The China-U.S. Trade War and Future Economic Relations

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*All opinions expressed herein are the author’s own and do not necessarily reflect the views of any of the organisations with which the author is affiliated.
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◆ The Different Measurements of the Bilateral Trade Balance
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◆ The Real Impacts of the Mutual Tariffs on the Two Economies
◆ Economic and Technological Competition
◆ Economic Complementarities between China and the U.S.
◆ Coordinated Expansion of Trade
◆ Concluding Remarks
Introduction

◆ The China-U.S. trade war actually started in January 2018, even though the first tariffs did not actually take effect until mid-2018. Thus far, the trade war does not seem to have done too much noticeable damage to either the Chinese or the U.S. economy.

◆ In 2017, the Chinese economy grew 6.8%. In 2018, the Chinese economy grew 6.6%, exceeding the Plan target of 6.5%. For 2019Q1-Q3, the Chinese economy grew an annualised 6.2%, a decline of 0.6% from 2017. For 2019 as a whole, the target is between 6% and 6.5%. This target should be achievable without difficulty.

◆ The U.S. economy grew 2.9% in 2018, close to its long-run average of 3%. It grew 3.1%, 2.1% and 2.1% in 2019Q1, Q2 and Q3 respectively. The latest forecast made by the U.S. Federal Reserve Board for the rate of growth in 2019 is 2.3%, a decline of 0.6%.

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Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y

Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y

Percent per annum

Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y

GDPQ1 GDPQ2
GDPQ3 GDPQ4
Monthly Rates of Growth of Real Value-Added of the Chinese Industry, Y-o-Y
Introduction

- Even if the Phase 1 agreement is signed, as U.S. President Donald Trump has announced, in Washington D.C. on 15 January 2020, a large proportion of the tariffs, especially on Chinese exports of goods to the U.S., will remain in effect. The Phase 1 Agreement will take effect 30 days after signing. But at least the situation is stabilized, and a great deal of uncertainty is eliminated.

- However, it is also inevitable that there will continue to be economic, technological and geo-political competition between China and the U.S., the two largest economies in the world. This is because the U.S. has been the unchallenged leader of the non-Communist world since the end of the Second World War in 1945 and the sole hegemon since the dissolution of the former Soviet Union in 1991. Some people in the U.S. feel that its global leadership position is threatened by the rise of China even if China professes not to wish to replace the U.S. And it is better to take on China sooner rather than later.

- The economic and technological competition between China and the U.S. will become the “new normal”. Moreover, the trade war itself might have damaged the longer-term relations between the two countries.

- It is also in part a reflection of the rise of populism, isolationism, nationalism and protectionism almost everywhere in the world, including in the U.S.
Introduction

- The chronically large China-U.S. bilateral trade surplus is the proximate cause of the current China-U.S. trade war, but there are other underlying economic, technological and geo-political causes as well.
- We begin by summarizing the chronology of the China-U.S. trade war.
- However, the two countries do not even agree on the size of the bilateral trade surplus. We shall show that the China-U.S. trade surplus, correctly measured, is not as large as it is made out to be, but is nevertheless still a large number.
- We then show that the gross value of the bilateral trade surplus does not reflect the relative benefits of the bilateral trade to the two trading-partner countries. Instead, we should look at the value-added (GDP) and employment generated directly and indirectly by the bilateral exports.
- In terms of both direct, indirect and total value-added generated by the exports of goods to each other, the China-U.S. bilateral gap is much smaller than that measured in terms of gross value of exports, and it appears feasible to close the gap with coordinated expansion of trade between the two economies within a couple of years.
Introduction

- We then analyse the real impacts of the mutual tariffs on the two economies. When two countries trade, they both benefit in the aggregate because their choice sets are enlarged. As long as the trade is voluntary, economic welfare must rise in both countries. A country always loses when it restricts its own choice set--its aggregate welfare will decline. But their trading-partner country will also lose. Thus, the mutual imposition of tariffs is a lose-lose proposition.

