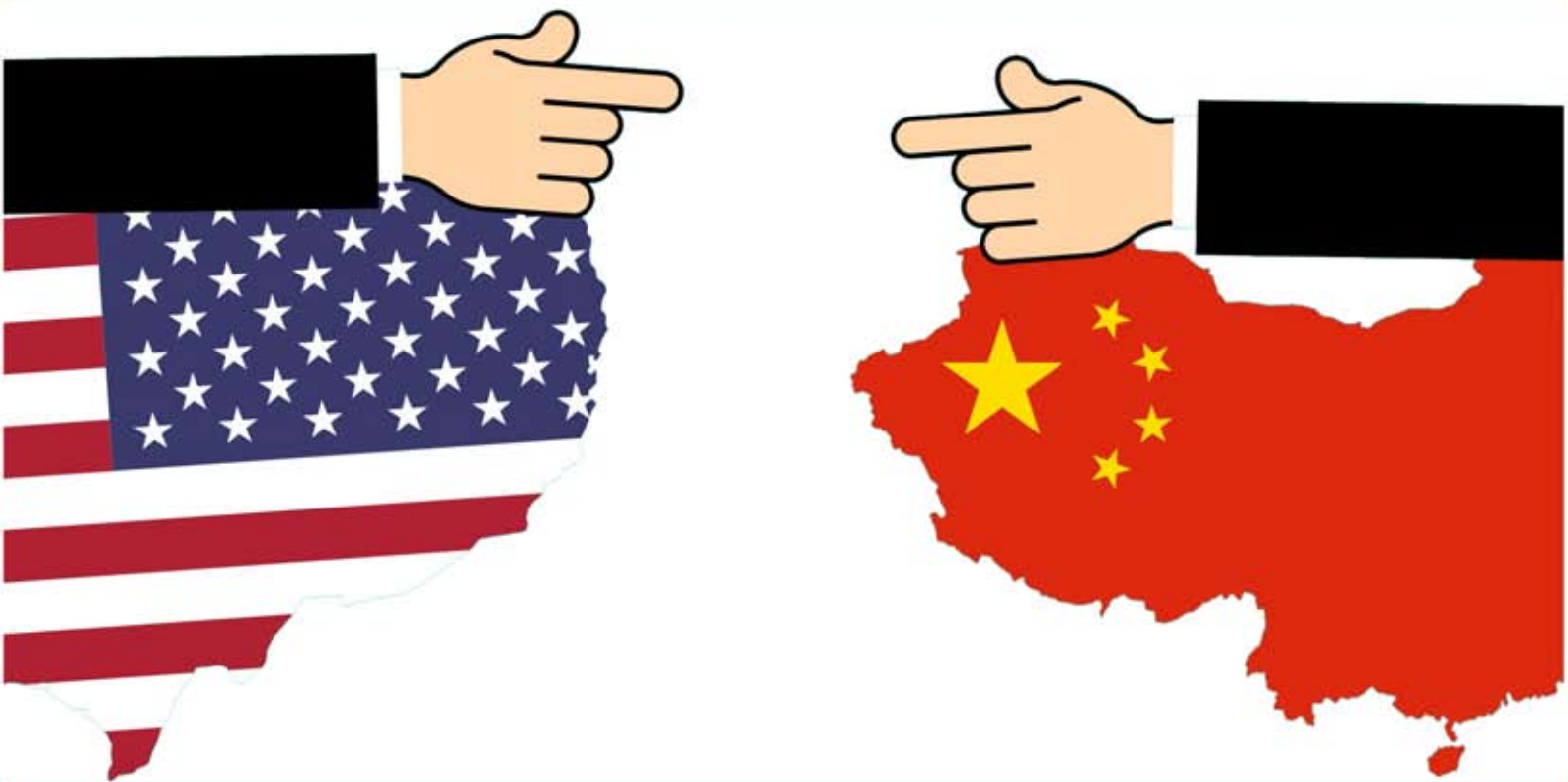




Vivekananda International Foundation

US-CHINA Trade War

Analyses of Deeper Nuances and Wider Implications



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About the Author



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US-CHINA Trade War:

Analyses of Deeper Nuances and Wider Implications

Introduction

On March 8, 2018, the US President Donald Trump announced imposing additional tariffs on China's export of steel and aluminium to USA. On March 22, 2018, President Trump announced plans to enact sanctions against China over its Intellectual Property Rights (IPR) policies that negatively affect the US stakeholders. These sanctions included raising tariffs by 25 percent on selected Chinese products valued at \$50 billion to \$60 billion. On April 1, China announced that it had retaliated against the US action by raising tariffs on various American products, such as pork. On April 3, the US administration unveiled a list of 1,333 products worth \$50 billion in trade to which it intended to apply a 25 percent tariff. These Chinese goods are in strategic sectors such as information technology, robotics, advanced rail and shipping, new energy vehicles and high-technology medicine and health care. A few hours later, China released its proportional response: 25 percent tariffs on 106 products, also worth \$50 billion in trade.

Thus, there is a tit-for-tat action going on between China and the US. The Trump administration's plans to tax \$50 billion worth of Chinese imports was met with threats by the Chinese to subject \$50 billion worth of American products to the same. China threatened to retaliate with tariffs on American cars, chemicals and other products. The 106 goods, many produced in parts of the country that have supported President Trump, were selected to deliver a warning that American workers and consumers would suffer in a protracted standoff.¹

Under the World Trade Organisation (WTO) rules, a developing country is entitled, to a certain extent, to use non-market practices to spur economic development. Since it became an economic power house trailing only the US, developed countries want China to follow the same rules and responsibilities as a market economy. So far, China's government has reacted to new tariff actions by the Trump administration with relatively restrained words and promises of proportional responses to the American government's actions.

The actual intention behind the Trump administration's recent series of anti-China moves goes beyond this rhetoric. It has two aspects:-

- Forcing Beijing to open its market further for US goods and services and providing US companies with more favourable investment conditions.

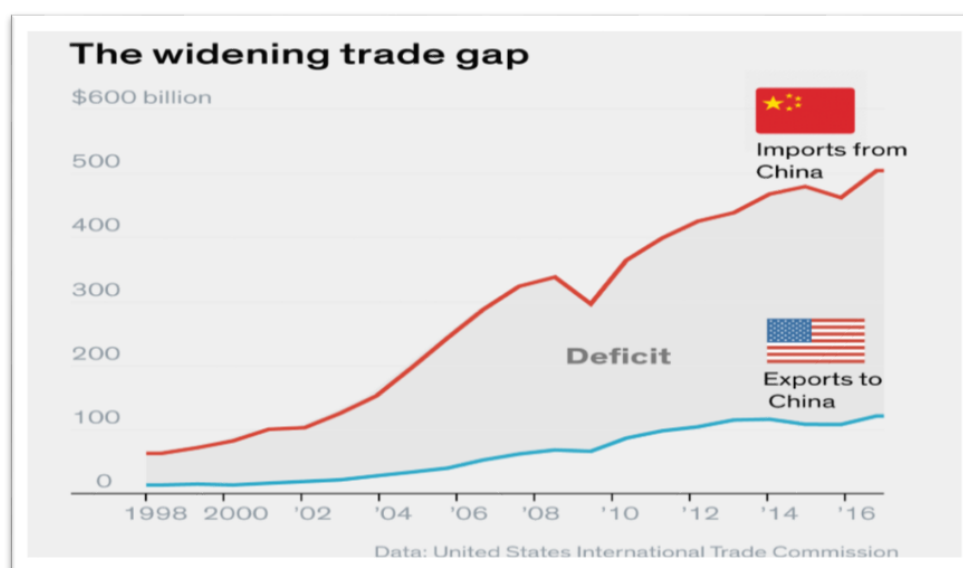
1. Steven Lee Myers, "Why China is Confident it Can Beat Trump in a Trade War", The New York Times, April 5, 2018, available at: <https://www.nytimes.com/2018/04/05/world/asia/china-trade-war-trump-tariffs.html>

- Curbing the state-backed high-tech sectors that form the core of Beijing’s ‘Made in China 2025’ strategy.

The US and China are the two biggest economies in the world. A trade war would have very serious repercussions all over the world. It could derail the current global economic expansion and cripple American businesses that depend on business with China. It could also further complicate geopolitical priorities given the Trump administration has enlisted the help of the Chinese in solving the crisis with North Korea.

US-China Trade Relations

The US-China trade rose rapidly after the two nations re-established diplomatic relations in January 1979, signed a bilateral trade agreement in July 1979 and provided mutual most favoured nation (MFN) treatment, beginning in 1980. In that year (which was shortly after China’s economic reforms began), the total US-China trade (exports plus imports) was approximately \$4 billion. In 2017, the total US merchandise trade with China was \$636 billion, making China the US’ largest trading partner.²



US Merchandise Trade with China

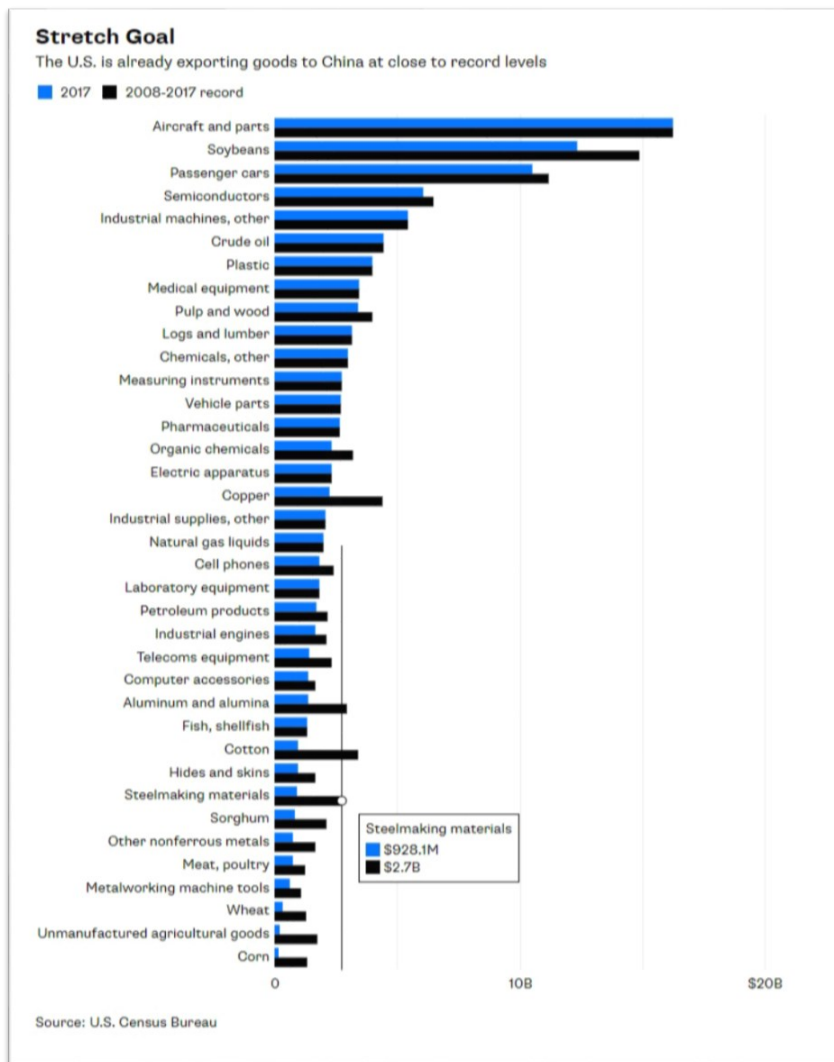
The US Merchandise Exports to China

The US merchandise exports to China in 2017 were \$115.6 billion. China was the third-largest US merchandise export market after Canada and Mexico. China was the second-largest US agricultural export market in 2017, at \$19.6 billion, 63 percent of which consisted of soybeans. The top merchandise US exports to China in 2017 were:

2. Wayne M. Morrison, “China-US Trade Issues”, April 16, 2018, available at: <https://fas.org/sgp/crs/row/RL33536.pdf>

- Aerospace products (mainly civilian aircraft and parts)
- Oil seeds and grains (mainly soybeans)
- Motor vehicles
- Semiconductors and electronic components
- Waste and scrap

Many trade analysts argue that China could prove to be a much more significant market for US exports in the future. China is one of the world’s fastest growing economies. Healthy economic growth is projected to continue in the years ahead, provided that it implements new comprehensive economic reforms. China’s goals of modernising its infrastructure, rebalancing the economy, upgrading industries, boosting the services sector and enhancing the social safety net could generate substantial new demand for foreign goods and services.



