Professional MBA
Entrepreneurship & Innovation

TRADE CONFLICT BETWEEN THE UNITED STATES AND CHINA AND ITS IMPACT ON THE GLOBAL ECONOMY

A Master's Thesis submitted for the degree of
“Master of Business Administration”

supervised by
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Vienna, 22.07.2019

Affidavit

I, **JOVDAT MAMMADOV**, hereby declare

1. that I am the sole author of the present Master's Thesis, "TRADE CONFLICT BETWEEN THE UNITED STATES AND CHINA AND ITS IMPACT ON THE GLOBAL ECONOMY", 88 pages, bound, and that I have not used any source or tool other than those referenced or any other illicit aid or tool, and
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ABSTRACT

The United States and China relations have evolved from tense standoffs to a complex mix of intensifying diplomacy, growing international rivalry, and increasingly intertwined economies. In 1979, the United States and China re-established diplomatic relations and signed a bilateral trade agreement, providing mutual most-favored-nation treatment, which allowed to substantially expand their economic relationship since then. Between 1980 and 2018, the United States and China trade rose from US$ 4.9 billion to US$ 738.6 billion, making them each other's largest trading partners on a country basis. Between 1990 and 2018, the United States merchandise trade deficit with China rose from US$ 10.4 billion to US$ 419.3 billion. China's large merchandise trade surpluses and some trading practices with the United States have strained both countries relations. In 2018, China was the largest foreign holder of the United States government debt at US$ 1.113 trillion. The rising China's economy set off alarm bells amongst advanced economies, particularly the Unites States. Thus, their bilateral trade balances have come under scrutiny. Recently, trade tariffs, as an instrument of trade and foreign policy, have returned to mainstream politics in the United States, raising fears of resurgence of protectionism. The United States imposed tariff hikes on US$ 250 billion worth of Chinese products, while China retaliated with tariff hikes on US$ 110 billion worth of the United States products. Their rivalry began playing out in the crucial technology sector. The ongoing trade conflict between the world's two largest economies, which account to 40% of global GDP, had increased fears that further escalation would harm the global economy. In 2019, the International Monetary Fund reported that the United States and China tensions have negatively affected consumers and producers in both countries. Although the imposed tariffs have reduced trade between them, their bilateral trade deficit remained broadly unchanged, while the impact on global growth was relatively modest. However, disruption risks remained for the global supply chains. It is argued that trade wars are not easy to win, even for large economies such as the United States. China has the tools to manage the economic blow. Thus, the United States and China will eventually reach a deal to lift some of their reciprocal tariffs, but their economic competition will persist as the United States strategy evolves beyond tariffs to counter China's emergence as an economic, military, and political peer. It is argued that both countries might be falling in a "Thucydides trap", when a major rising power challenges a major ruling power.

PREFACE

This thesis is submitted for the degree of Master of Business Administration offered jointly by the Vienna University of Economics and Business and the Vienna University of Technology (TU Wien). This thesis, based on historical context, provides an analysis of current tensions between the United States and China, while explaining reasons of trade conflict and summarizing the potential impact of enacted tariffs on both countries and the global economy. The purpose of this thesis is to demonstrate that the current trade conflict between the United States and China obscures a fundamental and important issue that involves the long-term systemic contest for leadership of the world economy. The recent resurgence of protectionism in the United States will ratchet up this competition to frustrate China's development, which became evident in trade, investment and technology relationships between the world's two largest economies. Both sides have ammunition to fight a trade war. Deepening the United States and China economic competition, however, does not mean a full-fledged war as both countries will keep the door open for future dialogue. The International Monetary Fund's data from 2019 indicates that the United States, China, and the world economy are the losers from the current trade conflict. It estimated that the United States and China imposed tariffs could reduce global GDP by 0.5 percent in 2020, which will amount to a loss of about US$ 455 billion. Thus, both countries will have to reach a deal and compromise on tariffs, but their economic competition will persist further.

The originality of this thesis is based on research of recent data, analysis and review of international literature on the subject, and empirical research performed, resulting in variety of idiosyncratic, applicable conclusions for experts in global business and trade, business strategy and policymakers.

The research described herein was conducted under the supervision of Professor Doctor Jonas Puck, Head of Institute for International Business of the Department of Global Business and Trade at the Vienna University of Economics and Business.

This work is to the best of my knowledge original, except where acknowledgments and references are made to previous work.

Finally, I take this opportunity to express my gratitude to my family for their love, unfailing encouragement and support.

Jovdat Mammadov, July 2019, Vienna

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1. INTRODUCTION

The United States has played a leading role in shaping the global trade system by facilitating the establishment of its framework, institutions and rules since the end of the Second World War. Ironically, in 2019, the Bretton Woods multilateral institutions are marking the seventy-fifth anniversary of their establishment, which comes at the time of a deepening trade conflict between the United States and China amid the resurgence of protectionism in the United States. Moreover, in 2019, at the time of evolving trade conflict between the United States and China, the two nations are marking the fortieth anniversary of their diplomatic relations. It is argued that the United States has diminished the leadership on global trade liberalization in recent years, which will have important implications for the global economy. The rise of protectionism in the United States poses a challenge to the open, rules-based trading system that fostered globalization. However, this leadership has waned in recent years, not least because anti-trade sentiment is on rise among the American public. Globalization and trade liberalization have produced widespread social discontent about inequality of outcomes from economic growth and integration for employment opportunity and income. Besides, gains from technological advancements have been spread unevenly. Public sentiment on globalization and trade liberalization supported the resurgence of economic protectionism in developed counties as many jobs were relocated to other industries and countries, especially in manufacturing sector. Meantime, many developed countries have shifted from manufacturing economy to service economies in recent decades. Out of globalization and trade liberalization, China emerged as the world's second largest economy. Moreover, China became the world's largest manufacture of goods. China's share of global manufacturing gradually increased from 2.7% in 1990 to 25% in 2017. At the same time, China's share of

global GDP has risen from 1.8% in 1990 to about 16% nowadays[1]. Thus, China's competitive and low-coast manufacturing sector allowed China to became the largest trading nation in the world, which in turn created trade imbalances, especially in merchandise, between China and advanced economies. China has grown faster for longer than any other country on record as a result of gradual economic reform over forty years. Even though China's growth rate has declined since the recent global financial crisis, it has continued to make a disproportionately large contribution to the pace of global expansion. Despite close commercial ties, the bilateral economic relationship between the United States and China has been deteriorating since a while and it has recently become increasingly complex and fraught with tension. The United States, which has the world's largest trade deficit over four decades, subjected China to scrutiny over its trade policies on intellectual property, technology and innovation, and their bilateral trade imbalances. The United States has implemented three rounds of tariff increases on a total of US$ 250 billion worth of Chinese products and China retaliated by tariff increases on US$ 110 billion worth of the United States products, which amount to a total US$ 360 billion worth products. Given the global stature of both countries, this quest will reverberate around the world. It appears that the United States is convinced that China's economic rise poses a national security threat. Thus, the United States economic war against China will grow to encompass more than just tariff threats. It appears that trade wars, as an instrument of trade and foreign policy, have returned to mainstream politics in the United States. Certainly, dare predictions from analysts and policymakers about how the United States strategy to counter China's emergence as an economic, military and political peer could hurt global growth have only increased concerns. Thus, the United States tariffs on China are likely to last for some time. In this trade war, the United States appears to have the upper hand. It is assumed, during conflict, an imbalance in strength should lead to a swift resolution. However, here the side with the advantage may prolong the war. Are trade wars easy to win? What are the United States goals?

The current trade conflict between the United States and China is an actual and important topic for research as the trade friction between these countries has drawn growing attention and concern over its possible impact on the global economy, given that both countries are the world's two largest economies. This thesis provides an overview of the current realities and future possibilities of trade relations between the United States and China, comprehending reasons of trade friction and summarizing the potential impact of enacted tariffs on both countries and the global economy. After setting out the historical, economic and political context of contemporary the United States and China relationships, this thesis examines the reasons underlying the current United States policy shift toward China and an increased role for trade in a deal-making model of foreign relations.

Absence of a sizeable body of literature examining the current trade conflict between the United States and China and its causes, poses research challenges due to rapidly evolving dynamics of this conflict in a short period of time. A review of online

[1] China Economic Quarterly Q1 2019, https://www.pwccn.com/en/research-and-insights/china-economic-quarterly-q1-2019.html

resources led to websites maintained by organizations such as the World Bank, the International Monetary Fund, the United Nations Conference on Trade and Development, the World Economic Forum, Peterson Institute for International Economics, China Finance 40 Forum (CF40), PwC, BBC, Bloomberg, Reuters, the United States Congressional Research Service, with a high degree of relevance to the topic of this thesis and helped to frame the research problem. Furthermore, two very interesting books which provided valuable resources and a lot of food for thought to better understand the historical, geopolitical and economic settings of contemporary international trade and politics, are listed below:

Ronald Findlay & Kevin H. O'Rourke (2009). Power and Plenty: trade, war, and the world economy in the second millennium. Princeton and Oxford, United States of America: Princeton University Press.

Robert D. Kaplan: The revenge of geography. What the map tells us about coming conflicts and the battle against fate. The Random House Publishing Group, New York, United States, 2013.

2. THE EVOLUTION OF GLOBALIZATION AND INTERNATIONAL TRADE

The World Economic Forum's report on Globalization 4.0[2] defines four phases of global economic integration in modern times. The first phase was the period leading up to 1914, when immigration and cross-border capital and trade flows were quite large but the global institutional architecture was very limited. The second phase was the period extending from the Second World War to the late 1990-s in which much of the modern international economic enabling architecture was established (trade, financial and development institutions and agreements) and multinational corporations greatly expanded their operations across the globe, supported by policy liberalization and improved communications. The third phase began from the late 1990-s until very recently and was characterized by the advent of the internet, the establishment of the World Trade Organization and the formal entry of China into the trading system through its accession to that institution. This period displayed critical improvements in information and communications technology and financial risk management systems combined with continued trade and capital liberalization, particularly through regional free trade agreements and bilateral investment treaties. These advances in globalization increased further the integration of markets and cross-border expansion of value chains. Trade as a proportion of world GDP has risen by half since the mid-1990-s. It is argued that the recent developments suggest that a new phase - Globalization 4.0 - is now taking shape. This phase of globalization will be defined by shifts in the United States foreign and economic policies, Brexit, and developments surrounding such issues as immigration, data privacy and security, China's Belt and Road Initiative, multi-speed European integration, and automation's impact on the future of work and economic development. The recent developments strongly suggest

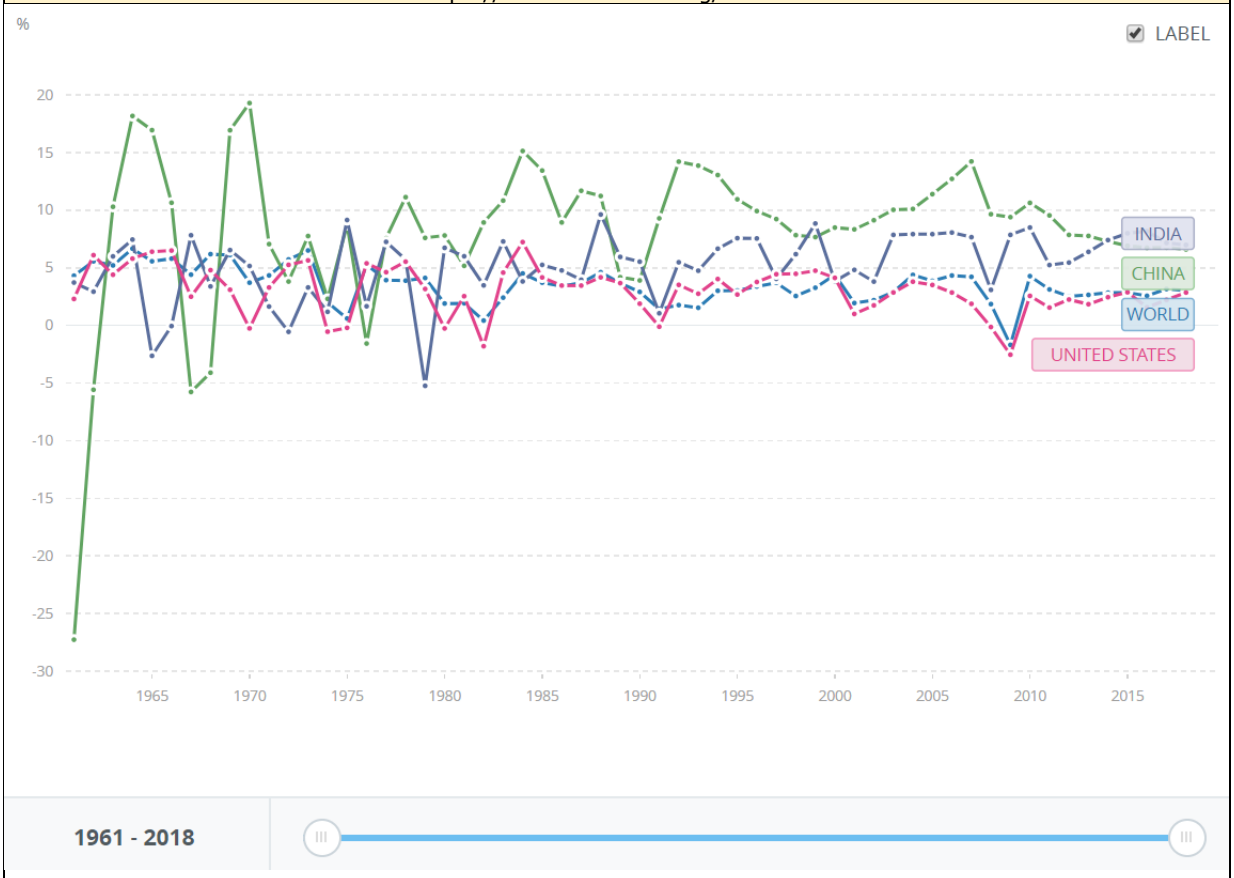
[2] Richard Samans: Globalization 4.0. Shaping a New Global Architecture in the Age of the Fourth Industrial Revolution, April 2019, World Economic Forum.

that the world has been moving towards a distinctly new era in which many of the assumptions of prior periods no longer hold. Like previous phases, Globalization 4.0 will be shaped by a combination of governance decisions and technological developments. From the international trade perspective, Ronald Findlay and Kevin H. O'Rourke[3] explain that the history of late-twentieth-century international trade consists of two important periods: the first period, which lasted almost until 1980, was about a dramatic policy divergence between developed countries and the rest of the world, with developed counties adopting ever more liberal trade policies, and developing countries moving in the opposite direction; the second period was about policy convergence, as increasing numbers of developing countries chose, or were forced by circumstances, to dismantle protectionist barriers and move in the direction of free trade. This change began in the 1980-s, and further accelerated during the 1990-s. By the end of twentieth century, the ratio of world trade to GDP was higher than ever before in history. In this regard, the World Economic Forum's report on Globalization 4.0[4] points out that as trade expanded, its share of global GDP rose from about 7% to 8% from the 1950-s to 1970-s to about 25% in 2019, driven substantially by the principles of non-discrimination and national treatment, and uniform customs regulations enshrined in the General Agreements on Tariffs and Trade, and its successor - the World Trade Organization. Ronald Findlay and Kevin H. O'Rourke[5] observe that the second half of the twentieth century saw an unprecedented economic growth due to openness and convergence between countries. The world's GDP per capita rose by 185% between 1950 and 2000, or at 2.1% per annum, despite a 140% increase in the world's population, which showed an amazing performance. In the United States, which by the end of the Second World War accounted for 45% of world industrial output, growth was just above the world average for the half century as a whole, at 2.2%, but this was not where the really rapid growth occurred. Rather, the Asian Tiger economies (Hong Kong (China), the Republic of Korea, Taiwan Province of China and Singapore) with half-century growth rates of 5.5% per annum, 4.9% in Japan, and 2.9% in Western Europe, converging on the United States from 1950-s to 1980-s. China joined the convergence club in the late 1970-s and India in the 1980-s. China's sharp growth increase was remarkably impressive that its half-century growth rate was 4.2%, while over the fifty years as a whole India's growth slightly exceeded that in the United States. This convergence was followed by a steady growth in their prosperity. As the Asian Tiger economies, Japan, and Western Europe were considered the great success stories of the late twentieth century, the world turned its gaze towards China and India amid realistic expectations that both China and India would match those achievements in the twenty-first century, implying an unprecedented improvement in human welfare, and as trend shows they did not disappoint them. The World Bank data shows that China with GDP annual growth rate at 6.6%, India at 6.982% and Singapore at 3.139% from the convergence club have managed to maintain higher growth rates in comparison with

[3] Ronald Findlay, Kevin H. O'Rourke: Power and Plenty. Trade, War, and the World Economy in the Second Millennium. Princeton and Oxford, United States of America. Princeton University Press, 2009.
[4] Richard Samans: Globalization 4.0. Shaping a New Global Architecture in the Age of the Fourth Industrial Revolution, April 2019, World Economic Forum.
[5] Ronald Findlay, Kevin H. O'Rourke: Power and Plenty. Trade, War, and the World Economy in the Second Millennium. Princeton and Oxford, United States of America. Princeton University Press, 2009.

the world average growth rate at 3.035% in 2018, with both China and India having impressive more than twofold higher growth rates. On the other hand, the World Bank data shows that advanced economies have been struggling to keep their growth going on the right path since then (Figure 1 - illustrates comparative curves of GDP annual growth rates between China, India, the United States and the world from 1961 to 2018).

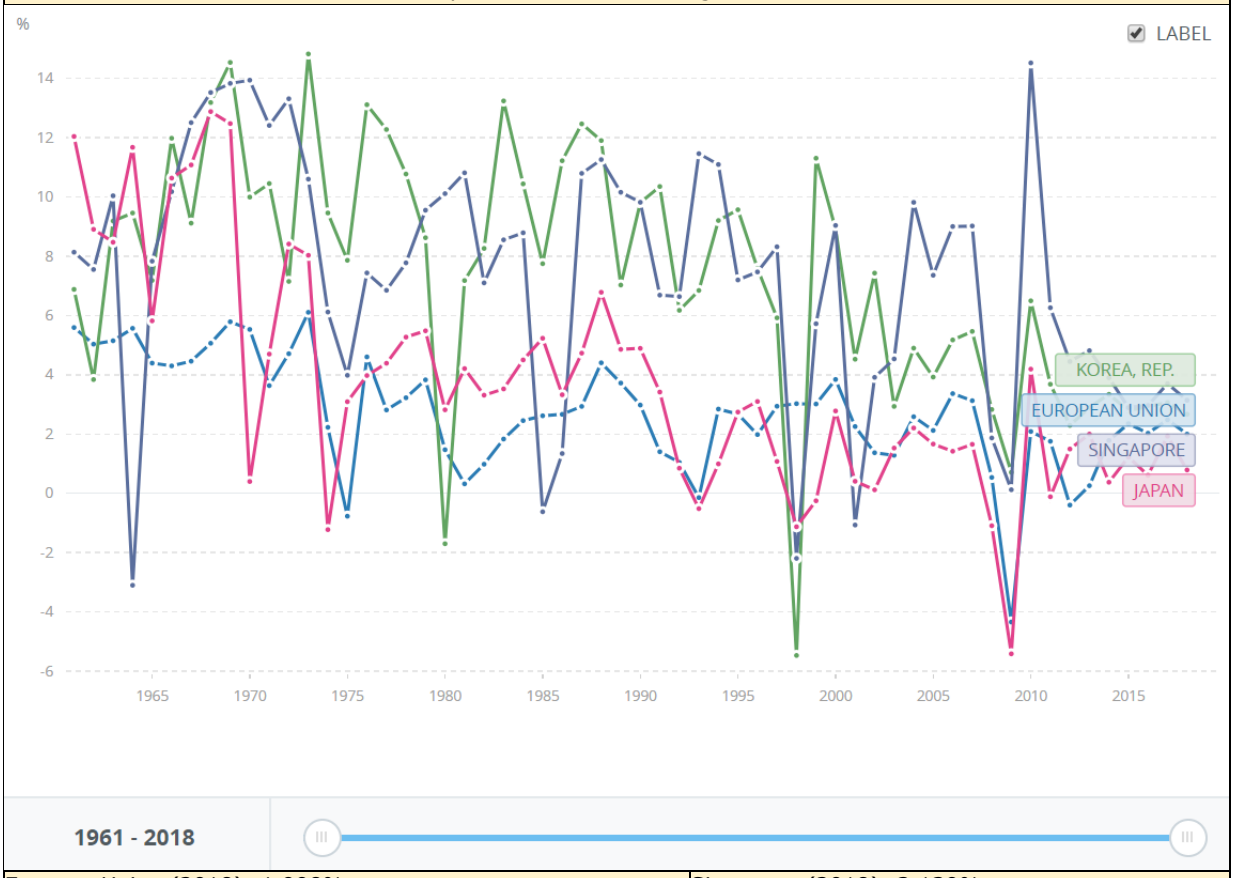
Figure 1. GDP Growth Comparison between China, India, the United States and the World from 1961 To 2018 (Annual %)
https://data.worldbank.org/indicator



China (2018): 6.6%	United States (2018): 2.857%
India (2018): 6.982%	World (2018): 3.035%

In 2018, the United States GDP annual growth was at 2.857% and in the Republic of Korea at 2.668%, slightly below the world average growth rate at 3.035%, in comparison with the underperformance of the European Union with GDP annual growth rate at 1.998% and Japan at 0.788% below the world average growth rate in 2018 (Figure 2 - illustrates comparative curves of GDP annual growth rates between the European Union, the Republic of Korea, Singapore and Japan from 1961 to 2018).

Figure 2. GDP Growth Comparison between the European Union, the Republic of Korea, Singapore and Japan from 1961 To 2018 (Annual %)
https://data.worldbank.org/indicator



Europen Union (2018): 1.998%	Singapore (2018): 3.139%
Republic of Korea (2018): 2.668%	Japan (2018): 0.788%

Further, Ronald Findlay and Kevin H. O'Rourke[6] explain that increasing openness does not appear to have guaranteed convergence, as the disappointing experience of Latin America and, especially, Africa during the 1990-s demonstrated. The median developing country growth rate across all continents was zero during 1980–99, down from 2.5% during 1960–79, despite the trend toward greater openness documented earlier. Thus, it is argued that growth depends on a wide range of variables other than exposure to trade. Ronald Findlay and Kevin H. O'Rourke[7] define that standard growth models point to the importance of investment in physical and human capital, and thus to savings rates and educational systems; to the important temporary growth effects that can be associated with a rising share of the population in employment, and hence to the factors of the labor force participation rate; and to technological progress, and hence to investment in research and development, or mechanisms enabling countries to import new technology, such as foreign direct investment. In turn, all of these variables can be influenced by government policy, the institutional environment of a country, and a multitude of other factors. Thus, studies show that government interventions designed to boost and direct investment efforts were crucial to East Asian success. Similarly, the Western European economic miracle of 1950–73 was reasonably attributed to domestic corporatist institutions that

[6] Ronald Findlay, Kevin H. O'Rourke: Power and Plenty. Trade, War, and the World Economy in the Second Millennium. Princeton and Oxford, United States of America. Princeton University Press, 2009.
[7] Ibid.

favored wage moderation and high investment rates. Thus, import substitution may have permitted initial sharp growth increase in many developing countries, but eventually their domestic markets became saturated and growth declined. The late twentieth century was dominated by the unprecedented expansion of world output and trade as a result of trade liberalization and growth in the industrial countries, and technological diffusion to newly industrializing countries. This eventually led to the rapid growth of manufactured exports from these countries, particularly China and India, and to the beginnings of a narrowing of the huge per capita income gaps between them. The 1980-s and the 1990-s saw an increase in share of manufactured exports in the South economy, and a switch in the composition of North (core) and South (periphery) trade, with the South economy shifting from an almost exclusive reliance on exporting primary products to exporting larger volumes and a wider range of manufactured goods. Thus, globalization was linking continents with very different factor proportions, the South having substantially lower capital–labor ratios and less well-educated workforces than the North, which gave rise to distributional shifts, in particular hurting unskilled workers in developed countries. Also, the rapid growth of both China and India has significantly increased the demand for world energy supplies, driving up prices and intensifying competition for energy and raw-material resources, to the disadvantage of the United States, Europe and Japan. There is every indication that this pattern will continue into the future, unless drastic measures are taken to cut demand and find alternative sources. The United States and its allies have been in a dilemma about how to adapt to the rise of China and India since then.