- However, it is also inevitable that there will be economic, technological and geo-political competition between China and the U.S., the two largest economies in the world.
Introduction

- We identify the economic complementarities between China and the U.S. The potential benefits from bilateral trade are higher when two economies are more different, with different endowments, existing capital stocks and comparative advantages.
- We then discuss the possibility of coordinated expansion of trade that can be win-win for both countries and consider how mutual economic interdependence can and should be enhanced.
- Finally, we discuss some Chinese economic policy options in the light of the trade war.
- Brief concluding remarks are made at the end.
The Chronology of the Trade War

- The trade war began in March 2018 with a Section 301 investigation of China by the U.S. Government, which resulted in a 25% tariff on US$50 billion, in two separate batches of US$34 billion and US$16 billion worth of Chinese exports of goods to the U.S., in June and August 2018 respectively.
- In September 2018, the U.S. imposed 10% tariff on US$200 billion of Chinese exports of goods to the U.S. and China announced a 5%-10% tariff on US$60 billion of U.S. exports to China.
- On 10 May 2019, the 10% tariff rate on the US$200 billion of Chinese exports was raised to 25%. However, the marginal effect of this increase in the tariff rate from 10% to 25% was not likely to be large because the 10% tariff rate would be already high enough to be almost prohibitive for most Chinese exports to the U.S. There simply is not that kind of profit margin for such exports for the tariffs to be absorbed by the Chinese manufacturers and exporters.
The Chronology of the Trade War

- Tariffs at a rate of 10% on the remaining approximately US$300 billion of Chinese exports of goods to the U.S. were ordered by President Donald Trump to take effect on 1 September 2019.
- This last batch of Chinese exports to the U.S. consists of products such as the Apple iPhones (around US$50 billion), personal computers, garments and shoes and packaged re-exports of semi-conductors. The incidence of the tariffs would be mostly borne by U.S. enterprises and households including Apple Inc. (One incidental and unintended beneficiary would be Samsung of South Korea whose Galaxy cellphones compete with the Apple iPhones and they are not subject to the new tariffs on U.S. imports from China.)
The Chronology of the Trade War

◆ However, on 13 August, U.S. President Donald Trump announced that the tariff will be delayed until 15 December on approximately US$160 billion worth of goods such as cellphones, laptop computers, shoes and toys, so as not to affect the Christmas shopping season. The tariff was dropped altogether on 25 types of products “based on health, safety, national security and other factors”.

◆ On 23 August 2019, it was announced that the 10% and 25% tariff rates would be raised by 5% to 15% and 30% respectively on 1 October 2019.

◆ However, as a gesture of goodwill, the U.S. postponed the 5% increase in the tariff rates to 15 October 2019.
The Chronology of the Trade War

◆ Chinese tariffs, with rates up to 25%, have also been imposed on US$110 billion of U.S. exports of goods, with $75 billion of which subject to increased tariffs on 1 October.

◆ However, on 11 September, the Chinese Government announced an exemption of Chinese tariffs on 16 types of U.S. goods including cancer drugs, lubricant oils and some specialty chemicals, for one year beginning on 17 September.

◆ Moreover, on 13 September the Chinese Government announced an exemption from tariffs for pork, soybeans and other agricultural imports from the U.S. and signalled that Chinese enterprises would be making large purchases of both pork and soybeans from U.S. suppliers. Subsequently there have been reports that actual purchases have been made by Chinese enterprises.
On 10-11 October, the Chinese and U.S. teams resumed their negotiations in Washington, D.C. and reached what was called a “Phase 1” Agreement, which provided for significant Chinese purchases of U.S. agricultural commodities of between US$40-50 billion and a delay in the implementation of new and increased tariffs scheduled for 15 October. There are also provisions for strengthening intellectual property protection and facilitating the provision of financial services.

On 13 December, both sides agreed to cancel the additional tariffs in different stages. In particular, the U.S. has not imposed the additional tariffs that are supposed to take effect on 15 December.

Meanwhile, China's General Administration of Customs and the Ministry of Agriculture and Rural Affairs are studying lifting the restrictions on US exports of poultry products to China.
The Chronology of the Trade War

- Under the Phase 1 Agreement, the full details of which are not yet known, China has apparently agreed to increase overall imports of U.S. goods and services by $200 billion over the next two years.

- China also announced that it would lower import tariffs for all trading partners on 859 types of products including frozen pork, pharmaceuticals and some high-tech components starting from 1 January. The plan will also cut import tariffs for more than 8,000 products even lower for countries and regions that have free-trade agreements with China, including Australia, South Korea, Iceland, New Zealand and Pakistan. Moreover, China will further reduce the tariff rates on some information-technology products and services from 1 July 2020.