Major US Exports to China in 2017

Economic growth has improved the purchasing power of Chinese citizens considerably, especially those living in urban areas along the east coast of China. In addition, China's large foreign exchange reserves (at \$3.1 trillion as of December 2017) and its huge population (at 1.39 billion) make it a potentially enormous market. To illustrate:-³

- A January 2017 study prepared by Oxford Economics for the US-China Business Council estimated that in 2015 US exports of goods and services to China plus bilateral Foreign Direct Investment (FDI) flows directly and indirectly supported 2.6 million US jobs and contributed \$216 billion to US GDP. The study further predicted that US exports of goods and services to China would grow from \$165 billion in 2015 to over \$520 billion by 2030.
- In 2016, Chinese visitors to the US totalled 3.0 million, ranking China as the fifth largest source of foreign visitors to the US. Chinese visitors spent \$33 billion in the US in 2016 (including on education), which was the largest source of visitor spending in the US. The US Department of Commerce projects that by 2021, Chinese visitors to the US will total 5.7 million.
- As of June 2017 China has the world's largest mobile phone network with 1.36 billion mobile phone subscribers and the largest number of internet users at 751 million.
- China's online sales in 2016 totalled \$752 billion (more than double the US level at \$369 billion).
- Boeing Corporation delivered 202 planes to China in 2017 (26 percent of total global deliveries), making it Boeing's largest market outside the US. Boeing predicts that over the next 20 years (2017-2036), China will need 7,240 new airplanes valued at nearly \$1.1 trillion and will be Boeing's largest commercial airplane customer outside the US.
- General Motors (GM) reported that it sold more cars and trucks in China than in the US each year from 2010 to 2017. The US motor vehicle exports to China were \$8.3 billion in 2016, making it the second-largest US motor vehicle export market after Canada.
- According to estimates by Credit Suisse (a global financial services company), China overtook the US in 2015 to become the country with the largest middle class at 109 million adults (with wealth between \$50,000 and \$500,000); the US level was estimated at 92 million. A

3. Ibid.

study by the Brookings Institute predicts that spending by China’s middle class will rise from \$4.2 trillion in 2015 (12 percent of global total) to \$14.3 trillion (22 percent of global total) in 2030.⁴

Major US Merchandise Imports from China

China was the largest source of US merchandise imports in 2017, at \$506 billion. China’s share of total US merchandise imports rose from 8.2 percent in 2000 to 21.6 percent in 2017. The top five US imports from China in 2017 were communications equipment, computer equipment, miscellaneous manufactured commodities such as toys and games, apparel and semiconductors and other electronic components.

Table: Major US Merchandise Imports from China in 2017 (\$ in millions and percentage change)

Products	2016	2017	Per cent Change 2016-2017
Communications Equipment	65,674	77,957	18.7 %
Computer Equipment	52,180	58,609	12.3 %
Miscellaneous Manufactured Commodities	34,408	36,497	6.1 %
Apparel	25,483	24,559	-3.6 %
Semiconductors & Other Electronic Components	18,903	23,158	22.5 %
Household & Institutional furniture & Kitchen Cabinets	16,535	18,222	10.2 %
Household Appliances and Misc Machines	14,062	14,494	3.1%
Footwear	14,620	14,074	-3.7%
Plastics Products	12,319	13,771	11.8%
Motor Vehicle Parts	13,117	13,533	3.2%
Total	462,618	505,597	9.3%

Throughout the 1980s and 1990s, nearly all the US imports from China were low-value, labour intensive products, such as toys and games, consumer electronic products, footwear and textiles and apparel. However, over the past few years, an increasing proportion of US imports from China are more technologically advanced products. According to the US Census Bureau, the US imports of

4. China-US Trade Issues, Congressional Research Service, January 11, 2018 available at: https://www.everycrsreport.com/files/20180111_RL33536_2feb6ffda4aff65b96799e387e5e88839421255b.pdf

“advanced technology products” (ATP) from China in 2017 totalled \$171.1 billion. Information and communications products were the largest US ATP import from China. ATP products accounted for 33.8 percent of total US merchandise imports from China.

Some see the large and growing US trade deficit in ATP with China as a source of concern, contending that it signifies the growing international competitiveness of China in high technology. Others dispute this, noting that a large share of the ATP imports from China are in fact relatively low end technology products and parts, such as notebook computers, or are products that are assembled in China using imported high technology parts that are largely developed and/or made elsewhere.⁵

Some analysts find a direct correlation between trade deficit and GDP growth in case of USA.



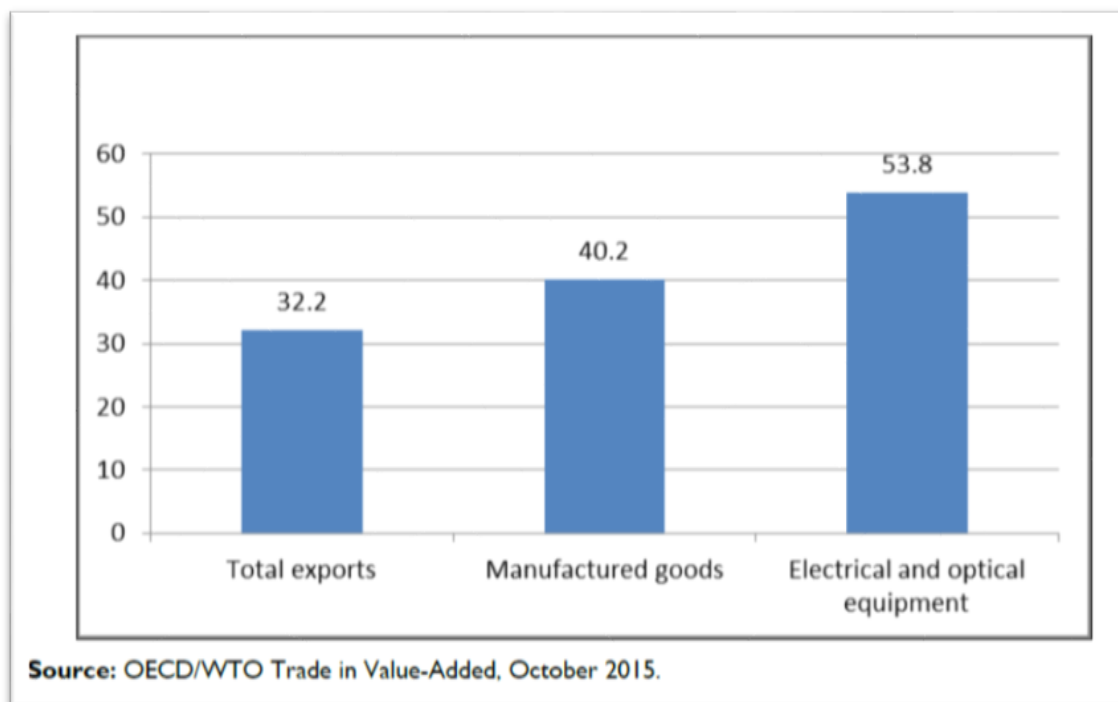
Trade in Services

China is a major US trading partner in services. In 2016, China was the fourth largest services trading partner at \$69.6 billion, the third largest services export market at \$53.5 billion and the 11th largest source of services imports at \$16.1 billion. According to data from the Bureau of Economic Analysis, the US

5. Wayne M. Morrison, “China-US Trade Issues”, April 16, 2018, available at: [https:// fas.org/sgp/crs/row/RL33536.pdf](https://fas.org/sgp/crs/row/RL33536.pdf)

actually ran a surplus in the services trade with China in 2017 — to the tune of roughly \$38.5 billion. When you factor that surplus into the two countries’ overall trade balance, the US ran a roughly \$336 billion deficit with China last year — which means Trump’s figure was off by about \$164 billion.

China as a Major Centre for Global Supply Chains



Estimated Percentage Foreign Value – Added to China’s Exports

A joint study by the Organisation for Economic Cooperation and Development (OECD) and the WTO has sought to estimate trade flows according to the value that was added in each country. For example, the OECD/WTO study estimated that in 2011, 32.2 percent of the overall value of China’s gross exports was comprised of foreign imports. This level increased to 40.2 percent for China’s total manufactured exports. For electrical and optical equipment, it was 53.8 percent. The study estimated that if bilateral trade imbalances were measured according to the value of trade that occurred domestically in each country, the US trade deficit in goods and services with China in 2011 would decline by 35 percent (from \$278.6 billion to \$181.1 billion). This is largely because of the role of trade in intermediate goods (parts and materials imported to make products). The World Bank estimates that US intermediate exports and imports to and from China in 2016 were \$19.3 billion and \$33.5 billion, respectively. Thus, many Chinese products contain US-made inputs and some US products contain Chinese made inputs.

According to Apple Corporation, it utilised over 200 corporate suppliers with nearly 900 facilities located around the world. The top five largest country sources of these facilities in 2017 were China (358), Japan (137), the US (64), Taiwan (55), and South Korea (34). Some US corporate suppliers to Apple have facilities located in many countries. For example, Intel Corporation has 10 facilities that supply products to Apple, three of which are located in the US, two in China, two in Malaysia, and one each in Ireland, and Israel, Malaysia, and Vietnam. Apple iPhones are mainly assembled in China by Taiwanese companies (Foxconn and Pegatron) using a number of intermediate goods imported from abroad (or in many cases, intermediates made by foreign firms in China). Many analysts have estimated that the value-added that occurs in China in the production of the i-Phone is small relative to the total value of the product because it mainly involves assembling foreign made or foreign owned components. Apple Corporation, on the other hand, is thought to be the single largest beneficiary (in terms of gross profit) on the sale of the i-Phone. However, conventional trade data does not accurately attribute the value-added that occurs in each stage of making the i-Phone.

When the US imports i-Phones from China, US trade data attributes nearly the full value of the product as originating in China, which, some argue artificially inflates the size of the US trade deficit with China. One 2010 study estimated that in 2009, China exported 11.3 million i-Phones to the US, with a shipping price of \$179 per unit and total export value at \$2.0 billion. The study estimated that 96.4 percent of the value of the i-Phone was attributed to foreign suppliers and producers of components and parts, including the US (at \$122 million). Standard trade data would put China's trade surplus in i-Phone trade with the US at \$1.9 billion, but that level would fall to \$73.5 million if that trade was measured according to the value-added that occurred in each country. Several analysts have concluded that Apple's innovation in developing and engineering its products, along with its ability to source most of its production in low cost countries, such as China, has helped enable the company to become a highly competitive and profitable firm as well as a source for high paying jobs in the US.

Apple products illustrate that the rapidly changing nature of global supply chains has made it increasingly difficult to interpret the implications of the US trade data because, while they may show where products are being imported from, they often fail to reflect who benefits from that trade.⁶

6. Ibid.

The US View

The US President, Donald Trump, has for years accused the Chinese Government of unfair trade practices, which he says puts the US companies at a disadvantage. Many other foreign leaders have agreed that China unfairly subsidises its businesses and has at times devalued its currency to boost exports. However, most countries have favoured a multi-national approach to apply pressure on Beijing.

While China has significantly liberalised its economic and trade regimes over the past three decades, it continues to maintain or has recently imposed a number of state directed policies that appear to distort trade and investment flows. The US policy-makers and stake holders have expressed concern that China does:-

- Extort or steal its rivals' intellectual property.
- Pursue industrial policies aimed precisely at creating advantages for many designated key sectors of its economy over foreign competitors.
- Limit exports of critical commodities like rare earths to give its own producers advantage on rival non-Chinese companies to move operations to China.
- Subsidise massive overcapacity in goods like steel and aluminium in order to undercut the competition globally.
- Place many restrictions on foreign providers of farm products along with banking, insurance, tele-communications, Internet related, audio-visual, express delivery, legal and other services.
- Sue its trade partners in the WTO simply because they're exercising their right to bring actions against China.
- Remain determined to keep foreign firms in the dark about the regulations concerning licensing and operating requirements; product, investment, business expansion approvals and business license renewals.

The US Government's grievances centre on the Chinese trade practices impacting technology transfer, intellectual property and innovation. The Trump administration's Section 301 Report identifies four areas of specific concern, which are summarised below:-

- China has an unfair regime of forced technology transfer, implemented through formal and informal practices and policies. Through foreign investment restrictions, US companies seeking to operate in China are

made to engage in a joint venture with a Chinese partner, most often a state owned enterprise. In selected sectors, such as aero-space and information technology, Chinese regulations require that the Chinese enterprise maintain the controlling interest in the joint venture.

