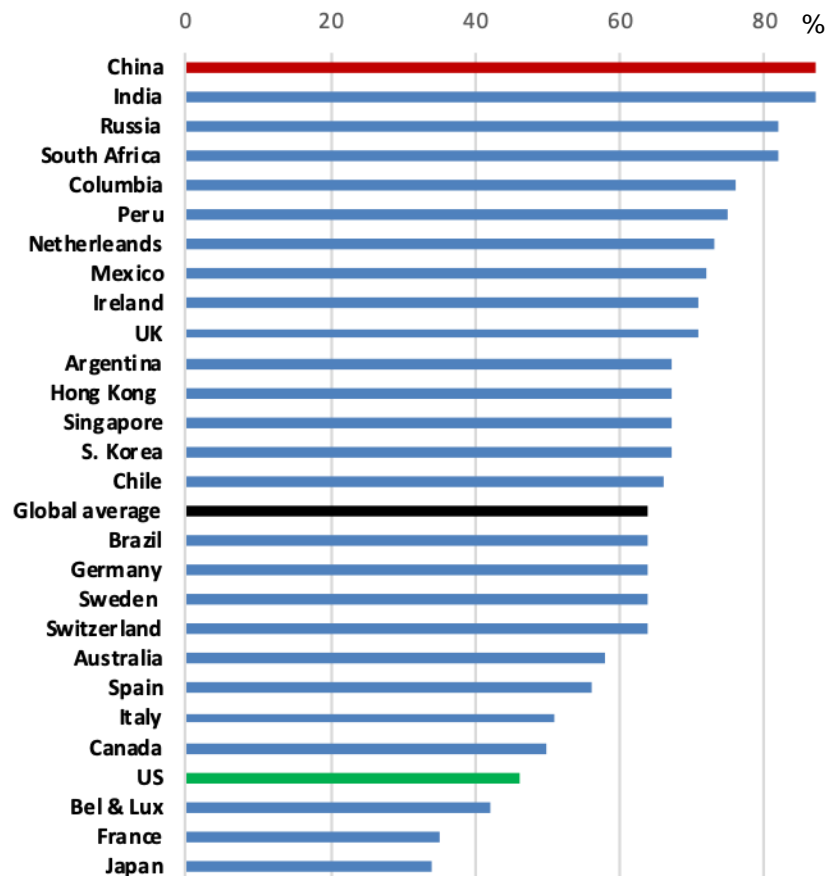
E-commerce Portion of Total Retail Sales



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

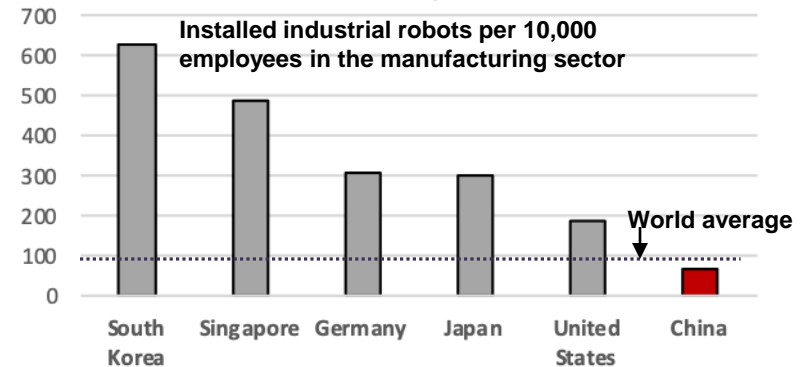
China's AI Strategy: At the Frontier

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

Goals (RMB)

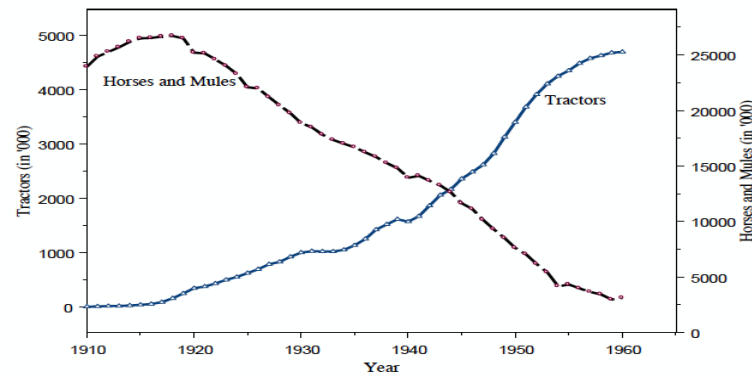
	<u>AI Core</u>	<u>AI Related</u>	<u>Global Position</u>
2020	150 bil	1 trl	In line with ROW
2025	400	5	World leading
2030	1000	10	Primary global AI center