- Ahead of the signing of the Phase 1 Agreement, U.S. President Donald Trump also pledged on 31 December that he would travel to Beijing to begin negotiation of a Phase 2 Agreement at a later date.
Chinese Surplus and U.S. Deficit with the World, Trade in Goods and Services

- Chinese Trade Surplus
- U.S. Trade Deficit

USD billions

Chinese Trade Surplus and U.S. Trade Deficit in Goods and Services as Percents of Respective GDPs

Annual Chinese Trade Surplus and U.S. Trade Deficit in Goods and Services as Percents of Respective GDPs

- Chinese Trade Surplus as a Percent of GDP
- U.S. Trade Deficit as a Percent of GDP
The Different Measurements of the Bilateral Trade Balance

♦ In 2018, despite the trade war and the tariffs, Chinese exports of goods to the U.S. in nominal US$ terms actually increased by 11.3% to US$478 billion. In real terms, the increase was even higher, because of the slight devaluation of the Renminbi in 2018. Part of the increase may be attributed to the acceleration of exports in anticipation of the imposition and increases of tariffs. U.S. exports to China actually declined by 7.3% to US$121 billion, reflecting the Chinese tariffs on U.S. agricultural commodities as well as U.S. restrictions on high-technology exports.

♦ The official U.S. estimate of the U.S.-China trade deficit in goods only in 2018 is US$419.6 billion, an increase from US$375.8 billion in 2017. The official Chinese estimate of the bilateral trade surplus is US$323.3 billion, an increase from US$275.8 billion. There is a difference between the Chinese and U.S. estimates of almost US$100 billion.

♦ However, these numbers suffer from a number of imperfections and are not directly comparable.
# The Different Measurements of the Bilateral Trade Balance: A Summary

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Goods Only, Exports FOB, Imports CIF</td>
<td>323.3</td>
<td></td>
<td>419.6</td>
</tr>
<tr>
<td>Goods Only, Based on Bilateral Exports FOB Data</td>
<td></td>
<td>356.4</td>
<td></td>
</tr>
<tr>
<td>Goods Only, Based on Bilateral Exports and Estimated Re-Exports, FOB</td>
<td></td>
<td>350.9</td>
<td></td>
</tr>
<tr>
<td>Goods, Exports FOB, Imports CIF, and Services</td>
<td>268.4</td>
<td></td>
<td>380.8</td>
</tr>
<tr>
<td>Goods, including Estimated Re-Exports, FOB, and Services Based on U.S. Data</td>
<td></td>
<td>312.1</td>
<td></td>
</tr>
<tr>
<td>Goods, including Estimated Re-Exports, FOB, and Services Based on Bilateral Imports Data</td>
<td></td>
<td>276.0</td>
<td></td>
</tr>
</tbody>
</table>
The Relative Benefits from the Bilateral Trade

- However, the gross value of exports does not reflect accurately the real benefits of exports to the exporting country. What really matters is the GDP created by the exports, that is, the domestic value-added created by the exports, directly and indirectly. (The employment and GNP generated by the exports are also important.)

- As an example, consider the Apple iPhone, an export of China since it is finally assembled by Foxconn (Hon Hai Precision Industry Co., Ltd. of Taiwan) in China. The value of an iPhone is at least US$600 whereas the Chinese domestic value-added is less than US$20, with a direct value-added content of at most 3.3%. (The GNP generated is even lower since Foxconn is not a Chinese company.)
## The Relative Benefits from the Bilateral Trade in Terms of Value-Added: A Summary

<table>
<thead>
<tr>
<th>Measurement</th>
<th>China</th>
<th>The U.S.</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Value-Add, Goods Only, Based on Bilateral Exports and Estimated Re-Exports, FOB</td>
<td>159.8</td>
<td>128.6</td>
<td>31.2</td>
</tr>
<tr>
<td>Indirect Value-Added, Goods Only, Based on Bilateral Exports and Estimated Re-Exports, FOB</td>
<td>201.9</td>
<td>53.3</td>
<td>148.6</td>
</tr>
<tr>
<td>Total Value-Added, Goods Only, Based on Bilateral Exports and Estimated Re-Exports, FOB</td>
<td>361.8</td>
<td>181.9</td>
<td>179.9</td>
</tr>
<tr>
<td>Value-Added from Service Exports, Based on U.S. Data</td>
<td>18.3</td>
<td>57.1</td>
<td>-38.8</td>
</tr>
<tr>
<td>Value-Added from Service Exports, Based on Bilateral Service Imports Data</td>
<td>18.3</td>
<td>93.2</td>
<td>-74.9</td>
</tr>
<tr>
<td>Total Value-Added, Good and Services, Based on U.S. Service Trade Data</td>
<td>380.1</td>
<td>239.1</td>
<td>141.1</td>
</tr>
<tr>
<td>Total Value-Added, Good and Services, Based on Bilateral Service Imports Data</td>
<td>380.1</td>
<td>275.1</td>
<td>105.0</td>
</tr>
</tbody>
</table>
The Rate of Growth of US Non-Oil Price Index and the Chinese Share of Non-Oil Imports
The Chinese, Hong Kong and U.S. Stock Market Indexes, 2018M1 to Date