- Forced technology transfers occur through discriminatory licensing restrictions under the Chinese technology import-export regulations. Chinese companies are able to “free ride” on their US counterparts’ research and development in virtually any imported technology transfer arrangement.
- The Chinese Government directs and unfairly facilitates the systematic investment in and acquisition of, US companies and assets by Chinese companies, as a means of obtaining intellectual property and generating large scale technology transfer in industries deemed important by state industrial plans. The ‘Made in China, 2025’ programme blunts US innovation and corrodes its distinct competitive advantage.
- Over a decade, the Chinese Government has conducted and supported cyber intrusions into US commercial networks targeting confidential business information held by US firms. Through these cyber intrusions, Beijing has gained unauthorised access to a wide range of commercially valuable business information, including trade secrets, technical data, negotiating positions and sensitive and proprietary internal communications.⁷

The office of the US Trade Representative said that the tariff targets were developed using a computer algorithm designed to choose products that would inflict maximum pain on Chinese exporters, but limit the damage to the US consumers. The tariff list proposed by the US focused on technology parts and components — such as printed circuit assemblies, transistors and semiconductor devices — instead of finished goods like mobile phones or computers. That meant the US consumers may not experience a significant rise in the price of imported electronics goods from China. When it came to technology, both the US and the Chinese markets were ‘incredibly intertwined’ and that meant the countries could not walk away from each other.⁸

Adverse Effect on US Business Interests

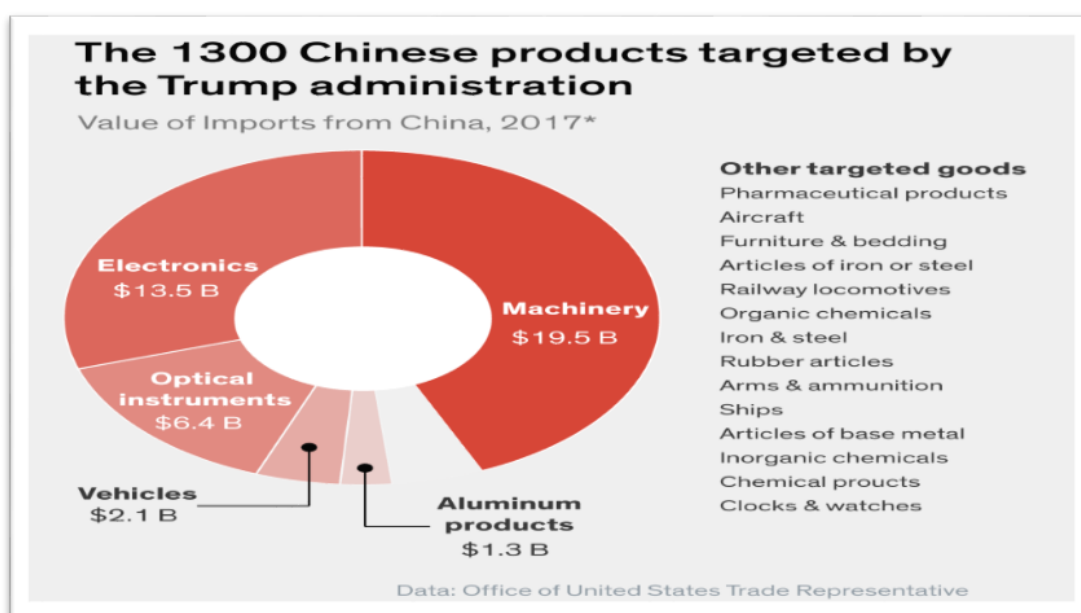
The tariffs could backfire because they could make it harder for American companies to sell goods overseas if other nations retaliate. A number of US agriculture firms have warned that they could be caught in the middle of a trade

7. Roncevert Ganan Almond, “Ring of Fire: Tremors and Eruptions in the US-China Trade War”, *The Diplomat*, April 12, 2018, available at: <https://thediplomat.com/2018/04/ring-of-fire-tremors-and-eruptions-in-the-u-s-china-trade-war/>

8. Saheli Roy Choudhury, “Why China Could Get Hurt More From a Trade War in the Tech Sector”, April 5, 2018, available at: https://www.cnbc.com/2018/04/05/us-china-trade-war-tech-sector-impact.html?_source=sharebar&par=sharebar.washingtonpost.com/opinions/global-opinions/trump-is-right-chinas-a-trade-cheat/2018/04/05/6cd69054-390f-11e8-8fd2-49fe3c675a89_story.html?utm_term=.ce8996b7fbfc

war, particularly if Trump follows through on threats against China and Mexico. The National Pork Producers Council said in late March that its members exported \$1.1 billion of pork to China last year, making it the third-largest market. In addition to pork, the new tariffs from the Chinese Government would include US exports of apples, oranges, almonds, pineapples, grapes, watermelons, cranberries, strawberries, raspberries, cherries and a host of other items.⁹

Many US firms view participation in China’s market as critical to their global competitiveness. The US imports of lower cost goods from China greatly benefit the US consumers. The US firms that use China as the final point of assembly for their products, or use Chinese made inputs for production in the US, are able to lower the costs of their products.



Most US imports from China are not a threat to the US national security. These imports include cheap Chinese products such as apparel, toys, furniture, and consumer electronics upon which lower income Americans rely. They consist of more than 40 per cent of China’s exports to the US. This also applies to most US exports to China, including copper, pulpwood, plastic materials, logs and lumber and medical equipment. Together, these products add up to 12 percent of the total US exports to China. The USA can and should continue to buy these products from China and vice-versa. Both countries could source these goods elsewhere but would face higher prices for doing so.¹⁰

Many of the targeted products are consumer goods such as televisions and dishwashers. When a large country such as the US imposes tariffs, the pain is shared between consumers who pay higher prices and producing firms abroad who

9. Damian Paletta, “Trade War Escalates as China Says it Will Impose Tariffs on 128 US Exports, Including Pork and Fruit”, Washington Post, April 1, 2018, available at: https://www.washingtonpost.com/news/business/wp/2018/04/01/trade-war-escalates-as-china-vows-to-impose-tariffs-on-128-u-s-exports-including-pork-and-fruit/?utm_term=.b2437a9c1171

10. Daniel Rosen, “China-Trump Administration: Is a Trade War the Only Option? An Alternative Approach to Taking On China”, Foreign Affairs, March 20, 2018, <https://www.foreignaffairs.com/articles/china/2018-03-20/trade-war-only-option>

have to absorb lower profit margins. Tariffs are a very poor instrument for punishing China for any unfair trading practices. Some of the cost will be borne by:-

- American consumers.
- American firms that either produce in China or use intermediate products from China.
- Firms in countries (mostly US allies) that supply China.
- Chinese firms (mostly private ones).

The same analysis can be applied to Chinese retaliatory tariffs. Chinese consumers will pay more for soybeans and products like pork that rely on soybeans. Chinese airlines will be less productive if they cannot buy American aircraft. It happens that these US exports have mostly domestic content, so that most of the pain felt by producers will be within the US. There are some sectors in which China's exports consist primarily of domestic value-added. These tend to be old industrial sectors. In textiles, for example, 75 percent of value added is really 'Made in China'. If Washington wants to limit collateral damage on its own firms and third countries, then it makes sense to go after an old sector like textiles.¹¹

The 15-year-old joint venture between General Motors (GM) and Shanghai Automotive Industrial Corporation has resulted in GM's selling more vehicles today in China than it does in America. This has been great for GM's bottom line. But, it has also increased the probability that China will soon have its own global auto that will compete head-to-head with GM inside and outside China.

The American firms would:-

- Like to have unfettered access to the Chinese market.
- Prefer not to have to enter joint ventures with Chinese firms.
- Worry that 'tech transfer' in China sometimes takes the form of intellectual property theft.¹²

Some experts feel overall, tariffs are the wrong instrument to address the US-China trade issues. Tariffs will cause a lot of unnecessary pain for consumers and third countries, not to mention American firms caught in the crossfire.

The issues are complex. The US is an advanced industrialised economy that relies on liberal, free market principles to spur innovation and grow the economy.

In contrast, China seeks to occupy a similar position in global commerce, but through a managed economy led by national champions, often state owned en-

11. David Dollar and Zhi Wang, "Why a Trade War with China Would Hurt the US and Its Allies, Too", April 4, 2018, available at: https://www.brookings.edu/blog/order-from-chaos/2018/04/04/why-a-trade-war-with-china-would-hurt-the-u-s-and-its-allies-too/?utm_campaign=Brookingspercent20Brief&utm_source=hs_email&utm_medium=email&utm_content=61867197

12. Geoffrey Garrett, "Why the US-China 'Trade War' Is Really About the Future of Innovation", The Wharton, April 9, 2018 available at: <http://knowledge.wharton.upenn.edu/article/u-s-china-trade-war-really-future-innovation/>

terprises and a top-down industrial policy. While there are missing nuances in this characterisation, this fundamental difference should be the starting point for any level-headed approach to addressing the dispute.

ZTE

In March 2017, Zhongxing Telecommunications Equipment Corporation (ZTE Corp.) pleaded guilty in a federal court to charges of conspiring to violate the US sanctions against shipping US-made goods to Iran, obstructing justice and making ‘a materially false statement’. In an agreement, the ZTE admitted it had intentionally disguised shipments using third parties and countries. The ZTE agreed to pay US \$1.19 billion (7.5 billion yuan) in penalties, making it the costliest export control fine ever. ZTE relies on US suppliers for an estimated 25 to 30 percent of the components in its networking equipment and smartphones.¹³

Before the tariff list was announced, the Committee on Foreign Investment in the US (CFIUS), with expanded power granted by the White House, had already blocked several Chinese Government-backed acquisitions of US high tech companies in order to protect ‘national security and sensitive civil data’. On April 16, 2018 Commerce Secretary Wilbur Ross banned US export privileges for ZTE Corp and affiliates for seven years, putting the business of the Shenzhen based smartphone maker at risk. For ZTE this was a fatal blow - the company sources nearly 30 percent of its components like micro-processing chips, components in its networking equipment and smartphones from US companies, like Intel and Qualcomm, industry leaders in producing these. Soon thereafter, trading of ZTE stock was suspended on Chinese markets, in Hong Kong and Shenzhen, and less than a month later, on May 9, 2018, ZTE announced the closure of its main business operations.

On May 13, 2018, Trump tweeted that he and Chinese President Xi Jinping were working together to give ZTE Corporation, “a way to get back into business, fast” as there were too many jobs in China lost. Trump announced that he had instructed US Commerce Secretary Wilbur Ross to “get it done.” The following day, however, Ross contradicted the President by saying that ZTE would not be subject to trade negotiations: “Our position has been that that’s an enforcement action separate from trade.”¹⁴

China’s Ministry of Commerce re-launched its review of the US chipmaker Qualcomm’s purchase of Dutch competitor NXP, and Chinese negotiators were reportedly willing to remove tariffs on US agricultural products in exchange for relief for ZTE. The potential reprieve has prompted critics, including some

13. Michael Lelyveld, “China’s ZTE Seeks to Ease US Export Ban”, April 3, 2018, available at: https://www.rfa.org/english/commentaries/energy_watch/chinas-zte-seeks-to-ease-us-export-ban-04302018105144.html

14. Roncevert Ganan Almond, “Ring Of Fire: Tremors and Eruptions in the US-China Trade War”, The Diplomat, April 12, 2018, available at: <https://thediplomat.com/2018/04/ring-of-fire-tremors-and-eruptions-in-the-u-s-china-trade-war/>

members of his own party, to accuse Mr Trump of caving in to a company that has raised national security concerns. Existing sanctions, including US tariffs on steel and aluminium and Chinese tariffs on US products such as wine, remain in effect.

In the long run, however, the sanctions would function as a stimulus for Chinese high-tech enterprises to invest in the development and manufacture of the key components that they had long relied on the overseas market. Since 2013, each year China has imported more than \$220 billion chips and integrated circuit components, or twice the annual cost of its imported oil. For most Chinese companies, buying such components has been the most cost-effective way to do business. They see no necessity to produce them on their own, which entails huge and long-term investments. As a result, China has consumed as much as 59 percent of all chipsets of the world in recent years. But, the recent sanction against ZTE has served as a wake-up call, forcing the indigenous Chinese firms to invest massively in the development and manufacturing of chips. China's meta power almost guarantees their success in this endeavour. Once these new investments come into operation in the following years, China would be a formidable competitor in the global market of chips and integrated circuit products, following the steps of South Korea and Taiwan. China's shift to high end manufacturing has been ongoing for years and will continue whether or not a trade war breaks out between the two largest economies. But the sanctions against the Chinese firms would likely facilitate, rather than impede, the process.¹⁵

Job Opportunities

15 Nobel laureates signed an open letter warning the Trump administration that "new tariffs in response to trade imbalances" would harm workers across the country, much like protectionist measures did in the 1930s. Today Washington depends far more on trade, supply chains and globalization than it did over three quarters of a century ago. A Brookings Institution analysis estimated there are "some 2.1 million jobs in the 40 industries that produce products now slated for Chinese retaliation." If Washington and Beijing proceed with reciprocal impositions of tariffs, an even more recent study concludes, nearly 134,000 Americans would lose their jobs, and American farmers' net income would fall by 6.7 percent.

Rise of China

In 1990, China's gross domestic product ranked only the eleventh, lagging behind not only the US, Japan, Germany, France, UK, Italy, Canada and Spain, but also two developing countries, Iran and Brazil. By 2010, China rose to number two, next only to the US. China's rapid economic growth has been attributed to:-

15. Huaiyin Li, "How China Will Benefit from a Trade War with America", National Interest, May 17, 2018, available at : <http://nationalinterest.org/feature/how-china-will-benefit-americas-trade-war-25873?page=3>

- The Chinese Government's reform measures, which ranged from the introduction of the household responsibility system in place of collective organisations in agriculture and the rise of township and village enterprises in the 1980s.
- Privatisation and incorporation of state-owned enterprises in the 1990s.
- Massive inflow of foreign direct investment.

However, these are not uncommon in the rest of the world. These are found more or less in almost all other developing countries, but none of these countries has experienced economic growth as fast and enduring as in China. Economic factors alone cannot fully explain China's rapid economic expansion in the past or the sharp power it has developed outside the country. The reasons behind China's rise as a global power may be due to China's history and culture, which work together to influence the behaviour of the people and government in China in their pursuit of personal well-being or the national goal of economic growth. Specifically, there are five factors:-

- Immense size of China's population and market.
- The homogeneity of its society and its ethnic composition.
- The secularized values of its people.
- The abundance and high quality of its human capital.
- The intervention and strategizing of the state that combine to propel and sustain China's economic growth.

What is unique to China is that all these five factors exist there simultaneously, and all of them have their roots in Chinese cultural traditions or historical legacies before the Communist Revolution in 1949.