3. THE ASIAN "FLYING GEESE" DEVELOPMENT MODEL

Laike Yang[8] defines that East Asia followed a so-called "flying geese" model from the 1950-s to the 1990-s, in which one country leads others towards industrialization step-by-step with a V-shaped formation. The leader of the region passes its older industries (low-value-added, lower-technology based industries) down to the followers as its own production cost rises and it moves into newer industries (higher-value-added, high-technology-based industries). From labor-intensive manufacture to capital-intensive manufacture and subsequently high-technology-intensive manufacture, the leader passes down its obsoleted industries to its close followers while upgrading its own industrial technologies. The flying geese model started soon after the Second World War, led by Japan, followed by Asia's newly industrialized economies, joined by ASEAN-4 (the four major economies in the Association of South-East Asian Nations (ASEAN), namely Indonesia, Thailand, Malaysia and the Philippines) and finally followed by China in the 1980-s, and more recently Vietnam and Cambodia. After that the Asian economies took off one after another across half a century. As the evolving comparative advantages of Japan caused it to shift increasingly further away from labor-intensive production to more capital-intensive activities, the country shed its low-productivity production to nations further down in

[8] Laike Yang: Production Sharing in East Asia: China's Position, Trade Pattern and Technology Upgrading, DAAD Workshop on Development Strategies: Country Studies and International Comparisons in Shanghai, 11–16 November 2013.

the hierarchy in a pattern that subsequently reproduced itself between the countries in the lower tiers. Under this model, the GDP of many economies in this region has more than tripled in three decades. During the same period, East Asia experienced an unprecedented change in its industrial relationship and international trade patterns. Prior to the 1970-s, East Asian trade was dominated by a typical North-South vertical division of labor, whereby trade between North (core) and South (periphery) was characterized as typical inter-industry trade. The developing Asian economies exported resource-based and labor-intensive products to Japan, while Japan exported a wide range of final manufactured goods to its Asian neighbors. Subsequently, Japan shifted from labor- to capital-intensive industries in the 1970-s due to the rising labor costs, while the Asian Tigers (Hong Kong (China), the Republic of Korea, Taiwan Province of China and Singapore) took over the labor-intensive manufactures. In the 1980-s, Japan shifted further to high-technology industry, whereas the Asian newly industrialized economies took over some of the capital-intensive sectors and passed the labor-intensive sectors to newcomers. This model formed a three-layer inter-industry trade between Asian countries. In Laike Yang's[9] observation two important changes have emerged in East Asia in the past decades. First, international production sharing has become a unique feature of the region's economic landscape. Trade in parts and components (trade fragmentation) has grown faster than in any other part of the world. The production process is vertically sliced within one industry shared between East Asian economies, with each country specialized in a particular stage of production. The consequence of this production sharing is the increased inter-dependency between advanced and developing Asian economies, as the former depends on cheap labor, rich resources and lucrative markets, while the latter depends on imports of high-technology parts and components. Secondly, China has moved from a periphery country to the center of the Asia's production network, transforming from a primary good supplier to a major manufacturing and assembly center within the regional production network. Meantime, China has replaced Japan as the world's second largest economy and important trading partner in the Asian region and globally. Laike Yang[10] concludes that international production sharing has been a key feature of East Asian economic development in recent decades, with firms in advanced economies relocating their production to China, using it as an assembly base and exporting the final products to the United States and Europe. China has taken advantage of this process and transformed itself into a global manufacture center, with the country's emergence having reshaped the Asian production network and trade pattern. As China has moved to the center of East Asia's production network, thanks to its export-led development strategy, it has also significantly upgraded its technology and narrowed its technology gap with advanced economies.

[9] Laike Yang: Production Sharing in East Asia: China's Position, Trade Pattern and Technology Upgrading, DAAD Workshop on Development Strategies: Country Studies and International Comparisons in Shanghai, 11–16 November 2013.
[10] Ibid.

4. THE IMPACT OF GLOBALIZATION AND INTERNATIONAL TRADE ON LABOR MARKET AND INEQUALITY

The World Economic Forum's report on Globalization 4.0[11] points out that the world's rules-based multilateral system has underpinned decades of notable human progress. In 1950, two-thirds of humanity lived in extreme poverty. This rate declined to 42% by 1980 and 10% by 2015. Thus, much of the remarkable progress humanity has experienced since the Second World War has been built on the foundation of international norms and shared policy and action agendas organized through the United Nations system and Bretton Woods institutions. Within the framework of this multilateral system, however, globalization and trade liberalization have produced widespread social discontent about the inequity of outcomes from economic growth and integration in terms of employment opportunity and income. While it has contributed hugely to poverty reduction and progress in living standards over the past generation, it has also significantly increased inequality and economic insecurity in a wide range of countries. It is said that advanced economies have been facing a distributional shift against unskilled workers and in favor of the higher skilled workers. Ronald Findlay and Kevin H. O'Rourke[12] argue that the United States experience has been particularly dramatic: between 1979 and 1995, real wages of workers with less than twelve years of education fell by 20.2%; real wages of workers with twelve years of education fell by 13.4%; on the contrary, real wages of workers with sixteen or seventeen years of education rose by 1.0%; and real wages of workers with eighteen years of education or more rose by 14%. However, international trade is just one possible cause of this rise in inequality. Technological change that was skill-using and unskilled-labor-saving would have precisely the same effect. Marianne Schneider-Petsinger[13] points out that mainstream economic theory holds that while the losses arising from trade liberalization in the form of job displacement and lower wages are concentrated in particular sectors of the economy and geographic areas, the gains are spread more widely. Marianne Schneider-Petsinger[14] claims that the rise of China in the global economy, and its admission to the World Trade Organization in 2001, contributed to job losses in the United States. A study, published in 2016, found that the United States lost up to 2.4 million jobs due to increase in imports from China between 1999 and 2011. About 985,000 of those lost jobs were in manufacturing, accounting for about 17% of 5.8 million manufacturing jobs lost during that period. Another study, published in 2017, concluded that trade resulted in 13% of job losses in manufacturing between 2000 and 2010. Meanwhile, the productivity growth stemming from automation and other technologies caused over 85% of job losses. In other words, trade is not the main reason for jobs lost in the United States manufacturing sector. Because it is difficult to establish straightaway whether international trade or technological change might be a cause for job displacement,

[11] Richard Samans: Globalization 4.0. Shaping a New Global Architecture in the Age of the Fourth Industrial Revolution, April 2019, World Economic Forum.
[12] Ronald Findlay, Kevin H. O'Rourke: Power and Plenty. Trade, War, and the World Economy in the Second Millennium. Princeton and Oxford, United States of America. Princeton University Press, 2009.
[13] Marianne Schneider-Petsinger: Trade Policy Under President Trump. Implications for the US and the World. Chatham House, the Royal Institute of International Affairs, November 2017.
[14] Ibid.

trying to distinguish between these two possibilities has given rise to a lively academic controversy. In this regard, Joshua P. Meltzer and Neena Shenai[15] note that international trade increases economic productivity by reallocating jobs to more efficient industries. On the contrary, Joshua P. Meltzer and Neena Shenai[16] suggest that while jobs were lost in some sectors of economy, jobs were created in other sectors. In the case of the United States and China trade, there has been job creation in some areas of the United States economy such as agriculture and services, and job destruction in some sectors, particularly low-wage manufacturing. For example, the Unites States exports, overall, have created about 6.6 million jobs from 1995 to 2001. The recent data shows that the United States exports to China support around 1.8 million jobs in sectors such as services, agriculture, and capital goods. The United States consumers have also gained from trade with China. For example, from 2000 to 2007, the impact of lower priced imports from China produced an economic gain of US$ 202 billion for the United States equivalent to US$ 101,250 per job lost in manufacturing during this period. Joshua P. Meltzer and Neena Shenai[17] argue that although the United States trade with China has led to job losses in the United States manufacturing sector, it is likely that data overstates the job losses as it fails to account for the extent to which the United States imports from China include the United States value-added. China remains a center of significant amounts of processing trade critical to global value chains, whereby low value-added product assembly using inputs from the United States and elsewhere are then exported to the United States and globally, while high-value inputs such as research and development, design, distribution, retail remain outside China. For example, each iPhone imported into the United States from China is recorded as US$ 240, but China's value-added to the iPhone is only around US$ 8.50 or 3.6% of the total, while the imported United States value-added in the iPhone is worth around US$ 70. Joshua P. Meltzer and Neena Shenai[18] suggest, based on the iPhone example, that a proper accounting of the United States trade with China should include the United States value embedded in imports from China, consequently, data would display lower impact of imports from China on the United States manufacturing jobs by over 32%. Joshua P. Meltzer and Neena Shenai[19] argue that the initial China shock to the United States economy is largely complete and trade with China is having fewer negative effects on the United States manufacturing. Evidence of firm reorganization and innovation shows that the United States business has been more skillful at competing with imports from China. In fact, since 2010, the United States has added over 1.2 million manufacturing jobs. Overall, the impact of trade as opposed to technological change on the labor market is not easy to distinguish as these two factors can go hand in hand. It is argued that China's export growth after its accession to the World Trade Organization has caused considerable dislocation in the United States labor market. However, the negative political reactions to these exports and China's large

[15] Joshua P. Meltzer, Neena Shenai: The US-China economic relationship. A comprehensive approach. Policy brief as part of a project entitled "Rethinking Globalization" by Brookings Institution and American Enterprise Institute, February 2019.
[16] Ibid.
[17] Ibid.
[18] Ibid.
[19] Ibid.

trade surplus with the United States were contained because the United States consumers benefited from low-priced goods and firms profited from being able to assemble their products in China and export to its large market. Nevertheless, the consensus view regarding the impact of trade on income inequality, is that international trade and globalization have certainly increased inequality in the United States, despite the fact that most research concludes that international trade accounts for a relatively small share of inequality and other factors, such as technological changes, are much more important drivers. Due to insufficient adjustment mechanisms, displaced workers find it very difficult to transition to different sectors of the economy. The failure by policymakers to acknowledge the related costs of international trade has created a space for those tapping into the sentiments of people who adversely affected by job displacement and encourage them to speak out against further liberalization, particularly in the United States, giving surge in protectionism. Ronald Findlay and Kevin H. O'Rourke[20] suggest that the fact that voters appear to hold opinions about international trade, because it generates distributional changes against unskilled workers and in favor of higher skilled workers in advanced economies, will be very relevant to future of globalization. Thus, it is emphasized that developed countries need to implement complementary domestic policies, including educational, training, and welfare programs, in order to maintain political support for liberal trade policies. And, with the return of protectionism, the United States, which played a crucial role in shaping the global trade system, will no longer lead on global trade liberalization. Ronald Findlay and Kevin H. O'Rourke[21] conclude that contemporary globalization, and its economic and political consequences, have not arisen out of a vacuum, but from a worldwide process of uneven economic development that has been centuries in the making. In turn, this process has been critically shaped by the changing ways in which the various world regions have interacted with each other through trade, migration, and investment, as well as politically and culturally, over time. Politics thus determined trade, but trade also helped to determine politics, by influencing the capacities and the incentives facing countries. In this manner, many of today's key interregional tensions can be traced back to earlier interactions between the world's main regions. It is emphasized that one of the lessons of history is that the geopolitical context is crucial in determining the extent of international trade.

5. THE EVOLUTION OF THE UNITED STATES AND CHINA RELATIONSHIP

The Council on Foreign Affairs - a United States-based think tank - in its review of the United States and China relations notes that both countries relationships have evolved

[20] Ronald Findlay, Kevin H. O'Rourke: Power and Plenty. Trade, War, and the World Economy in the Second Millennium. Princeton and Oxford, United States of America. Princeton University Press, 2009.
[21] Ibid.

from tense standoffs to a complex mix of intensifying diplomacy, growing international rivalry, and increasingly intertwined economies since 1949.[22]

The United States and China relationship went through a radical change towards rapprochement, after differences over security, ideology, and development models strained relations between China and the Soviet Union. Disagreements between China and the Soviet Union culminated in border skirmishes in March 1969, during which hundreds of thousands of troops were deployed from the Soviet Union side and one million troops from the Chinese side of the border. Then, the Soviet Union launched the policy of détente with the United States to help relieve pressure on its western flank in Europe and to concentrate on China in the Far East. For its part, China saw itself surrounded by pro-Soviet states such as Mongolia, Vietnam, Laos and India. Consequently, the split between China and the Soviet Union contributed to the eventual rapprochement of China with the United States, which both, the United States and China, were able to skillfully exploit to their advantage.[23]

In July 1971, the United States Secretary of State made a secret trip to China, and shortly after that, the United Nations - the world's main organization for deliberating matters of peace and security - recognized China and transferred the permanent Security Council seat from the Republic of China on Taiwan to the People's Republic of China.[24] The United States and China are permanent members of the United Nations Security Council, and nowadays, the two largest contributors to the United Nations regular annual budget, which covers administrative costs and programs, and to the United Nations peacekeeping operations budget. Thus, the United States contributions amount to 22% of regular annual budget and 28% of peace operations budget, and China's contributions amount to 12% and 10%, respectively.[25] It is evident that China's rapidly increasing economic weight boosts its diplomatic and political influence at the international level while rousing the United States ire because China's emergence as the rising power poses challenges for the United States as the ruling power.

In January 1979, the United States and China re-established diplomatic relations, while the United States acknowledging mainland China's One-China principle and severing normal ties with Taiwan.[26] Ironically, in 2019, at the time of evolving trade conflict between the United States and China, the two nations are marking the fortieth anniversary of their diplomatic relations. In July 1979, both countries signed a bilateral trade agreement, and in 1980 provided mutual most-favored-nation treatment, which allowed to substantially expand their economic relationship since

[22] U.S. Relations with China, 1949 – 2019, Council on Foreign Relations, https://www.cfr.org/timeline/us-relations-china
[23] Robert D. Kaplan: The revenge of geography. What the map tells us about coming conflicts and the battle against fate. The Random House Publishing Group, New York, United States, 2013.
[24] U.S. Relations with China, 1949 – 2019, Council on Foreign Relations, https://www.cfr.org/timeline/us-relations-china
[25] https://peacekeeping.un.org/en/how-we-are-funded
[26] The United States maintains only unofficial relations with Taiwan, while upholding the 1979 Taiwan Relations Act, including provisions requiring arms sales to Taiwan.

then.[27] The United States - China Relations Act of October 2000 advanced their trade relations, paving the way for China to join the World Trade Organization in 2001. However, China's integration into the world trading system has not been smooth as the United States - the most vocal among the organization's members - began challenging China's policies in large numbers through formal dispute settlement.

In 1980, the total United States - China trade (exports plus imports) was US$ 4.9 billion (Table 1). China ranked as the United States' twenty-fourth largest trading partner, sixteenth largest export market, and thirty-sixth largest source of imports.[28]

Table 1. Merchandise trade between the United States and China 1980 - 2017 (US$ in billions)[29]

Year	U.S. Exports	U.S. Imports	U.S. Trade Balance
1980	3.8	1.1	+2.7
1990	4.8	15.2	-10.4
2000	16.3	100.1	-83.8
2010	91.9	365.0	-273.0
2011	104.1	399.4	-295.3
2012	110.5	425.6	-315.1
2013	121.7	440.4	-318.7
2014	123.7	468.5	-344.8
2015	115.9	483.2	-367.3
2016	115.6	462.6	-347.0
2017	130.4	505.6	-375.2

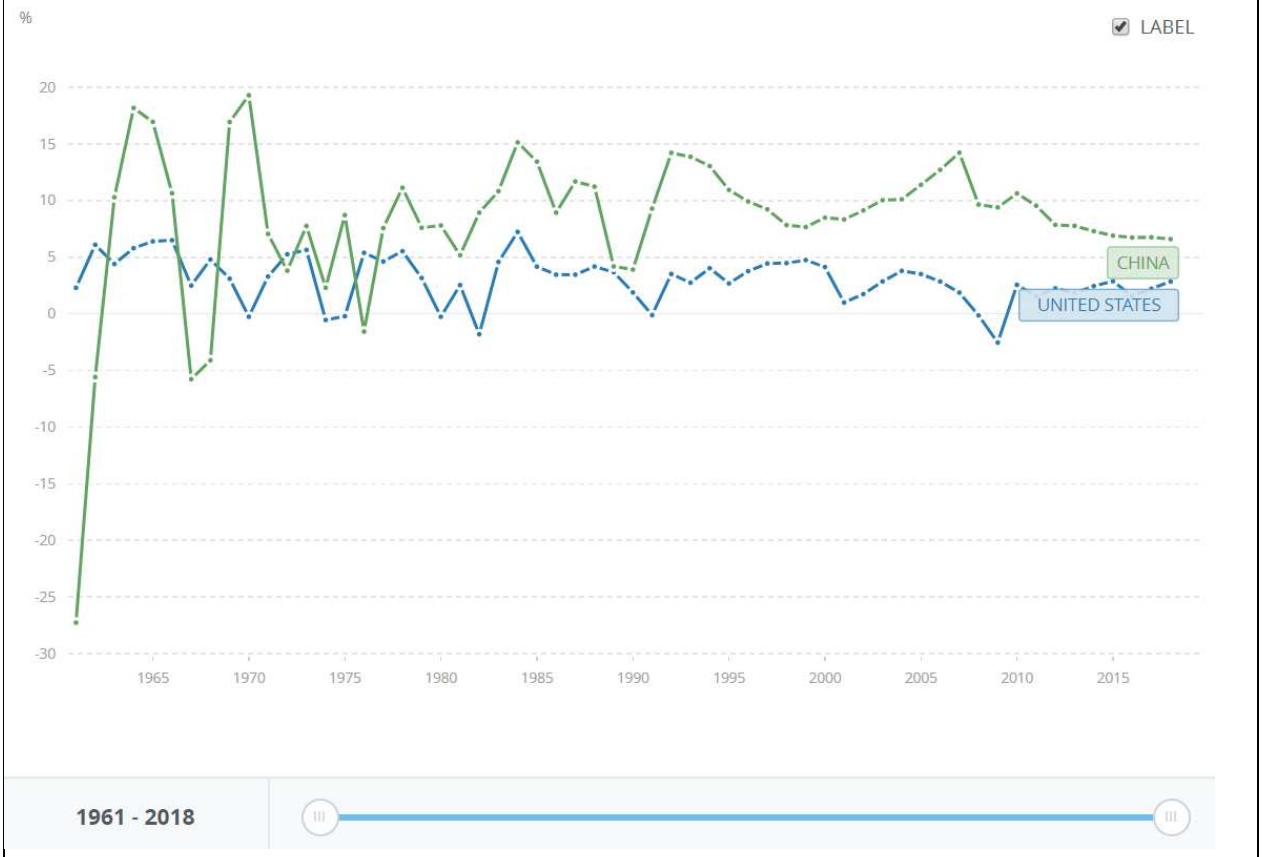
Source: U.S. International Trade Commission (USITC) DataWeb.

However, between 1980 and 2004, the United States - China trade rose from US$ 4.9 billion to US$ 231 billion. And, in 2006, China surpassed Mexico as the United States' second biggest trade partner, after Canada.[30] The share of China in the United States trade has significantly increased over the past two decades. In 2000, it accounted for 2.0% of the total United States exports and 7.1% of the total United States imports. By comparison, in 2018, China's share stood at 7.2% of the total United States exports and 17.9% of the total United States imports. In 2018, China, on a country basis, was the largest trading partner of the United States in terms of two-way (exports plus imports) totaled US$ 738.6 billion.[31]

[27] Wayne M. Morrison: China-U.S. Trade Issues. U.S. Congressional Research Service, 30 July 2018, https://crsreports.congress.gov/
[28] Ibid.
[29] Ibid.
[30] U.S. Relations with China, 1949 – 2019, Council on Foreign Relations, https://www.cfr.org/timeline/us-relations-china
[31] Andres B. Schwarzenberg: U.S. Trade: Recent Trends and Developments. U.S. Congressional Research Service, 24 April 2019, https://crsreports.congress.gov/

As China's growth continued, in September 2008, China surpassed Japan to become the largest foreign creditor of the United States holding its debt at around US$ 600 billion. The growing interdependence between economies of the United States and China became evident. By comparison, in 2018, China was the largest foreign holder of the United States Treasury securities at US$ 1.113 trillion, equivalent to 17.3% of the total amount of treasury securities issued to foreign countries, which amounts to US$ 6.433 trillion, and followed by Japan at US$ 1.064 trillion, equivalent to 16.5%.[32]

Figure 3. GDP Growth Comparison between the United States and China from 1961 to 2018 (Annual %) https://data.worldbank.org/indicator



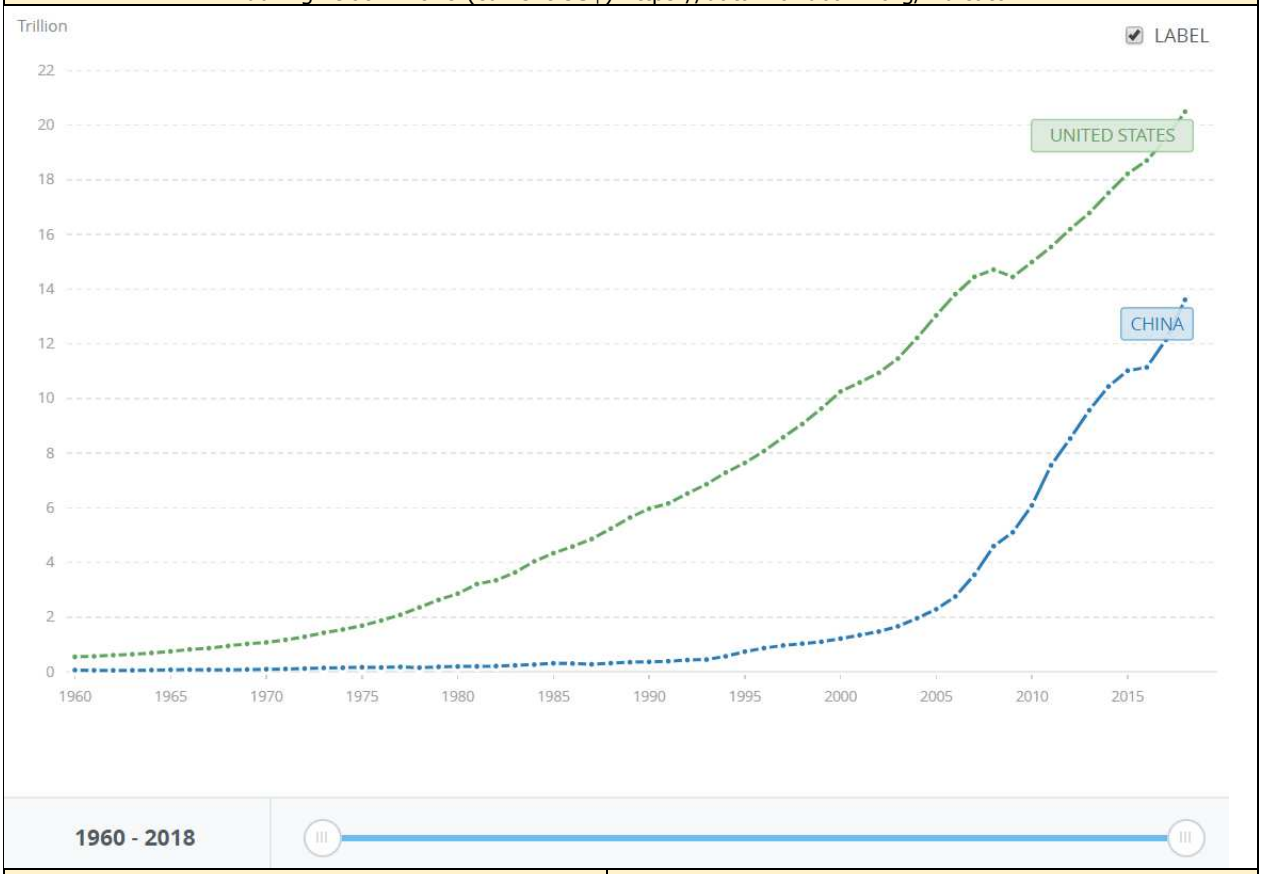
China (2018): 6.6%	United States (2018): 2.857%

In August 2010, China surpassed Japan as the world's second-largest economy after it was valued at US$ 1.33 trillion for the second quarter of 2010, slightly above Japan's US$ 1.28 trillion for that year. At the start of 2011, China reported a total GDP of US$ 5.88 trillion for 2010, compared to Japan's US$ 5.47 trillion.[33] China managed to maintain the world's second-largest economy status since then. In 2018, China with GDP annual growth rate at 6.6%, in comparison with the Unites States, had an impressive more than twofold higher the world average growth rate at 3.035% in 2018. China has been able to maintain higher growth rates for past four decades. On the other hand, the United States has been struggling to keep its growth going on the right path during the same period. In 2018, the United States GDP annual growth was at 2.857%, slightly below the world average growth rate at 3.035% in 2018 (Figure

[32] https://howmuch.net/articles/foreign-holders-of-usa-debt
[33] U.S. Relations with China, 1949 – 2019, Council on Foreign Relations, https://www.cfr.org/timeline/us-relations-china

3). In 2018, China's GDP was valued at US$ 13.608 trillion, after the United States at US$ 20.494 trillion (Figure 4).