Stock Price Indices of Various Stock Exchanges, 1 January 2018 = 100

- Hong Kong (Overall)
- Hong Kong (China Enterprise)
- Shanghai
- Shenzhen
- MSCI China
- S&P 500 Index
The Quarterly Rates of Growth of Chinese Real GDP versus the Chinese Stock Price Index

Quarterly Rates of Growth of Chinese Real GDP vs. Quarterly Rates of Changes of the Shanghai Stock Exchange Composite Index

-50 0 50 100 150 200 250
Quarterly Rates of Changes of Stock Exchange Composite Index, percent

GDP vs. Index of Shanghai SE
The RMB Central Parity Exchange Rate and the CFETS Index, 29/12/2017 to the Present

The Central Parity Rate and the CFETS Index, 29 Dec. 2017 = 100

Index of CFETS Currency Basket (Yuan/Currency Basket)
Index of Central Parity Rate (Yuan/US$)
Quarterly Rates of Growth of Exports of Goods: Selected Asian Economies
Quarterly Rates of Growth of Imports of Goods: Selected East Asian Economies
Quarterly Rates of Growth of Real GDP, Year-over-Year: Selected East Asian Economies

- China, P.R.: Hong Kong
- India
- Indonesia
- Korea
- Malaysia
- Philippines
- Singapore
- Thailand
- Taiwan Prov. of China

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The Real Impacts of the Mutual Tariffs on the Two Economies

- The maximum negative impact to the Chinese economy, assuming that half of Chinese exports to the U.S. are halted, may be estimated at 0.45% of Chinese GDP in the first instance, and eventually cumulatively 1.2% of Chinese GDP, if all the indirect effects are included. If all of Chinese exports of goods to the U.S. are halted, the eventual total damage would be 2.4% of Chinese GDP.

- The maximum negative impact to the U.S. economy, assuming that half of U.S. exports to China are halted, may be estimated at 0.145% of GDP in the first instance, and eventually cumulatively 0.26% of U.S. GDP, if all the indirect effects are included. If all of U.S. exports of goods to China are halted, the eventual total damage would be 0.51% of U.S. GDP.

- However, these estimates do not include the effects of the uncertainty and unpredictability created by the trade war.

- They also do not include U.S. losses of exports of goods or royalties and license fees through its own restrictions on Chinese high-technology enterprises such as Huawei from using U.S. products such as the Intel chips and the Android operating system of Google.
Chinese Exports of Goods and Services and Goods Only as a Percent of Chinese GDP

Exports of Goods and Services as a Percentage of GDP

Exports of Goods Only to the World as a Percentage of GDP
Chinese Exports of Goods and Services and Goods to the U.S. as Percent of Chinese GDP
The Distribution of U.S. Apparel Imports by Countries and Regions of Origin

Percent

Hong Kong, South Korea and Taiwan
China (Mainland)
ASEAN
The Rest of the World

0 10 20 30 40 50 60 70 80 90 100
Exports to the World as Percent of GDP: Hong Kong

- Total Exports of Goods and Services
- Total Exports of Goods Only
- Domestic Exports of Goods Only
- Re-Exports of Goods Only
Exports to the U.S. as Percent of GDP:
Hong Kong

[Graph showing trends and data points for exports to the U.S. as a percent of GDP for Hong Kong from 1972 to 2018. The graph includes four lines representing different types of exports: Total Exports of Goods and Services, Total Exports of Goods Only, Domestic Exports of Goods Only, and Re-Exports of Goods Only.]
U.S. Exports of Goods and Services and Goods Only as Percent of U.S. GDP

- Exports of Goods and Services as a Percent of GDP
- Exports of Goods Only to the World as a Percent of GDP
U.S. Exports of Goods and Services and Goods Only to China as Percent of U.S. GDP
Chinese Inbound Foreign Direct Investment as Percent of Chinese Gross Domestic Investment
Chinese National Savings and Gross Domestic Investment as Percents of GDP

Chinese National Savings and Gross Domestic Investment as a Percent of GDP since 1952

- **Savings Rate**
- **Investment Rate**
Economic and Technological Competition

- Even though the proximate cause of the current trade war between China and the United States is the large trade imbalance in China’s favour, but it is actually a manifestation of the potential competition between China and the U.S. for economic and technological dominance in the world.