Robot Density: 2016

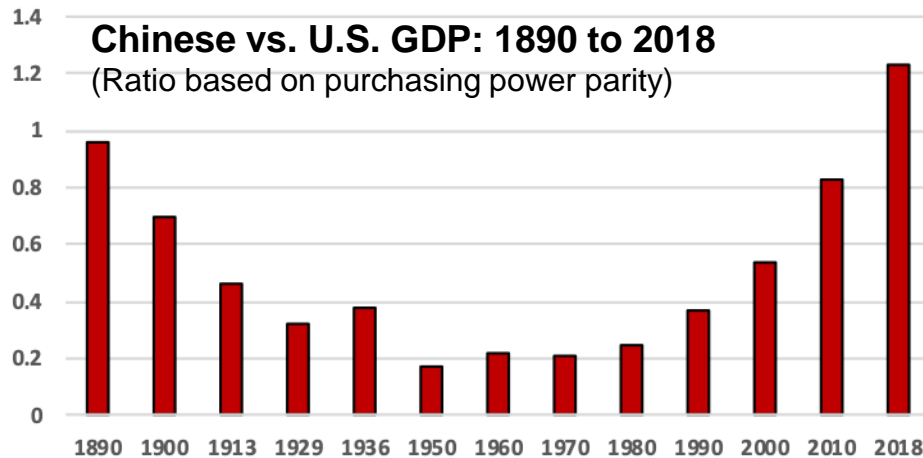


Will Humans Go the Way of Horses?

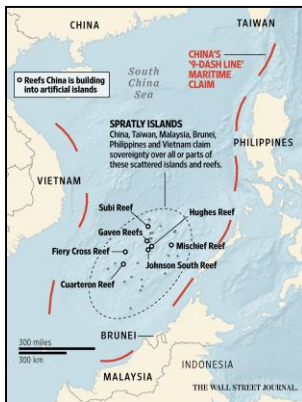
Rise of the Machine: 1910 to 1960



From Trade War to Hot War? Perils of the Thucydides Trap



South China Sea



East China Sea



Source: Angus Maddison, *The World Economy: A Millennial Perspective*, OECD (2011); IMF *World Economic Outlook* database; Graham Allison, Belfer Center, Harvard University

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

Period	Ruling power	Rising power	Outcome
16 th c	France	Hapsburgs	War
16-17 th	Hapsburgs	Ottoman	War
17 th	Hapsburgs	Sweden	War
17 th	Dutch Rep	England	War
17-18 th	France	Great Brit	War
18-19 th	UK	France	War
19 th	UK, France	Russia	War
19 th	France	Germany	War
19-20 th	Rus, China	Japan	War
20 th	UK	US	No war
20 th	Rus, UK, Fr	Germany	WWI
20 th	USSR, UK, Fr	Germany	WWII
20 th	US	Japan	WWII
20 th	USSR	Japan	No war
20 th	US	USSR	No war
20 th	UK, Fr	Germany	No war

From Trade War to Cold War 2.0?



*Pence's China Speech Seen
as Portent of 'New Cold War'*

New York Times, October 5, 2018

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

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

Fading Strength

US economy	Then: 1947-91	Now: 2010-18
Real GDP growth	3.5%	2.3%
Net national saving rate	8.8%	2.5%
Productivity growth	2.2%	1.1%

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 ownerships 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