Figure 4. GDP Growth Comparison between the United States and China during 1960 – 2018 (current US$) https://data.worldbank.org/indicator



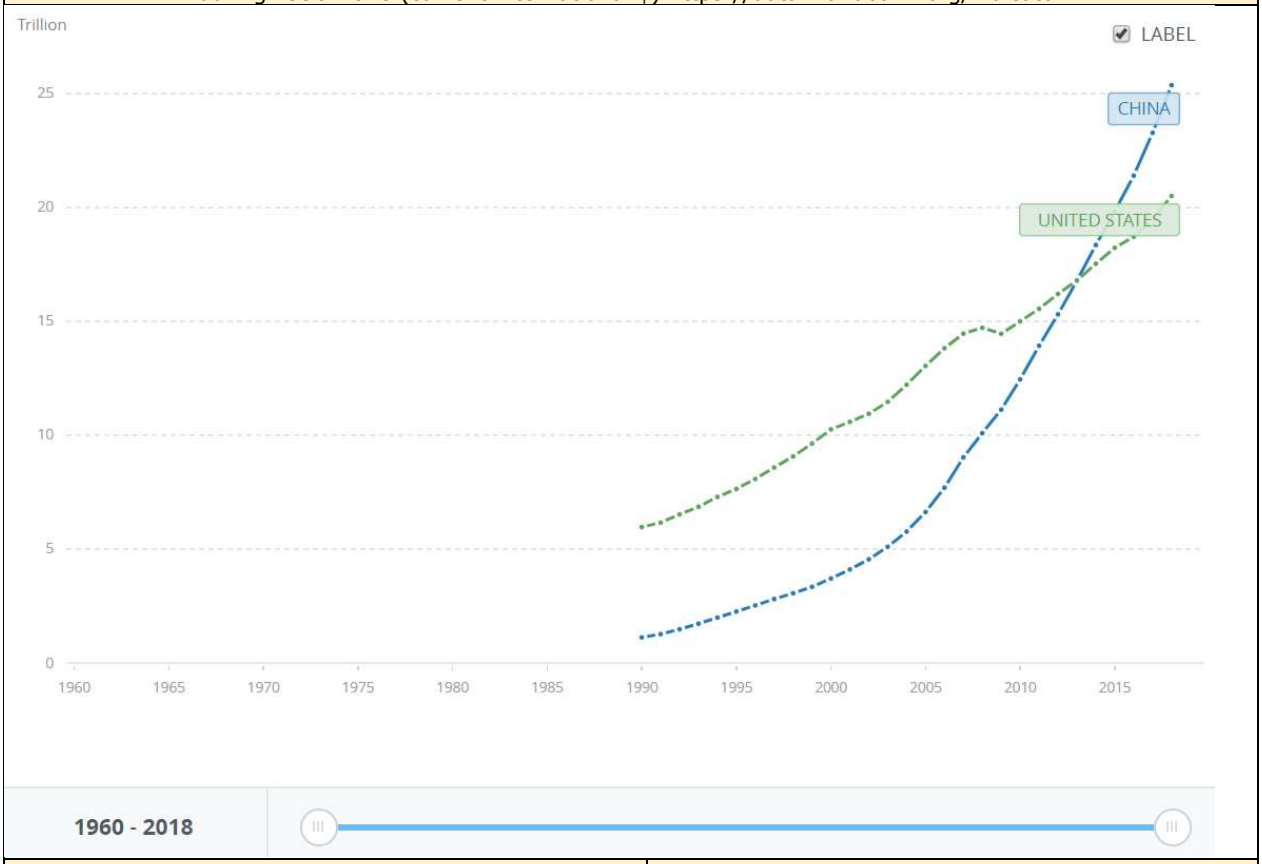
China (2018): US$ 13.608 trillion	United States (2018): US$ 20.494 trillion

By comparison, in 2018, China's GDP adjusted to PPP (purchasing power parity) was valued at US$ 25.362 trillion, above the United States at US$ 20.494 trillion (Figure 5). The rising China's economy set off alarm bells amongst advanced economies, particularly the United States. Goldman Sachs predicts that China is on track to overtake the United States as the world's number one economy by 2027[34]. Also, PwC forecasts that six of the seven largest economies in the world are projected to be emerging economies in 2050 led by China (first) and India (second), while the United States could be down to third place in the global GDP rankings and the European Union's share of world GDP could fall below 10% by 2050.[35]

[34] U.S. Relations with China, 1949 – 2019, Council on Foreign Relations, https://www.cfr.org/timeline/us-relations-china

[35] The World in 2050. The long view: how will the global economic order change by 2050? PricewaterhouseCoopers LLP, February 2017, https://www.pwc.com/world2050#download, https://www.weforum.org/agenda/2017/02/a-prediction-the-worlds-most-powerful-economies-in-2030

Figure 5. GDP - PPP Growth Comparison between the United States and China during 1990-2018 (current international $) https://data.worldbank.org/indicator



China (2018): international $ 25.362 trillion	United States (2018): international $ 20.494 trillion

In response, the United States turned on Asia with increased investments in diplomatic, economic and strategic efforts to counter China's growing economic power. As a result, in November 2011, at the Asia-Pacific Economic Cooperation summit, the United States and eight other nations reached an agreement on the Trans-Pacific Partnership - a multinational free trade agreement, which was signed on 4 February 2016.[36] Previously, the United States sought to use regional trade agreements such as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership to write trading rules to deal with the problems presented by China that could not be handled under the World Trade Organization's rules. The idea was that if a critical mass of Asian and other major trading countries would sign on to the rules, China could be pressured either to follow them or at least to negotiate with the United States and other signatory countries.[37] However, to the surprise of many, in January 2017 the Office of the United States Trade Representative issued a letter to signatories of the Trans-Pacific Partnership Agreement that the United States has formally withdrawn from the agreement per guidance from the President of the United States.[38] After that the agreement could not enter into force and became defunct. The remaining nations negotiated a new trade agreement that incorporated most of the provisions of the Trans-Pacific Partnership Agreement, and called the

[36] https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text
[37] Robert Z. Lawrence: US-China Trade Frictions and the Global Trading System, Chapter 3. US-China Economic Relations: From Conflict to Solutions, China Finance 40 Forum - Peterson Institute for International Economics, June 2018.
[38] https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership

Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which was signed on 8 March 2018 and entered into force on 30 December 2018.[39] The United States withdrawal from the Trans-Pacific Partnership Agreement and push for renegotiation of the North American Free Trade Agreement with Canada and Mexico under a new agreement called the United States-Mexico-Canada Agreement, is evident that a shift takes place in the United States trade policy towards creating more balanced and reciprocal trade with a deal-making model of foreign relations. For this reason, the United States dismissed the previous approaches, and currently it prefers to use access to the United States market as leverage to renegotiate the terms of the United States engagement bilaterally with other countries, even when this new approach obviously involves breaches of the World Trade Organization's rules.

In June 2013, at the Sunnylands Estate in California, the presidents of the United States and China made an effort to ease tense relationships, including issues concerning trade tensions, and both vowed to establish a new model of relations, stemming from the Chinese concept of establishing a new type of great power relations for the United States and China[40]. This rapprochement suggests the United States recognition of the changing situation and the historical transformation in the global economic landscape with power shifts amongst advanced economies, and the United States desire to bring China's behavior in line with its own agenda.

The United States runs the world's largest trade deficit, mainly in goods, over the past four decades. In 2018, the United States net trade deficit in goods and services totaled US$ 622.115 billion. On the other hand, in 2018, China had a net trade surplus of US$ 102.921, and their net trade imbalances have been increasing over past four decades. Although the United States trade deficits in goods are high, these imbalances are partially offset by surpluses in services trade. In 2018, the total United States merchandise deficit was US$ 891.322 (Figure 6).

Figure 6. United States Trade Balance

(in billions of current U.S. dollars)

Source: Bureau of Economic Analysis, April 17, 2019.

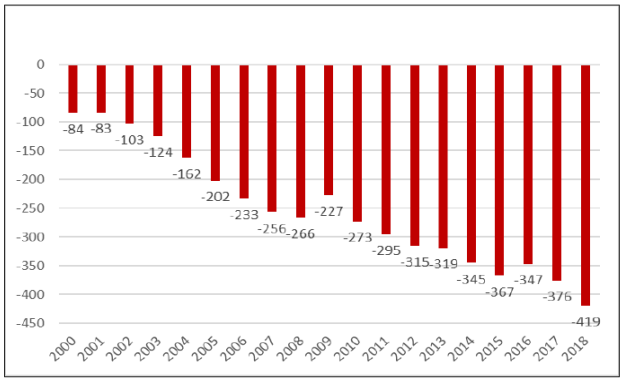
However, China's large and growing merchandise trade surpluses with the United States, including China's trading practices, have strained both countries relations. The United States merchandise trade deficit with China rose from US$ 10.4 billion in 1990 to US$ 419.3 billion in 2018, and has been significantly larger than with any other country, which prompted the United States to view it as unbalanced, unfair and damaging to its economy (Figure 7). It is to note that many experts view conventional bilateral

[39] https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/cptpp-ptpgp/index.aspx?lang=eng

[40] U.S. Relations with China, 1949 – 2019, Council on Foreign Relations, https://www.cfr.org/timeline/us-relations-china

trade deficit data as misleading, given the growth of global supply chains used by multinational firms.

Figure 7. The United States and China Merchandise Trade Balances (US$ billions)



Source: USITC Dataweb.

In April 2017, the President of the United States and the Chinese President met for a two-day summit at the Mar-a-Lago estate in Florida, where bilateral trade was high on the agenda. Both presidents cited huge progress, better understanding and greater trust building in the United States and China relationship. Following this meeting, in mid-May 2017, the United States Commerce Secretary unveiled a ten-part agreement between the United States and China aimed to expand trade of products and services.[41] However, this rapprochement between the United States and China was jeopardized by opening several investigations into China's trading practices and imposing far-reaching tariffs on Chinese imports by the United States which suggests the resurgence of protectionism in the United States.

6. THE UNITED STATES TARIFFS UNDER SECTION 201 OF THE UNITED STATES TRADE ACT OF 1974

In January 2018, on the recommendation of the United States International Trade Commission, the President of the United States granted safeguard tariff protection to the United States solar panel and washing machine industries under Section 201 of the United States Trade Act of 1974, effective 7 February 2018. This tariff covers imports from all countries, except certain developing countries, and Canada. Although the World Trade Organization permits safeguard tariffs, it requires that the country implementing the safeguards must compensate its trading partners in other areas or face retaliation. Following this proclamation, the European Union, South Korea, Taiwan and China have sought consultations on the United States tariffs in their filings with the World Trade Organization.[42] This measure, as part of the America First trade policy aimed to protect local manufactures from foreign competition, especially in respect to trading interests of China and South Korea with the United States, caused some alarm at the 2018 Annual Meeting of World Economic Forum held in January 2018 in Davos-Klosters of Switzerland.[43] Although world leaders came to the defense of free trade and global cooperation at that meeting, it became evident that the United States began putting its new trade policies into action which signals that globalization

[41] U.S. Relations with China, 1949 – 2019, Council on Foreign Relations, https://www.cfr.org/timeline/us-relations-china
[42] Robert Z. Lawrence: US-China Trade Frictions and the Global Trading System, Chapter 3. US-China Economic Relations: From Conflict to Solutions, China Finance 40 Forum - Peterson Institute for International Economics, June 2018.
[43] https://www.weforum.org/agenda/2018/01/davos-2018-trade-trump-tpp-nafta/

is on reverse course and reveals that the protectionism underpins the United States trade strategy. According to the IMF's World Economic Outlook 2018, one of the risks of the global economy over the medium term was identified as possible adoption of inward-looking policies (increased regulatory and trade barriers).[44]

7. THE UNITED STATES TARIFFS UNDER SECTION 232 OF THE UNITED STATES TRADE EXPANSION ACT OF 1962

In March 2018, the President of the United States issued two proclamations increasing import tariffs on aluminum by 10% and steel by 25%, based on the controversial legal justification that these imports threatened the United States national security, under Section 232 of the United States Trade Expansion Act of 1962, effective 23 March 2018. After being deferred, the import tariffs on aluminum and steel went ahead on 1 June 2018 for the European Union, Canada, Mexico, following the United States decision not to extend temporary exemptions. However, Argentina, Australia, Brazil and South Korea managed to obtain permanent exemptions as a result of deals made with the United States. In the case of South Korea, the United States used the tariff threats to facilitate the renegotiation of the United States - Korea Free Trade Agreement, new version of which aims to rebalance bilateral trade, reduce trade deficit, and expand the United States export opportunities.[45] For all other countries, including China and Japan, the United States tariffs had already taken effect at the end of March 2018. In April 2018, China filed a formal dispute at the World Trade Organization and retaliated with raising tariffs on the United States exports worth US$ 3 billion. After talks with the United States failed to result in a permanent exemption, the European Union filed a complaint at the World Trade Organization. Both, China and the European Union, consider the United States tariffs to be safeguard measures to which national security exceptions do not apply, thus the trading partners can seek immediate compensation under the World Trade Organization's Agreement on Safeguards. Other United States trading partners have responded in similar ways, raising fears that this could be the start of a full-blown trade war that would harm economic growth. The G7 summit of June 2018 was dominated by disagreements, notably over trade, and their leaders were not able to resolve their differences.[46] Consequently, in June 2018, the European Union adopted rebalancing measures in response to the United States steel and aluminum tariffs by targeting the United States products worth EUR 2.8 billion, and additional products worth EUR 3.6 billion after three years or after a positive outcome form the World Trade Organization.[47] It is argued that the true objective of the United States tariff measures was to renegotiate existing trade agreements, for example the United States - Korea Free Trade Agreement and the North American Free Trade Agreement, while insisting on concessions from its trading partners. Likewise, tariff measures will pressure other

[44] International Monetary Fund, 2017 (updated on 22 January 2018). Seeking Sustainable Growth: Short-Term Recovery, Long-Term Challenges. Washington, DC, October 2017.
[45] https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2018/march/new-us-trade-policy-and-national
[46] https://www.bbc.co.uk/news/world-us-canada-44427660
[47] http://europa.eu/rapid/press-release_IP-18-4220_en.htm

trading partners, for example the European Union and Japan, to seek negotiations with the United States to defuse trade tensions that increases role for trade in a deal-making model of foreign relations.

8. THE UNITED STATES TARIFFS UNDER SECTION 301 OF THE UNITED STATES TRADE ACT OF 1974

Since then, fears of a trade war have been stoked by rising trade tensions between the United States and China. In March 2018, the United States Trade Representative released the findings of an investigation under Section 301 of the United States Trade Act of 1974 that determined the acts, policies, and practices of the Government of China related to technology transfer, intellectual property, and innovation covered in the investigation were unreasonable or discriminatory and burden or restrict the United States commerce.[48] The investigation identified four Chinese policies of particular concern: forced technology transfer requirements, discriminatory licensing requirements, state-directed investments in and acquisitions of the United States companies to obtain cutting-edge technologies and intellectual property, and state-directed cyber-theft of the United States trade secrets.[49] To pressure China to address those issues, in March 2018, the President of the United States signed a Memorandum on Actions by the United States Related to the Section 301 Investigation, which directed the United States Trade Representative to take actions: (1) to consider whether appropriate actions under Section 301 should include increased tariffs on goods from China; (2) to pursue dispute settlement in the World Trade Organization to address China's discriminatory licensing practices and unfair trade practices; and, (3) to address concerns about investment in the United States directed or facilitated by China in industries or technologies deemed important to the United States (investment restrictions).[50] The United States and China have conducted high-level economic and trade consultations for some time to address the United States concerns and these discussions have gone on to include issues beyond the mentioned four intellectual property and innovation policies. In May 2018, the United State and China in a joint statement outlined progress on a number of trade issues, including China's commitments to significantly increase purchases of the United States goods and services and to strengthen its intellectual property laws and regulations, thus putting on hold their trade tensions.

[48] https://www.regulations.gov/document?D=USTR-2019-0004-0001
[49] Susan V. Lawrence, Wayne M. Morrison, Jonah Langan-Marmur: U.S.-China Relations, U.S. Congressional Research Service, 11 April 2019, https://crsreports.congress.gov/
[50] https://www.whitehouse.gov/presidential-actions/presidential-memorandum-actions-united-states-related-section-301-investigation/

Table 2. The United States - China Section 301 Tariff Actions

Country Imposing Tariff	Ad Valorem Tariff Rates	Stated Imports Impacted	Tariff Actions and Dates
U.S. Tranche 1	25%	$34 billion	Implemented 7/6/2018
China Tranche 1	25%	$34 billion	Implemented 7/6/2018
U.S. Tranche 2	25%	$16 billion	Implemented 8/23/2018
China Tranche 2	25%	$16 billion	Implemented 8/23/2018
U.S. Tranche 3	10%, then 25%	$200 billion	10% hike effective 9/24/2018; raised to 25% by 6/15/2019
China Tranche 3 (4 lists)	5% and 10%, then 10%, 20%, and 25%	$60 billion	5% and10% hikes on 9/24/2018; increased to 10%, 20%, and 25% on selective products, effective 6/1/2019
U.S. Tranche 4 proposed	25%	$300 billion	Draft USTR notice issued 5/13/2019 (action pending)

Sources: USTR and Chinese Ministry of Finance.

Nevertheless, in May 2018, in the middle of these consultations, the United States announced that it planned to implement the Section 301 actions against China, and requested China to remove all trade barriers and make taxes and tariffs between the two countries reciprocal in nature and value. In response, China stated that these actions were contrary to their recent agreement and it would not implement the pledged measures while being threatened with tariff hikes. First two rounds of tariff measures, the United States implemented in July 2018 covering US$ 34 billion worth of products, and in August 2018, covering US$ 16 billion worth products, by imposing additional tariffs of 25% on Chinese exports worth total US$ 50 billion. Third round of tariff measures went on in September 2018 for additional tariffs of 10% on US$ 200 billion of Chinese exports, which were planned to be further raised to 25% in January 2019. In addition, the United States threatened further tariffs on all remaining Chinese exports worth US$ 300 billion, leading to rapid escalation of the economic and trade tensions between the two countries. China responded in kind and, likewise, raised tariffs by 25% on the United States imports worth total US$ 50 billion, in July 2018 for products worth US$ 34 billion and in August 2018 for products worth US$ 16 billion, mirroring the United States tariff measures. Additionally, China raised tariffs by 5% and 10% on the United States imports worth US$ 60 billion in September 2018 (Table 2).[51]

[51] Wayne M. Morrison: Enforcing U.S. Trade Laws: Section 301 and China, U.S. Congressional Research Service, Updated 26 June 2019, https://crsreports.congress.gov/

Table 3. Total Tariffs Imposed

The ongoing trade conflict between the world's two largest economies, which account to 40% of global GDP, had increased fears that further escalation would harm the global economy. At that point, the United States and China economic relationship had reached a critical juncture, as both countries-imposed tariff measures affected products in total worth US$ 360 billion. The world got anxious about possible tit-for-tat trade war between the world's two largest economies (Table 3).