China's huge population and the immensity of its domestic market allow for the growth of all sectors of manufacturing and the emergence of thousands of industrial clusters throughout the country. These, coupled with the abundant supply of a well-educated, hardworking labour force and the unusual stability of a homogeneous society, explain China's unparalleled attractiveness to investors home and abroad. The central government's implementation of long term growth plans and its massive investment in infrastructural networks further contribute to China's global competitiveness. It is the functioning of all these factors that propels the phenomenal growth of the Chinese economy.¹⁶

16. Ibid.

View from China

China is a hard-nosed global player, pursues its national interest vigorously. They've taken a non-ideological approach to economics over the last few decades, picking market based tools and government policies to their advantage. China's Ministry of Commerce made the Chinese position very clear. It said, "We do not want to fight, but we are not afraid to fight a trade war. The Chinese side will follow suit to the end and will not hesitate to pay any price and will definitely fight back. It must take a new comprehensive response and firmly defend the interests of the country and the people."¹⁷

There is a school of thought that the new tariffs will hardly send China into an economic tail-spin. China's more than \$13 trillion economy exported \$2 trillion in 2016. The tariffs will adversely affect some businesses and industries, but their total value (25 percent of between \$50 billion and \$65 billion) represents only about 2.5 percent of China's overall exports to the US. China is at the end of the Asian supply chain. Many of the goods it exports, particularly consumer goods, contain a substantial amount of intermediate products from elsewhere in the region that Chinese companies then assembled into a finished product.¹⁸

But, China has been making a concerted and successful push to reduce its dependence on trade; the share of total exports in its gross domestic product fell from over 30 percent in 2007 to under 20 percent last year. During that same time, the share of exports to the US fell from approximately 9 percent of China's economy to just over 4 percent. If Beijing concludes that trade tensions with Washington are likely to stay, and perhaps even intensify, it may well take steps to accelerate that trend.¹⁹

China plays the globalisation game by what we might call Bretton Woods rules, after the much more permissive regime that governed the world economy in the early post-war period. China's practices are not much different from what all advanced countries have done historically when they were catching up with others. One of the main US complaints against China is that the Chinese systematically violate intellectual property rights in order to steal technological secrets. But, in the nineteenth century, the US was in the same position in relation to the technological leader of the time, Britain, as China is today vis-à-vis the US. And the US had as much regard for British industrialists' trade secrets as China has today for the American intellectual property rights.

17. Ana Swanson and Keith Bradsher, "Trump Doubles Down on Potential Trade War With China", The New York Times, April 5, 2018, available at: <https://www.nytimes.com/2018/04/05/business/trump-trade-war-china.html>

18. "With China Tariffs, Trump Barks but Doesn't Bite", Stratfor Analysis, March 23, 2018 available at: <https://www.marketwatch.com/story/with-china-tariffs-trump-barks-but-doesnt-bite-2018-03-23>

19. Ali Wyne, "The Greater Danger of US-China Trade Tensions", The Diplomat, May 9, 2018 available at: <https://thediplomat.com/2018/05/the-greater-danger-of-us-china-trade-tensions/>

Made in China 2025²⁰

China has taken an initiative known as ‘Made in China 2025’ to comprehensively upgrade the Chinese industry. The Made in China 2025 initiative has clear principles, goals, tools, and sector focus. Its guiding principles are:-

- To have innovation driven manufacturing.
- Emphasise quality over quantity.
- Achieve green development.
- Optimize the structure of Chinese industry.
- Nurture human talent.

The goal is to comprehensively upgrade Chinese industry, making it more efficient and integrated so that it can occupy the highest parts of global production chains. The plan identifies the goal of raising domestic content of core components and materials to 40 percent by 2020 and 70 percent by 2025.

Although there is a significant role for the state in providing an overall framework, utilising financial and fiscal tools, and supporting the creation of manufacturing innovation centres (15 by 2020 and 40 by 2025), the plan also calls for relying on market institutions, strengthening intellectual property rights, protection for small and medium sized enterprises (SMEs) and the more effective use of intellectual property (IP) in business strategy and allowing firms to self declare their own technology standards and help them better participate in international standards setting.

Although the goal is to upgrade industry writ large, the plan highlights 10 priority sectors:-

- New advanced information technology.
- Automated machine tools & robotics.
- Aerospace and aeronautical equipment.
- Maritime equipment and high-tech shipping.
- Modern rail transport equipment.
- New energy vehicles and equipment.
- Power equipment.
- Agricultural equipment.

20. Scott Kennedy, “Made in China 2025”, available at: <https://www.csis.org/analysis/made-china-2025>

- New materials.
- Bio-pharma and advanced medical products.

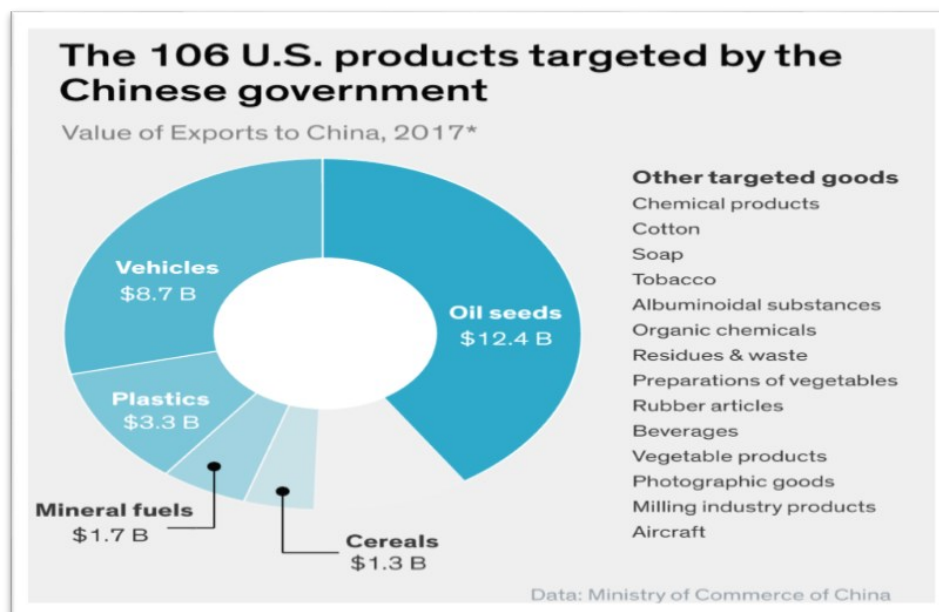
‘Made in China’ 2025 is different in multiple respects:-

- It focuses on the entire manufacturing process and not just innovation.
- It promotes the development of not only advanced industries, but also traditional industries and modern services.
- There is still a focus on state involvement, but market mechanisms are more prominent.
- There are clear and specific measures for innovation, quality, intelligent manufacturing and green production, with benchmarks identified for 2013 and 2015 and goals set for 2020 and 2025.

China is vigorously pursuing the Made in China 2025 initiative. The Chinese state will not withdraw support for strategic industries, especially those at the core of Made in China 2025. Advancement in these sectors, including information technology, automated machinery and robotics, aerospace, marine equipment and shipping, advanced rail transport, new energy vehicles, power equipment, agricultural machinery, new materials and bio-pharma and medical, allows the Chinese industries to upgrade and move up along global production chains. They will likely continue to receive financial and policy assistance from the government, as a core part of China’s industrial policy and keep trying to acquire advanced foreign technologies and IPs.

Actions Taken by China

China retaliated by putting tariff of \$13.7 billion worth of soybean imports, alongside a little over \$3 billion in cotton, sorghum, wheat and corn. China's decision to play its biggest card — soybean imports — is risky. The country accounts for 60 percent of global soybean imports. It receives the majority from two sources - Brazil and the US. It bought a third of total US output last year. Though the Chinese market is important for the American soybean growers, these exports are vital in helping contain food price inflation in China, since these crops are widely used to feed the livestock that satisfy the country’s soaring appetite for beef and pork. Though China cannot fully replace the US as a source of soy, it can take several steps to mitigate the impact. China is likely to increase imports from Brazil, increase domestic production and use of domestic stocks and start using alternative feed sources like corn.



The US is likely to be able to withstand most of the restrictions without significant shortages or pricing impacts. However, given that China can use subsidisation to account for rising import costs, Beijing is in a stronger position than Washington is when it comes to this specific tariff.²¹

China already has outlined a strategy to respond in the WTO while also targeting politically sensitive US exports that would squeeze Trump's support base. In February, China opened an investigation into the alleged US farm subsidies for sorghum production. The country's government also has raised the possibility of targeting other agricultural exports, including pork and soybeans, for investigations that could hurt business in states such as Iowa, Nebraska, Indiana and Missouri which are traditional Republic strongholds. Reports have circulated in the Chinese state media that Beijing may drop aircraft orders from the US aerospace firm Boeing Co. in favour of France's Airbus.

China included narrow-body aircraft but not wide-body aircraft in its retaliatory tariffs. Only two companies in the world make wide-body planes: Boeing and Airbus. If China put a tariff on planes from the American Boeing but not the European Airbus, it would lose leverage with Airbus with which to extract favourable prices and access to cutting edge technology. China has imposed tariffs on the easy stuff: luxury goods like American wine and liquor and agricultural goods that are considered luxuries within China, like almonds and pistachios.

China's Options

China can limit the operations of American banks and other service providers in China. The government could also urge the Chinese public not to buy

²¹ "Here Are the Major Takeaways From Trump's Tariff List", The Stratfor, April 4, 2018, available at: <https://worldview.stratfor.com/article/united-states-china-trump-tariffs-trade>

American brand cars like Chevrolets and Fords, even though those are built almost entirely from Chinese made parts and assembled in factories in China.

Through Geopolitical Actions

China could try to raise the temperature in the dispute by installing more military equipment on the artificial islands that it has recently built across the South China Sea. China could also step up pressure on Taiwan. Not likely at this stage.

Eswar Prasad, an economist at Cornell University who studies Chinese economic relations writes: “One of the very important tools that the Chinese have is the ability to make life difficult for a large number of American businesses. They have all of these unconventional weapons that are not covered by traditional trading rules that could be potent weapons in actually fighting a trade war. American automakers who make cars in China might find their local joint venture partners squeezing them out. Regional governments might send safety inspectors to plants of American companies so often as to disrupt production”.

American companies do significant business in China that doesn't show up in trade data. When Apple assembles an i-Phone in Zhengzhou and sells it in Shanghai, that doesn't count as international trade, though the profits accrue to the benefit of the California based company. The Chinese Government has any number of tools to try to weaken that business if it wishes. It could decide that phones made by a foreign company are a national security threat or shut down plants because of minor regulatory problems.²²

The importance of the US-China relationship is already being challenged by other players. Apple's i-Phone sales in China are running into competition from local Chinese manufacturers. Samsung is more than happy to fill any void that the Chinese can't deal with. Likewise, the Chinese would happily shift their trillion dollars in future aircraft purchases to Airbus, a European firm that is already building a plant in China to finish assembly of large, twin-aisle jets. As for automobiles, most Chinese would just as soon drive a Mercedes, BMW or Lexus in place of say a Ford.²³

The details of what China might do are speculative. Thus far, China's government has reacted to new tariff actions by the Trump administration with relatively restrained words and promises of proportional responses to the American government's actions. The tariffs won't even go into effect until after a comment period, setting up a potentially long period of lobbying and negotiation that could

22. Neil Irwin, “If There's a US-China Trade War, China May Have Some ‘Unconventional Weapons’”, The New York Times, April 5, 2018, available at: https://www.nytimes.com/2018/04/05/upshot/us-china-trade-war-unconventional-retaliation.html?emc=edit_mbae_20180405&nl=&nid=7575417020180405&te=1&login=smartlock&auth=login-smartlock

23. Winter Nie, “Why China Doesn't Need The US For Trade”, February 7, 2017 available at: <https://www.forbes.com/sites/winternie/2017/02/07/why-china-doesnt-need-the-us-for-trade/#5c295a853969>

rein in their scope or even delay them indefinitely. But, just because matters have been calibrated thus far doesn't mean they will stay that way.

There are a number of issues that will be deferred to avoid confrontations as long as possible. Perhaps President Xi Jinping can simply wait-out the current US administration. China can play the long game better than any other country today and has proven that in any number of instances.

A senior Chinese economist with close ties to the government said: "However, there is a deal that could be struck, as both sides have a lot to lose, especially China, as we are not ready for economic warfare with such a big power as America. What scares me, and many government officials, is the rhetoric is heating up very quickly, leaving both sides very little room to work out a deal. Both sides are making a big mistake, as trying to score quick points for their own domestic political audiences is a big error. Now is the time to get both sides in a room, lock the doors, and work towards a deal that is fair to everyone."²⁴

Rare Earth Metals

The US is almost entirely dependent on China specifically for rare earth metals that have been processed into a final and usable form. These metals are not actually rare, however, they are difficult to mine and process. They play crucial roles in everything from smart phones to electric car motors, hard drives, wind turbines, military radar, smart bombs, laser guidance and more. If China clamps down on these exports, it would create a panic type situation into America's supply chain for high tech consumer products and military's advanced weapons systems. China has shown its willingness to use its advantage in rare earth metals earlier in 2009. China did cut off its rare metal exports to Japan entirely after an international incident involving a collision between two ships. This was eventually resolved at WTO.²⁵

America has plenty of rare earth deposits. The problem is maintaining a domestic industry to mine the minerals and transform them into final components. Colorado-based Molycorp started mining rare earths at Mountain Pass. But, it struggled to turn a profit, and eventually went bankrupt. In the middle of last year, a bankruptcy proceeding sold the mine to another China involved consortium. The Chinese partner in the consortium, Shenghe, will have exclusive sales rights to the mined product!