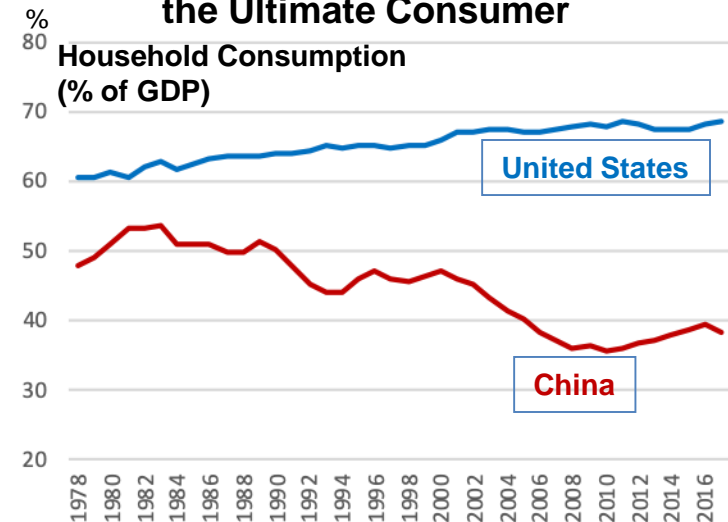
Codependence: The unhealthy relationship

- 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*

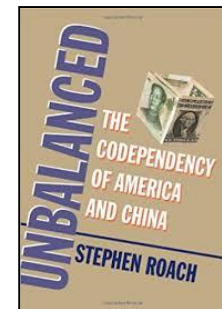
Interdependence: The healthy relationship

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

The Ultimate Producer and the Ultimate Consumer

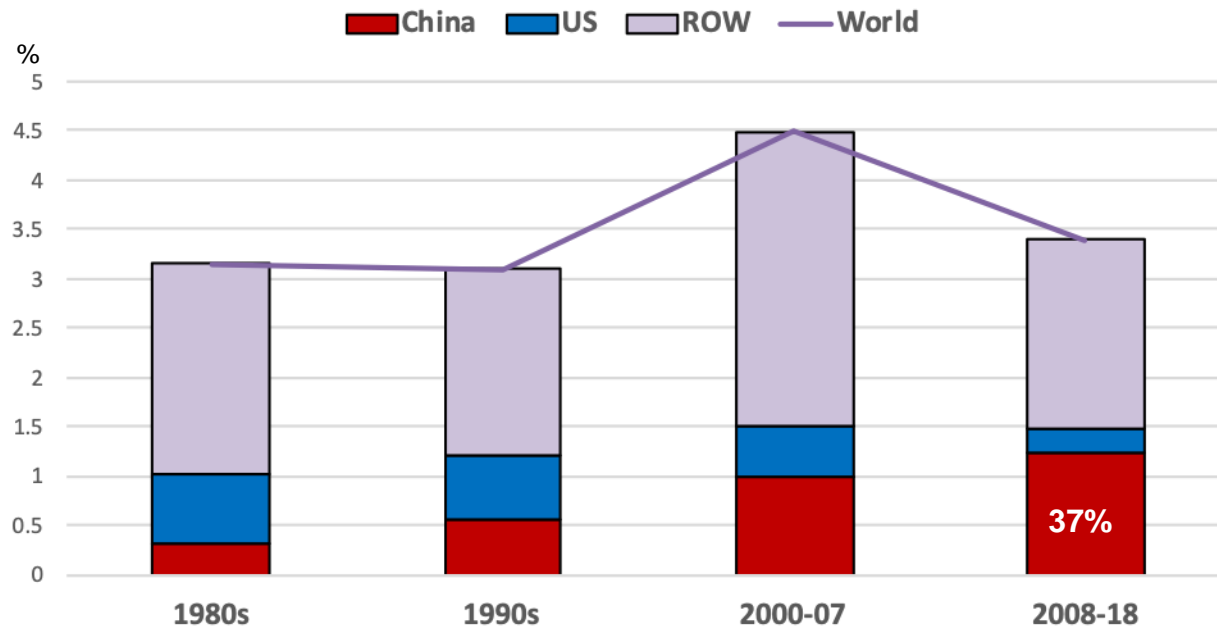


Source: World Bank Development Indicators



Global Consequences

The Two Most Important Economies in the World



Contributions to Global GDP Growth:

US and China	32%	39%	34%	44%
Rest of the World	68%	61%	66%	56%

Source: IMF World Economic Outlook (Apr 2019)