On 1 December 2018, at the G20 summit in Buenos Aires of Argentina, the presidents of the United States and China agreed to resolve their trade dispute within 90 days, by 1 March 2019, though this deadline was further extended to allow trade talks to progress. After the United States has ended abruptly the talks with China in May 2019, the United States intensified its trade war with China and, in third round, raised tariffs from 10% to 25% on US$ 200 billion worth of Chinese goods, which were initially planned for January 2019. Furthermore, the United States threatened China to hit by 25% tariffs an additional US$ 300 billion of Chinese products. In June 2019, China retaliated by increasing tariffs by 10%, 20% and 25% on selective products from the United States worth US$ 60 billion. The United States and China trade conflict escalated, but it fell short of a full-fledged war. The United States, while prioritizing competition over cooperation, believes the high costs imposed by tariffs will force China to make a deal favorable to the United States. However, this strategy may not work regarding China as it has sufficient economic weight it can throw around. China believes the more it offers to the United States the more the latter wants, restoring to intimidation and coercion, and persisting with exorbitant demands, which encroach on China's sovereign affairs.[52] In June 2019, at the G20 summit in Osaka of Japan, the United States and China agreed to a truce in their trade war and vowed to restart trade negotiations. The United States has agreed to delay indefinitely placing more tariffs on imports from China, including the pending tariff measures on US$ 300 billion worth products, and lift some of its export controls on the Chinese firm Huawei Technologies. In return, China will consider buying more agricultural products form the United States. Both counties have re-started their trade talks, but signs are showing a comprehensive deal could be a long way off, tense with many sticking points. After all, both the United States and China have agreed to two such temporary agreements before, and both eventually broke down, as many key demands from each side remain unresolved. Nevertheless, it appears that the United States may be willing to weaken some of its demands to get a deal with China. The latest trade cease-fire between the

[52] Full text: China's Position on the China-US Economic and Trade Consultations, the State Council Information Office of the People's Republic of China, 2 June 2019, http://english.gov.cn/archive/white_paper/2019/06/02/content_281476694892692.htm

United States and China gives the perception that trade wars are not easy to win, even for such a powerful country as the United States. The reason might also be that China has already developed necessary capabilities to compete on an equal footing with the United States. Nevertheless, for the time being, the U.S.-China trade war will enter a period of negotiation and renewed hope for a deal, thus the global economy can let out a sigh of relief in near future.

9. THE UNITED STATES TRADE IN GOODS AND SERVICES WITH LEADING PARTNERS

The comparative analysis of the United States bilateral trade flows and balances and their composition with its leading partners allows us to better understand the recent United States efforts to examine key trading relationships with them and trade policy choices facing the United States.

9.1. OVERVIEW OF THE UNITED STATES MERCHANDISE TRADE (2018)

According to a report of the United States Congressional Research Service[53], in 2018, the United States exports of goods totaled US$ 1,672.3 trillion, a US$ 118.9 billion increase, equivalent to 7.7%, from the 2017 level (Table 4, Figure 8).

Table 4. United States Trade in 2018

	U.S.$ (billions)	% Change from 2017*
Total Exports	2,500.8	6.4
Exports of Goods	1,672.3	7.7
Exports of Services	828.4	3.9
Total Imports	3,122.9	7.6
Imports of Goods	2,563.7	8.6
Imports of Services	559.2	3.1
Total Balance (Deficit)	-622.1	12.6
Balance on Goods (Deficit)	-891.3	10.4
Balance on Services (Surplus)	269.2	5.5

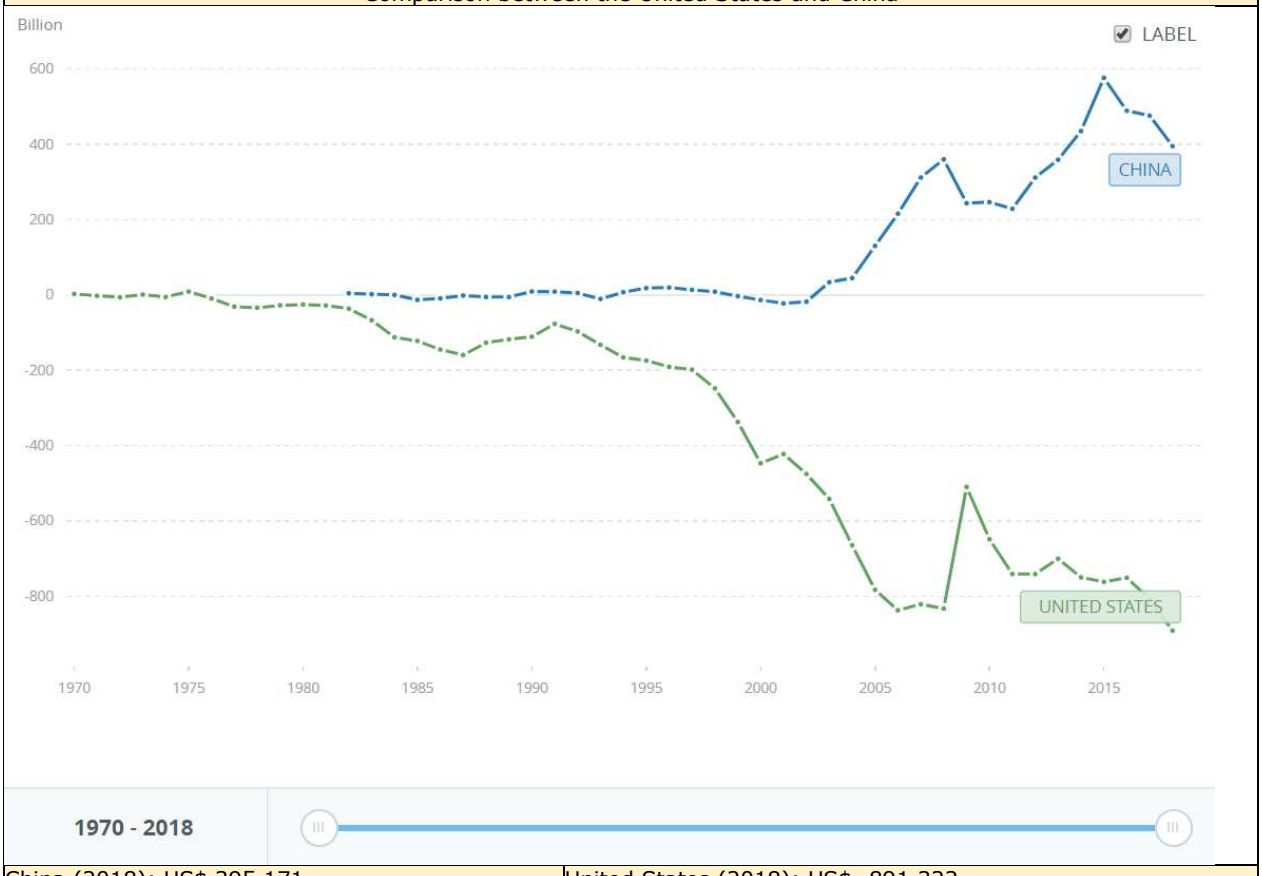
Source: Bureau of Economic Analysis, April 17, 2019.
Note: * not adjusted for inflation.

In 2018, the value of the United States imports of goods was US$ 2,563.7 trillion, an increase of US$ 202.7 billion, equivalent to 8.6%, from the 2017 level. This suggests that the United States imports increased more than its exports, leading to an increase of US$ 83.8 billion, equivalent to 10.4%, in the United States merchandise trade deficit to US$ 891.3 billion. In 2018, the European Union - as a single entity - was the United States' top trading partner in goods (exports plus imports), followed by China, Canada, and Mexico. It is to note that China's share in the United States merchandise trade has increased almost threefold during the past two decades, from 5.8% in 2000 to 15.6% in 2018. In 2018, the European Union was the leading market for the United States exports, which totaled US$ 320.5 billion, equivalent to 19.2% of all the United States exports. Canada was the second-largest export market, which totaled US$ 299.4 billion worth of the United States exports, equivalent to 17.9%, followed by Mexico and China. In 2018, China was the leading source of the United States imports, which totaled US$

[53] Andres B. Schwarzenberg: U.S. Trade: Recent Trends and Developments. U.S. Congressional Research Service, 24 April 2019, https://crsreports.congress.gov/

540.3 billion, equivalent to 21.1% of all the United States imports, followed by the European Union, which totaled US$ 490.8 billion, equivalent to 19.1%, Mexico, and Canada. The analysis of the United States bilateral trade flows and balances suggests that in 2018, the United States had merchandise trade deficits with most of its leading partners, including with China totaled US$ 419.3 billion, the European Union totaled US$ 170.3 billion, Mexico totaled US$ 87.3 billion, and Japan totaled US$ 68.9 billion. It is to note that the United States exports of goods to most of its leading partners increased from 2017 to 2018. The largest was a US$ 37.5 billion, equivalent to 12.5%, increase in the United States exports to the European Union, followed by a US$ 21.7 billion increase in exports to Mexico, equivalent to 8.9%, and a US$ 16.5 billion increase to Canada, equivalent to 5.8%. In 2018, on a country basis, the largest increases in the United States exports were to India (29.0%), Italy (25.7%), and the United Kingdom (17.8%). However, the United States exports to China and Saudi Arabia decreased 7.2% and 16.7%, respectively.

Figure 8. Net Trade in Goods (Balance of Payment, current US$)
Comparison between the United States and China



China (2018): US$ 395.171 | United States (2018): US$ -891.322

Despite the fact that United States exports of goods increased from 2017 to 2018, these gains were offset by increased the United States imports of goods from all major trading partners, except Hong Kong, in 2018. The largest increases in imports were US$ 53.4 billion, equivalent to 12.2%, from the European Union, US$ 34.0 billion, equivalent to 6.7%, from China, and a US$ 32.9 billion, equivalent to 10.3%, from Mexico. While, the largest increases in the United States imports of goods were from Singapore (40.0%), Saudi Arabia (27.6%), and the United Kingdom (14.6%), the United States imports from Hong Kong decreased 12.8%.

9.2. OVERVIEW OF THE UNITED STATES TRADE IN SERVICES (2018)

In 2018, the United States exports of services increased 3.9% totaled US$ 30.7 billion, from US$ 797.7 billion to US$ 828.4 billion, while the United States imports of services increased 3.1% totaled US$ 16.7 billion, from US$ 542.5 billion to US$ 559.2 billion. Thus, the United States trade surplus in services increased 5.5% and totaled US$ 14.0 billion, to US$ 269.2 billion. [54] As with merchandise trade, the European Union was the United States' top trading partner in services (exports plus imports) in 2018, while the largest single-country services trading partners were the United Kingdom, Canada, Japan, and China. Since 2000, the share of the United States trade in services has decreased with leading partners like the United Kingdom, Canada, and Japan, while trade in services has significantly increased with China and India. In 2018, the European Union was the largest export market for the United States services, and the same time, it was the largest source of the United States imports of services, accounting for US$ 255.9 billion, equivalent to 30.1%, of total United States exports of services and for US$ 196.01 billion, equivalent to 35.1%, of total United States imports of services. Besides the European Union, on a country basis, the top markets for the United States exports of services were the United Kingdom, Canada, China, and Japan, while the top sources of the United States imports of services were the United Kingdom, Canada, Germany, and Japan. In 2018, the United States maintained a trade surplus in services with every major services trading partner except Italy (US$ 3.6 billion deficit), India (US$ 3.0 billion), and Taiwan (US$ 1.6 billion). The United States exports of services to almost all leading trading partners increased in 2018. Exports declined to Japan (down US$ 1.0 billion, or 2.2%) and Saudi Arabia (down US$ 430 million, or 4.7%). The largest increase in value was US$ 12.5 billion to the European Union, followed by US$ 5.3 billion to the United Kingdom and US$ 3.4 billion to Canada. In percentage terms, on a country basis, the largest increases in the United States services exports were to Singapore (16.3%), France (10.5%), Hong Kong (9.8%), and India (8.6%). The imports of the United States services from all but three of the major trading partners increased in 2018. Imports from both Brazil and Germany fell in 2018, down 12.4% (US$ 896 million) and 6.8% (US$ 2.4 billion), respectively. The largest increases in imports were from the European Union (US$ 6.4 billion), the United Kingdom (US$ 4.0 billion), and Canada (US$ 3.5 billion). In percentage terms, the largest increase in the United States services imports in 2018 was from Saudi Arabia (up 30.9%), followed by South Korea (up 13.7%) and Singapore (up 9.4%).

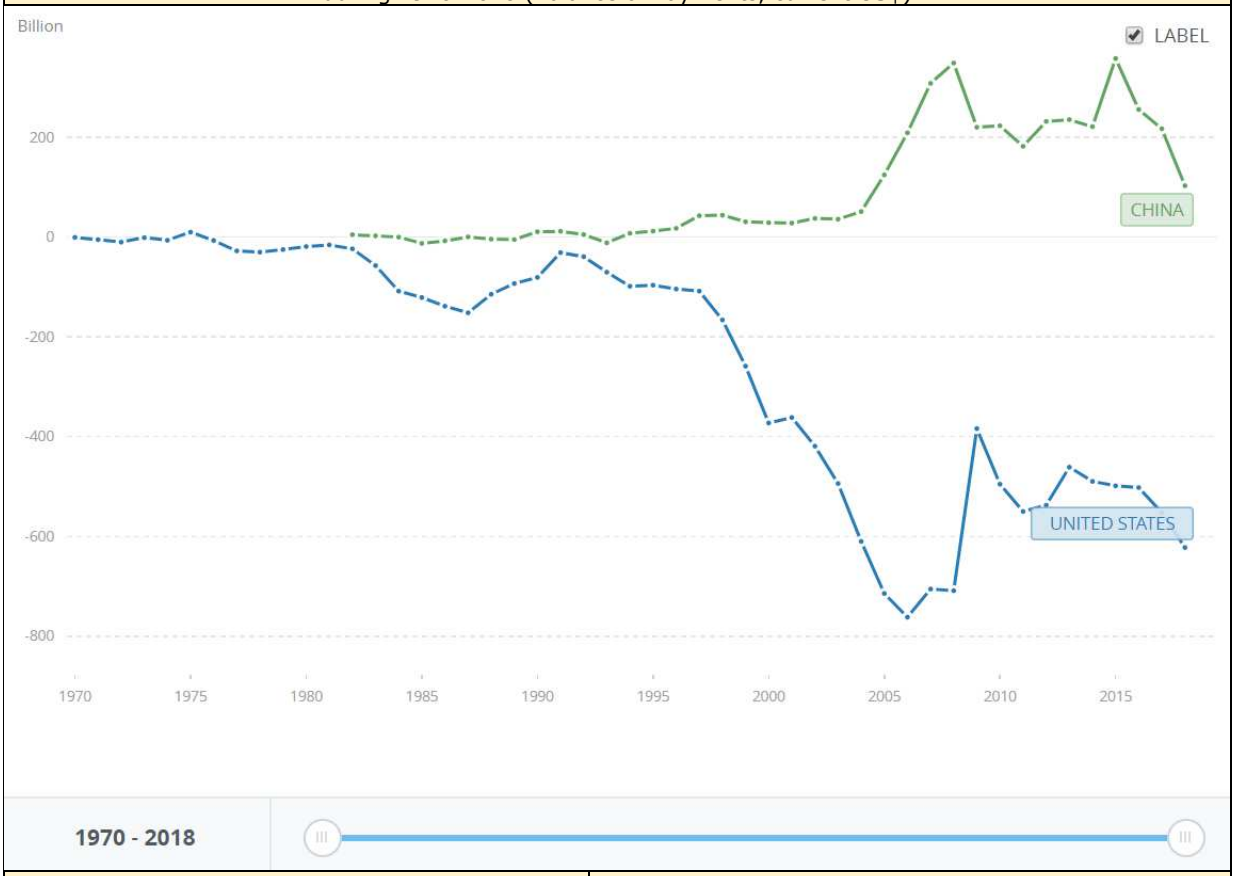
9.3. OVERVIEW OF THE UNITED STATES TRADE IN GOODS AND SERVICES (2018)

In 2018, the United States exports of goods and services totaled US$ 2.5 trillion, while imports totaled US$ 3.1 trillion, resulting in an overall deficit of US$ 622.1 billion, up 12.6% from 2017, but down from the all-time high level registered in 2006,

[54] Andres B. Schwarzenberg: U.S. Trade: Recent Trends and Developments. U.S. Congressional Research Service, 24 April 2019, https://crsreports.congress.gov/

which was US$ 761.7 billion. [55] The deficit on goods, however, increased to an all-time high of US$ 891.3 billion, from $807.5 billion in 2017 (Figure 9).

Figure 9. Net Trade in Goods and Services Comparison between the United States and China during 1970-2018 (Balance of Payments, current US$)



China (2018): US$ 102.921 billion	United States (2018): US$ -622.115 billion

[55] Andres B. Schwarzenberg: U.S. Trade: Recent Trends and Developments. U.S. Congressional Research Service, 24 April 2019, https://crsreports.congress.gov/

9.4. OVERVIEW OF THE UNITED STATES TRADE IN GOODS AND SERVICES WITH LEADING PARTNERS

Table 5. United States Trade in Goods and Services in 2018 (in billions of U.S. dollars)

(in billions of U.S. dollars)

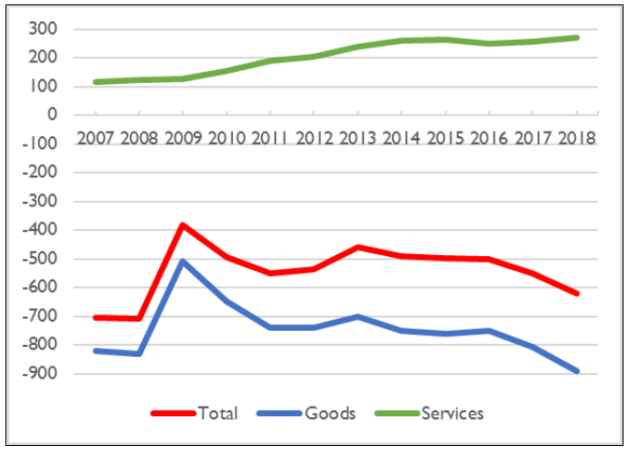
	Total Trade	Exports	Imports	Balance
European Union*	1,263.2	576.4	686.8	-110.4
China	738.6	179.9	558.7	-378.7
Canada	721.2	361.2	360.0	1.2
Mexico	677.8	299.7	378.1	-78.5
Japan	300.3	121.1	179.1	-58.0
United Kingdom	263.5	141.5	122.0	19.6
Germany	251.7	92.4	159.2	-66.8
South Korea	169.4	82.0	87.3	-5.3
India	142.3	59.0	83.3	-24.3
France	128.8	57.7	71.0	-13.3
Brazil	102.3	66.2	36.1	30.1
Rest of the World	2,128.0	1,040.0	1,088.0	-48.1

Source: Bureau of Economic Analysis, April 17, 2019.
Note: * includes trade with all 28 member states combined.

The European Union was the United States' largest market for exports of the United States goods and services in 2018, accounting for US$ 576.4 billion or 23% of total the United States exports, as well as the leading source of the United States imports, which totaled US$ 686.8 billion or 22% of total the United States imports. Canada was the second-largest United States export market, with US$ 361.2 billion worth of the United States exports or 14.4% of total the United States exports, and the fourth-largest source of the United States imports, which totaled US$ 360.0 billion or 11.5%. The share of China in the United States trade has increased dramatically over the past few decades. In 2000, it accounted for 2.0% of total the United States exports and 7.1% of total the United States imports. In 2018, China's share stood at 7.2% of total the United States exports and 17.9% of the United States imports.

Figure 6. United States Trade Balance

(in billions of current U.S. dollars)



Source: Bureau of Economic Analysis, April 17, 2019.

The analysis of the United States trade balances in goods and services suggest that the United States has a competitive advantage in trading services that allows to outperform its competitors worldwide. The United States is the world's leader in services trade. Many developed countries have in recent decades shifted from manufacturing economies to service economies. Services account for three-quarters of the United States GDP and 4 out of 5 jobs in the United States. Thus, the United States is highly competitive in services trade, regularly recording a surplus on the order of US$ 200 billion per year. With every US$ 1 billion in the United States services exports supporting an estimated 7,300 jobs. The United States supports the Trade in Services Agreement, which is a trade initiative focused exclusively on service industries, to expand services trade globally and also unlock new opportunities for the United States firms. This initiative aims at promoting fair and open trade across the full spectrum of service sectors - from telecommunications and technology to distribution and

delivery services, in which twenty-three economies are presently participating, representing nearly 70% of the world's US$ 55 trillion services market.[56]

10. THE UNITED STATES TRADE IN GOODS AND SERVICES WITH CHINA (2018)

The comparative analysis of the United States bilateral trade flows and balances and their composition with China allows us to better understand the recent United States efforts to examine trading relationships with China as the United States takes actions with the intention of reducing its bilateral trade deficits, enforcing trade laws and agreements, and promoting what it considers to be free, fair and reciprocal trade.

According to information from the Office of the United States Trade Representative[57], the United States trade in goods and services with China totaled an estimated US$ 737.1 billion in 2018, respectively exports totaled US$ 179.3 billion and imports totaled to US$ 557.9 billion. As a result, the United States trade deficit in goods and services with China was US$ 378.6 billion in 2018.

China is currently the United States' largest goods trading partner with US$ 659.8 billion in total (exports and imports) goods trade during 2018. Goods exports totaled US$ 120.3 billion; goods imports totaled US$ 539.5 billion. The United States goods trade deficit with China was US$ 419.2 billion in 2018.

According to China's General Administration of Customs, the trade in goods between China and the United States grew from less than US$ 2.5 billion in 1979 when the two countries forged diplomatic ties to US$ 633.5 billion in 2018, a 252-fold increase. In 2018, the United States was China's largest trading partner and export market, and the sixth largest source of imports, with the trade in goods reaching US$ 633.5 billion. During the past ten years from 2009 to 2018, China was one of the fastest growing export markets for the United States goods, with an annual average increase of 6.3% and an aggregate growth of 73.2%, higher than the average growth of 56.9% represented by other regions in the world.[58]

Trade in services with China (exports and imports) totaled an estimated US$ 77.3 billion in 2018. Services exports were US$ 58.9 billion; services imports were US$ 18.4 billion. The United States services trade surplus with China was US$ 40.5 billion in 2018. According to the United States Department of Commerce, the United States exports of goods and services to China supported an estimated 911,000 jobs in 2015 (latest data available), whereas 601,000 supported by goods exports and 309,000 supported by services exports. [59]

[56] https://ustr.gov/TiSA
[57] https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china#
[58] Full text: China's Position on the China-US Economic and Trade Consultations, the State Council Information Office of the People's Republic of China, 2 June 2019, http://english.gov.cn/archive/white_paper/2019/06/02/content_281476694892692.htm
[59] https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china#

China is the largest destination for the United States tourists in the Asia-Pacific and the United States is the largest overseas destination for Chinese students. According to Chinese figures, two-way trade in services rose from US$ 27.4 billion in 2006, the earliest year with available statistics, to US$ 125.3 billion in 2018, a 3.6-fold increase. In 2018, China's services trade deficit with the US reached US$ 48.5 billion.[60]

As it is evident from the above-mentioned data, there are discrepancies between data from the Office of the United States Trade Representative and China's General Administration of Customs. It is said that these differences are attributable to factors like statistical methods, transit trade and service trade as the existing statistical methods are not applicable in this period of globalization with growing global supply chains[61] (Table 7. Trade in goods between the United States and China, 2008-2017).