- This competition, whether explicit or implicit, and whether intentional or not, will not go away soon. It did not begin with President Donald Trump. Both the “pivot to Asia” and the “Trans-Pacific Partnership” were initiated by President Barack Obama as strategies aimed in part at containing China. It will not go away even after President Trump leaves office.
In terms of aggregate GDP, China went from only one-fifth of the U.S. GDP in 2000 to two-thirds in 2017, in only 17 years (64.1% in 2018 because of exchange rate changes). It is only a matter of time that the Chinese GDP will catch up with the U.S. GDP, probably in the early 2030s.

However, in terms of GDP per capita, China is still way behind, with US$9,415 (less than S$10,000, thus technically still a developing economy), compared to US$62,609 for the U.S. in 2018.

My own projections suggest that it will probably take until the end of the 21st Century before Chinese GDP per capita can approach the U.S. level, if ever. (Because of the differences in natural endowments between China and the U.S., China may not be able to catch up with the U.S. in terms of GDP per capita.)
Growth Rate vs. Level of Real GDP per Capita (2018 tril. US$): China, Japan and the U.S.
Comparison of National Savings Rates: China, Japan and the U.S.
Comparison of Capital-Labour Ratios: China, Japan and the U.S.
The Distribution of Chinese GDP by Sector Since 1952
The Distribution of Chinese Employment by Sector Since 1952

The Distribution of Employment by Sector since 1952

- Primary Sector
- Secondary Sector
- Tertiary Sector
Scatter Diagram between the Shares of Employment and GDP of the Primary Sector

The Percentage of the Primary Sector in National Employment

The Percentage of the Primary Sector in GDP

China
Taiwan
South Korea
Japan
The Number of Internet Users in Selected Economies

China
United States
Japan
India
Germany
Korea, Rep.
Taiwan
The Number of Internet Users as a Percent of the Population in Selected Economies

China
United States
Japan
India
Germany
Korea, Rep.
Taiwan

Percent

The Number of Internet Users as a Percent of the Population in Selected Economies


0
10
20
30
40
50
60
70
80
90
100
Actual and Projected Levels and Growth Rates of Chinese and U.S. Real GDP (2018 tril. US$)
Actual and Projected Levels and Growth Rates of Chinese and U.S. Real GDP (2018 tril. US$)
Actual and Projected Chinese and U.S. Real GDP per Capita and Their Rates of Growth (1,000 2018 US$)

Actual and Projected Chinese and U.S. Real GDP per Capita and Their Rates of Growth (thousand, 2018 US$)

- Rates of Growth of U.S. Real GDP per capita (right scale)
- Rates of Growth of Chinese Real GDP per Capita (right scale)
- U.S. Real GDP per Capita, in 2018 prices
- Chinese Real GDP per capita, in 2018 prices
R&D Expenditures as a Share of GDP and Their Target Levels at 2020: G-7 Countries, 4 East Asian NIEs, China & Israel

R&D Expenditures as a Ratio of GDP: G-7 Countries, 4 East Asian NIEs, China & Israel

Legend:
- U.S.
- Japan
- W. Germany
- Germany
- Italy
- France
- Canada
- South Korea
- Singapore
- Taiwan, China
- Mainland, China
- HK, China
- Israel
Patents Granted in the United States: G-7 Countries, 4 East Asian NIEs, China & Israel
U.S. Patents Granted and R&D Capital Stocks: G-7 Countries, 4 EANIEs, China & Israel

\[
y = 2.160 + 1.145 x
\]

(0.126)    (0.025)
Basic Research Expenditure as a Share of Total R&D Expenditure: China, Japan and the U.S.
Technological Competition: Cumulative Number of Nobel Laureates in Physics

Cumulative Number of Nobel Prizes in Physics

Canada | China | France | Germany | Italy | Japan | U.K. | U.S.
Economic Complementarities between China and the U.S.

