The New Era of Uncertainty in China-U.S. Economic Relations

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Abstract: China-U.S. Economic Relations are crucial for both countries and the world. Since the Trump administration, U.S.-China relations have witnessed a dramatic downward spiral not seen in 40 years. Average US tariffs on Chinese exports reaches as high as19.3 percent, which are more than six times higher than before the trade war began in 2018 and covers 66.4 percent of US imports from China. President Biden has largely maintained his predecessor's approach to trade with China. Biden also tries to establish a supply chain without China and adopt the "small yard, high fence" strategy. The economic and technological competition between the two economies is likely to continue, especially in an era of conflicts and geopolitical tensions. We are in the new era of uncertainty in China-U.S. Economic Relations.

1. Introduction

U.S. trade with China has grown enormously in recent decades and is crucial for both countries. Just a few years ago, the United States imports more from China than from any other country, and China is one of the largest export markets for U.S. goods and services. It has been described by world leaders and academics as the world's most important bilateral relationship of the century.

It is a relationship of economic cooperation and mutual suspicion over the other's intentions. Consequently, each country considers the other as a potential adversary and an extremely strong economic partner at the same time. A great amount of trade between the two countries necessitates positive political relations of some magnitude.

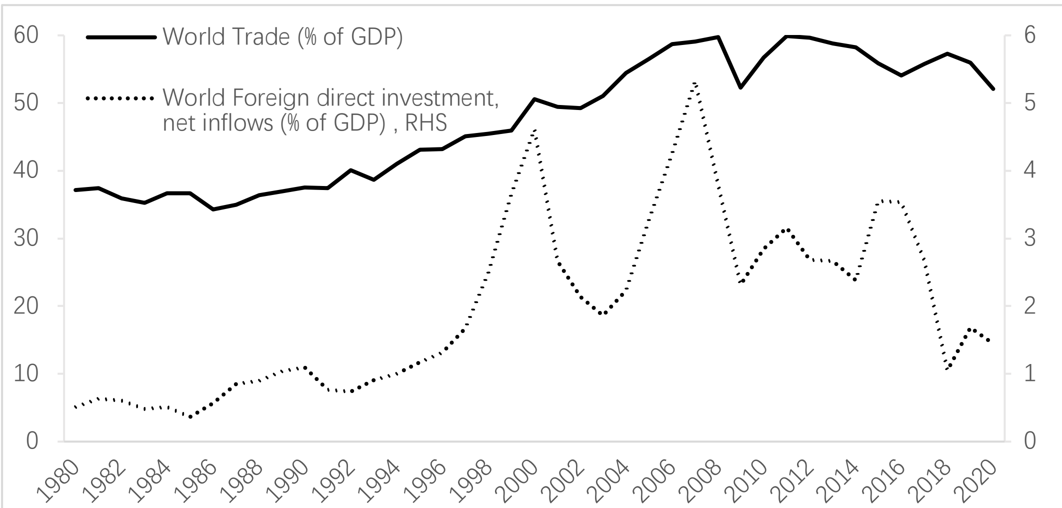
As China-U.S. competition intensifies in recent years, the China-U.S. economic relationship has reached a critical juncture and faces more uncertainty. To be specific , President Trump wielded tariffs in an effort to reshape the bilateral relationship. President Biden wants a more multilateral approach but is still crafting his response.

China-U.S. Economic Relations are in an new era of uncertainty.

2. Protectionism and Deglobalization

The breakup of the Soviet Union and global economic liberalization from the 1980s onwards led to about half of today's world population being integrated into the global economy. Labor supply became so abundant, and production capacity so large, that even periods of strong demand rarely succeeded in putting persistent upward pressure on prices and wages. However, even before the pandemic and Russo-Ukrainian conflict, protectionism and nationalism were on the rise. Tariff and non-tariff barriers were raised as the benefits of free trade were increasingly being called into question. Political support for globalization policies of free trade is waning fast. Today, the world economy is at risk of fracturing into competing security and trade blocs. The international network that connects our economies is fragile. We are witnessing new and alarming forms of protectionism and experiencing the longest period of trade stagnation in 70 years(see figure 1).

Figure 1 Globalization is slowing in recent years



Source: World Bank database.

One of the main driving factors is U.S.'s unilateralism. From 2018, former U.S. President Donald Trump started a series of trade wars with the world involving multiple battles with China as well as American allies. Each battle has used a particular U.S. legal rationale, such as calling foreign imports a national security threat, followed by

Trump imposing tariffs and/or quotas on imports. Subsequent retaliation by trading partners and the prospect of further escalation risked significantly hampering trade and investment, and possibly the global economy. And a lot of countries choose to impose retaliatory tariffs in response.