10.1. THE UNITED STATES EXPORTS TO CHINA

China was the United States' third largest goods export market in 2018. The United States goods exports to China in 2018 were US$ 120.3 billion, down 7.4% (US$ 9.6 billion) from 2017 but up 72.6% from 2008. The United States exports to China are up 527% from 2001 (pre-World Trade Organization's accession). The United States exports to China account for 7.2% of overall the United States exports in 2018. The top export categories in 2018 were: aircraft (US$ 18 billion), machinery (US$ 14 billion), electrical machinery (US$ 13 billion), optical and medical instruments (US$ 9.8 billion), and vehicles (US$ 9.4 billion). The United States total exports of agricultural products to China totaled US$ 9.3 billion in 2018, making China the fourth largest agricultural export market of the United States. Leading domestic export categories include: soybeans (US$ 3.1 billion), cotton (US$ 924 million), hides and skins (US$ 607 million), pork and pork products (US$ 571 million), and coarse grains (ex. corn) (US$ 530 million). The United States exports of services to China were an estimated US$ 58.9 billion in 2018, 2.2% (US$ 1.3 billion) more than 2017, and 272% greater than 2008 levels. It was up roughly 997% from 2001 (pre-World Trade Organization's accession). Leading services exports from the United States to China were in the travel, intellectual property (trademark, computer software), and transport sectors.[62]

10.2. THE UNITED STATES IMPORTS FROM CHINA

China was the United States' largest supplier of goods imports in 2018. The United States goods imports from China totaled US$ 539.5 billion in 2018, up 6.7% (US$ 34.0 billion) from 2017, and up 59.7% from 2008. The United States imports from are up 427% from 2001 (pre-World Trade Organization's accession). The United States imports from China account for 21.2% of overall the United States imports in 2018. The top import categories in 2018 were: electrical machinery (US$ 152 billion),

[60] Full text: China's Position on the China-US Economic and Trade Consultations, the State Council Information Office of the People's Republic of China, 2 June 2019, http://english.gov.cn/archive/white_paper/2019/06/02/content_281476694892692.htm

[61] G. Bin Zhao: What China-US trade tensions mean for Chinese economy and business? PwC, 2018, https://www.pwccn.com/

[62] https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china#

machinery (US$ 117 billion), furniture and bedding (US$ 35 billion), toys and sports equipment (US$ 27 billion), and plastics (US$ 19 billion).

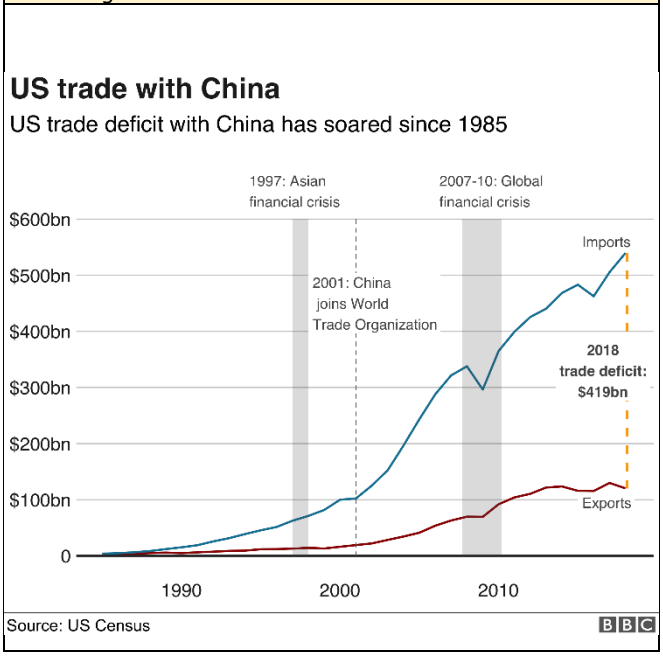
The United States total imports of agricultural products from China totaled US$ 4.9 billion in 2018, the United States' third largest supplier of agricultural imports. Leading categories include: processed fruit and vegetables (US$ 1.2 billion), fruit and vegetable juices (US$ 393 million), snack foods (US$ 222 million), spices (US$ 167 million), and fresh vegetables (US$ 160 million).

The United States imports of services from China were an estimated US$ 18.4 billion in 2018, 5.5% (US$ 963 million) more than 2017, and 68.3% greater than 2008 levels. It was up roughly 414% from 2001 (pre-World Trade Organization's accession). Leading services imports from China to the United States were in the transport, travel, and research and development sectors.

10.3. THE UNITED STATES AND CHINA TRADE IMBALANCE

The United States has a services trade surplus of an estimated US$ 41 billion with China in 2018, up 0.8% from 2017. However, the United States merchandise trade deficit with China, a contentious issue between two countries, was US$ 419.2 billion in 2018, a 11.6% increase (US$ 43.6 billion) up from $376 billion in 2017. It is by far the largest United States bilateral trade imbalance. Many the United States policymakers view large and rising size of the United States bilateral trade deficits as the result of uneven measures that distort international trade and an indicator of an unfair trade relationship (Table 7. Trade in goods between the United States and China, 2008-2017)

Figure 10. The United States Trade with China



Others, however, view conventional bilateral trade deficit data as misleading, given the growth of global supply chains used by multinational firms. Products may be invented or developed in one country and manufactured or assembled elsewhere using imported components from multiple foreign sources and then exported. Conventional United States trade data may not fully reflect the value added in each country, and thus are often a relatively poor indicator of the beneficiaries of its global trade. Also, most economists argue that the overall size of the trade balance is what really matters to the economy and not bilateral balances, and that this is largely a function of macroeconomic forces, such

as low United States domestic savings relative to total investment, not trade barriers.[63]

Table 7. Trade in goods between the United States and China 2008-2017 (Unit: US$ 100 million)[64]

	Figures released by the US			Figures released by China		
Year	Exports to China	Imports from China	Trade balance	Exports to the US	Imports from the US	Trade balance
2008	713	3,396	-2,682	2,523	814	1,709
2009	706	2,979	-2,272	2,208	774	1,434
2010	931	3,661	-2,731	2,833	1,020	1,813
2011	1,054	4,006	-2,952	3,245	1,222	2,023
2012	1,119	4,268	-3,149	3,518	1,329	2,189
2013	1,229	4,416	-3,188	3,684	1,526	2,159
2014	1,247	4,697	-3,449	3,961	1,590	2,370
2015	1,165	4,841	-3,676	4,095	1,487	2,608
2016	1,159	4,632	-3,473	3,851	1,344	2,507
2017	1,304	5,063	-3,759	4,298	1,539	2,758

Source: General Administration of Customs, P.R. China, U.S. Bureau of Economic Analysis

The International Monetary Fund's research found that most of the changes in bilateral trade balances over the past two decades were explained by the combined effect of macroeconomic factors, which include fiscal policy, credit cycles, and, in some cases, exchange rate policies and widespread subsidies to tradable sectors.[65]

10.4. THE UNITED STATES AND CHINA INVESTMENTS

The United States foreign direct investment (FDI) in China (stock) was US$ 107.6 billion in 2017, a 10.6% increase from 2016. The United States direct investment in China is led by manufacturing, wholesale trade, and finance and insurance. China's foreign direct investment (FDI) in the United States (stock) was US$ 39.5 billion in 2017, down 2.3% from 2016. China's direct investment in the United States is led by manufacturing, real estate, and depository institutions. Sales of services in China by majority the United States-owned affiliates were US$ 55.1 billion in 2016 (latest data available), while sales of services in the United States by majority China-owned firms were US$ 8.3 billion. Over the past forty years, two-way investment between China and the United States has grown from near zero to approximately US$ 160 billion. According to China's Ministry of Commerce, by the end of 2018 accumulative Chinese business direct investment in the United States exceeded US$ 73.17 billion. The rapid growth of Chinese business investment in the United States has contributed to local economic growth, job creation, and tax revenues. According to China's Ministry of Commerce, the paid-in investment by the United States in China was US$ 85.19 billion

[63] Wayne M. Morrison: U.S.-China Trade Issues, U.S. Congressional Research Service, 8 April 2019, https://crsreports.congress.gov/

[64] G. Bin Zhao: What China-US trade tensions mean for Chinese economy and business? PwC, 2018, https://www.pwccn.com/

[65] Johannes Eugster, Florence Jaumotte, Margaux MacDonald, and Roberto Piazza: Economic Forces, Not Tariffs, Drive Changes in Trade Balances, IMF, 03 April 2019. https://blogs.imf.org/2019/04/03/economic-forces-not-tariffs-drive-changes-in-trade-balances/

by the end of 2018. In 2017, the total annual sales revenues of the United States-invested firms in China were US$ 700 billion, with profits exceeding US$ 50 billion.[66] It is evident that the United States and China foreign direct investment (FDI) flows are relatively small given the high level of bilateral trade, although estimates of such flows differ. The United States Bureau of Economic Analysis (BEA), is the official United States agency that collects and reports foreign direct investment data, estimated that the stock of Chinese foreign direct investment in the United States through 2017 was at US$ 40 billion and the stock of the United States foreign direct investment in China at US$ 108 billion. Some analysts contend methodology of the United States Bureau of Economic Analysis for measuring foreign direct investment, as it significantly undercounts the level of actual United States and China foreign direct investment, in large part because it does not capture all foreign direct investment that is made through other countries, territories, as well as acquisitions made by the United States affiliates of foreign firms. The Rhodium Group (RG), a private advisory firm, attempts to identify foreign direct investment by Chinese firms in the United States, regardless of where they are based or where the money for investment comes from. The Rhodium Group's data on the United States and China foreign direct investment are much higher than the United States Bureau of Economic Analysis data. For example, the Rhodium Group estimated that the stock of China's foreign direct investment in the United States through 2017 was at US$ 140 billion and the stock of the United States foreign direct investment in China at US$ 256 billion. Furthermore, the Rhodium Group estimated that China's foreign direct investment flows to the United States rose from US$ 14.9 billion in 2015 to US$ 45.6 billion in 2016, but fell to US$ 29.4 billion in 2017 and to US$ 4.8 billion in 2018. The decline in Chinese foreign direct investment flows to the United States may reflect China's efforts to rein in unreasonable capital outflows and enhanced scrutiny by the United States government, which contends that the Chinese government seeks to obtain the United States cutting-edge technologies and intellectual property in order to further its industrial policy goals. Thus, the United States enactment the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) in August 2018 to address its concerns over the Chinese foreign direct investment in the country and enhance the capacity of the Committee on Foreign Investment to adequately screen foreign investment in terms of national security.[67]

11. THE GREAT POWER COMPETITION AND HIGH-STAKE TECHNOLOGY BATTLES BETWEEN THE UNITED STATES AND CHINA

The United States and China dispute goes well beyond trade as it represents a power-struggle between two very different world systems. The two countries will most likely remain divided on crucial ideologies for decades to come, and their economic war and

[66] Full text: China's Position on the China-US Economic and Trade Consultations, the State Council Information Office of the People's Republic of China, 2 June 2019, http://english.gov.cn/archive/white_paper/2019/06/02/content_281476694892692.htm
[67] Wayne M. Morrison: U.S.-China Trade Issues, U.S. Congressional Research Service, 8 April 2019, https://crsreports.congress.gov/

competition for technology dominance is set to last a very long time. Thus, it is not a surprise that the United States and China rivalry began playing out in the crucial technology sector as both countries try to establish themselves as the world's technology leader, and issues around technology transfer have been key during trade talks between the world's two largest economies.

11.1. HIGH SPEED INTERNET AND ELECTRONIC COMMERCE AND DIGITAL TRADE

Because the information technology revolution has served as a catalyst for electronic connectivity, altered the production function, enhanced productivity growth, facilitated the collection of data, spearheaded the transmission of ideas and extended the reach of economic and social interactions, thus it became crucial for any great power to dominate the technology sector, including the sphere for high-speed internet. As the global internet develops and evolves, electronic commerce and digital trade using the internet, including the transmission of information and data across borders have become more prominent on the global trade and economic policy agenda. In 2016, the economic impact of the internet was estimated to be US$ 4.2 trillion, making it the equivalent of the fifth-largest national economy. According to the McKinsey Global Institute's estimation, the current electronic commerce accounts for 12% of global trade of physical goods, both business-to-business and business-to-consumer sales. In 2016, the United States International Trade Commission reported that global electronic commerce totaled over US$ 27 trillion, with business-to-business comprising over 85% of the total. Other studies show 1.8 billion people globally purchased goods online in 2018, and 57% of online buyers purchase from foreign sellers.[68] Through online sales, businesses are able to scale efficiently and reach customers in new markets both domestically and abroad, especially small and mid-sized enterprises, thus the electronic commerce is likely to play a prominent role in the future of international trade. According to the McKinsey Global Institute's estimation, global electronic commerce could add US$ 1.3 - US$ 2.1 trillion in international trade by 2030, boosting trade in manufactured goods by 6% - 10%. The German research firm Statista expects Asia to be the largest electronic commerce market in 2019, making it attractive to the United States firms, and it forecasted that retail electronic commerce in Asia will exceed the rest of the world by 2023. Chinese retail electronic commerce alone is expected to grow 70% from 2018 to 2023, compared to 45% of the United States growth over the same time period. For example, while Amazon hosts over 2 million third-party sellers, China's Alibaba platform hosts over 10 million. Similarly, PayPal is the most widely accepted digital payment method for North American sellers, but is much smaller by comparison with Alibaba's Alipay, which has more than three times the number of users. Turning to digital trade, in 2017, the digital economy accounted for 6.9% of current-dollar GDP in the United States[69]. Digital trade includes end-products, such as downloaded movies, and products and services that rely on or facilitate digital trade, such as

[68] Rachel F. Fefer: International Trade and E-commerce, U.S. Congressional Research Service, 1 May 2019, https://crsreports.congress.gov/

[69] Rachel F. Fefer, Shayerah Ilias Akhtar, Wayne M. Morrison: Digital Trade and U.S. Trade Policy, U.S. Congressional Research Service, 21 May 2019, https://crsreports.congress.gov/

productivity-enhancing tools like cloud data storage and email. Thus, due to the information technology revolution, digital trade has been growing faster than traditional trade in goods and services. For example, in 2017, the United States exports of information and communications technology-enabled services (excluding digital goods) were an estimated US$ 439 billion. Digital trade is growing on a global basis, contributing more to the world's GDP than financial or merchandise flows. Thus, the increase in digital trade raises new challenges for the global competition. For example, China's policies on internet sovereignty and cybersecurity pose challenges for the United States firms operating there.

With regard to global competition, Niall Ferguson[70] notes that there are three essential points to understand about the information technology revolution. The first is that it was almost entirely a United States-based achievement. Secondly, the most important of the United States technology companies are now extraordinary dominant. Thirdly, this dominance translates into huge amounts of money. Confronted with this United States network revolution, the rest of the world had two options: (1) capitulate and regulate, or (2) exclude and compete. As a response, the Europeans chose the former by enacting the European Union's General Data Protection Regulation, while the Chinese, by contrast, opted to compete. The core of their strategy has been to limit the access of the big United States information technology companies to the Chinese market and to encourage local entrepreneurs to build a Chinese answer to it. Thus, the rise of the Chinese technology sector has helped power its competition with the United States. It is evident that economic attacks on China, especially in technology sector, are only one component of the United States' long-term plan to contain China's rise.

11.2. CONTROVERSY OVER THE CHINESE FIRM - HUAWEI TECHNOLOGIES

The recent efforts of the United States to counter China's technology champions, including its most profitable foreign venture Huawei Technologies from selling and operating in the United States as well as proscribing the United States technology suppliers from working with the Chinese firm, go well beyond trade leverage and fit into a broader United States strategy to damage China's technology giants as the United States and China battle for technological dominance intensifies. These efforts have already taken effect, leading to a move by Google parent Alphabet Inc. to halt some business with the telecommunications giant[71]. Huawei Technologies is the world's second-largest smartphone maker and the world's largest producer of radio access network gear for the telecommunications sector and, critically, for 5G, thus it is of immense value to China and future of electronic commerce and digital trade. 5G stands to replace wired connections and open the door for many more devices to be connected and updated via the internet, including home appliances, hospital devices, industrial machines and robots, self-driving cars, that rely on 5G's bandwidth. Thus, Huawei Technologies is in a prime position to snatch the lion's share of a 5G market

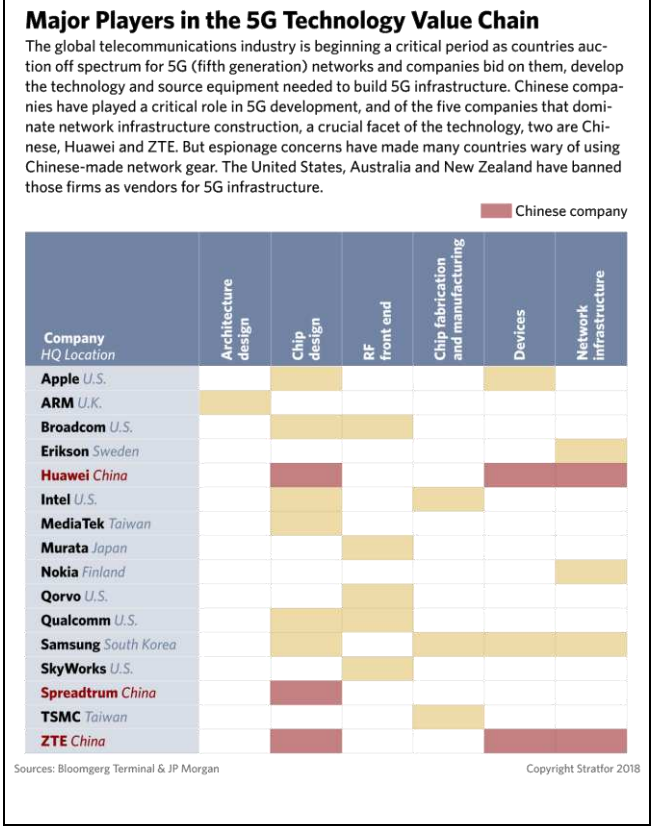
[70] Niall Ferguson: The Square and the Tower. Networks and Power from Freemason to Facebook. Penguin Press, Mew York, 2018.
[71] How China Will Handle Its Trade War with the United States in 2019, Stratfor, 14 November 2018.

that, by some estimates, could be worth US$ 123 billion in five years' time[72]. Obstructing the firm's expansion into the United States and European markets could have the convenient side effect of letting competitors catch up. The United States appears to have decided that it is simply too risky for a Chinese company to control too much 5G infrastructure. Thus, the United States has sought to dissuade allies and partners from including equipment from Huawei Technologies in their critical information systems, citing national security concerns, and Huawei Technologies has been the focus of intense international scrutiny since then[73]. Thus, it is not a surprise that in May 2019, the President of the United States signed an executive order giving the United States Commerce Department the authority to block certain transactions involving information and communications technologies developed, designed or manufactured by companies, subject to the jurisdiction of a foreign adversary[74]. While the order did not explicitly mention China and Huawei Technologies, its intention was to pave the way for the United States to block Huawei Technologies from its 5G networks and other critical infrastructure. Coming on the heels of arrest of Ms. Meng Wanzhou, the chief financial officer of Huawei Technologies, in December 2018 in Canada at the United States' request, the United States Commerce Department added Huawei Technologies and its 70 affiliates to its Entity List. This requires any of the United States firms which want to export technology, services or products to Huawei Technologies to obtain a special license from the United States Commerce Department. The ban applies to goods that have 25% or more of the United States-originated technology or materials.[75] These actions are intended to damage Huawei Technologies and China's economy. In March 2019, amid legal proceedings against Ms. Meng, Huawei Technologies filed a separate lawsuit against the United States for banning the federal agencies and firms from using its equipment. Huawei Technologies is one of the world's most competitive technology firms, but it depends heavily on the technology sector's global supply chains, which include the United States equipment, technology and knowledge. As a result, the United States actions have created uncertainty for firms involved in the technology sector, particularly technology suppliers. The United States, similarly, in 2018, temporarily denied export privileges to another Chinese technology company, ZTE. However, the United States Commerce Department can choose to be flexible in allowing deals to go through to minimize the risk of Chinese retaliation and subsequent damage to the United States firms operating in China. Furthermore, the United States could also try to exert leverage on Huawei Technologies in its ongoing investigations and criminal cases involving potential violations of the United States sanctions, which is one of the legal justifications for placing Huawei Technologies on the Entity List. However, the United States attempts to disrupt technology supply chains and its campaign to try to cut off China's access to the United States technology and products will most likely force China to increase its own nationalist stance regarding technology development. It will

[72] Will Knight: The real reason America is scared of Huawei: internet-connected everything, MIT Technology Review, 8 February 2019. (https://www.technologyreview.com/s/612874/the-real-reason-america-is-scared-of-huawei-internet-connected-everything/)
[73] https://www.bbc.co.uk/news/business-47848861
[74] New Huawei Restrictions Turn Up the Heat on the U.S.-China Tech Cold War, Stratfor, 17 May 2019.
[75] https://www.reuters.com/article/us-huawei-suppliers-factbox/factbox-global-tech-companies-shun-huawei-after-u-s-ban-idUSKCN1TC1KW

drive China to increase support for firms in domestic technology sector and to improve the country's semiconductor production capabilities through initiatives like the Made in China 2025 plan, which the United States wants China to stop as a part of its trade war. China will also try to ensure that Chinese-led and developed standards in the technology sector are adopted worldwide so that Chinese firms can sell their products in foreign markets without fear of the United States claiming patent infringement. And over time, the rise of Chinese competitors in the chip manufacturing sector and the rollout of Chinese software alternatives, such as Huawei Technologies mobile operating system challenger to iOS and Android, are likely to contribute further to the fragmentation of the global technology sector.