- China and the U.S. have very different economic endowments. China has a large population that is more than four times that of the U.S. The U.S. has more arable land, more tangible capital stock, more human capital, almost four times more R&D capital stock than China, and much more natural resources (for example, oil and gas deposits) than China.

- China has a high savings rate and the U.S. has a low savings rate. Chinese savings exceed Chinese domestic investment and U.S. savings are less than U.S. domestic investment. China is a net capital exporter and the U.S. a net capital importer.

- China has a large bilateral trade surplus in goods; the U.S. has a large bilateral trade surplus in services.

- Economic theory tells us that the more different two economies are, the greater they potentially benefit from trading and interacting with each other.

- The two countries are economically complementary to each other.
### Economic Complementarities between China and the U.S.

<table>
<thead>
<tr>
<th></th>
<th>China</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arable land per capita, hectare</td>
<td>0.098</td>
<td>0.098</td>
</tr>
<tr>
<td>Real capital stock per capita, 2016 prices, US$</td>
<td>15,472</td>
<td>16,927</td>
</tr>
<tr>
<td>Real R&amp;D capital stock per capita, 2016 prices, US$</td>
<td>654</td>
<td>734</td>
</tr>
<tr>
<td>Working age population per capita</td>
<td>0.725</td>
<td>0.720</td>
</tr>
</tbody>
</table>
Coordinated Expansion of Trade

◆ A bilateral trade gap can be closed by either the deficit country increasing its exports to the surplus country, or by the surplus country reducing its exports to the deficit country. (If two countries stop trading, the bilateral trade balance is by definition zero.) It is much better to close a bilateral trade gap by increasing the exports from the deficit country to the surplus country than for the surplus country to reduce its exports to the deficit country. In the former case, both countries win; in the latter case, both countries lose.

◆ It is conventional wisdom that reducing a bilateral trade surplus per se, for example, by increasing exports from the deficit country to the surplus country, cannot change the aggregate trade deficit with the world of the deficit country, nor increase the GDP of the deficit country.
Coordinated Expansion of Trade

- However, this is based on the assumption that the aggregate output of the deficit economy is given so that a simple reallocation of its trade flows among its trading partners cannot change its aggregate trade balance with the world.

- It is not necessarily true if the increased exports can come from new domestic production based on previously idle resources in the deficit country, which increases both its domestic GDP and employment, rather than the diversion of existing exports from another trading-partner country. One way to think about it is that there is an autonomous increase in permanent supply in response to an exogenous increase in permanent demand.

- Coordinated long-term increases of U.S. production and exports of agricultural products such as beef, chicken, pork and soybeans, and energy commodities such as shale oil and liquefied natural gas, for exports to China can increase both U.S. GDP and employment and decrease the bilateral U.S.-China as well as the overall U.S. trade deficit with the rest of the world.
Two sources of potential U.S. exports to China that can be huge and are relatively uncontroversial are agricultural commodities and energy. China has a huge demand for agricultural commodities, and, in addition, there is also great potential for the U.S. to increase the value-added content of U.S. agricultural exports, for example, by producing and exporting meat (beef, pork and poultry) instead of feed grains (corn and soybeans) to China.

In 2017, China imported more than US$115 billion of agricultural commodities, but only 20 percent of the imports came from the U.S. Moreover, Chinese imports of agricultural commodities has been increasing by more than 10 percent per year. Thus, there is the potential of U.S. exports of agricultural commodities to China rising from the current US$20 billion plus a year to US$50 billion a year in three to five years, on the basis of new as well as higher value-added U.S. production. The U.S. has significant surplus production capacity (for example, it has an abundance of land, water and pastures) for agricultural commodities if there is assured long-term demand.
Coordinated Expansion of Trade

- There is also a huge and growing Chinese demand for energy, especially relatively clean energy, which can be met by exports of liquefied natural gas (for example, from Alaska) and shale oil, which are again new production, from the U.S.
- In 2016, China imported a total of US$117 billion of crude oil and US$9 billion of natural gas. Chinese imports of oil and gas from the U.S. was minuscule, at US$0.2 billion and US$0.08 billion respectively. Given China’s huge and growing demand for energy, and especially for non-polluting energy such as natural gas, and the U.S. being transformed into a net energy exporter because of its rising shale oil and gas production, it is entirely possible for the U.S. to become a top energy exporter to China, gradually increasing to US$50 billion a year or more, again based on new production and not the diversion of existing production, thus increasing both U.S. GDP and employment.
Coordinated Expansion of Trade

