Free exchange | Trading peace for war

Sino-American interdependence has been a force for geopolitical stability

IN THE 1990s America and Europe had a trade dispute over bananas. No one worried that tanks might soon roll as a result. But trade is about more than economics. The European Union, the world's most ambitious free-trade area, was founded on the idea that trade integration would make war between members "not merely unthinkable, but materially impossible". As the risk of a serious Sino-American trade war grows, attention is mostly focused on the prospect of dearer iPhones and unhappy soyabean farmers. But the stakes are much higher.

China's economic miracle could not help but provoke geopolitical stress, given its size and illiberality. Relations between America and China are built on mutual suspicion. Geopolitical rivalry has been moderated, however, by economic interdependence: a mutual entanglement some economics wags have dubbed "Chimerica".

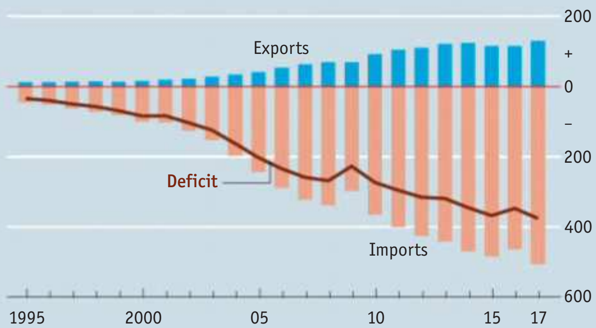
As China opened up, American consumers hoovered up cheap Chinese goods. American firms built China into their supply chains, enjoying low labour costs and gaining a presence in a domestic market that would one day be the world's largest. Export-oriented development created vast numbers of Chinese jobs, and American investment allowed Chinese firms to gain technological expertise. As China grew richer, it purchased American bonds to keep its currency low and its exports competitive. That allowed America to consume beyond its means year after year. This circular flow of money saw America's current-account deficit grow in pace with China's surplus.

Both countries have strained at these ties. Even before Donald Trump became president, America bristled at the theft of its intellectual property, aggressive government support for Chinese industry, and the destabilising currency manipulation. China deplored its dependence on foreign technology and consumers. These vulnerabilities were highlighted by the financial crisis, when plummeting global demand threatened to plunge China into recession, even though it is quite separate from the global financial system.

Support within America for a tougher line with China has been building for a while. And China is ever keener to achieve technological self-sufficiency. The share of domestic value-added in its exports has been rising steadily. "Made in China 2025", the national development strategy, aims to create high-tech substitutes for foreign products from computer components to robots, cars and planes.

Fair trade is no robbery

United States trade with China, $bn



Source: US Census Department

Yet an end to Sino-American interdependence is not inevitable. China might yet hew more closely to rich-country trade rules, and intervene less in its economy and foreign-exchange markets. Trade between America and China could continue to grow, even as the technological gap between them, and their bilateral imbalance, shrink. Expensive goods, investment and services could flow both ways, as between America and Europe.

But this sunny future looks increasingly remote. America already limits some Sino-American trade on national-security grounds. Past spats over dumping and other unfair trade practices led to punitive duties on some goods, as allowed under WTO rules. An all-out trade war would blow the two economies apart.

The higher tariffs being mooted on half, or nearly all, of America's imports of Chinese goods would cause serious economic pain in both countries. In America the prices of many goods would jump and those of others, like the soyabeans exported to China by the shipload, would plummet. A sudden drop in China's trade surplus with America, now over 3% of Chinese GDP, would be a heavy blow. Even though a weaker currency would make it easier to export more to other countries, China would probably need both monetary and fiscal stimulus to avoid a socially disruptive rise in unemployment.

Bad break-up

Then the real trouble would start. However warily American and Chinese leaders eye each other, economic self-interest keeps their most hawkish impulses in check. The interests of American consumers and firms constrain officials keen to keep sensitive technology out of Chinese hands (or snooping Chinese technology out of American households). China's dependence on American spending and technology limits diplomatic and military adventurism. The break-up of Chimerica would mean an end to those constraints.

It might also shove the world economy back towards mercantilism and competing spheres of economic influence. China is already cultivating its economic imperium via the Belt and Road Initiative, a plan to build infrastructure for trade and to invest heavily in resource-rich developing economies. Cut off from American consumers, China would seek to strengthen ties with its neighbours in the hope of selling them more stuff. As Mr Trump's economic sabre-rattling has grown louder, China has started to cultivate relations with Japan and South Korea. Mr Trump would probably view America's allies strengthening their trade ties with China as a strategic blow—even though he has picked trade fights with them, too. He might limit access to the American market for countries that do not join his anti-China campaign. A world of mutually beneficial trade could turn into one in which there are no winners without losers, and no victory without conflict.

America has become embroiled in trade spats with fast-growing upstarts before; with Japan in the 1980s, for example. But these involved democratic countries grateful for American protection during the cold war—and American presidents with quite different characters. A closer analogy might be the early 20th century, when economic interdependence proved no match for rising nationalism and bad leadership. The fear is that Mr Trump's tariffs are less a way to correct legitimate trade grievances than a step towards a much darker world. ■

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