3. Trump era：The Trade War

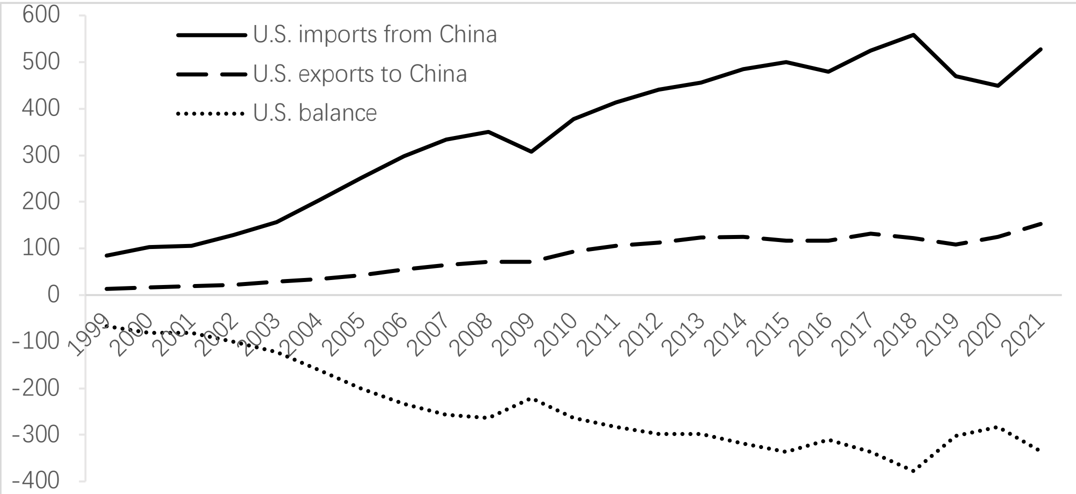
During the Trump era, U.S.-China relations have witnessed a dramatic downward spiral not seen since normalization. America's four-decade-long policy of strategic engagement with China has been largely abandoned. Washington has begun to view China as its biggest competitor and adversary, that is bent on challenging American primacy.

For thirty years following the establishment of the People's Republic of China in 1949, there was virtually no trade between the two countries as Washington had severed ties with Beijing. In 1979, the United States and China normalized relations, prompting an explosion of trade over the next four decades from a few billion dollars to hundreds of billions of dollars annually.

China aimed to boost trade and investment, and in 1986 Beijing applied to rejoin the General Agreement on Tariffs and Trade, the WTO's predecessor. After protracted negotiations with the United States and other WTO members, China joined the WTO in December 2001. WTO membership ensured "permanent normal trade relations," thereby providing U.S. and foreign companies additional certainty that they could produce in China and export to the United States. U.S.-China trade has exploded in the two decades since China joined the WTO. The value of U.S. goods imports from China rose from about $100 billion in 2001 to $500 billion in 2017(see figure 2). This leap in imports is due in part to China's critical position in global supply chains; Chinese factories assemble products for export to the United States using components from all over the world.

Figure 2 China-U.S. trade Surged Over the Past Two Decades

(Trade in goods and services, billions of dollars)



Source: U.S. bureau of Economic Analysis.

During the 2016 campaign, Mr. Trump pledged to get much tougher on trade with China, which he accused of "raping" the U.S. and causes huge deficit. As president, in August 2017, he directed the Office of the United States Trade Representative (USTR) to investigate Chinese economic practices. The resulting report, issued in March 2018, attacked many aspects of Chinese economic policy, focusing particularly on alleged technology transfer, which the report stated cost the US economy $225 billion and $600 billion annually. Following the issuing of the report, Trump ordered the imposition of tariffs on Chinese products, the filing of a WTO case against China and restrictions on Chinese investment in high-tech sectors of the US economy. The tariffs were imposed in 2018 and 2019 thousands of Chinese imports valued then at $370 billion, of which 250 billion with 25 percent tariffs and 120 billion with 7.5 percent tariffs.

On January 15, 2020, China and U.S. signed the agreement known as the "Phase One Agreement". Under the deal, China agreed to expand purchases of certain U.S. goods and services by $200 billion for the two-year period from January 1, 2020, through December 31, 2021, above 2017 baseline levels. But most tariffs stay the same. Average US tariffs on Chinese exports remain elevated at 19.3 percent. These tariffs are more than six times higher than before the trade war began in 2018. These tariffs cover 66.4 percent of US imports from China.

Despite all the tariffs and deals, the U.S. deficit doesn't change much. The U.S. trade deficit over the four years of President Donald Trump's presidency soared to its highest level since 2008. The combined U.S. goods and services trade deficit increased to $679 billion in 2020, compared to $481 billion in 2016, the year before Trump took office. The trade deficit in goods alone hit $916 billion, a record high and an increase of about 21 percent from 2016. In fact, the U.S. trade deficit is less a product of restrictions on U.S. imports than it is a reflection of a low U.S. domestic savings rate, which requires overseas capital to fund U.S. domestic investment needs and the growth in U.S. government debt.