- However, coordination is necessary to make possible the development of the natural gas reserves in Alaska to be sold to Chinese customers. Significant long-term investments will have to be made in Alaska. Without committed Chinese buyers, the project cannot be financed (future markets for natural gas does not extend beyond a couple of years). Without committed and well-capitalised developers with a track record in the U.S., the potential Chinese buyers are unlikely to commit either. Moreover, only a U.S. firm or a consortium of U.S. firms is likely to be able to navigate successfully the federal, state and local regulations governing the development of the natural gas reserves in Alaska.
Coordinated Expansion of Trade

- Another fast-growing component of U.S. exports of services to China that has huge potential for expansion is education and tourism. The expenditures of Chinese students (currently totalling 360,000) and tourists in the U.S. have been rising rapidly. Moreover, their presence in the U.S. can enhance the understanding between the Chinese and American people and improve long-term ties. And on their return to China, they can act as goodwill ambassadors for the U.S., especially those who have been students in the U.S. U.S. students and tourists in China can also play the same role.

- A further area of significant potential win-win collaboration is the deployment of the excess Chinese savings in the U.S. for the financing of the renovation and upgrading of U.S. basic infrastructure as well as the augmentation of the equity capital of U.S. corporations through a secondary listing of their shares on the Chinese stock market.
Concluding Remarks

- The competition between China and the U.S., whether friendly or unfriendly, can be assumed to be an ongoing and long-term one. It is the “new normal”. The trade dispute is only a symptom of the potential possible conflicts between the two countries.

- Prof. Graham Allison, of the Kennedy School of Government at Harvard University, has written a book titled *Destined for War*, about the inevitability of a war between China and the U.S. As a rising power challenges the dominance of an established power, the established power is likely to respond with force. He refers to this “inevitability” as the “Thucydides Trap”, drawing on the book by Thucydides, *History of the Peloponnesian War*, a war in ancient Greece (431-404 B.C.) between Athens and Sparta.67
Concluding Remarks

- However, the rise of the former Soviet Union between the end of the Second World War and 1990 provides a counter-example that an established power and a rising power must go to war. The truth is that a thermonuclear war today is so devastating that there are effectively no real winners. It is this “mutually assured destruction” that prevented the Soviet Union and the U.S. from going to war and instead to enter into a number of arms control treaties such as the Anti-Ballistic Missile (ABM) Treaty. And it will similarly prevent wars between major powers in the future.

- It is also important to distinguish between the rivalry between the U.S. and the former Soviet Union with the competition between China and the U.S. The former was existential, as the former Soviet Union would like to impose the Communist system on other countries. China has no intention of proselytising its ideology or system of government to other countries and hence its competition with the U.S. is non-existential.
Concluding Remarks

China and the rest of the world, except possibly the U.S., will continue to uphold the current multilateral trading system under the World Trade Organisation (WTO). After all, they have all benefitted and will continue to benefit from it.

China is committed to further opening of its economy to international trade and both inbound and outbound direct investment. It will likely adopt, over time, a “three zeroes strategy”—zero tariffs, zero barriers and zero subsidies and offer national treatment to foreign direct investors on a reciprocal basis.

Maintaining good economic relations with the rest of the world, and opening its economy further to international trade and investment, in particular, to the European Union, ASEAN, Japan and Russia on a reciprocal basis, is a must for China going forward.

China is the largest trading-partner country of almost all of the East Asian countries and regions. It is also becoming the largest foreign direct investor in these countries and regions.
Concluding Remarks

- In the long run, if China and the U.S. cooperate and work together, many global problems such as reform of the World Trade Organisation (WTO), denuclearisation, prevention of climate change, and the economic development of Africa, can be solved.

- If the two countries compete in a friendly way, much innovation is possible, as in the competition to build the fastest super-computer. China and the U.S. can also both collaborate and compete in finding cures for diseases such as cancer and Alzheimer’s disease, and every country in the world will benefit from it.

- The U.S. can invite China to participate in the exploration of Mars and share in the cost, which has been estimated to be hundreds of billions of U.S. dollars.

- There are still many win-win possibilities for the Chinese and U.S. economies to work together, e.g., exchange rate coordination, which will rebound to the benefit of the entire world.

- The two countries should aim to become competitive partners!