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US-China Trade Conflicts and China's Economic Management as of August 2018

Naoki Umehara
Senior Economist
umehara@iima.or.jp
Emerging Economy Research Department
Institute for International Monetary Affairs (IIMA)

Deepening Trade Conflicts between the United States and China

In 2018 the Trump administration started to launch, despite criticisms in and out of the United States, trade negotiations with many countries, using an increase of tariffs as a weapon.

The United States announced in March that it would impose punitive tariffs on the $50 billion worth of imports from China as a counteraction against its “unfair” trade with infringement of intellectual property rights and coercing of technology transfers. In response to this, China dispatched in May two missions to Washington headed by Mr. Liu He, a reliable vice premier of President Xi Jinping and faced with the negotiations. However, they ended in failure due to a hardline stance of the U.S.[1] In early June, the two countries held a third meeting in Beijing, only to confirm a result of breakoff.

In such process of negotiations, the U.S. implemented tariff increase on $34 billion-worth of imports from China starting July 6, and China responded it with an immediate implementation of retaliatory tariffs in similar scale. The exchange of these retaliations led to an additional application of punitive tariffs on another $14 billion worth of imports, fulfilling U.S.’s initial target of higher tariffs on total imports worth $50 billion. Further, on September 24, the U.S. imposed 10% of punitive tariff on the $200 billion worth of imports. It meant that almost half of the imports from China, or $250 billion worth of them, to be covered by higher tariffs. Although

[1] The US government discussed the problems arising from China’s strategic economic policies in the following report. “How China’s Economic Aggression Threatens the Technologies and Intellectual Property of the United States and the World”, White House Office of Trade and Manufacturing Policy, June 2018, https://www.whitehouse.gov/wp-content/uploads/2018/06/FINAL-China-Technology-Report-6.18.18-PDF.pdf

China for the first stage showed a hard retaliatory stance against the U.S. punitive tariffs, it confined its response to an equivalent of $60 billion against the U.S. tariff increase taken September 24. That is because the U.S. said, if China had kept retaliation, it would impose punitive tariffs on the remaining items worth more than $260 billion, which means all the imports from China. This meant that the trade skirmish between the U.S. and China took a pause with a tentative concession on the Chinese side.

US-China Trade Conflicts Becoming "Protracted War"?

The Chinese room for negotiation has been narrowed by the tough stance of the United States. It would be unrealistic from China's domestic political situation that its authorities seek an easy conclusion by compromising with U.S. and take measures to realize "fair" economic policies with changes in intellectual property practices and abandoning industrial policies with subsidies. If so, the option would be a "protracted war (持久战)" strategy for which Mao Zedong showed the greatest talent. On September 26, Mr. Xi Jinping stated that China have to pursue the way of "self-reliance (自力更生)" supposedly indicating his determination to resist the U.S. the whole way.

A "protracted war" may be a chicken game that competes over which side can hold on the battle longer; that is a "battle of patience" over which of them first acknowledges its defeat through the economic pains caused by higher tariffs and etc.. In the U.S., there is a possibility that the Trump administration may lose support of the people following the possible defeats of the Republicans in the mid-term elections. However, this does not necessarily mean that the U.S. will return back to a pro-China attitude. It is too optimistic for China to think that the U.S. will become much easier to handle if the administration should change from the Republican to Democratic regime. If the import duties of 25% should become a "new normal" in the U.S.-China relationship, the U.S. may take next steps which even include a designation of China as a "country that manipulate foreign exchange rate against the dollar." The U.S.-China trade conflicts should not be viewed as a temporary disorder that the Trump administration aimed to win the elections. The U.S. has repeatedly requested China to correct its "unfair" trading customs and the Trump administration seems to be just doing it more strongly. It seems that deeper divisive factors exist beyond that.

The United States are threatened by China's growing national strength. This consciousness of crisis of U.S. has been rising especially from competition in the area of advanced technology that affects its military and security strength. The U.S. seriously considers what it should do to survive as a super power. Therefore, the competing and conflicting relationship between the U.S. and China will last for long. The world may be involved in this "battle of patience" or "protracted war". We need to share wisdom in considering how to deal with this and how to manage the risks resulting from it.

A Look back in a history

Let us look back a bit in history here. About 10 years after the start of reform and open-door policies, China experienced the Tiananmen incident in June 1989, when the western countries placed economic sanctions against China. However, the collapse of the Soviet Union in 1991 helped improve the relationship between China and the western countries including the United States. In December 2001, China became a member of the World Trade Organization (WTO) under U.S.'s support, for it expected that China would become a democratic country after economic development. China achieved a rapid growth in the 2000s benefitting from the open U.S. market. The U.S. wanted appreciation of Chinese yuan, however China, while implementing a reform of exchange rate system in 2005, succeeded in avoiding a rapid appreciation of the exchange rate in 2000s, which made possible China's economy to keep growing.

