**An uneasy truce**

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When great powers fight, the whole world watches them with bated breath. When a truce is reached, the world heaves a sigh of relief.

Since March 2018 when the US and China, the globe’s largest economies and trading nations, began to slap each other with import tariffs, the lesser nations had remained strung up lest the fray might throw the global economy into a tailspin. Now that the two economic powerhouses have reached a provisional agreement, the tensions have simmered down.

On January 15, US President Donald Trump and the visiting Chinese vice premier signed the first phase of the agreement, which has brought their trade war to a halt. Negotiations for the second and final phase of the agreement will start immediately but they may drag until the US presidential election scheduled in November this year. In order to appreciate the significance of the January 15 deal, we need to look into the factors that brought the two powerful nations head-to-head.

The last two decades have seen a gradual downswing in the economic strength of the US and an upsurge in that of China. Between 1997 and 2018, the US economy registered a modest average annual growth of 2.3 percent to surpass $20 trillion. By contrast, the Chinese economy grew on average 9.0 percent a year to reach $13.6 trillion.

In the case of China, the consistently high growth rate has been underpinned by a spectacular export performance, which itself has been undergirded by massive foreign direct investment (FDI) inflows. The country’s merchandise exports, which were only $18 billion in 1980, rose to $62 billion by 1990, $249 billion by 2000, $1.6 trillion by 2010, and $2.5 trillion by 2018. During the last decade, China overtook the US as the globe’s largest exporter.

A direct relationship can be observed between export growth and that in FDI. From $1.66 billion in 1985, FDI inflows into China doubled to $3.49 billion in 1990, and jumped to $40 billion in 2000 and further to $244 billion in 2010. In 2018, China received $203 billion FDI, which accounted for nearly 17 percent of the worldwide capital receipts in investment mode.

Both exogenous and endogenous factors account for China’s rise as the globe’s largest recipient of FDI. The current wave of globalization that started in the late 1980s has seen the establishment of global value chains (GVCs), as multinational enterprises (MNEs) fragmented their manufacturing activities across countries and regions on the basis of the latter’s factor endowments and market conditions. The basic thrust has been to produce the components of a product, such as smart phones and laptops, in those locations where those activities could be carried out most efficiently. By virtue of its cheap labour and economic reforms, China became one of the favourite places for GVCs-related FDI including that from US-based MNEs, such as Apple.

The rise of GVCs as the driving force of international trade and investment meant that the MNEs would carry out a diminishing amount of manufacturing in the parent country and an increasing amount offshore. Thus Apple manufactures its gadgets in different countries including China, from where they are shipped back to the US as final products.

As a result, manufacturing and related employment declined, while trade deficit ballooned up, in countries like the US. Thus bringing back manufacturing and jobs to America as well as correcting the trade imbalance was a pre-poll promise of Donald Trump and subsequently one of his main motives for starting the trade war with China. The idea was that the imposition of tariffs on imports will jack up their prices and force the US-based MNEs to resume their erstwhile manufacturing operations in the home country.

China was chosen as the adversary for the trade war, because it is the main recipient of FDI from US-based MNEs and the major source of the country’s massive trade deficit. Between 2009 and 2018, on average, China accounted for 45 percent ($347 billion a year) of US annual worldwide trade deficit. On a strategic level, the US is keen to pre-empt the rise of China as the world’s largest economy, which it’s predicted to become in next two decades.

Although militarily Washington will remain well ahead of Beijing, a redistribution of economic power will act heavily on each nation’s capability to shape international events. In particular, China’s ambitious One Belt One Road initiative, under which it is committed to inject billions of dollars for infrastructure development in different countries, and which is seen by Washington as a strategy for worldwide domination, is bankrolled by a steady stream of massive export revenues.

The first shot in the trade war was fired when in March 2018 the Trump administration slapped 25 percent punitive tariffs on import of steel from China and some other countries. Beijing retaliated by levying up to 25 percent tariffs on American imports. In total, the US imposed tariffs between 10 and 25 percent on Chinese goods valuing $360 billion, which represent more than 70 percent of total American imports from China in 2017. Beijing hit back with tariffs in the range of 5-25 percent on $110 billion worth of American imports, which make up 85 percent of total Chinese purchases from the US in 2017.

Tariffs rack up the cost of production and raise prices in the importing country, which makes consumers worse off. However, in case of big countries, like the US and China, increased import duties also depress international prices and thus bring down the total economic output. That’s the reason the US-China tariff war was casting its shadow across the globe.

But did the tariff war achieve its immediate objectives? A simple way to answer this question is to glance at the latest available trade data. In the first eleven months of 2019, the US imported $418.5 billion worth of goods from China compared with $493.7 billion and $460.7 billion purchases in the corresponding period of 2018 and 2017 respectively. US trade deficit with China, which sat at 344.6$ billion and $382.7 billion respectively in the first eleven months of 2017 and 2018 declined to $320.8 billion in the corresponding period of 2019. Thus both US imports and trade imbalance went down appreciably.

Not only that, in 2019, China registered 6.1 percent economic growth – down from 6.6 percent in 2018 – which is the lowest over last three decades. The tariff war was one, though by no means the only, contributor to the growth deceleration. However, the revival of manufacturing in the US is easier said than done, as GVCs set up by the MNEs have left only a limited scope for value addition in the country, where wages are comparatively high. In fact, wages are also on the rise in China, which is likely to face a similar situation a few years down the road.

Coming back to the Phase-I deal, the increased tariffs have not been rolled back by either side. The only exception is the tariffs imposed by the US in September last, which will be cut by half. Nor has any timeline been agreed to do away with the punitive duties. China, however, has agreed to enhance its imports from the US by $200 billion over the 2017 level, which will further curtail American trade deficit. This is the immediate achievement for Trump in the election year. In addition, Beijing has committed to bolster its protection of intellectual property rights (IPRs) and allow its currency to appreciate so as not to secure an ‘unfair’ competitive advantage over its trading partners.

The Chinese think long term and the concessions granted by them are a reflection of the leadership’s overarching commitment to dust down any obstacle that may put the skids under the country’s staggering economic progress.

The reduction of the tariffs to the pre-2018 level and other thorny issues, such as the state subsidies allegedly granted to public-sector enterprises in China, will be taken up in further negotiations, which are supposed to usher in a final agreement.

Thus the truce reached through the Phase-I deal is uneasy. In case currency or IPR reforms in China don’t measure up to US expectations or another issue crops up, the agreement is likely to fall apart and the two sides may resort to tit-for-tat tariffs.

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