Is it War on Innovation?

The recent National Security Strategy 2017 of the US claims that in order to compensate for its "own systemic weakness" stemming from a "state-driven

24. Harry J. Kazianis, "A US-China Trade War is Coming, but Here's How to Stop It", Fox News, April 6, 2018 available at: <http://www.foxnews.com/opinion/2018/04/06/us-china-trade-war-is-coming-but-heres-how-to-stop-it.html>

25. Jeff Spross, "How China Can Win a Trade War in 1 Move", April 6, 2018, available at: <http://theweek.com/articles/765276/how-china-win-trade-war-1-move>

economic model,” China steals proprietary technology and early stage ideas from the US private sector, thereby undercutting American prosperity and hijacking the “innovation of free societies.” As per Beijing, China faces a unique set of challenges and has successfully adopted a strategy of “socialist modernisation” to speed its development while preserving its independence. To the extent Western companies transfer technology to Chinese partners, they do so voluntarily in pursuit of enrichment within Chinese borders. The truth may lie somewhere in between.

Experts believe that recent trade skirmishes between China and the US are less about steel and soybeans and more about which country will be the leader in global innovation in the 21st century. Consider the following:-

- China has laid down more high speed rail lines than the rest of the world combined.
- Mobile payments in China are 50 times as large as in the US.
- Last year, more electric vehicles were sold in China than in the rest of the world.
- More than twice as many industrial robots were in use in China than in the US.
- Two Chinese companies—Alibaba and Tencent joined Apple, Amazon, Facebook, Google and Microsoft among the top 10 companies in the world by market capitalisation.
- Total Artificial Intelligence (AI) investment in the US was about \$18 billion, compared with only \$2 billion in China over the period 2012-2016. By 2020 China intends to invest about \$150 billion in AI — giving enormous advantage to China.

Most of the best new underlying technology continues to come out of the US. It will take China many years, probably decades, to change this. However, the ability of China to adopt and adapt niche technology at rapid speed and massive scale is extraordinary. If the definition of innovation is turning ideas into outcomes, China is already an innovation economy.

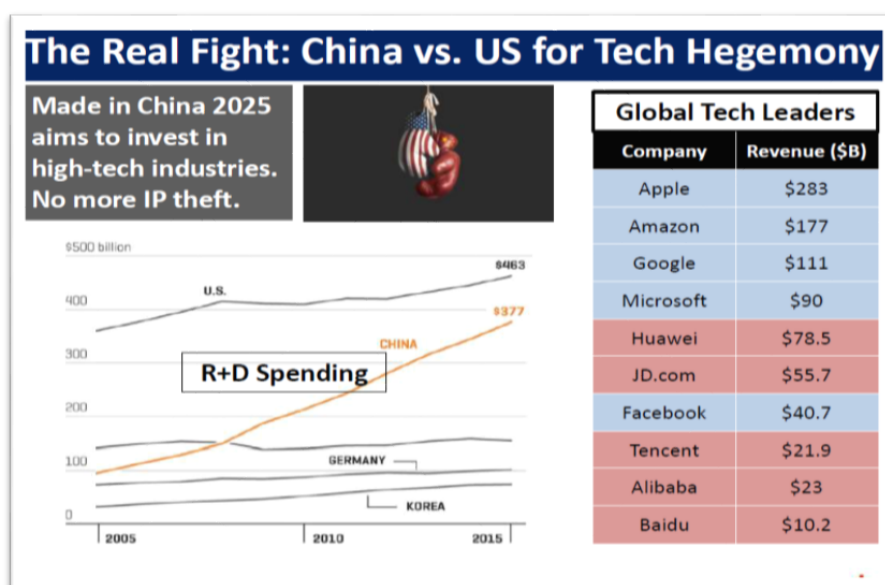
The Chinese Government has an active ‘industrial policy’ to transform its economy from a low cost assembler and manufacturer into a global leader in the cutting edge industries of the 21st century. The Chinese Government regulates what American firms do in China, with a view both to protect domestic firms and to ensure that the Chinese companies get access to leading edge American intel-

lectual property. The Chinese Government says it has the right to regulate its own market and it is improving intellectual property protections all the time. China says what the US is doing is unfair, and why its own retaliation is justified.

The stakes are much higher where the future of innovation is concerned. US and China are complementary where innovation is concerned. The US has a comparative advantage in incubating innovation; China’s comparative advantage is scaling it. This makes cooperation so much better than conflict. The whole world will benefit from more innovation no matter where it comes from. China-US competition over innovation is here to stay. Struggle over who will win the battle for global pre-eminence in innovation will only intensify. Calling it a trade war is not only misleading but also an understatement of what is really going on between the two most powerful countries in the world.²⁶

The US and its partners have two pressing concerns. First, China is seeking technological superiority in fields — AI, robotics, autonomous vehicles, augmented reality — that will be crucial for military, not just civil, innovation. The US and its allies need to maintain their edge on the battlefield.

There is a school of thought which maintains that the main target of USA is Huawei. It is expected to take the lead in 5G technology. If that happens, it will be the first time somebody not from West will take the lead in Telecom and IT industry. This will have a far-reaching effect for the future.²⁷



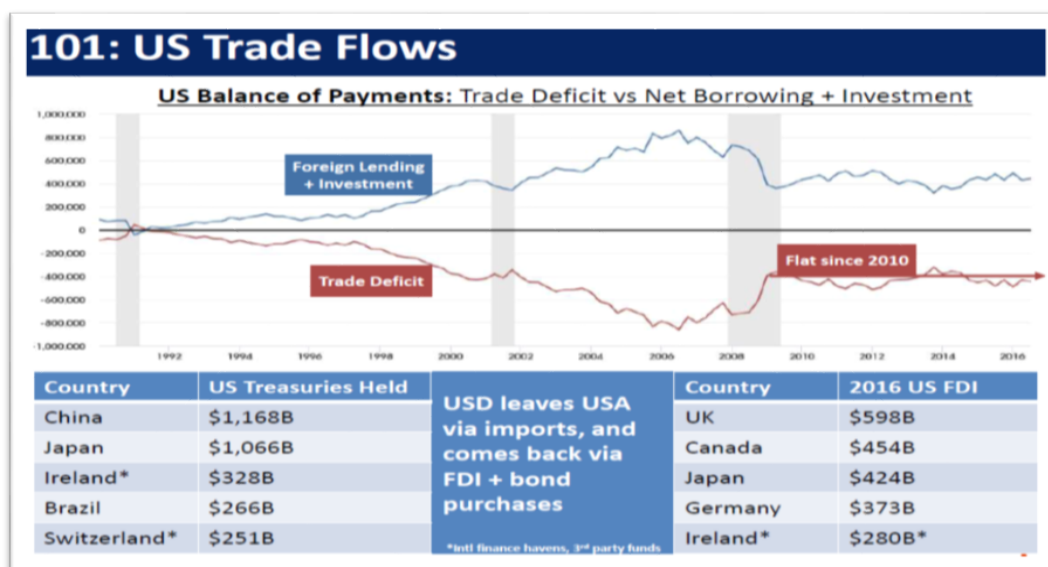
China’s Holdings of US Public and Private Securities

China’s holdings of the US public and private securities constitute the largest category of Chinese investment in the US. These securities include US

26. Geoffrey Garrett, “Why the US-China ‘Trade War’ is Really About the Future of Innovation”, The Wharton, April 9, 2018 available at: <http://knowledge.wharton.upenn.edu/article/u-s-china-trade-war-really-future-innovation/>

27. Gordon Watts, “5G becomes the Latest Battlefield in US-China Tech War”, available at: <http://www.atimes.com/article/5g-becomes-the-latest-battlefield-in-us-china-tech-war/>

Treasury securities, US Government agency securities, corporate securities and equities (such as stocks). China’s investment in public and private US securities totalled \$1.63 trillion as of June 2016, making it the second largest holder after Japan. The US Treasury securities, which help the federal government finance its budget deficits, are the largest category of the US securities held by China. China’s holdings of the US Treasury securities rose to nearly \$1.19 trillion in 2017, making China the largest foreign holder of US Treasury securities. In 2017, China’s holdings of the US Treasury securities as a share of total foreign holdings rose to 18.8 percent.²⁸



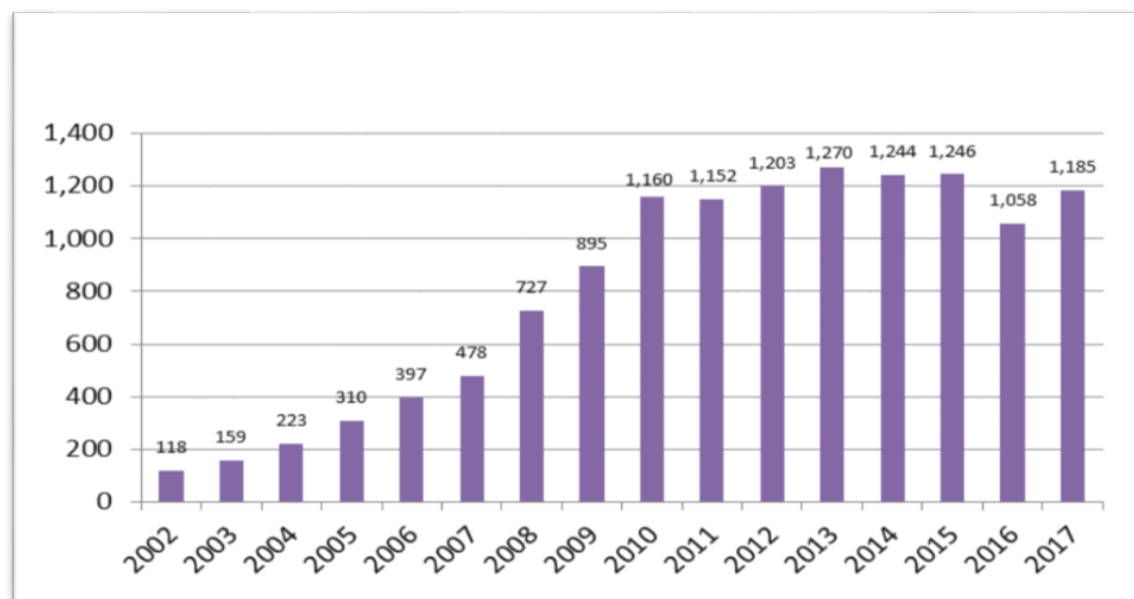
Some analysts and members of the US Congress have raised concerns that China’s large holdings of the US debt securities could give it leverage over the US foreign policy, including trade policy. They argue that China might attempt to sell or threaten to sell a large share of its US debt securities over a policy dispute, which could damage the US economy. Others counter that China’s holdings of the US debt give it very little practical leverage over the US. They argue that, given China’s economic dependency on a stable and growing US economy, and its substantial holdings of the US securities, any attempt to try to sell a large share of those holdings would likely damage both the US and Chinese economies. This could also cause the US dollar to sharply depreciate against global currencies, which could reduce the value of China’s remaining holdings of US dollar assets.

The US Secretary of Defence issued a report in July 2012, stating that “attempting to use US Treasury securities as a coercive tool would have limited effect and likely would do more harm to China than to the US. As the threat is not credible and the effect would be limited even if carried out, it does not offer China deterrence options, whether in the diplomatic, military, or economic realms, and this would remain true both in peacetime and in scenarios of crisis or war.”

28. Wayne M. Morrison, “China-US Trade Issues”, April 16, 2018, available at: <https://fas.org/sgp/crs/row/RL33536.pdf>

China's Holdings of US Treasury Securities: 2002-2017

(\$ in billions)



(Source: US Department of the Treasury)

Could China use its role as No. 1 lender to exert pressure in a trade war? It would be a risky manoeuvre, in which China itself would potentially have much to lose. But, it cannot be ruled out. If China were to suddenly unload some of its holdings, or even signal an intention to buy fewer dollar assets in the future, that would probably cause long-term interest rates in the US to rise, at least temporarily. And this would cause some pain in the US, as borrowing costs would rise. Furthermore, China needs to maintain significant reserves of the US debt to manage the exchange rate of the renminbi. Rise of currency's exchange rate would make the Chinese exports more expensive in foreign markets. It would also drive down the value of China's existing bond portfolio, meaning China could lose billions. And, it would tend to push down the value of the dollar relative to other currencies, which would actually help the US attain more advantageous trade terms. As such, China's holdings of the American debt do not provide China with undue economic influence over the US.²⁹ That doesn't mean there isn't room to cause some near-term pain and disruption. The Chinese have some leverage to rattle the US bond markets, even if the threat of substantive action is not very credible.