Figure 11. 5G Technology Value Chain



Many technology suppliers and global economies consider China the most important future growth market for technology since the developed world is essentially saturated. Suppliers in Japan, South Korea, Taiwan, Vietnam and the rest of the world thus have a large economic incentive to not completely cut off economic relationships with China and its technology sector. Instead, they will seek to balance between China and the United States. Thus, many countries caught between the United States and China in the Asia-Pacific region are choosing to play both sides, with varying degrees of success. Because of this, foreign firms and countries will find themselves needing to navigate a growing labyrinth of overlapping and contradictory export control rules and regulations. These rules and regulations, as well as the physical supply chains that bind them together, will be difficult to unravel, having been built up over years of globalization. But now the United States is trying to fragment globalization and it may start with Huawei Technologies. In a battle with China for technological supremacy, the United States launched an aggressive campaign warning allies not to use Huawei Technologies equipment, on security grounds, to build 5G networks. Australia and New Zealand have both blocked the use of Huawei Technologies gear in next-generation 5G mobile networks. However, the United States ongoing diplomatic efforts to pressure countries in Europe, Latin America and Southeast Asia into imposing similar bans against Huawei Technologies equipment on national security grounds are already stalling.[76] This is because most countries are unwilling to tolerate the much higher costs and implementation delays for 5G networks that would come with blacklisting Huawei

[76] Stratfor Worldview, 2019 Third-Quarter Forecast, 16 June 2019, https://www.stratfor.com/

Technologies. Eventually, even if the United States and China do resolve their trade war, the battle for economic and technology supremacy between the world's two largest economies will drag on. In turn, China will seek to diversify its export market while advancing trade and technology cooperation with major powers in order to prevent the United States from disrupting important supply chains and discouraging its allies from advancing trade deals with China. On almost every front, from trade and investment to technology and innovation, it has become clear that the United States and China relationship has entered a new, increasingly contentious period marked more by overt confrontation and competition than by coordination and cooperation.[77]

12. THE IMPACT OF THE UNITED STATES AND CHINA TRADE CONFLICT ON THE GLOBAL ECONOMY AND TRADE

12.1. OVERVIEW OF GLOBAL GROWTH

In early 2018, economic activity was accelerating in almost all regions of the world, and the global economy was projected to grow at 3.9% in 2018 and 2019. One year later, in 2019, much has changed. The escalation of the United States and China trade tensions, required credit tightening in China, macroeconomic stress in some countries, disruptions to auto sector, and financial tightening alongside the normalization of monetary policy in the larger advanced economies have all contributed to a significantly weakened global expansion, especially in the second half of 2018.[78] The weakness was especially visible in the manufacturing sector and trade by the end of 2018. Thus, recent economic forecasts found that the global economy remained weak in early 2019, following a slowing down of activity at the end of 2018, centered mostly in developed economies and Asia, according to the International Monetary Fund and the Organization for Economic Co-operation and Development (Table 8).[79]

[77] U.S. Relations with China, 1949 – 2019, Council on Foreign Relations, https://www.cfr.org/timeline/us-relations-china
[78] Gita Gopinath: The Global Economy. A Delicate Moment, IMF, 9 April 2019, https://blogs.imf.org/2019/04/09/the-global-economy-a-delicate-moment/
[79] James K. Jackson, Andres B. Schwarzenberg: The Global Economy: Is Slower Growth Ahead?, U.S. Congressional Research Service, 12 April 2019, https://crsreports.congress.gov/

Table 8. OECD and IMF Forecasts of Global Economic Growth (https://crsreports.congress.gov/)

		OECD Forecast		IMF Forecast	
	2018	2019	2020	2019	2020
World Output	3.7%	3.3%	3.4%	3.3%	3.6%
Advanced Economies	2.3	3.5	3.7	1.8	1.7
United States	2.9	2.6	2.2	2.3	1.9
Euro Area	1.8	1.0	1.2	1.3	1.5
Germany	1.5	0.7	1.1	0.8	1.4
France	1.5	1.3	1.3	1.3	1.4
Italy	1.0	-0.2	0.5	0.1	0.9
United Kingdom	1.4	0.8	0.9	1.2	1.4
Japan	0.9	0.8	0.7	1.0	0.5
Asia	6.5	NA	NA	6.3	6.3
China	6.6	6.2	6.0	6.3	6.1
India	7.3	7.2	7.3	7.3	7.5
Latin America	1.1	NA	NA	1.4	2.4
Middle East	2.4	NA	NA	1.5	3.2

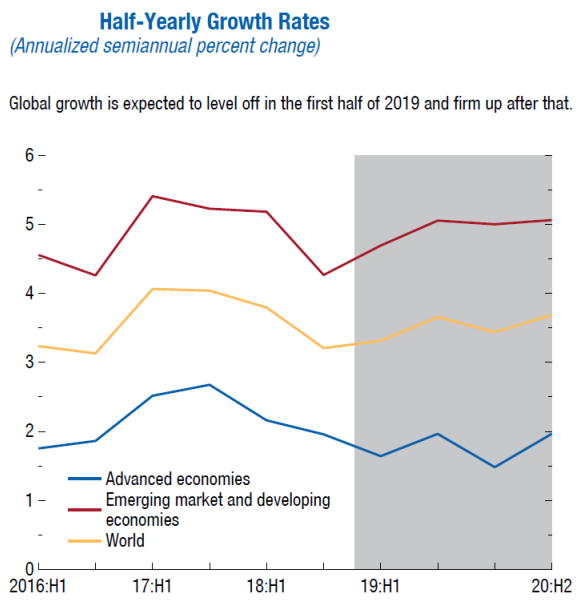
Source: Organisation for Economic Co-operation and Development and International Monetary Fund.
Note: The OECD forecast for advanced economies constitutes the G-20 group of countries, which includes China.

The International Monetary Fund's April 2019 World Economic Outlook report[80] notes that after strong growth in 2017 and early 2018, global economic activity slowed notably in the second half of 2018, reflecting a confluence of factors affecting major economies. For example, China's growth declined following a combination of needed regulatory tightening to rein in shadow banking and an increase in trade tensions with the United States. The euro area economy lost more momentum than expected as consumer and business confidence weakened over the same period. Trade tensions increasingly took a toll on business confidence and, thus, financial market sentiment worsened, with financial conditions tightening for vulnerable emerging markets in the spring of 2018 and then in advanced economies later in 2018, weighing on global demand.

As a result of these developments, global growth is projected to slow from 3.6% in 2018 to 3.3% in 2019, before returning to 3.6% in 2020. Growth for 2018 was revised down by 0.1 percentage point relative to the International Monetary Fund's October 2018 World Economic Outlook report, reflecting weakness in the second half of the year, and the forecasts for 2019 and 2020 are marked down by 0.4 percentage point and 0.1 percentage point, respectively. The downgrade was broad-based across all income groups with 70% of the global economy, based on purchasing power parity - GDP, projected to see slower growth in 2019 than in 2018. The current forecast envisages that global growth will stay at the same level in the first half of 2019 and remain stable after that (Figure 12).

[80] World Economic Outlook: Growth Slowdown, Precarious Recovery, IMF, 2 April 2019. https://www.imf.org/en/Publications/WEO

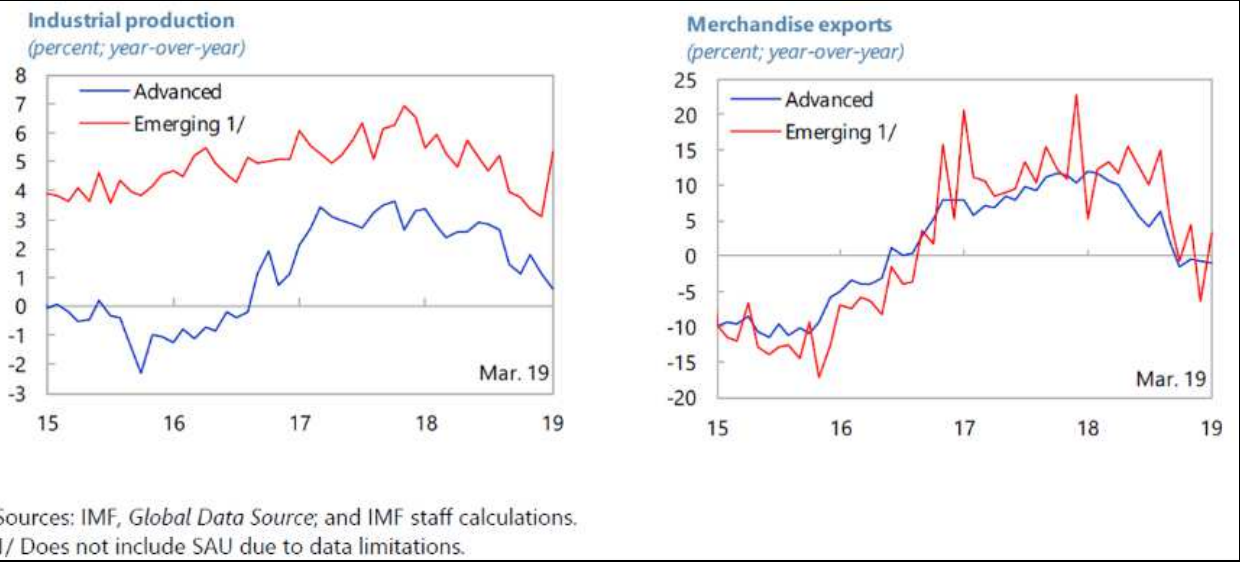
Figure 12. Half-Yearly Growth Rates (https://www.imf.org/en/Publications/WEO)



For instance, the Organization for Economic Co-operation and Development forecasted that global growth will slow to 3.3% in 2019 and 3.4% in 2020, with a downgrade of 0.2 percentage point for 2020 in comparison with the International Monetary Fund's projections[81]. Both organizations have similar estimations for global growth in 2019 and 2020. The International Monetary Fund's April 2019 World Economic Outlook report[82] stated that the projected pickup in the second half of 2019 is predicated on an ongoing buildup of policy stimulus in China, recent improvements in global financial market sentiment, the weakening of some temporary drags on growth in the euro area, and a gradual stabilization of conditions in stressed emerging market economies. Conditions have eased in 2019 as the United States Federal Reserve, the European Central Bank, the Bank of Japan, and the Bank of England have all shifted to a more accommodative stance. China increased fiscal and monetary stimulus to provide temporary support for economic activity in order to counter the negative effect of trade tariffs imposed by the United States and negative growth impacts. Thus, the 2019 growth pickup is supported by significant monetary policy accommodation by major economies and made possible by the absence of inflationary pressures despite growing at near potential. And, global markets became more optimistic about a possible trade deal between the United States and China after both countries, at G-20 summit in Osaka, Japan in June 2019, agreeing to a truce in their trade war and vowing to restart trade negotiations. These policy responses have helped reverse the tightening of financial conditions to varying degrees across countries. Emerging markets have experienced some resumption in portfolio flows, a decline in sovereign borrowing costs, and a strengthening of their currencies relative to the United States dollar. While the improvement in financial markets has been rapid, those in the real economy have been slow to materialize. Measures of industrial production and investment remain weak for 2019 in many advanced and emerging market economies, and global trade needs to recover in 2019 (Figure 13).

[81] James K. Jackson, Andres B. Schwarzenberg: The Global Economy: Is Slower Growth Ahead?, U.S. Congressional Research Service, 12 April 2019, https://crsreports.congress.gov/
[82] World Economic Outlook: Growth Slowdown, Precarious Recovery, IMF, 2 April 2019. https://www.imf.org/en/Publications/WEO

Figure 13. G-20 High-Frequency Indicators of Economic Activity
(https://www.imf.org/external/np/g20/index.htm)



Sources: IMF, *Global Data Source*; and IMF staff calculations.
1/ Does not include SAU due to data limitations.

Thus, improved momentum for emerging market and developing economies is projected to continue into 2020, primarily reflecting developments in economies currently experiencing macroeconomic distress. By contrast, activity in advanced economies is projected to continue to slow gradually as the impact of the United States fiscal stimulus fades and growth tends toward the modest potential for them. In this regard, the International Monetary Fund forecasted that the United States economy will experience a slower growth at 2.3% in 2019 and further slow down to 1.9 % in 2020. However, the Organization for Economic Co-operation and Development provided a slightly higher estimation for the United States economy with growth at 2.6% in 2019 and at 2.2% in 2020. Similarly, in March 2019 the Federal Reserve forecasted that the United States economy would grow by 2.1% in 2019, down by 2.3% from a previous forecast.[83] Despite the United States outperforming other developed economies in 2018 with a 2.857% rate of GDP annual growth, which was slightly below the world average growth rate at 3.035% in 2018, its further growth is projected to decelerate in next years, with more than 1.0% lower than the world's projected average at 3.3% in 2019 and 3.6% in 2020.

[83] James K. Jackson, Andres B. Schwarzenberg: The Global Economy: Is Slower Growth Ahead?, U.S. Congressional Research Service, 12 April 2019, https://crsreports.congress.gov/

Table 9. IMF Forecast of Global Economic Growth 2019-2020 (https://blogs.imf.org)

Global Economy: A Delicate Moment

Latest *World Economic Outlook* growth projections

(percent change)

		Projections	
	2018	2019	2020
World Output	**3.6**	**3.3**	**3.6**
Advanced Economies	**2.2**	**1.8**	**1.7**
United States	2.9	2.3	1.9
Euro Area	1.8	1.3	1.5
Germany	1.5	0.8	1.4
France	1.5	1.3	1.4
Italy	0.9	0.1	0.9
Spain	2.5	2.1	1.9
Japan	0.8	1.0	0.5
United Kingdom	1.4	1.2	1.4
Canada	1.8	1.5	1.9
Other Advanced Economies	2.6	2.2	2.5
Emerging Market and Developing Economies	**4.5**	**4.4**	**4.8**
Commonwealth of Independent States	2.8	2.2	2.3
Russia	2.3	1.6	1.7
Excluding Russia	3.9	3.5	3.7
Emerging and Developing Asia	6.4	6.3	6.3
China	6.6	6.3	6.1
India	7.1	7.3	7.5
ASEAN-5	5.2	5.1	5.2
Emerging and Developing Europe	3.6	0.8	2.8
Latin America and the Caribbean	1.0	1.4	2.4
Brazil	1.1	2.1	2.5
Mexico	2.0	1.6	1.9
Middle East, North Africa, Afghanistan, and Pakistan	1.8	1.5	3.2
Saudi Arabia	2.2	1.8	2.1
Sub-Saharan Africa	3.0	3.5	3.7
Nigeria	1.9	2.1	2.5
South Africa	0.8	1.2	1.5
Low-Income Developing Countries	4.6	5.0	5.1

Source: IMF, *World Economic Outlook*, April 2019.

INTERNATIONAL MONETARY FUND

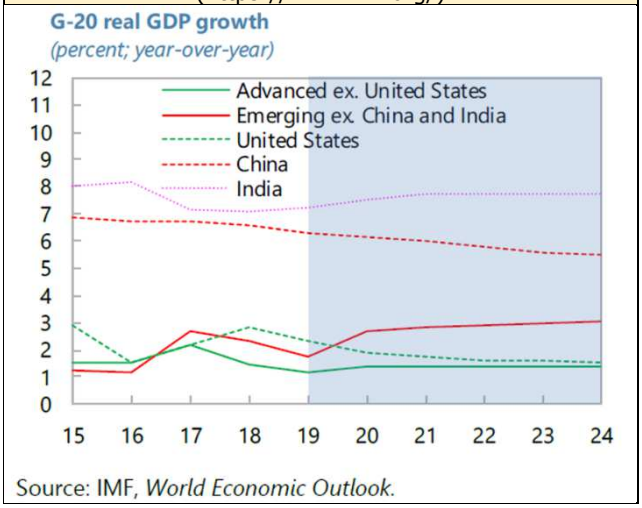
By comparison, according to the International Monetary Fund's forecast, China's economy will slow down to 6.3% in 2019 and 6.1% in 2020, which is slightly down by 0.3 percentage point for 2019 and 0.5 percentage point for 2020 compared to China's GDP annual growth rate at 6.6% in 2018. And yet, China will remain way above the world's projected average growth rate at 3.3% in 2019 and at 3.6% in 2020. According to a 2019 China Economic Quarterly report from PwC China and Hong Kong, the GDP growth rate in China was 6.4% in first quarter of 2019, which is better than the market expectation, and within an official target range of 6% to 6.5% adopted by the Chinese government.[84] Turning to the United States, some economic indicators suggest that its economy remains comparatively strong, but a deterioration in the economies of major trading partners could negatively affect the United States economy and alter the forecasts. Broad financial and economic linkages tie the United States and global economies, which means the United States affects and is also affected by events in the global economy. These effects are reflected in capital flows, the international exchange value of the dollar, interest rates, and the United States trade balances. The International Monetary Fund's April 2019 World Economic Outlook report[85] projected that with improved prospects for the second half of 2019, global growth is forecasted to remain stable at around 3.6 percent but will rely on weights shifting toward countries with relatively higher growth rates, mainly G-20 emerging markets such as China and India, which are projected to have robust growth by comparison to slower-growing advanced and some emerging market economies, even though Chinese growth will eventually moderate. However, this recovery is risky and based on a rebound in emerging market and developing economies, where growth is projected to increase from 4.4 percent in 2019 to 4.8 percent in 2020, but this forecast is subject to considerable uncertainty.[86]

[84] China Economic Quarterly Q1 2019, PwC China and Hong Kong, https://www.pwccn.com/en/research-and-insights/china-economic-quarterly-q1-2019.html

[85] World Economic Outlook: Growth Slowdown, Precarious Recovery, IMF, 2 April 2019. https://www.imf.org/en/Publications/WEO

[86] Gita Gopinath: The Global Economy. A Delicate Moment, IMF, 9 April 2019, https://blogs.imf.org/2019/04/09/the-global-economy-a-delicate-moment/

Figure 14. Real GDP Growth (https://www.imf.org/)

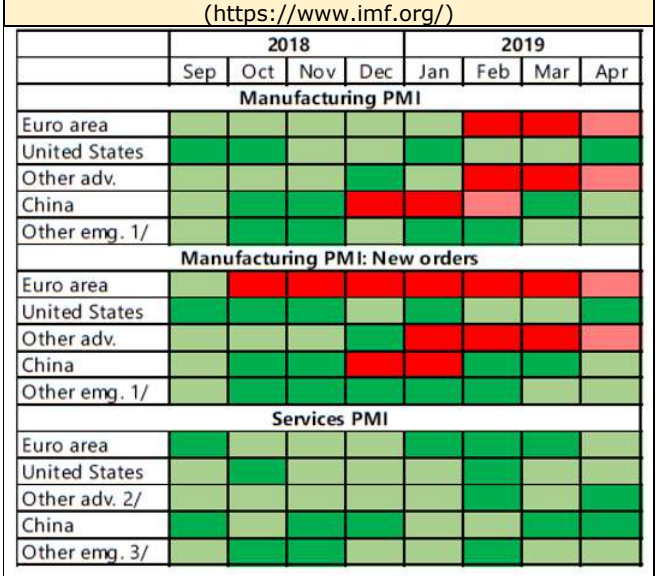


Growth in advanced economies will slow slightly in 2020, despite a partial recovery in the euro area, as the impact of the United States fiscal stimulus fades and growth tends toward the modest potential for the euro area. It is noted that over the medium term, growth is projected to remain below historical averages for many countries, as aging populations and low productivity growth weigh on the outlook in G-20 advanced economies and some emerging markets. Concerning developed economies, Germany, France, Italy, and the United Kingdom are projected to experience slower growth in 2019. The European Central Bank lowered its forecast for economic growth in Europe to 1.1% in 2019, down from 1.7% forecasted in December 2018.[87] Growth in European countries is expected to be affected by domestic political issues, slower economic growth in export markets, and continuing uncertainty over the economic impact of Brexit. Japan is projected to experience a more positive rate of growth in 2019 compared with 2018, but the rate is projected to fall by half to 0.5% in 2020. Growth across emerging market and developing economies is projected to stabilize slightly below 5%, though with variations by region and country[88]. The baseline outlook for emerging Asia remains favorable, with China's growth projected to slow gradually toward sustainable levels and convergence in frontier economies toward higher income levels. Of particular concern is the pace at which China's growth rate slows. China's growing role in the global economy means it has far-reaching influence through its trade and financial relations. As China's rate of growth slows, it likely will import fewer raw materials, with secondary and other effects on commodity exporters. These effects would be compounded by a slowdown in the rate of growth in Europe and the United States, which likely would reduce further China's rate of growth. For some G-20 emerging economies, high levels of public debt and financing costs along with volatile commodity prices could weigh on medium-term growth prospects and convergence toward advanced economies by constraining fiscal space and limiting investment opportunities. [89] For other regions, the outlook is complicated by a combination of structural bottlenecks, slower advanced economy growth and, in some cases, high debt and tighter financial conditions. These factors, alongside subdued commodity prices and civil strife or conflict in some cases, contribute to subdued medium-term

[87] James K. Jackson, Andres B. Schwarzenberg: The Global Economy: Is Slower Growth Ahead?, U.S. Congressional Research Service, 12 April 2019, https://crsreports.congress.gov/
[88] World Economic Outlook: Growth Slowdown, Precarious Recovery, IMF, 2 April 2019. https://www.imf.org/en/Publications/WEO
[89] Helge Berger, Lone Christiansen, Johannes Eugster, Margaux MacDonald, Susanna Mursula, Eric Bang, Pankhuri Dutt, Ilse Peirtsegaele: G-20 Surveillance Note, International Monetary Fund. G-20 Finance Ministers and Central Bank Governors' Meetings, 8–9 June 2019, Fukuoka, Japan.

prospects for Latin America; the Middle East, North Africa, and Pakistan region; and parts of sub-Saharan Africa.

Figure 15. G-20 Growth Momentum (https://www.imf.org/)



Sources: Haver Analytics; IMF, *World Economic Outlook*; and IMF staff calculations.
1/ Excludes ARG, SAU, and ZAF due to data limitations.
2/ Excludes CAN and KOR due to data limitations.
3/ Includes BRA, IND, and RUS.

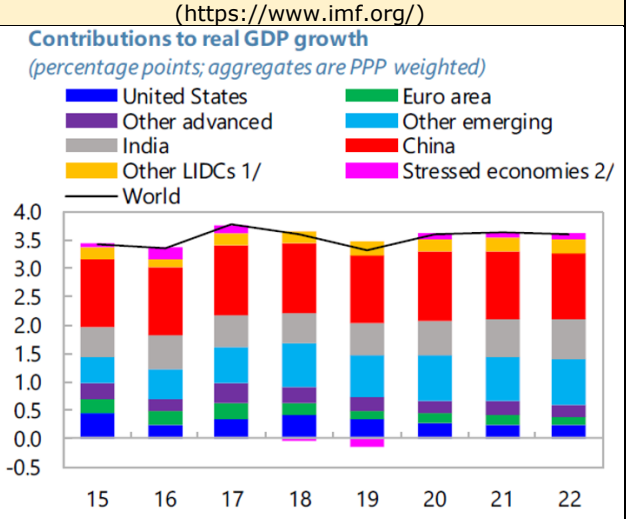
In particular, convergence prospects are bleak for some 41 emerging market and developing economies, accounting for close to 10% of global GDP in purchasing power parity terms and with total population close to 1 billion, where per capita incomes are projected to fall further behind those in advanced economies over the next five years.[90]

In fact, the most recent economic data indicate that the slowdown may have bottomed out, with some firming of economic activity expected to continue and growth projected to stabilize at slightly higher levels in 2020.[91] Concerning advanced economies, first-quarter growth surprised on the upside in the United States and the euro area, including Germany, with exports helping to narrow the United States trade deficit in February and March 2019 to its lowest level since mid-2018 and Germany's industrial production increasing slightly in March 2019 after a period of sustained decline. However, at least part of the unexpected growth is attributable to temporary factors (e.g., inventories in the United States), and the level of manufacturing activity remains weak.

[90] World Economic Outlook: Growth Slowdown, Precarious Recovery, IMF, 2 April 2019. https://www.imf.org/en/Publications/WEO

[91] Helge Berger, Lone Christiansen, Johannes Eugster, Margaux MacDonald, Susanna Mursula, Eric Bang, Pankhuri Dutt, Ilse Peirtsegaele: G-20 Surveillance Note, International Monetary Fund. G-20 Finance Ministers and Central Bank Governors' Meetings, 8–9 June 2019, Fukuoka, Japan.

Figure 16. Contributions to Global Growth (https://www.imf.org/)



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
1/ LIDCs: Low-income developing countries.
2/ Stressed economies: ARG, IRN, IRQ, LBY, SDN, SSD, TUR, VEN, and YEM.

