The US-China Trade War, Much More than Trade

The Trade War as of September, 2019

By Dr. Antonio Graceffo

Many see the US-China trade war as a US effort to curb China’s global economic expansion and rise to world dominance, including such issues as; The Belt and Road Initiative, the debt slavery of most of the developing world, claims on the South China Sea, the independence of Taiwan, and perhaps even the continued semi-autonomy of Hong Kong.

Irrespective of geopolitical factors, the United States has a number of very real, very tangible economic grievances with China. Even under previous administrations, the US has brought suit against China in the World Trade Organization, but, the same complaints raised by President Obama remain unresolved.

US Grievances with China

Donald Trump has called China a “trade cheat.” It is absolutely true that under the umbrella of its Made in China 2025 plan, China gives subsidies to its stat-owned and state-invested firms to make their products more competitive on world markets; a direct violation of WTO rules (Schultz, 2019 and Gross, 2019). It has been estimated that this practice alone has cost America millions of jobs.

Oponents of the trade war insist that free trade would be better for both economies. And while this may or may not be true, the US has never enjoyed free trade with China. China has historically levied very high tariffs on US products which were five or more times those levied by the US on Chinese imports. The president is calling for these, pre-trade-war tariffs to be removed (Gross, 2019).

Reciprocal market access is another point of contention. For years, essentially all US market sectors were open to Chinese firms, while US firms were restricted or even barred from entering certain sectors of the Chinese economy (Gross, 2019). Just one simple example of restricted market access would be that Chinese firms can and do buy land in the US, while US companies cannot buy land in China.

Another grievance is that Chinese laws and Chinese courts fail to protect US intellectual property rights. In some cases, technology is stolen, products are cloned and Chinese courts stand idly by. In other instances, in order to operate in certain Chinese business sectors, US companies are forced to have a local joint venture partner, to whom they are forced to transfer their technology (Gross, 2019).

One-in-five North American-based corporations on the CNBC Global CFO Council reported that China had stolen their IP in the past year (Rosenbaum, 2019). The United States Trade Representative estimates that China steals or forcibly acquires between $225 billion and $600 billion worth of US IP each year (Pham, 2018). This is money which was spent by the US government and private companies to develop new technologies. Without having to spend anything on research and development, China is able to sell the same or similar products cheaper, undercutting the US manufacturers. US consumers, while benefitting from the cheap products, ultimately pay for the stolen R&D through taxes, job cuts, and through higher costs on other American products through which companies are hoping to recover their lost R&D money.

The one, somewhat, spurious grievance the President has with China is that he keeps accusing them of being a currency manipulator. While the value of the Chinese currency is influenced by the central government, it is largely influenced by market forces. Rather than accusing China of currency manipulation, it would be more constructive to ask whether or not a currency which is not 100% driven by market forces should be included in the IMF Special Drawing Rights currencies.

Through the trade war, the president is hoping to bring China to the table to negotiate a fairer, more-level playing field (Gross, 2019).

As many Americans oppose the trade war, the president does not stand alone in believing it is a necessary evil. “For all the extensive criticisms of President Trump’s trade war with China, he is “the only president of recent vintage” to understand that ‘China is an imperturbable geopolitical foe’ and ‘the United States ought to be taking a serious look at a long-term strategy to contain and then reverse’ Chinese dominance, Ben Shapiro writes at Real Clear Politics”. (Post Editorial Board, 2019)

The Trade War So Far

While American consumers who continue to buy Chinese products are paying the tariffs, they are impacting China much more, through price deflation, currency devaluation, and a disruption of supply chains (Shiff, 2019). China’s GDP growth rate has fallen short of predictions, hitting a 30-year low (Yao, 2019). Industrial production in China grew by only 4.8% in July, the worst growth in 17 years. Urban unemployment has increased to 5.3% (He, 2019). And the yuan has hit an 11-year low (Hideyuki, 2019).

In China, consumer spending has fallen short of projections, with auto sales dropping for the ninth straight month. If the trade war continues, consumer spending is expected to decrease further. One reason why consumer confidence still remains somewhat high is because, since last year, the Chinese government began bracing for the effects of the tariffs by shoring up the economy, the same way they did during the Global Financial Crisis. This includes government stimulus, through expansionary monetary policy, tax cuts and infrastructure spending, totaling 4.25% of GDP (Yeung, 2019). Conventional wisdom suggests, however, that a government can only spend its way out of difficulty for so long until it runs out of money. China already suffers from massive public debt which stands at 300% of GDP, representing 15% of the world’s total. Meanwhile, Beijing has instructed banks to increase lending to keep the economy afloat (Reuters, 2019).

And banks are riddled with non-performing loans, largely made to state owned enterprises. Non-performing loans in China have reached $317.66 billion USD, which is the highest point since 2003 (CBNEditor, 2019). In any economy, an increase in non-performing loans means that companies and individuals are borrowing but are unable to repay their loans on time. This is a harbinger of an economic down turn. In China, non-performing loans have deeper significance, as many of the borrowers are state-owned or state-controlled companies, and even municipalities. Borrowing by these entities usually increases just before or during an economic down turn as the Central government utilizes these entities to inject money into the economy. Therefore, an increase in borrowing, combined with a decrease in the percentage of loans not being repaid, suggests that the economy is slowing and that the government is trying to prevent it from getting worse.

Capital flight measures have also been put in place. Banks in China have been restricting the purchase of US dollars by Chinese citizens. Banks are refusing to allow citizens to wire money overseas, using such arbitrary reasons as “You are too old” (Zhou, 2019). Similar controls were enacted in 2015 and 2016 when the economy was struggling and the Chinese government was spending heavily on stimuli. "Some Chinese banks have increased scrutiny of foreign-currency withdrawals and quietly reduced the amount of US dollars customers are allowed to withdraw" (Zhou, 2019).