Given that a trade war with such a major trading partner is without precedent in modern times, we don't really know what it would look like. But, it's a safe bet that Chinese officials are already thinking through their options in case that is where the latest round of economic sabre rattling ultimately leads.³⁰

29. "Is it a Risk for America that China holds over \$1 Trillion in US Debt?" available at: https://chinapower.csis.org/us-debt/?utm_source=CSIS+All&utm_campaign=9876bdd0d0-EMAIL_CAMPAIGN_2018_03_02&utm_medium=email&utm_term=0_f326fc46b6-9876bdd0d0-174083245

30. Neil Irwin, "If There's a US-China Trade War, China May Have Some 'Unconventional Weapons'", The New York Times, April 5, 2018, available at: https://www.nytimes.com/2018/04/05/upshot/us-china-trade-war-unconventional-retaliation.html?emc=edit_mbae_20180405&nl=&nid=7575417020180405&te=1&login=smartlock&auth=login-smartlock

Why does China Buy US Debt?

China's large US Treasury holdings say as much about the US power in the global economy as any particularity of the Chinese economy. The US debt is an in-demand asset. It is safe and convenient. As the world's reserve currency, the US dollar is extensively used in international transactions. Trade goods are priced in dollars and due to its high demand, the dollar can easily be cashed in. Furthermore, the US Government has never defaulted on its debt.

Reconciliation

There has been lot of rhetoric and statements from both sides. The standard protocol in a trade dispute is: One country takes action against another country, which hits back with a proportional response and then both sides call a *de facto* truce.

Neither Washington nor Beijing's tariffs will take effect immediately. The US had laid out a roughly six to eight week period for the tariffs to receive public comment before going into effect. China's announcement, on the other hand, did not include a date. Beijing is hoping backdoor discussions will persuade Washington to hold off on the tariffs, thus preventing the need for retaliation. China would not implement its tariffs until after the US takes action. China would adjust its decision based on what the US does. Trump has to decide whether to accept something like the deal offered by the Chinese or to proceed with the tariffs on \$50 billion of imports. China then would certainly proceed with the matching tariffs on \$50 billion that it has identified.

It has been observed that whenever Trump or his officials talk tough on China, the US stock market falls. Whenever there is more conciliatory talk about negotiating an agreement, markets rise. This is an indication that major companies have a lot at stake in resolving the dispute, preferably with some better market access, rather than having a trade war. Also, there are a number of farmers in Trump country who have a lot to lose if exports to China are penalised. There are strong incentives for Trump to accept something like the deal offered by China and to declare victory.

China, which is worried about the health of its financial sector, appears to be willing to open up certain markets, responding to domestic concerns. Details remain in the works. Beijing already has shown willingness to make several concessions to Washington including:-

- Reducing investment restrictions on financial, automotive and other sectors.
- Offering to increase the market access on restricted financial and service industries.
- Purchases of various US exports, such as liquefied natural gas and semiconductors.

But, China has so far been making offers that carefully align with its own domestic reform priorities. As its domestic market grows more robust, it is not likely to concede to changes that alter the foundation of its heavily state influenced economy, which is what hawkish US negotiators want most.

On April 10 2018, at the Boao Forum for Asia known as ‘China Davos’, Xi Jinping made some eagerly-awaited statements in his keynote address. Some of these were:-

- In the automobile area, in addition to the tariff reduction on cars, Beijing would permit more foreign investment in domestic auto companies and financial services and greater protection for intellectual property.
- International Import Expo would be held in Shanghai in November “to open up the Chinese market.”
- He said that China’s door of opening up will not be closed and will only open even wider.
- Xi reiterated a call for developed nations (US) to ease restrictions on high tech exports to China. That is not about to happen, with Washington citing national security concerns that such technologies would find their way into China’s defence industry.
- While making no direct mention of the trade war with the US, he said a ‘zero-sum’ and ‘Cold War’ mentality looks even more out of place than ever in the modern world.

The Chinese President Xi Jinping’s speech assuaged investors’ concerns about a potential trade war, at least temporarily. The overt message was that China would continue to gradually open up on its own terms and the implicit message was that American firms may lose out on the benefits if President Trump pursues the trade war. The Trump administration’s trade policy team—USTR Robert Lighthizer, Commerce Secretary Wilbur Ross, Treasury Secretary Steven Mnuchin, National Economic Council Director Larry Kudlow and National Trade

Council Director Peter Navarro— has been to Beijing to get China to commit certain actions that would enable tensions to come down. China has announced the suspension of its retaliatory tariffs, which cleverly singled out the products of the Republican farm states. Trump, on Twitter, suggested that the Chinese have “agreed to buy massive amounts of additional Farm/Agricultural Products.” At least for now, he appears to have dropped, or tempered, his demands for big, structural changes in how China treats domestic and foreign companies.³¹

It is clear that China is willing to negotiate some modest changes in policies and purchases that Trump could take as a victory, but that they are not willing to negotiate with a gun to their head. However, China was not willing to accede to a key US demand — to stop subsidising the 10 high tech industries targeted in the Made in China 2025 programme.

Oil and Gas

Vice Premier Liu He has reportedly offered to reduce the trade imbalance by \$50 billion through purchases of Liquefied Natural Gas (LNG), semiconductors and agricultural products. Buying LNG would be particularly smart for China because they need diversified sources and it could make a big dent in the bilateral deficit. China also reportedly offered to open up financial services more rapidly and to give the US firms access to the rapidly growing e-commerce market in China.³²

China has been scouring the world to feed its voracious energy demands, while the US has begun exports of crude oil and liquefied natural gas only in the past few years. The US was the fastest growing major crude exporter to China last year. It’s a similar story with natural gas. China is fast turning into the big beast of the global liquefied natural gas market, with import volumes doubling over the past two years. That trend is only getting started.

Chinese imports of petroleum and natural gas from the US are soaring. The LNG consumption has risen by 23 percent a year from 2016 to 2020, taking imports to 61.2 million metric tons annually from 26.2 million tons in 2016, according to Wood Mackenzie, a consultancy. According to the International Gas Union, total re-gasification capacity would rise to more than 100 million tons a year in 2022, at a time when the US liquefaction capacity would be approaching 70 million tons a year.³³ Although this would not wipe out the trade deficit, but some reduction would certainly take place.

31. John Cassidy, “Why China Is Winning the Trade War”, The New Yorker, May 23, 2018 available at: <https://www.newyorker.com/news/our-columnists/why-china-is-winning-the-trade-war>

32. David Dollar, “Is China Willing to Deal on Trade? What We Learned from Xi’s Recent Speech”, April 11, 2018 available at: <https://www.brookings.edu/blog/order-from-chaos/2018/04/11/is-china-willing-to-deal-on-trade-what-we-learned-from-xis-recent-speech/>

33. David Fickling, “China Can’t Cut Its Trade Gap by \$200 Billion”, May 18, 2018, available at: <https://www.bloomberg.com/view/articles/2018-05-18/china-can-t-cut-its-u-s-trade-surplus-by-200-billion>

USA Yielding Space to China

Trump's messaging on trade is accompanied by wider practical implications. Not only does the US policy allow China to play an increasing successful role in the domain of global institutional economic governance in established bodies like the IMF, World Bank and WTO, but also it encourages it to develop new bodies like the Asian Infrastructure Investment Bank (AIIB). While other actors such as the European Union (EU) and Germany and now France individually have aspirations, they are not playing a global leadership role reflective of their influence and standing. Threats to the international economics and political orders in the absence of both individual and collective leadership from the world's greatest power are real. While the US is still a major player in the overall economy of the Asia Pacific, it has effectively vacated the institutional playing field. Notwithstanding the target for the tariffs was China, the victims would be its allies, notably Canada, Germany and South Korea.³⁴

World Trade Organisation (WTO)

Unlike Great Britain, France, and other countries that exerted international influence through colonies, the US preferred to govern the world by establishing a series of international systems: the United Nations and its affiliates for the political and security arena; the alliance system and military base network in the military arena; the Bretton Woods system for finance and the General Agreement on Tariffs and Trade (GATT, which later evolved into the WTO) for trade in 1995.³⁵

State-State disputes

Most state-state disputes are handled by the WTO system, the primary body governing international trade. Each of its 164 members has agreed to the rules about trade policy, such as limiting tariffs and restricting subsidies. A member can appeal to the WTO if it believes another member is violating those rules. The US, for instance, has repeatedly brought WTO cases against China over its support for various export industries, including one in early 2017 alleging that Beijing unfairly subsidises aluminium producers. Although the case has not been decided, yet the Trump administration has already retaliated by unilaterally imposing tariffs on some Chinese aluminium producers.³⁶

China has stolen the US intellectual property rights and violated other trade obligations to the US. The Trump administration's policy on this subject has to deal with the following aspects:-

34. Richard Higgott, "From Policy to Populism: Donald Trump's Trade Policy in Global Context", Elcano Royal Institute, April 10, 2018, available at: <http://www.realinstitutoelcano.org/wps/wcm/connect/ae4e55bf-7b15-4798-8c43-9ad4e152b533/ARI47-2018-Higgott-From-policy-to-populism-Donald-Trumps-trade-policy-global-context.pdf?MOD=AJPERES&CACHEID=ae4e55bf-7b15-4798-8c43-9ad4e152b533>

35. Xue Li and Cheng Zhangxi, "Will China Replace the US Global Role?" The Diplomat, April 28, 2018, available at: <https://thediplomat.com/2018/04/will-china-replace-the-us-global-role/>

36. James McBride, "How Are Trade Disputes Resolved?" March 13, 2018, available at: https://www.cfr.org/background/how-are-trade-disputes-resolved?utm_medium=email&utm_source=dailybrief&utm_content=052418&sp_mid=56680848&sp_rid=bXVsbGJjay5wa0ByZWRpZmZrYWlsLmNvbQs2

- Launch a WTO complaint about ‘coerced transfers’, or China’s act of coercing intellectual property transfers by the US firms operating in that country. The Trump administration has shown little patience to go through a WTO process to address that.
- The Trump administration’s response to China’s alleged trade agreement violations with import tariffs.
- Restricting Chinese foreign investment in the US.

The US has two options to retaliate against another country for violating trade treaty obligations:-

- **The Legal Route.** It involves raising a complaint at the World Trade Organization, which would mean litigation to prove to a WTO panel that the other country violated a trade agreement, followed by a similar process at an appellate body. If the charge is proved, the other country would then be given a chance to comply with the rules. If it fails to comply, the appellate body would approve specific retaliation, all of which generally take about four years.
- **Not Following the WTO Process.** It risks pushing everyone into a trade war and a seriously dangerous downward spiral. Trump’s memorandum on the tariffs gives the US trade representative that option of pursuing the four year process, even if his rhetoric did not indicate that.

Criticisms of the WTO’s System

Most trade experts see the WTO’s arbitration forum as one of its most successful efforts, helping to institutionalise rules and reduce the threat of trade wars. However, critics, including the Trump administration, have criticised the WTO system on several grounds. The US Trade Representative (USTR) Robert Lighthizer has argued the WTO has an anti US bias because 134 complaints have been brought against the US, more than any other country, and it has lost most of those cases. But, many economists argue this is misguided, noting that complainant countries, including the US, usually win cases they bring to the WTO because they tend to bring only the strongest cases. As former USTR Michael Froman points out, the US under President Barack Obama brought more cases to the WTO than any other country during that time, including sixteen against China. The US won all those cases that have been decided.

Other analysts argue that the WTO has been increasingly undermined by its most powerful members, including the US. For instance, the Obama administration ignored a series of unfavourable rulings and blocked the appointment of a WTO judge for the first time.³⁷ The WTO rules, written before many of these technologies were even envisioned, are not adequate for regulating, say, digital trade. Rather than expressing disgust with the WTO, Trump should want America to lead it, as it has before — by rewriting rules that need to be updated and putting more teeth into the enforcement mechanisms.

Key Challenges Facing the WTO at Institutional Level

At the institutional level, key challenges facing the WTO are:-

- Decision making in the WTO is close to be paralysed. Consensus based decision making all too often turns into veto politics, incoherence and turf battles amongst members, yet consensus in some form or another remains essential to legitimacy and good policy implementation.
- The WTO has focused far too much on trade liberalisation since its creation. Large multilateral trade negotiations are no longer feasible and many other venues for sector specific negotiation exist.
- More attention needs to be paid to upholding the WTO's rule making function. The existence of the rules is more important than is understood by populist rhetoric as mechanisms for enhancing pre-commitment, levelling and compliance.
- The future of the WTO is in jeopardy unless responsible global actors can pick up the baton dropped by the US.³⁸

China has already officially filed a trade complaint against the US with the WTO over the steel and aluminium tariffs.

How does the WTO Adjudicate Cases?

The WTO's forum for arbitration is called the dispute settlement mechanism (DSM). The DSM is run by a rotating staff of judges, as well as a permanent staff of lawyers and administrators. The WTO appoints a panel to hear the case if the opposing parties are unable to resolve the issue through negotiations. A panel's rulings, if not overturned on appeal, are binding on the respondent country. If guilty, it has the choice to cease the offending practice or provide compensation. If the country fails to respond, the plaintiff country can take targeted measures to offset any harm caused, such as blocking imports or raising

37. Ibid.

38. Richard Higgott, "From Policy to Populism: Donald Trump's Trade Policy in Global Context", Eleano Royal Institute, April 10, 2018, available at: <http://www.realinstitutoelcano.org/wps/wcm/connect/ae4e55bf-7b15-4798-8c43-9ad4e152b533/ARI147-2018-Higgot-From-policy-to-populism-Donald-Trumps-trade-policy-global-context.pdf?MOD=AJPERES&CACHEID=ae4e55bf-7b15-4798-8c43-9ad4e152b533>

tariffs. Member states have filed more than five hundred disputes since the WTO's creation in 1995, but most of these cases have been settled prior to litigation.³⁹

The US officials have said are they are ready to talk with China. Both sides are making use of the procedures available in the WTO to reduce the risks of disputes escalating. The US has asked for consultations with China on intellectual property. It must be said that both sides appear reluctant to give the WTO's dispute procedure time to reach a conclusion. It does take many months - sometimes years. Of course the judgment won't inevitably be what the complaining country wants.