Regarding emerging market economies, the most recent economic data shows that high frequency indicators in China surprised on the downside in April 2019 on weak domestic and external demand, though after a strong showing in March 2019, which suggest that the turnaround remains fragile. While the rest of emerging Asia and Latin America mostly surprised on the downside in the first quarter on weak investment and exports, recent manufacturing indicators point to a tentative rebound, except in India. In conclusion, the most recent economic data indicate that global growth may be stabilizing. For example, while first-quarter economic activity disappointed in parts of emerging Asia and Latin America, growth was stronger than expected in the United States, the euro area, and Japan.[92] Beyond 2020, however, global growth is expected to stabilize at around 3.5%, bolstered mainly by growth in China and India and their increasing weights in world income. Meantime, growth in emerging market and developing economies will stabilize at 5%, though with considerable variance as emerging Asia continues to grow faster than other regions. A similar pattern holds for low-income countries with some, particularly commodity importers, growing rapidly but others falling further behind the advanced world in per capita terms. [93]

12.2. OVERVIEW OF RISKS TO GLOBAL GROWTH

The International Monetary Fund and the Organization for Economic Co-operation and Development estimate that various risks weigh on global economic growth.[94] While the global economy continues to grow at a reasonable rate and a global recession is not in the baseline projections, there are many downside risks. Possible triggers of risks to global economy include escalation in trade tensions, tightening financial conditions, monetary policy mismatches between central banks (some central banks are raising interest rates and reducing monetary stimulus while others are doing the opposite), high levels of personal and public debt, uncertainty over the potential impact of a no-deal withdrawal of the United Kingdom from the European Union (Brexit) and a slowdown in China's rate of growth.[95] Both, the International Monetary Fund and the Organization for Economic Co-operation and Development identified trade tensions among serious risks that could affect global growth. It is noted that

[92] Christine Lagarde: How to Help, Not Hinder Global Growth, 5 June 2019, https://blogs.imf.org/2019/06/05/how-to-help-not-hinder-global-growth/
[93] Gita Gopinath: The Global Economy. A Delicate Moment, IMF, 9 April 2019, https://blogs.imf.org/2019/04/09/the-global-economy-a-delicate-moment/
[94] James K. Jackson, Andres B. Schwarzenberg: The Global Economy: Is Slower Growth Ahead?, U.S. Congressional Research Service, 12 April 2019, https://crsreports.congress.gov/
[95] Ibid.

trade differences need to be resolved quickly to support global growth growing favorably, thus allowing business confidence rebound and investor sentiment strengthen further. However, a further escalation of trade tensions and the associated increases in policy uncertainty could further weaken growth, thus the balance of risks to the outlook remains on the downside in 2019.[96] Tensions in trade policy could flare up again and play out in other areas (such as auto industry), with large disruptions to global supply chains. A deterioration in market sentiment could rapidly tighten financing conditions in an environment of large private and public sector debt in many countries. A rapid reassessment by markets of the monetary policy stance in the United States could also tighten global financial conditions. Over the medium term, climate change and political discord in the context of rising inequality are key risks that could lower global potential output, with particularly severe implications for some vulnerable countries. For example, progress to reduce income inequality has been unsatisfactory. While some countries have seen a decline in inequality since the global financial crisis (e.g., United Kingdom and China), it remains high and persistent in other countries, (e.g., South Africa remains among the most unequal countries in the world). Moreover, gains from technological advancements have been spread unevenly. For example, the adoption of new technologies has often favored high-skilled workers in occupations complementary to new technologies and low-wage service sector jobs, creating concerns about job and income polarization. In addition, many jobs involving low- and middle-skill routine tasks are potentially being eliminated through increasing use of automation and artificial intelligence.[97] Thus, the risks are high for the resurgence of economic nationalism in many developed countries, pressuring the rest of the world to adjust its expectations and strategies. Given these risks, the International Monetary Fund recommends to avoid costly policy mistakes and uncertainty that weakens investment, including rising trade tensions. It also identifies a need for greater multilateral cooperation to resolve trade conflicts, to address climate change and risks from cybersecurity, and to improve the effectiveness of international taxation. Across all economies, the imperative is to take actions that boost potential output, improve inclusiveness, and strengthen resilience. It concludes that if the downside risks do not materialize and the policy support put in place is effective, then global growth should rebound, and this is a delicate moment for the global economy.[98]

13. THE IMPACT OF THE UNITED STATES AND CHINA TRADE CONFLICT ON CONSUMERS, PRODUCERS AND GLOBAL TRADE

Recently, trade wars, as an instrument of trade and foreign policy, have returned to mainstream politics in the United States. The trade conflict between the United States

[96] World Economic Outlook: Growth Slowdown, Precarious Recovery, IMF, 2 April 2019. https://www.imf.org/en/Publications/WEO
[97] Helge Berger, Lone Christiansen, Johannes Eugster, Margaux MacDonald, Susanna Mursula, Eric Bang, Pankhuri Dutt, Ilse Peirtsegaele: G-20 Surveillance Note, International Monetary Fund. G-20 Finance Ministers and Central Bank Governors' Meetings, 8–9 June 2019, Fukuoka, Japan.
[98] World Economic Outlook: Growth Slowdown, Precarious Recovery, IMF, 2 April 2019. https://www.imf.org/en/Publications/WEO

and China has created a great deal of anxiety in the world. As a result of a shift in the United States foreign and economic policies toward containing China's growth, during 2018-2019 their trade conflict has further escalated after the United States imposed three rounds of tariffs raising them to 25% on US$ 250 billion worth of Chinese products. In turn, China retaliated by imposing tariffs ranging from 5% to 25% on US$ 110 billion of the United States products. At this point, both counties have imposed tariffs totaled US$ 360 billion worth of products. After the United States has ended abruptly the talks with China in May 2019 by imposing the last round of tariffs, and threatened China to hit by 25% tariffs an additional US$ 300 billion of Chinese products, the world got anxious about possible tit-for-tat trade war between the world's two largest economies. In this regard, the International Monetary Fund in its 2019 World Economic Outlook report[99] warned that a full-blown trade war would weaken the global economy. Despite the fact the United States maintains a particular hard line on China as the United States strategic competition with China deepens in nearly all fronts. The United States strategy and actions regarding China are based on the assumption that the United States economy is on solid enough footing to justify tariffs, both as a wide-ranging negotiating tactic and as a means to drive down the United States trade deficit. However, deepening the United States and China economic competition does not guarantee a full-fledged trade war. The reason is very simple. Economically, China is able to compete with the United States on an equal footing. Thus, the United States-initiated trade conflict with China would not be easy to win even for such powerful country as the United States. That's why, at the G20 summit in Japan in June 2019, the United States called the additional tariff plan off and both countries decided to continue with negotiations without specifying a deadline. At this time, it is not early to make a straightaway conclusion about the true impact of the current trade conflict on the global economy. Nonetheless, it is expected that the United States and China will eventually reach a deal to lift some of their reciprocal tariffs, but their economic and political competition will persist in future.

An impact assessment of the trade conflict between the United States and China shows that the imposed tariffs have reduced trade between the United States and China, but the bilateral trade deficit remains broadly unchanged.[100] Tariffs imposed on Chinese products, in theory, make the United States-made products cheaper than imported ones, and encourage consumers to buy the United States-made products. However, the United States and China trade conflict has affected consumers and many producers in both countries, and increased risks and caused uncertainties for the global economy. Both the United States-based and international firms have complained that they are being harmed by the ongoing trade tensions between two countries. Also, fears about a further escalation have rattled investors and hit stock markets in the United State and Asia. While the impact on global growth is relatively modest at this time, the latest escalation with tariff hikes in May-June 2019 could

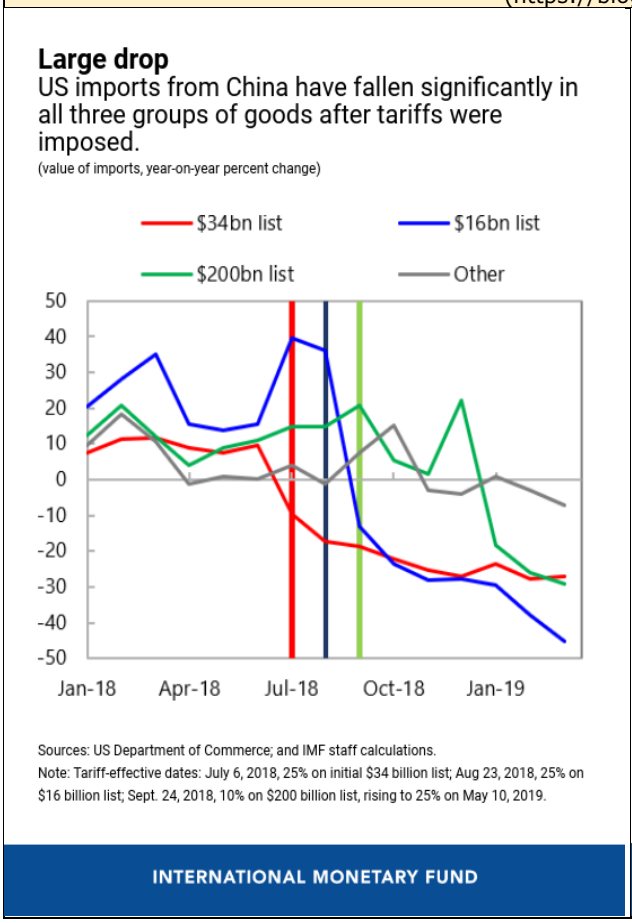
[99] World Economic Outlook: Growth Slowdown, Precarious Recovery, IMF, 2 April 2019. https://www.imf.org/en/Publications/WEO

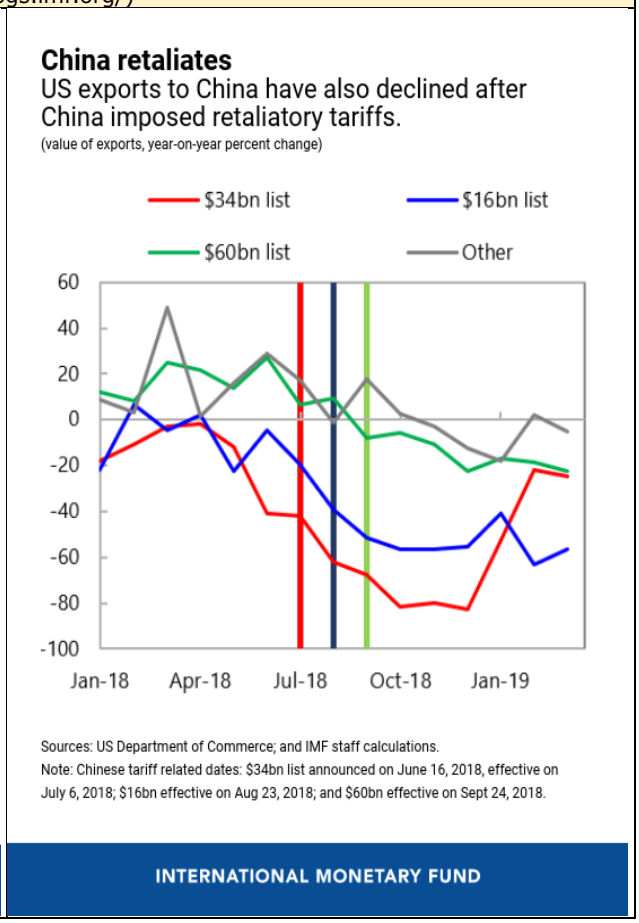
[100] Eugenio Cerutti, Gita Gopinath, Adil Mohommad: The Impact of US-China Trade Tensions, IMF, 23 May 2019. https://blogs.imf.org/2019/05/23/the-impact-of-us-china-trade-tensions/, https://www.weforum.org/agenda/2019/05/the-impact-of-us-china-trade-tensions/

significantly dent business and financial market sentiment, disrupt global supply chains, and jeopardize the projected recovery in global growth in 2019.

The impact of previously imposed tariffs in 2018 by the United States and subsequent retaliation by China is already evident in trade data. Both countries directly involved and their trading partners have been affected by rising tariffs (Figure 17: The United States Imports from and Exports to China).

Figure 17. The United States Imports from and Exports to China (https://blogs.imf.org/)





In 2018, the United States imposed tariffs sequentially on three lists of goods from China, targeting first US$ 34 billion of annual imports, then US$ 16 billion more, and finally an additional US$ 200 billion. As a result, the United States imports from China have declined quite sharply in all three groups of the goods on which tariffs were imposed. In cases where there was a delay between announcement and implementation of tariffs, as in the case of the US$ 16 billion and US$ 200 billion lists, or plans to phase in the tariff increase, as in the case of the US$ 200 billion list, it was observed an increase in import growth in advance of the effective dates. This suggests that importers stocked up ahead of the tariffs, accounting for the sharper decline in imports thereafter. As China imposed retaliatory tariffs, the United States exports to China also declined. While the front-loading dynamic is not evident in this case, the United States export growth to China has been generally weaker since the

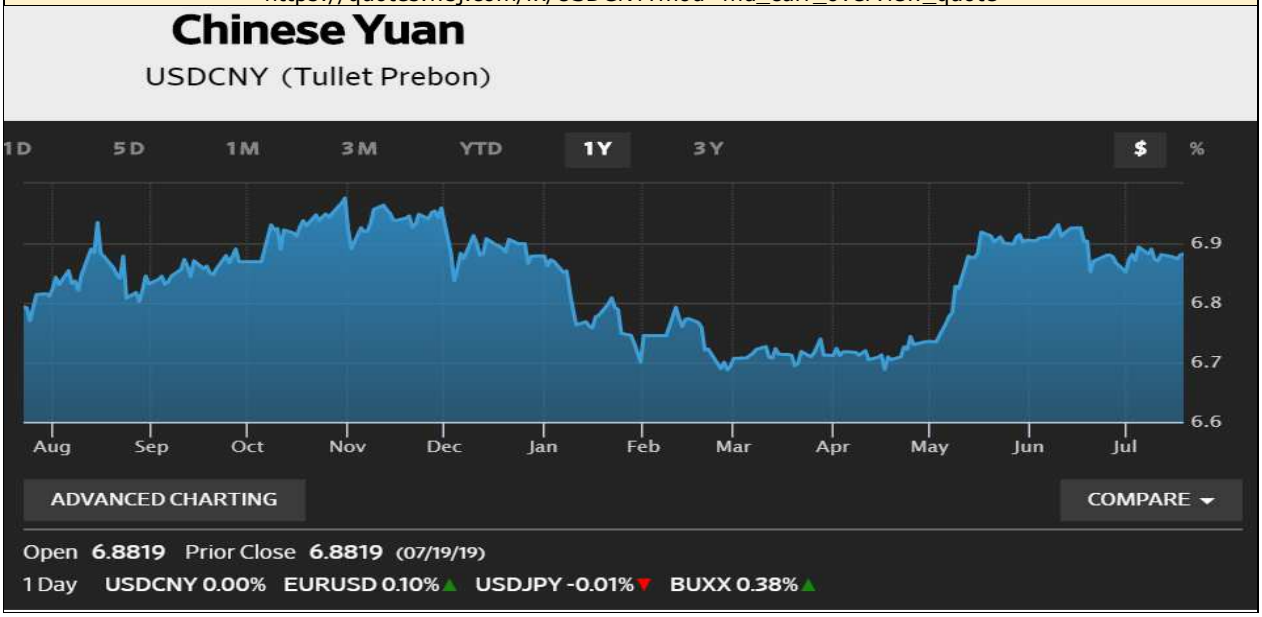
trade tensions began.[101] Data for the first quarter of 2019 show that the United States exports to, and imports from, China, dropped by 19.6% and 13.9%, respectively, year-over-year. Many economists warn that imposing tariffs on nearly all products from China could be costly to the United States consumers and firms that depend on trade with China. In addition, China could further retaliate by curbing operations of the United States-invested firms in China, reducing its holdings of the United States Treasury securities, and curtailing rare earth material exports to the United States.[102] In this regard, PwC China and Hong Kong in its China Economic Quarterly Q1 2019 market outlook notes that declining global economic growth, and the trade conflict between the United States and China have impacted China's imports and exports in first quarter of 2019.[103] Total imports and exports, reached 7.01 trillion yuan[104] in first quarter of 2019, increasing by 3.7% compared to 9.9% over the same period in 2018. It was slower that GDP growth of 6.4% in first quarter of 2019. Exports went up by 6.7% compared to 7.1% in 2018, year-on-year to 3.77 trillion yuan, and imports grew by 0.3% compared to 12.9% in 2018, year-on-year to 3.24 trillion yuan. The trade surplus went up 75.2% to 529.7 billion yuan in first quarter of 2019. Comparatively, net surplus in 2018 dropped by 18.3% compared to 2017. Meanwhile net exports contributed 22.8% to total GDP growth in first quarter of 2019, which is 42.4% higher than the same period in 2018. If converted to US dollars, total imports and exports reached US$ 1.03 trillion and decreased by 1.5% compared to 12.6% increase in 2018, in first quarter year-on-year. As a result of the trade conflict, China's imports to and exports from the United States substantially decreased by 11%, compared to 5.7% increase in 2018, to 0.82 trillion yuan accounting for 11.6%, compared to 13.7% in 2018, of China's total trade. However, China maintained a steady growth rate in trade with other major trading partners in first quarter 2019. For example, trade with the European Union increased by 11.5%, compared to 7.9% in 2018, accounted for 15.8% of China's total trade. Exports and imports with the Association of South-East Asian Nations (ASEAN) went up by 8.1%, compared to 11.2% in 2018, and accounted for 13.3% of China's total trade. Exports and imports with Japan grew slightly by 3.2% an accounted for 7.2% of China's trade. China's trade with countries under the Belt and Road Initiative accounted for 28.6% in first quarter of 2019, compared to 27.4% in 2018. Total trade with these countries went up 7.8%, compared to 13.3% in 2018, or 4.1% higher than overall trade growth and reached 2 trillion yuan. It is evident that growth is slowing compared to 2018 since global trade had declined. More specifically, trade with Russia, Saudi Arabia and Egypt increased by 9.8%, compared to 24.4% in 2018, and 33.8% compared to 23.2% in 2018, and 18.3% respectively. Although, China's total trade in first quarter 2019 only grew by 3.7%, in March 2019 the growth was 9.6%, much higher than January and February year-on-year. Thus, the United States and China trade conflict is expected to have a limited direct impact on the overall foreign trade of China. Despite the possibility of tariffs to marginally slow China's economic growth, the tariffs neither are powerful enough to derail the steady growth path of the Chinese economy nor will

[101] Eugenio Cerutti, Gita Gopinath, Adil Mohommad: The Impact of US-China Trade Tensions, IMF, 23 May 2019. https://blogs.imf.org/2019/05/23/the-impact-of-us-china-trade-tensions/, https://www.weforum.org/agenda/2019/05/the-impact-of-us-china-trade-tensions/
[102] Wayne M. Morrison: Enforcing U.S. Trade Laws: Section 301 and China, U.S. Congressional Research Service, Updated 26 June 2019, https://crsreports.congress.gov/
[103] https://www.pwccn.com/en/research-and-insights/china-economic-quarterly-q1-2019.html
[104] An average rate in March 2019 for USD-CNY (Chinese Yuan) was USD 1.0 to CNY 6.70 https://www.wsj.com/market-data/currencies

they lead to an economic downturn in China. It is expected that China's growth would recover in the course of 2019, as forecasted by the International Monetary Fund, and following a tariff truce reached in June 2019 at the G20 summit in Osaka of Japan between the United States and China.

In fact, the United States and China trade conflict has already influenced the exchange rate of the Chinese yuan against the United States dollar, accompanied by a fall in the exchange rate in last quarter of 2018. The exchange rate curve reflects the trend in the United States and China trade conflict, as the Chinese yuan significantly weakened by the end of 2018 after both sides implementing two rounds of tariff hikes, and then it stabilized during the time of the trade negations in early 2019, and again weakened after announcing the third round of tariff hike in May 2019 and implemented in June 2019 (Figure 18: Exchange Rate of the Chinese yuan against the United States dollar during August 2018 – July 2019). It is obvious that a weakened Chinese yuan can help reduce the adverse impact of the United States tariffs on Chinese goods and boost Chinese exports on the whole, and more importantly, it might largely offset some of the damage inflicted on the China's exports and imports by the trade conflict. And, the depreciation is very likely to continue as driven by market forces amid escalating the United States and China trade conflict.

Figure 18. Exchange Rate of the Chinese yuan against the United States dollar during August 2018 – July 2019
https://quotes.wsj.com/fx/USDCNY?mod=md_curr_overview_quote



Both, the United States and China have been implementing certain targeted measures to ease risks to and stress on economy and spillover effect of their trade conflict as their GDP growth is expected to slow down in 2019-2020. As uncertainties concerning the pace of global economic growth reflected through financial markets, investors began seeking safe returns. Due to targeted measures, implemented by the United States, in 2018 - 2019, investors moved out of Chinese and European stocks in favor of dollar-denominated assets. According to the United States Bureau of Economic Analysis, the United States multinational companies responded to tax incentives under the 2017 Tax Cuts and Jobs Act by repatriating dividends from their foreign

affiliates; created a sharp, but temporary, change in foreign investment flows of over US$ 500 billion in 2018 compared with 2017; and added to the appreciation of the dollar as the United States multinational companies converted funds accumulated abroad into dollars. Increasing demand for the dollar and dollar-denominated assets supported an appreciation of the dollar of about 7% between the end of 2017 and early 2019. In 2018, dollar appreciation and sustained demand for imports relative to external demand for the United States exports widened the United States merchandise trade deficit to US$ 891 billion in 2018.[105]

Concerning China, in 2019, China's growth declined following a combination of needed regulatory tightening to rein in shadow banking and an increase in trade tensions with the United States. In this regard, PwC China and Hong Kong in its China Economic Quarterly Q1 2019 market outlook pointed out that China's growth rate of GDP in first quarter of 2019 was 6.4%, which is better than the market expectation, and within the new official target range of 6% to 6.5%. China's GDP growth in early 2019 was measured favorably given the fact that the United States-imposed tariffs were already in place for a total US$ 250 billion worth Chinese products.[106] An analysis of China's macroeconomic indicators showed that the country's growth was on positive trend: the 6.4% growth rate of GDP in first quarter of 2019 is better than the market expectation as GDP increased by 21.34 trillion yuan (equivalent to total GDP for the year 2005); total fixed asset investment reached 10.19 trillion yuan, expanding by 6.3%; China's Purchasing Manager's Index (PMI) for the manufacturing sector during first quarter of 2019 entered a lower level and then rebounded in March 2019; non-manufacturing Purchasing Manager's Index (PMI) of the service sector slightly increased in March 2019; profits of industrial enterprises declined by 3.3%; total retail sales of consumer goods went up by 8.3%; imports and exports decreased by 1.5%; the producer price index (PPI) continued to fall and the consumer price index (CPI) was stable. The producer price index (PPI) went up by an average of 0.2% (3.5% in 2018) year-on-year in the first quarter of 2019, which is much lower than in 2018. The producer price index (PPI) in China is very likely to stay at a lower level, probably much lower than in 2018. Growth in the consumer price index (CPI) increased by 1.8% in first quarter of 2019 and year-on-year, which is slightly lower than fourth quarter of 2018. In future, it is likely that the consumer price index (CPI) in 2019 will probably stay at the current lower level, since energy related prices have cooled down and demand for consumer products will be weak due to slower economic growth.