The Nuclear-Currency Non-Option

Many media reports claim that China has a secret weapon in the trade war, because they could dump all of the US debt they hold in reserve. China has close to $3 Trillion in hard currency reserves, one-third of which is in US dollars and dollar equivalent government debt instruments such as T-Bills (Campbell, 2019). The doomsayers claim if China sold off all of this currency at once, it would depreciate the dollar and wreak havoc with the US economy. This is not consistent with experience, however, as in 2015, China dumped about $1 Trillion of US debt to finance its economic stimulus package and the Yuan still dropped against the dollar.

The US dollar is the most traded currency in the world and on any given day more dollars are traded than China’s total reserves. If China dropped the whole $1 Trillion in a single day, it would just be one heavy day of trading with very little impact on the price of the dollar. Keep in mind that there are nearly 200 countries recognized by the UN, as well as a number of other sovereign and semi-sovereign entities, which are all holding US dollars as the bulk of their currency reserves. In fact, China only holds about 5% of the total US debt (Investopedia, 2019).

Dumping all of its US currency holdings would hurt China much more than the US. It would devalue the Yuan, threatening its status as an IMF Special Drawing Rights (SDR) currency. In order to remain in the SDR, the Yuan has to maintain a value within a certain band. If it fluctuates too wildly or drops too low, the Yuan would no longer be considered an option as an international currency. Selling off all of China’s dollars would also scare off investors (Campbell, 2019). China is one of the world’s largest recipients of foreign direct investment, but that would end if investors were seeing their returns paid in worthless paper. Whether through government manipulation, as Trump claims, or through fair market forces, the Yuan has been in a steady decline since Trump assumed the presidency. If the Yuan were no longer backed by US dollar reserve holdings, that would depress the value even further.

Currently, if the Yuan drops below a level that Beijing finds acceptable, the Central government can go on world currency markets and trade dollars for Yuan until the price levels off. With no more dollars in reserve, the Central government would be unable to regulate the price of its own currency.

One option might be for Beijing to sell dollars and buy Euros. This would not solve all of their problems, however. Commodities, energy, and raw materials, which China is one of the largest importers of, are largely priced and settled in US dollars. This would, once again, necessitate, China going on the open market and buying back expensive dollars, but with a greatly depreciated Yuan. In short, China would be selling low and buying high.

China is also the world’s largest exporter. Most global trade is done in US dollars. In fact, countries that export goods generally demand payment in US dollars as a means of building up their hard currency reserves. If China dumps its US dollar holdings, would it also refuse to accept new dollars for its exports? And if so, how would they conduct business with developing countries with unstable or non-convertible currencies?

Selling off all of its US dollar holdings seems a suicidal non-option for China.

Cutting China Out of the Loop

Some American companies, such as Apple and auto manufacturers, earn a great deal of revenue selling to China’s domestic market. Neither US nor Chinese tariffs will affect those sales or that revenue. The part of their operation which will be subject to tariffs is the portion of their business which is manufactured in China and exported to the US. To avoid the tariffs, these companies just need to relocate their factories to a preferred trade partner country of the US. For example, a firm which manufactures motherboards for Google and Amazon is shifting production to Taiwan. Manufacturers for Inventec Corp. and HP have announced that they will do the same. GoerTek Inc. has moved its production of AirPods to Vietnam. Similarly, Apple has also announced that it will move some of its China production to Vietnam (Wu, 2019). The supply chains for American bound electronics run through Southeast Asia and even Indian. Reports have claimed that business is down because of the trade war. Shifting manufacturing directly to these countries would restore revenues in the supply chain, while creating new jobs in manufacturing. Experts say there is no reason why electronics have to be made in China and that other countries, particularly Taiwan, can create new global supply chains. For this reason, leading Taiwanese technology manufacturers are now expanding, even building new facilities in India (Wu, 2019).

Why the US Must Prevail

China often sets requirements for its business and aid partners such as rescinding recognition of Taiwan or refusing visits by the Dali Lama. They require close “friends” to vote in their favor in cases of global arbitration, such as in the South China Sea dispute. To receive Chinese investment, Hollywood films have allowed themselves to be censored by the Chinese government. The Chinese government asks foreign social media companies to share users’ personal data with them, and blocks media which publish sentiments which they perceive as anti-China. They also ask “friendly nations” to cancel visits by the president of Taiwan. Meanwhile, both developing and developed countries have been known to comply with China’s demands, due to their increasing economic dependence on China. During all of this, these countries simply accept the same types of unbalanced and unfair trade which the US is now standing up to.

If the US loses the trade war, China’s victory will become a cautionary tale for other countries who wish to oppose Beijing’s demands. Additionally, if one of those countries did stand up, Beijing could draw on their experience of confronting the US for clues on how to defeat any of the world’s other/smaller economies (Sullivan, 2019).

**About the Author**

Antonio Graceffo PhD China-MBA, works as an economics researcher and university professor in China. He holds a PhD from Shanghai University of Sport Wushu Department where he wrote his dissertation “A Cross Cultural Comparison of Chinese and Western Wrestling” in Chinese. He is the author of 11 books, including *Beyond the Belt and Road: China’s Global Economic Expansion, A Deeper Look at the Chinese Economy*, *The Wrestler’s Dissertation,* and *Warrior Odyssey*. Antonio completed post-doctoral coursework in economics at Shanghai University, specializing in US-China Trade, China’s Belt and Road Initiative, and Trump-China economics. His China economic reports are featured regularly in The Foreign Policy Journal and published in Chinese at The Shanghai Institute of American Studies, a Chinese government think tank.

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