Even if they do retaliate without having been authorised by the WTO, the fact that both are making use of the procedure suggests they attach some value to the rules based system that the organisation manages.⁴⁰

China

When China joined the WTO in 2001, it was allowed in as a 'developing nation', subject to very low tariffs on its exports to West, but was permitted to impose high tariffs to protect its own rising industries from the US and European competition. The assumption was that as China grew and the WTO moved to a new regime, China would quickly cut its tariffs. But, the WTO still has not completed a new trade round and China has refused to voluntarily lower its tariffs.

China developed an industrial policy that often bent the WTO rules. The government gave away cheap land and state guided banks granted cheap loans for new industries, but foreign companies that wanted access to China's market were forced to pay to play — to have a Chinese partner and be willing to transfer their advanced technology to them. As a result, over time, Beijing was able to force multinationals to shift more and more of their supply chains to China, and grow Chinese competitors to Western companies in its protected market, and then, once they were big enough, unleash them on the world as giants.

Even when the US protested to the WTO — as in the case of how China unfairly kept the US credit card companies out, then lost the arbitration case at the WTO — China still dragged its feet before following through on promises made 17 years earlier to open up. By then, Chinese companies, like UnionPay, so dominated China's credit card market that the US companies, like Visa, were left with the crumbs.⁴¹ Subsidies are within China's WTO rights. Economies adapt to new competition and Chinese subsidies can generate innovation that has global benefits. Chinese solar subsidies, for example, both were unfair (they artificially shifted the locus of the solar cell production toward China and drove a lot of the

39. James McBride, "How Are Trade Disputes Resolved?" March 13, 2018, available at: https://www.cfr.org/background/how-are-trade-disputes-resolved?utm_medium=email&utm_source=dailybrief&utm_content=052418&sp_mid=56680848&sp_rid=bXVsbGJjay5wa0ByZWRpZmZtYWlsLmNvbQs2

40. Andrew Walker, "Are We on the Brink of a US-China Trade War?" BBC News, April 13, 2018, available at: <https://www.bbc.com/news/business-43715084>

41. Thomas L. Friedman, "The US and China Are Finally Having It Out", May 1, 2018, available at: <https://www.nytimes.com/2018/05/01/opinion/america-china-trump-trade.html>

competition out of business) and good for the planet (as Chinese scale and process innovation significantly lowered the cost of solar).

Emmanuel Macron of France, Germany's Angela Merkel and EU Trade Commissioner Malmstrom have all said Europe would be more than happy to participate in trade related discussions with Washington that are conducted in good faith and in accordance with the WTO rules. But, the bloc would not do so — in the words of the French leader in Brussels — "with a gun pointed at our head."

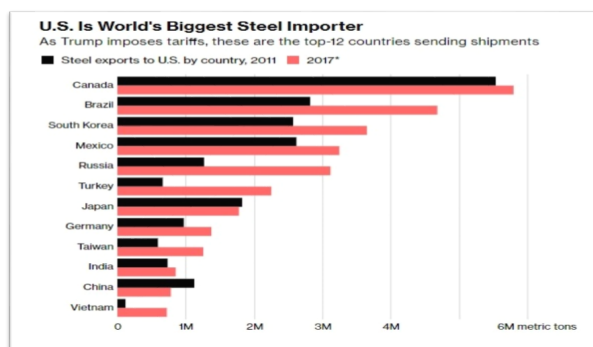
China's foreign currency reserves now stand at more than \$3 trillion. In contrast, the US has foreign exchange reserves that hover at around \$120 billion.

Trump's tariffs would automatically trigger penalties against the US in the WTO and might even lead to the WTO's collapse. While it might take a while for that to happen, the turmoil would be catastrophic for American business and employment. China, on the other hand, would emerge relatively unscathed.

European Union

The EU's response to the ongoing trade war between USA and China has been smart and measured. It shows that it will be difficult for the EU to maintain a middle course between the US, its primary market and second-largest supplier, and China, its primary supplier and second-largest market. One dimension that must be considered is security. It will be difficult to seriously undermine the transatlantic relationship without significant concerns about Europe's security guarantee.

During the past couple of decades, China has built a huge steel industry that now produces more than ten times as much output as the US steel industry does. China produces half of all the steel in the world. Rather than focussing on Chinese producers alone, the White House on March 1 announced that the new import levies—twenty-five percent on steel and ten percent on aluminium—would apply to all of America's trading partners, including close allies such as Canada and the EU.⁴²



(Source: US Commerce Department)

42. Rachel Tang, "China's Steel Industry and Its Impact on the US: Issues for Congress", Congressional Research Service, September 21, 2010 available at: <https://fas.org/sgp/crs/row/R41421.pdf>

The EU has taken note of the temporary exemptions that the US has granted and would like them to be permanent. The EU has been treated differently from China at its own request. South Korea has also received exemptions, and Japan is considering how far it can go in resisting Trump.⁴³ Political pressure on the EU is likely to increase as China and others affected by the US tariffs would try to redirect their supplies to the EU, increasing competitive pressures on the European firms. Will the EU be able to keep its borders open, or will lobby pressures become so great that the EU will also feel compelled to raise tariffs?

After meeting Angela Merkel, the German Chancellor, at the White House, Trump brought up the US steel industry, saying its success was vital to national security. But, he also discussed the US trade deficit in goods with the EU, which was \$151.4 billion last year, saying he was committed to “remedy these trade balances.” Trump singled out the auto industry, seemingly oblivious to the fact that General Motors and Ford have for many decades maintained extensive manufacturing operations in Europe. Since the nineteen-nineties, BMW and Mercedes-Benz have had plants in the US. Later, Merkel, the French President Emmanuel Macron, and British Prime Minister Theresa May spoke over the telephone, and Merkel issued a statement that Europe was “resolved to defend its interests.” The European Commission issued a statement, “As a longstanding partner and friend of the US, we will not negotiate under threat. Any future transatlantic work program has to be balanced and mutually beneficial.”

The EU has already drawn up a list of more than \$3 billion worth of US products — such as bourbon, tobacco, and Harley-Davidson motorcycles — that will be subject to retaliatory tariffs. Canada, too, announced its targets for retaliatory tariffs on everything from toilet paper to ballpoint pens. Reprisals from Canada and Mexico would hit the US economy even harder than the EU measures, as Mexico buys almost as many US goods as all of Europe. Enough progress was not achieved in discussions with the EU over trade concessions and Canada and Mexico on rewriting the North American Free Trade Agreement to give them permanent exemptions from the metals tariffs. The EU, Canada and Mexico together account for about 40 percent of the US steel imports.

After months of threats and a flurry of last-minute negotiations with Canada, Mexico, and Europe, the US went ahead and levied a 25 percent tariff on imports of steel and a 10 percent tariff on aluminium imports. The US Commerce Secretary, Wilbur Ross, said the tariffs would go into force from June 1, 2018. Canada and Mexico, the US’s biggest trading partners along with the EU, would also not be granted waivers from the punitive tariffs.

43. Mercy A. Kuo, “EU in Global Trade System: Balancing the US and China”, *The Diplomat*, April 24, 2018 available at: <https://thediplomat.com/2018/04/eu-in-global-trade-system-balancing-the-us-and-china/>

The reactions from the affected countries have been sharp and swift. In public statements in capitals from Ottawa and Brussels to Washington and Mexico City, politicians expressed their frustration and puzzlement at the US move. The European Commission President, Jean-Claude Juncker, tweeted: "It's a bad day for world trade. The US leaves us no choice but to proceed with a WTO dispute settlement case and the imposition of additional duties on a number of US imports. We will defend the EU's interests, in full compliance with international trade law." The EU Trade Commissioner, Cecilia Malmström, said in a press statement: "The US has sought to use the threat of trade restrictions as leverage to obtain concessions from the EU. This is not the way we do business, and certainly not between longstanding partners, friends and allies." The French Finance Minister, Bruno Le Maire, said that the US authorities "have to decide whether they want to enter a trade war with their closest partners." On May 31, 2018, the German Chancellor, Angela Merkel, said that the EU would prepare a "smart, determined and jointly agreed" response if the US refused to grant the exemption, noting that these tariffs are "not in line with World Trade Organisation rules." Her Finance Minister Olaf Scholz echoed this, informing Reuters that the EU's response must be "clear, strong, and smart."⁴⁴ The Canadian Prime Minister, Justin Trudeau, said the tariffs are an affront to the "long-standing security partnership" and to the Canadian and American soldiers who have fought and died alongside one another. "We have to believe that at some point common sense will prevail, but we see no sign of that in this action today by the US administration," Trudeau said at a press conference. The Mexican Economy Minister, Ildefonso Guajardo, said President Donald Trump "shot himself in the foot" with the tariffs. The EU has indicated it could target \$3.3 billion in American products. Both the EU and Canada said they intend to proceed with a case at the WTO against the US import restrictions.

The European Union is already preparing import restrictions of its own to shield its producers from a flood of any excess steel that is diverted away from the US market due to the tariffs. The US tariffs affect €6.4 billion (\$7.5 billion) worth of EU exports. Popular US products like bourbon, jeans, and peanut butter are likely to be slapped with duties as part of the EU's response. The EU said it would take immediate steps to retaliate, while Mexico vowed to impose duties on everything from US flat steel to cheese. Canada's Government announced it will impose tariffs on as much as \$16.6 billion (\$12.8 billion) of US steel, aluminium and other products from July 1. The EU further said it would challenge the US decision at the WTO. The EU and Japan issued a joint statement condemning the metals tariffs and saying the possible duties on cars "would cause serious turmoil in the global market and could lead to the demise of the multilateral trading system based on WTO rules." Worries are mounting about the prospect of a trade

44. Jill Petzinger, "A Previously Unthinkable US and EU Trade War Has Begun", Quartz, May 31, 2018 available at : <https://qz.com/1293592/trade-war-begins-trump-slaps-steel-and-aluminum-tariffs-on-the-eu-canada-and-mexico/>

war as the Trump administration also considers tariffs on US auto imports, which could hit top suppliers from Mexico, Canada, Japan and Germany.⁴⁵

EU and China

China needs the EU because EU is Beijing's biggest trading partner and they trade over \$1 billion in goods and services a day. The EU is also the biggest investor in China. At the end of 2015, the value of European investments in China was about \$207 billion, compared to about \$84 billion from the US at that time. Behind the numbers, a hefty portion of Europe's direct investment comes from factories which manufacture high-end appliances in China that come with a European label. The trade and investment relationship between China and the EU is strong enough that China can survive loss of access to the US market if the EU remains open for business.

China's Belt and Road Initiative includes ports in European waters and railroads that cut through the EU nations, and while some countries welcome the infrastructure — paid for and built by the Chinese — others fear it would give China broad influence in the more politically unstable Central and Eastern European nations. The EU Ambassadors' report says, the Initiative "runs counter to the EU agenda for liberalising trade and pushes the balance of power in favour of subsidised Chinese companies," The only Ambassador who did not sign its contents was Máté Pesti of Hungary, a nation which relies heavily on Chinese investment. Hungarian Prime Minister Viktor Orbán said in January, "Central Europe has serious handicaps to overcome in terms of infrastructure ... If the European Union cannot provide financial support, we will turn to China." Western European nations are concerned about weaker countries getting close to Beijing. On a state visit to China in January, French President Emmanuel Macron sounded the alarm: "For China, the new Silk Roads are also a tool to promote new international standards, rules and norms that are different from those currently used by France and other European countries ... By definition, these roads can only be shared. If they are roads, they cannot be one way."⁴⁶

The insular US approach to trade might just push Europe and other countries towards closer economic ties with China, the world's second-largest economy. Since coming into office, the Trump administration has taken a protectionist approach to trade and has moved away from the ambitious, multilateral trade deals that were a hallmark of the Obama administration. Trump pulled out of the Trans Pacific Partnership (TPP), envisioned as a 12-nation trading bloc and did little to advance similar talks with the EU. Other countries in Asia and Europe tried to prop up global free trade — the remaining TPP countries plowed ahead

45. Andrew Mayeda and Jenny Leonard, "Trump's Tariff Assault Risks Sideswiping His Strongest Allies", June 1, 2018, available at: <https://www.bloomberg.com/news/articles/2018-05-31/trump-s-tariff-assault-risks-sideswiping-his-strongest-allies>

46. Erica Pandey, "China Tries to Enlist European Allies in Trump's Trade War", April 20, 2018, available at: <https://www.axios.com/china-european-union-belt-and-road-initiative-trade-war-a3c85e28-c1fc-4e11-a299-e5446b54ec89.html>

without Washington, and Brussels was busy advancing trade deals with Canada, Mexico and Japan. But, the knock-on effects of the Trump administration's tariffs would further dent global free trade.⁴⁷

Effect on Other Countries

Trump's assault on the rules based order extends also to trade. While Trump has blinked on China by putting on hold his promised sweeping tariffs on the Chinese imports to the US, he has attempted to coerce and shame US allies like Japan, India and South Korea, even though their combined trade surplus with the US – \$95.6 billion in 2017 – amounts to about a quarter of China's. Trump has forced South Korea to accept a new trade deal, and has sought to squeeze India's important information technology industry – which generates output worth \$150 billion per year – by imposing a restrictive visa policy. As for Japan, Trump forced a reluctant Japanese Prime Minister Shinzo Abe to accept a new trade framework that the US views as a precursor to negotiations on a bilateral free trade agreement.