What changed this stream drastically was the eruption of the global financial crisis. The external pressure on appreciation of yuan exchange rate had dissipated and massive financial deregulation in China stimulated the economy, while it bred a proliferation of corruption. In autumn 2012, the Xi Jinping administration came to office on the occasion of 18^{th} Communist Party Congress. On one hand it promoted the policies like "Chinese Dream", "One Belt One Road" and "Made in China 2025" against a backdrop of its growing economic power, and on the other hand it strengthened internal control like limiting the freedom of speech and reinforced its dictatorial stance, placing itself at a distance from the western democratic regimes. In the 19^{th} Party Congress in autumn 2017, China expressed its intention to surpass the United States by 2035. As such, with the fading expectation that China would be eventually democratized, the Trump administration had been appealing the voters since the presidential election campaigns, in an easy-to-understand language albeit somewhat eccentric, that "there is a country which enforces the US companies a transfer of technologies, steals intellectual properties from them, and robs the wealth of the Americans." After taking office, it is trying to keep its commitments. It has approached the trade negotiations while taking into account the losses brought to the US companies and consumers. Its important goal is to make China understand fair trading rules and act based on them, but it also involves an issue of competition in advanced technologies.

It can be evaluated that in the past decade China has done fairly well at its economic management. Many emerging economies paid respects to China that has achieved a rapid economic development, evaluated favorably the "One Belt One Road" or Belt and Road Initiative and became members of the Asian Infrastructure Investment Bank (AIIB). The world has expectations on China for its enormous funding ability. On the other hand, however, China may have forgotten that it had received various supports from the western advanced countries when it made efforts to achieve economic development, and that it had been expected to be democratized sometime. It was in such a situation that the attitude of the U.S. to China suddenly changed in 2018. It is totally unclear when cooling trend of US-China relationship will come to an end.

China's Economic Management Policies since August 2018

Looking at the Chinese economy, the exchange rate of the yuan started to decline in mid-June in the face of intensifying trade rows between the U.S. and China, and stock prices have been flagging (Figures 1 and 2). While Chinese economy has been straddled with various problems, China accelerated in the past two years or so its efforts to reduce excessive debts or deleverage under the slogan of "supply-side structural reform". Since June this year, however, a cautious stance over the economy has developed at a stroke against the prospect that the solution of the trade conflicts with the U.S. became remote.

The middle of 2018 was inherently the period when the push-backs of the measures to support the economy taken before the Party Congress in the autumn 2017 tended to be generated. The measures included those for revitalization of the real estate markets in the small and medium sized cities. Although the Chinese government moved later in the year to control the real estate prices, the prices still continue to rise in some of the small and medium cities in 2018. If the rises become too excessive, the shocks would be quite large when the prices turn to fall in the future. Even in the case the prices start to weaken immediately, they might destabilize the economy depending on their speed. We see the growth of debts has been stabilized in the corporate sector reflecting the past efforts to promote deleverage, however, the growth of debts in personal housing loans remain relatively high, and there is a concern that the increase of the burden to repay the loans may have an adverse effect on the personal consumption.

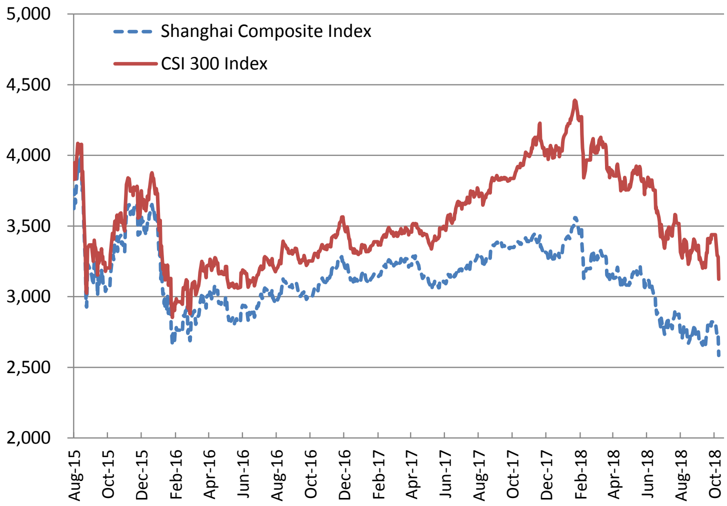
Premier Li Keqiang convened on July 23 a standing committee of the State Council, and he announced the policies to prop up the economy using both monetary and fiscal measures. This is considered to be to respond to the screaming calls from the localities. Further on July 31, a meeting of the Communist Party Politburo was held to discuss, based on the changing external environment and current economic conditions, the way of the economic management after August. The meeting decided to take somewhat easier management of monetary policy while maintaining its neutral stance, and to prop up the real economy by more aggressive fiscal policies including additional infrastructure investment. Yet it made it clear to avoid pork-barrel spending measures and continue to promote deleverages. It seems likely that while strengthening its cautious mode, the government will not substantially change the basic economic management policies that have been taken up to this point.

However, the steering of actual economic management has grown increasingly severe with consumption and investment starting to weaken. There may arise cases where the local small and medium companies will suffer heavier burdens. By the time the fourth plenary session of the Central Committee of the Communist Party is to be held this autumn or winter, there is a possibility that renewed economic policies will be announced. The political and economic development of China should be carefully monitored together with the development of the US-China trade conflicts.

Figure 1 Yuan Exchange Rates against the US Dollar (Shanghai Market Closing)

（出所）Thomson Reuters Datastream

Figure 2 Share Price Indices



（出所）Thomson Reuters Datastream

Address: 3-2, Nihombashi Hongokucho 1-Chome, Chuo-ku, Tokyo 103-0021, Japan
Telephone: 81-3-3245-6934, Facsimile: 81-3-3231-5422
〒103-0021　東京都中央区日本橋本石町 1-3-2
電話：03-3245-6934（代）ファックス：03-3231-5422
e-mail: admin@iima.or.jp　URL: https://www.iima.or.jp