4. Biden era: Limited Competition and Partial Decoupling

President Joe Biden's administration inherited Trump's idea of strategic competition between China and the U.S., and it still sees China as the biggest rival to US leadership and hegemony. U.S. Secretary of State Antony Blinken's tripartite framework, describing the U.S.-China relationship as "competitive when it should be, collaborative when it can be, and adversarial when it must be," has become the de facto China policy of Biden's administration. But unlike Trump, Biden has chosen a policy mix of limited competition and partial decoupling with China to prevent the conflict from escalating into a new Cold War. Another characteristic of Biden's China policy that separates him from Trump is that Biden has been much more effective in mobilizing allies to join hands in countering China.

President Biden has largely maintained his predecessor's approach to trade with China. Tariffs on Chinese goods and U.S. export controls remain in place, as do China's retaliatory tariffs on American exports. And the Biden administration talks with Beijing over its compliance with the Phase One deal. His administration has reportedly struggled to craft a trade approach to China due to internal disagreement, with some officials pushing for new trade deals in the region and others leery of them.

The main focus of Biden administration turns to supply chain and technology policy.

Supply chain excluding China

On February 24, 2021 President Biden signed Executive Order 14017 to secure America's critical supply chains. The Executive Order directed the Administration to immediately launch a 100-day review and strategy development process to address vulnerabilities in the supply chains of four key product categories, including: semiconductor, battery, critical materials, and pharmaceutical, with the outcomes of a review into six further sectors in February 2022.

Initiatives are underway to reshore some of these products back to the United States by revitalizing the country's industrial base. The latest example is the Chips and Science Act 2022 (Pub.L. 117–167), which the U.S. Congress recently passed to boost domestic semiconductor research, development, and manufacturing. Creating domestic jobs and subsidizing U.S. companies at home are much better talking points than shifting production from one foreign country to another. There has also been significant focus on "near-shoring," which involves moving supply chain to neighboring countries like Mexico or parts of Central and South America. The so called Inflation Reduction Act of 2022 (Pub.L. 117–169), which stipulates that by 2024, at least 50% of EV batteries must come from the U.S., Canada, or Mexico, with that figure rising to 100% by 2028. These markets have competitive labor costs, reduce lead times due to their proximity, and give the United States greater security over supply.

The efforts around reshoring and near-shoring are commendable, but they can't solve the problems around supply chain security by themselves. Not all manufacturing can move to the Americas. Some U.S. officials are also touting "friend-shoring," the practice of moving critical parts of the supply chain from the United States' rivals and adversaries to countries that are partners and allies. Russia's continued attempts to blackmail Europe by cutting off natural gas supplies are a powerful reminder of how dangerous it is to rely on unfriendly nations for the supply of critical goods and services. Though the United States no longer depends on other countries for energy, there are other sectors—particularly technology—in which China still plays an unduly dominant role in the U.S. supply chain.

For many good reasons, Asia will remain central to the U.S. supply chain. Some raw materials and components are only available in Asia. Certain types of complex manufacturing, particularly those related to semiconductors and other technology hardware, require a labor force with a specialized skill set that only exists at scale in a handful of countries. South Korea, alongside Japan and Taiwan China, is a very important market for the manufacture of high-technology products that are critical to the U.S. economy. The United States should continue to bolster the role these countries play. From a cost standpoint, however, Japan, Taiwan China, and South Korea will not always be suitable alternatives to China.

Technology: Small Yard, High Fence

The Trump administration not only launched a disruptive trade war against China, pursued a damaging decoupling of the two economies, but also imposed sanctions on Chinese high-tech giants such as Huawei and ZTE, carried out a witch-hunt of scientists accused of "stealing" American technologies on behalf of the Chinese government.

Acknowledging that a complete decoupling is unprofitable to U.S. interests, the Biden administration nevertheless believes the key to prevailing in the strategic competition against China is to protect its technological edge. Adopting a "small yard, high fence" strategy, the Biden administration is trying to decouple selectively in key technological fields including artificial intelligence, 5G, quantum computing, bioscience, etc. In the modality of a "precision strike," the competition with China will continue. "Small yard, high fence" means that the US government identifies specific technical and research areas directly related to national security (small yard), and delineates appropriate strategic boundaries (high fence) to protect its technological competitiveness. The US government would then tighten the blockade on core technologies in the "small yard" and reopen itself to China in some areas that are not in the "small yard."

5. Conclusion

The relationship between China and U.S. is quite strong though complex. Economy and trade relationship used to be the ballast in China-U.S. relations. But the tempo of new U.S. restrictions and ferocity of negative rhetoric are increasing. The economic and technological competition between the two economies is likely to continue even after the tariff war is settled. The Chinese economy will continue to grow at a faster real rate than the US economy and will likely surpass the US economy in terms of aggregate real GDP in the early 2030s. There are more and more uncertainties in China-U.S. Economic Relations, especially in an era of conflicts and geopolitical tensions.