Some of the losers in this trade war would be:-

- US allies in the Far East like Japan, South Korea and Taiwan that are deeply integrated into the manufacturing processes of high end consumer products like smartphones. Japan and South Korea, for example, are big exporters of integrated circuits to China, where they get used in the final assembly of electronic devices which are then shipped to the US and other countries.
- European companies whose production chains have roots in both the US and China are at risk. One example is BMW, a German car-maker that manufactures its automobiles in the US and sells them to the Chinese. Beijing's retaliation package includes action against the US autos.
- International suppliers that work with American companies like Boeing, one of China's targets, could feel the burn if Beijing starts cancelling orders and Boeing, in turn, slows down production. Boeing has suppliers in Japan, Italy, the UK and Canada. The American farmers, who are the targets of China's proposed soybean tariffs, would be hurt as they lose access to the Chinese market.
- Chinese and American consumers, who would see higher prices if tit-for-tat tariffs keep escalating.

47. Keith Johnson, "Trump's Steel Tariffs on Allies Complicate Bigger Problem: China", May 31, 2018, available at: <https://foreignpolicy.com/2018/05/31/trumps-steel-tariffs-on-allies-complicate-bigger-problem-china/>

- China, the world's largest consumer of pork, is targeting American pork and soybeans, which are often used to feed pigs in China. As prices for both those products rise, it would be more expensive to eat pork across China.

Some of the winners in this trade war may be:-

- International companies that compete with the American ones could see a sales hike.
- Airbus could gain from Boeing's loss of sales to China, although Boeing might make up for the loss of the Chinese market by diverting to India and the Middle East.
- The Japanese car-makers could benefit if retaliation slows the American auto sales in the Chinese market.
- Latin American exporters of soybeans could partially satisfy China's demand for the product as Beijing turns away from American farmers, but it's unclear whether there's enough growing capacity in South America to replace the US as a source.

India

NITI Aayog Vice-Chairman Rajiv Kumar who had a meeting at the fifth Strategic Economic Dialogue (SED) with his Chinese counterpart He Lifeng, the Chairman of China's top planning body the National Development and Reform Commission (NDRC), in Beijing on April 14, 2018 said: “India would not take sides in the ongoing trade spat between the US and China”. He also said, “India has always taken an independent position on trade issues”. In his address at the SED, Rajiv Kumar made a strong pitch for China to allow India's exports of soybean and sugar. Elaborating on his stand in asking China to import soybean and sugar from India, he said, “My hint was much more towards agricultural tariffs in China than anything else”. China's agricultural tariffs are high and India's agricultural exports suffer as a result of it.⁴⁸

According to a study by economists at Rabobank International, India's economy would be hit hard by a combination of a global tariff war and the US Federal Reserve's monetary tightening cycle. A tariff war would reduce exports and lead to imported inflation, which would hurt Indian purchasing power and investments. That could mean as much as 2.3 percent of missed GDP growth for India by 2022. “India could fall victim to adverse trade policies” of the US or China or both. This goes against the argument that India is relatively insulated

48. “India Says Will Not Take Sides in US-China Trade Spat”, The Indian Express, April 15, 2018 available at : <http://indianexpress.com/article/india/india-says-will-not-take-sides-in-us-china-trade-spat-5138441/>

from a trade war, given its low share of total world exports of just 1.7 percent. Besides a possible trade war, a faster than expected tightening of US monetary policy would lead to capital outflows. In such an event, the Rabobank model sees the rupee depreciating sharply and the missed capital flows would amount to \$32 billion by 2022.⁴⁹ It is stated that “If India uses its foreign reserves in such a case, interest rates could rise sharply as liquidity decreases. Even though India’s reserves are substantial, markets might still become concerned about the prospects of further declines. These developments will create major speed bumps on India’s road to economic prosperity.”

In an article published in *The Mint*⁵⁰ this issue has been explained. India should not remain complacent that Washington would not threaten New Delhi for enhanced market access in agricultural and dairy products and medical equipment. Although India’s trade surplus with the US is little over \$25 billion with the US, Washington reckons India as a big market for its dairy and agricultural products and medical equipment. The statements of President Trump on a trivial issue like tariffs on Harley Davidson motorcycle were not a good omen. In the dairy sector, India made significant strides for becoming self-sufficient thanks to ‘Operation Flood’ and ‘White Revolution’ launched by Verghese Kurien in 1970. The US remains determined to export its heavily subsidised dairy products to India that could wipe out the livelihood of millions of poor people engaged in the domestic dairy sector.

On May 9, 2018 the US filed a counter-notification for the first time since the establishment of the WTO against India, alleging that India’s market price support (MPS) programmes for wheat and rice breached New Delhi’s allowable levels of trade distorting domestic support. The US, which has a range of trade distorting support programmes for rice and other items, is targeting India after blocking the permanent solution for public stockholding programmes for food security. The US also launched a trade dispute against India on duty drawback and other programmes for Indian exporters. The US also wants to deny the generalised system of preferences (GSP) preferential market access for Indian textiles, leather and other products.⁵¹ Last but not least, the US wants to terminate the special and differential flexibilities for India, China and South Africa, among others. Unless New Delhi stands strong like China, without yielding ground and offering market access whenever Trump blows hot and cold, the government could worsen the plight of its hundreds of millions of poor farmers in the days to come.

India has complained to the WTO against the US’ tariffs on steel and aluminium imports citing inconsistency with global trade norms. New Delhi listed

49. Anirban Nag, “India May Become Surprise Victim of Trade War”, April 18 2018, available at : <https://www.livemint.com/Politics/hkTJ26wckCtx5PoqzIC9N/India-may-become-surprise-victim-of-trade-war-says-Rabobank.html>

50. D. Ravi Kanth, “Lessons for India from the US-China Trade War”, available at <https://www.livemint.com/Opinion/NOPsqYFGLbzUczPHLaJCRI/Lessons-for-India-from-the-US-China-trade-war.html>

51. *Ibid.*

multiple violations of WTO norms such as discrimination against its imports, introduction of restrictions in form of quotas and using tariffs to get other countries to agree to "voluntary export restraints" as the basis for the complaint.⁵² India said the US duties of 25 percent and 10 percent on imports of steel and aluminium products respectively, are inconsistent with provisions of the WTO's General Agreement on Tariffs and Trade (GATT) 1994 and of the Agreement on Safeguards in the request for dispute consultations.

China, India's largest trade partner, can definitely help with all that by buying more from India to cut down last year's trade surplus of \$51.7 billion. China is doing some of that. India's exports to China last year increased 39.1 per cent to \$16.3 billion. But, there is still a long way to go because China takes only about 4 percent of India's exports.

Key International Challenges

Internationally, the key challenges are:-

- Managing the combative economic relationship between the US and China.
- The slower growth in the transatlantic area (the US and Europe).
- The role of regional trade agreements (RTAs).

But, a trade war would exacerbate the weakening of, if not destroy, the liberal norms of openness that have characterised the global trading regime since the end of World War II. It would detract from China's infractions of the global trade system, cede moral high ground to China and very possibly strengthen its relations with Europe at the very time when transatlantic cooperation is also being weakened by US behaviour.

The role of regional trade agreements (RTAs) for the global trade regime is becoming even more theoretically. While there is a massive literature on the subject there is no definitive agreement on whether they are to be trade enhancing rather than defensive mechanisms in the wider geo-strategic game. Analysts and practitioners alike are not sure if RTAs are distractions or a complement to a more broad based approach to global trade governance.⁵³

Conclusion

China is unsatisfied with the degree of accommodation offered by the US and the US is uncomfortable with the strategic demands made by China. The

52. Kirtika Suneja, "Citing Discrimination, India Drags US to WTO on Steel, Aluminium Tariffs, ET Bureau, May 23, 2018, available at : [Http://economictimes.indiatimes.com/articleshow/64292453.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst](http://economictimes.indiatimes.com/articleshow/64292453.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst)

53. Richard Higgott, "From Policy to Populism: Donald Trump's Trade Policy in Global Context", Eleano Royal Institute, April 10, 2018, available at : <http://www.realinstitutoelcano.org/wps/wcm/connect/ae4e55bf-7b15-4798-8c43-9ad4e152b533/ARI147-2018-Higgott-From-policy-to-populism-Donald-Trumps-trade-policy-global-context.pdf?MOD=AJPERES&CACHEID=ae4e55bf-7b15-4798-8c43-9ad4e152b533>

Chinese allege that Washington has a hidden agenda of restricting China's development, while the Americans complain that China is acting overly aggressively. If China maintains its internal political stability and high economic growth rate, this tense transition period would continue for at least a couple more decades. Tensions would be further aggravated if the Chinese Government believes, as some Chinese analysts claim, that the more China "rises", the harder Washington will resist.

The US is heading into potential talks with several demands, and top among them is for China to reduce its trade deficit with the US by \$100 billion "immediately". But, it is an unrealistic request, given the time it would take to adjust supply chains and given the US consumers' demand for Chinese products. China certainly could not reduce the deficit by itself. Washington's second major demand is that China opens up more sectors to investment and trade without restriction, including automobiles. Given the possible contents of Xi's speech at the Boao Forum, this could end up being an area where both sides align.

America holds almost all the high cards in trade with China, and almost none of Beijing's supposed points of pressure are real threats. Most of the threats, for example, would hurt China's fragile currency far more than the sturdy US economy. The only element Washington lacked in previous administrations was political will to use its overwhelming power. So far, Trump has demonstrated such will, even in the face of withering criticism, especially at home.

In the political realm, however, Mr. Xi enjoys advantages that may allow him to cope with the economic fallout far better than Mr. Trump. His authoritarian grip on the news media and the party means there is little room for criticism of his policies, even as Mr. Trump must contend with complaints from American companies and consumers before important midterm elections in November. The Chinese Government also has much greater control over the economy, allowing it to shield the public from job cuts or factory closings by ordering banks to support industries suffering from American tariffs. It could spread the pain of a trade war while tolerating years of losses from state run companies that dominate major sectors of the economy.

Economically, both the US and China would lose from a trade war. Punitive tariffs would push up import prices, dent exports, cost jobs and crimp economic growth. Both sides would do best to avoid an outbreak of hostilities.⁵⁴

After the end of Cold War USA remained the sole superpower. China is fast rising power. USA has the advantage of science and technology and its innovation. China has rightly identified the emerging technologies and put in lot

54. Steven Lee Myers, "Why China Is Confident It Can Beat Trump in a Trade War", The New York Times, April 5, 2018, available at : <https://www.nytimes.com/2018/04/05/world/asia/china-trade-war-trump-tariffs.html>

of emphasis on innovation and technologies like artificial intelligence, quantum computing, 5G etc. USA would not let its supremacy in financial sector go easily. Every time some power like Japan, Germany or the EU came up as rival economic power or its currencies became competitors to the dollars in global market place, they have been cut down to size. Though China has its own internal fault lines it is treading carefully in the financial market place. With globalisation, WTO and intertwined economies it would not be easy for USA to subjugate China. There would be plenty of blood bath in financial market place. We will have to wait and watch.

There was a similar situation in 1985. The US trade deficit with Japan was substantial. Ronald Reagan, then US President pulled off a coup. He brought the US' main trade partners to the negotiating table to work out a multilateral pact. The pact entailed coordinated interventions in currency markets in order to depreciate the dollar with regard to the Japanese yen and German deutsche mark. And so, the Plaza Accord was born. The adjustment prompted a sharp rise in the yen and consequently an economic downturn in Japan. The US, after short-term relief, allowed the parties involved to adjust their policies. Japan then lowered the interest rate. But, given the overheated economy during the 1980s, the ultra-low interest rate ultimately led to an economic bubble two years later.

In 1985, the geopolitical climate was also very different from what it is today. Japan and West Germany were still heavily dependent on the US as part of the grand alliance against the Soviet Union. The US' position as leader of the Western bloc in a bipolar world order was also undisputed. Therefore, the US proposition to coordinate currencies faced relatively weak opposition. Geopolitics is much more complex today. The world's major economies no longer have a common adversary to unite against, which makes the task of bringing them to the negotiating table far more onerous.⁵⁵

China, with its rapid rise and geopolitical ambitions that run counter to US interests, is certainly no Japan. Japan invested in almost the whole manufacturing industry and exported products to the US, making it easy for Washington to hit the economy with tariffs and exchange action. China exports a lot of goods to the US which are dominated by foreign, even US companies. By this rationale, Washington would not see the expected results by imposing tariffs on China. Instead, the tariff move would hurt the well-being of its own people.

Trump is no Reagan. The chances of his achieving another economic coup like the Plaza Accord are low. The last of the ongoing trade war between USA and

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China has not been seen. The whole world is watching carefully. As the Chinese say, “May we live in interesting times”.

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