In the meantime, China's central bank substantially increased monetary support for the real economy.[107] According to data from the People's Bank of China, in the first quarter of 2019, aggregate financing to the real economy (AFRE)[108] was 8.18 trillion yuan, and substantially went up 2.34 trillion yuan year-on-year. Compared to the

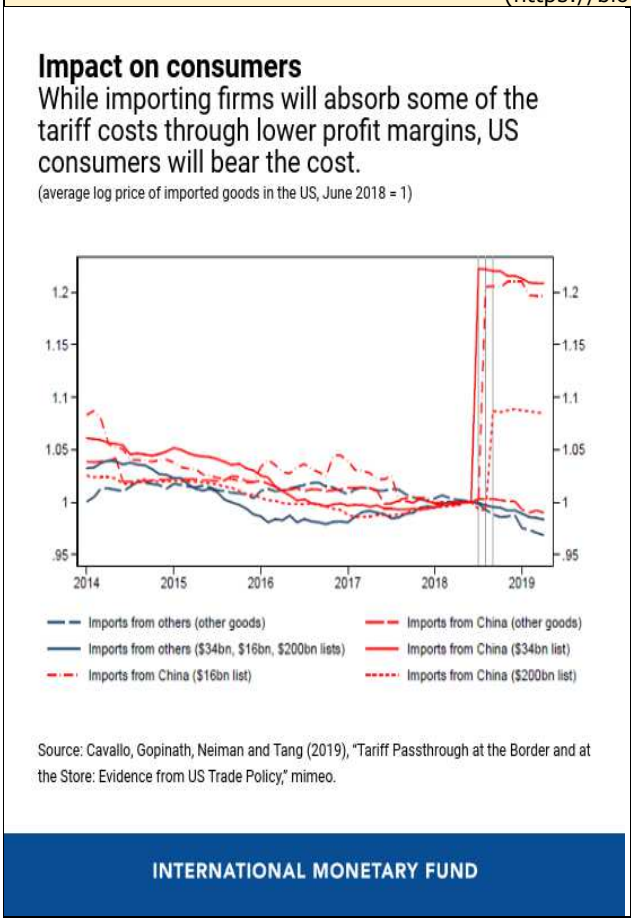
[105] James K. Jackson, Andres B. Schwarzenberg: The Global Economy: Is Slower Growth Ahead?, U.S. Congressional Research Service, 12 April 2019, https://crsreports.congress.gov/
[106] https://www.pwccn.com/en/research-and-insights/china-economic-quarterly-q1-2019.html
[107] Ibid.
[108] AFRE is the total volume of financing to the real economy, which includes flows of RMB loans, foreign currency-denominated loans, undiscounted bankers' acceptances, net financing of corporate bonds, domestic equity financing by non-financial enterprises, net financing of local government special bonds etc.

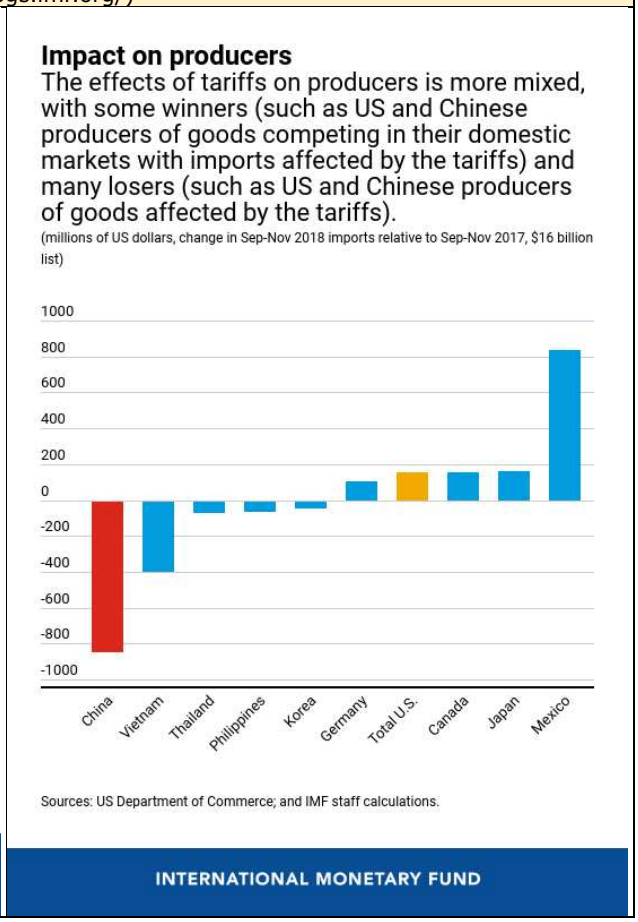
5.85 trillion yuan of aggregate financing in the first quarter of 2018, the growth rate reached about 40%. China increased fiscal spending by 15% in the first quarter of 2019, much higher than in 2018. In addition to stronger monetary measures to uphold economic growth, China's Ministry of Finance also accelerated fiscal support by increasing spending to 5.86 trillion yuan, which includes 0.69 trillion and 5.17 trillion yuan for central and local general public budget expenditure, respectively. The growth rate of fiscal spending was around 15%, or four percentage points higher than the same period in 2018. In 2018, manufacturing of automobiles in China had negative growth of 4.2% for the first time since 1990. This is an issue because China has the largest automobile market (in terms of sales and production), the second largest economy, and is the world's largest manufacturer. During the first quarter of 2019, manufacturing of automobiles declined 10.4% again, meanwhile, the growth of industrial added values for companies over certain scales went up 6.5%, but during the first two months of 2019, profits of industrial added values for companies over certain scales dropped 14.0% and revenues only increased by 3.3%.

Consumers in the United States and China are clearly the losers from trade tensions. Research conducted by the International Monetary Fund, using price data from the Bureau of Labor Statistics on imports from China, found that tariff revenue collected has been borne almost entirely by the United States importers[109]. There was almost no change in the (ex-tariff) border prices of imports from China, and a sharp jump in the post-tariff import prices matching the magnitude of the tariff (Figure 19. Impact of Tariff Hikes on Consumers and Producers in the United States). Some of these tariffs have been passed on to the United States consumers, like those on washing machines, while others have been absorbed by importing firms through lower profit margins. Any further increase in tariffs will likely be similarly passed through to consumers. While the direct effect on inflation may be small, it could lead to broader effects through an increase in the prices of domestic competitors. While, it is evident that the consumers have been directly affected by tariff increases, the effect of tariffs on producers is more mixed, with some winners and many losers. Some the United States and Chinese producers of goods competing in domestic markets with imports affected by tariffs, as well as competing third country exporters, are potential winners.[110] However, the United States and Chinese producers of the goods affected by the tariffs as well as producers that use those goods as intermediate inputs, are potential losers.

[109] Eugenio Cerutti, Gita Gopinath, and Adil Mohommad: The Impact of US-China Trade Tensions, 23 May 2019, IMF. https://blogs.imf.org/2019/05/23/the-impact-of-us-china-trade-tensions/, https://www.weforum.org/agenda/2019/05/the-impact-of-us-china-trade-tensions/
[110] Ibid.

Figure 19. Impact of Tariff Hikes on Consumers and Producers in the United States (https://blogs.imf.org/)





Trade diversion is one channel through which producers are affected. Aggregated bilateral the United States data suggests that trade diversion has occurred, as the decline in imports from China appears to have been offset by an increase in imports from other countries. For example, the United States imports from Mexico increased significantly among some goods on which the United States imposed tariffs. After the US$ 16 billion list was implemented in August 2018, a sharp decline of nearly US$ 850 million in imports from China was almost offset by about US$ 850 million increase from Mexico, leaving overall the United States imports broadly unchanged. For other countries such as Japan, Korea and Canada, one can observe smaller increases in the United States imports relative to the levels in September-November 2017. On the other hand, an assessment by Japanese investment bank Nomura found that importers in the United States and China are increasingly sourcing goods from third countries to ease costs of tariff hikes. It is suggested that some exporters in both countries may be willing to absorb part of the additional tariff costs in their profit margins, and some multinationals could opt to re-shore production, but the trade data shows that, over time, the largest response is likely to be trade diversion. Thus, higher the United States and China tariffs make suppliers in the rest of the world more competitive relative to the United States and Chinese firms.[111]

[111] Vietnam, Taiwan winning the US-China trade war, DW, 05 June 2019

Figure 20. Trade Diversion Beneficiaries

It's not the United States or China but the likes of Vietnam, Taiwan and Chile that have emerged as the winners of the trade conflict between the world's largest economies (Figure 20. Trade Diversion Beneficiaries). It is noted that Vietnam has so far been the biggest beneficiary of the trade diversion, gaining 7.9% of its GDP as a result of increased exports to both China and the United States. Taiwan, Chile, Malaysia and Argentina are the other big winners. These countries benefited more from demand from the United States importers as a result of the United States tariffs on China than from the Chinese ones looking to avoid China's tariffs on the United States goods. While the United States importers turned mainly to Asian countries not targeted by tariffs, their Chinese counterparts sourced goods from North and South America. The United States tariffs on Chinese goods caused the United States importers to look for alternative locations mostly for electronic products, followed by furniture and travel goods. China's tariffs on the United States have resulted in China import substitution mostly in soybeans, aircraft, grains and cotton. This substitution effect may be small in relation to the size of the United States and China GDP but the benefit from trade diversion can represent a substantial boost to the exports of third countries with smaller economies. European countries benefited only marginally from the trade diversion. However, these findings do not paint the full picture of the overall economic impact of the United States and China trade conflict. There are many other forces at work and the overall economic impact on most third countries will be negative. It is argued that many of the countries, which are seeing exports to the United States rise, are also likely to witness a fall in exports to China, considering most of them are major suppliers of intermediate goods to Chinese factories. Smaller Asian countries which supply raw material to Chinese firms are particularly vulnerable to higher United States tariffs on China as the levies target not only the assembler of the product but also suppliers through the value chain. In this regard, it is pointed out to the disruption in global supply chains and the uncertainty caused by a full-blown trade war. Of course, aggregate data could be masking other factors driving the bilateral trade patterns, such as the use of inventories. For example, there was little or no change in imports from third countries in the case of photosensitive semiconductor devices. The other channel by which producers could be affected is through market segmentation in the price of traded

https://www.dw.com/en/vietnam-taiwan-winning-the-us-china-trade-war/a-49068586-0

goods. This was most clearly observed in the case of soybeans, where the United States exports to China fell dramatically in 2018 after China imposed tariffs (Figure 21. Impact on Producers through Market Segmentation).

Figure 21. Impact on Producers through Market Segmentation (https://blogs.imf.org/)

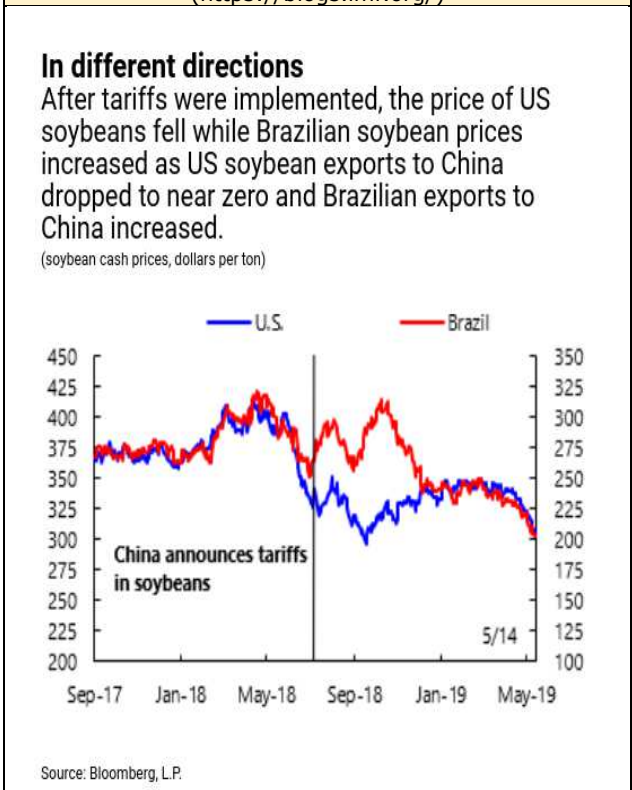
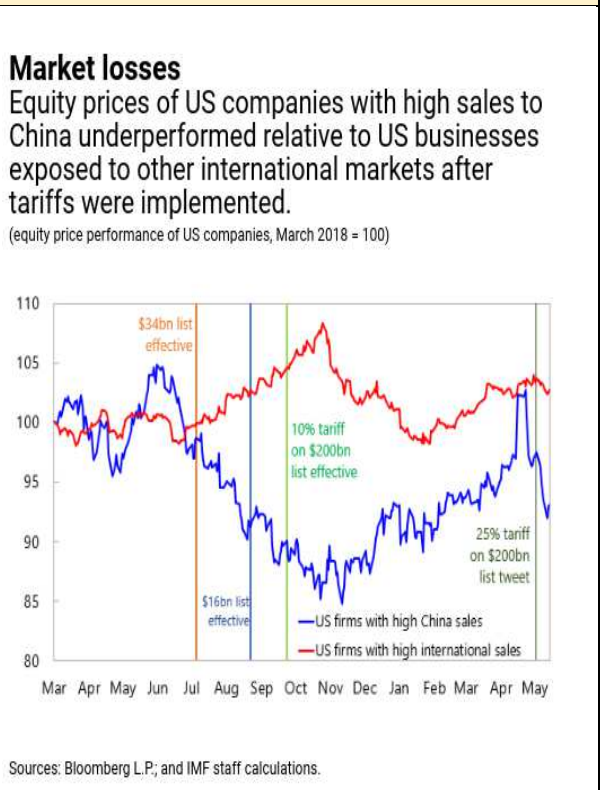


Figure 22. Market Losses in the United States (https://blogs.imf.org/)

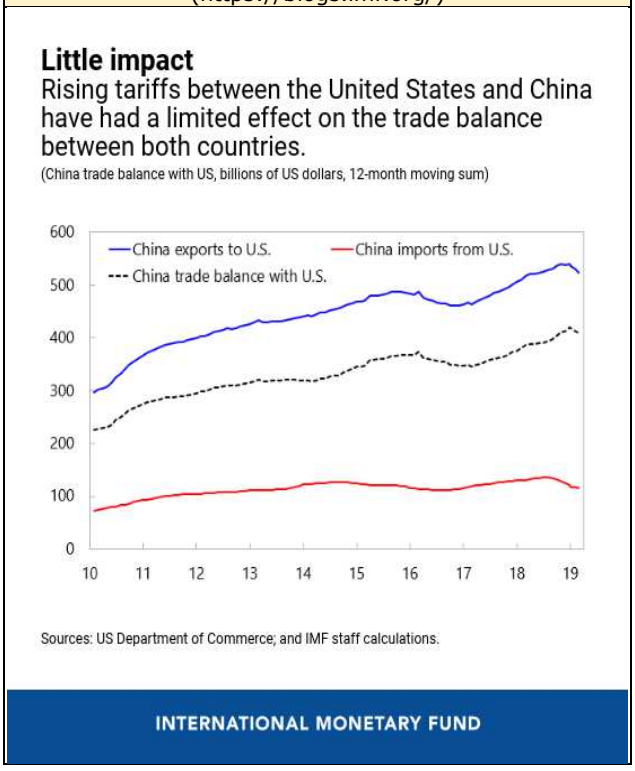


The United States was China's dominant soybean supplier, along with Brazil, in 2017. With the tariffs, the price of the United States soybeans fell while that of Brazilian soybeans increased, as the United States exports to China dropped to near zero and Brazilian exports to China trended higher. Though prices have since re-converged and soybean exports to China have resumed to some extent, the United States soybean farmers suffered, while those in Brazil benefited from trade diversion and market segmentation. The impact on the United States producers with significant exposure to Chinese markets was also captured in stock market valuations (Figure 22. Market Losses in the United States). For instance, the equity price performance of the United States companies with high sales to China underperformed relative to the United States businesses exposed to other international markets, after tariffs linked to the US$ 34 billion retaliation list by China were implemented. The gap narrowed at the beginning of 2019 with the trade truce. But it reopened again after the United States tariff increase to 25% on the US$ 200 billion list was announced in May 2019.

In this context, a survey conducted during 16-20 May 2019 by the American Chamber of Commerce in China and its sister organization in Shanghai found that three-

quarters of the United States companies in China say they were being hit hard by the ongoing the United States and China trade conflict.[112] The United States firms manufacturing in China were the hardest hit, with more than 80% reporting adverse effects from both the United States and Chinese tariffs. Nearly half of the two hundred and fifty respondents said they have experienced non-tariff retaliatory measures in China since 2018. About one in five the United States firms experienced increased inspections and slower customs clearance. Furthermore, the tariffs and rising protectionist tendencies have prompted many the United States firms to change their supply chain strategies. It is found that 35% of firms would adopt an "in China for China" strategy, which aims at sourcing within China and targeting the domestic market, as a result of tariffs. However, over 40% of firms were considering or have relocated production facilities outside China, with Mexico and Southeast Asia the preferred alternatives. It is noted, thus, the United States efforts to persuade its firms to move their production lines back to the United States seem to be not effective, as fewer than 6% of the surveyed businesses said they have moved or are considering moving their factories to the United States.

Figure 23. Limited Effect of Tariffs on Trade Balance (https://blogs.imf.org/)

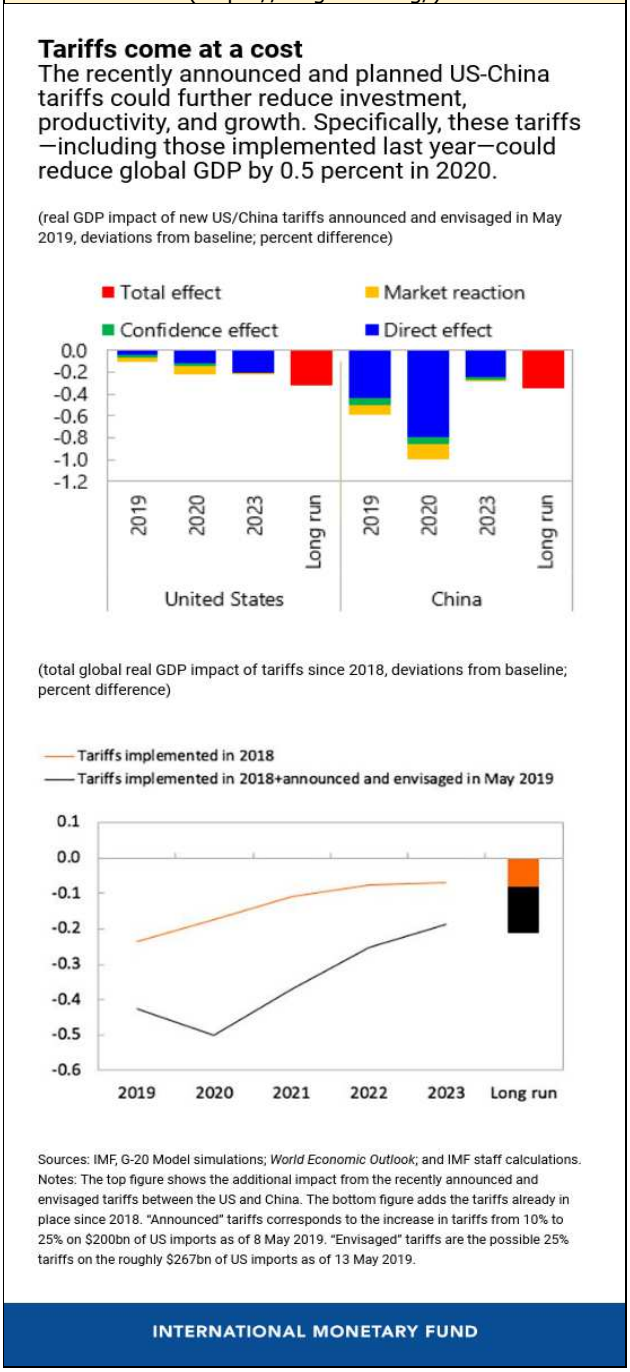


Thus, the ratcheting up of bilateral tariffs between the United States and China has had limited effect on their bilateral trade balance. In this regard, the International Monetary Fund's research found that a tariff-induced change in a specific trade balance between two countries tends to be offset by changes in bilateral balances with other partners through trade diversion, with little or no impact on the aggregate trade balance.[113] Instead, macroeconomics drives trade. It is found that most of the changes in bilateral trade balances over the past two decades were explained by the combined effect of macroeconomic factors, which include fiscal policy, credit cycles, and, in some cases, exchange rate policies and widespread subsidies to tradable sectors. In contrast, changes in tariffs played a much smaller role. However, this does not mean that tariffs do not hurt countries. It is concluded that in the context of a global economy characterized by global value chains, where production is carried out across multiple countries, sharp increases in tariffs can create significant long-term economic costs and ripple effects, leaving the global economy worse off. In fact, in 2018, the

[112] Tariffs prompt US firms to rethink China business: survey, 22 May 2019, https://www.dw.com/en/tariffs-prompt-us-firms-to-rethink-china-business-survey/a-48824637-0
[113] Johannes Eugster, Florence Jaumotte, Margaux MacDonald, and Roberto Piazza: Economic Forces, Not Tariffs, Drive Changes in Trade Balances, IMF, 03 April 2019. https://blogs.imf.org/2019/04/03/economic-forces-not-tariffs-drive-changes-in-trade-balances/

trade deficit increased for the United States as imports from China rose, which partly reflects the front-loading. As of March 2019, a small decline was observed, but the United States exports to China were also falling.[114] Indeed, macroeconomic factors, including relative aggregate demand and supply in partner countries and their underlying drivers, play a much bigger role than tariffs in determining bilateral trade balances.

Figure 24. Impact of Tariffs on the United States, China and World's GDP (https://blogs.imf.org/)



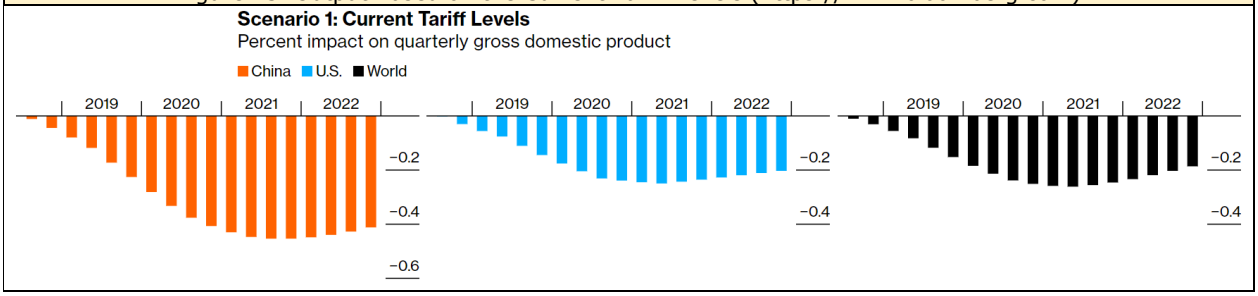
As trade tensions are looming larger, particularly, there are growing concerns over the impact of the current trade conflict between the United States and China. The risk is that the most recent United States and China tariffs could further reduce investment, productivity, and growth. The United States proposed tariffs on vehicles and auto parts imported from Mexico in June 2019 are also of serious concern. Indeed, there is strong evidence that the United States, China, and the world economy are the losers from the current trade tensions (Figure 24. Impact of Tariffs on the United States, China and World's GDP). At the global level, the International Monetary Fund estimated that, overall, the United States and China tariffs, including those implemented in 2018, could reduce global GDP by 0.5 percent in 2020, with more than half of the impact stemming from business confidence effects and negative financial market sentiment.[115] This amounts to a loss of about US$ 455 billion, larger than the size of South Africa's economy. Moreover, failure to resolve trade differences and further escalation in other areas, such as auto industry, which would cover several countries, could further dent business and financial market sentiment, negatively impact emerging market bond spreads and currencies, and slow investment and trade. In addition, higher trade barriers

[114] Eugenio Cerutti, Gita Gopinath, and Adil Mohommad: The Impact of US-China Trade Tensions, 23 May 2019, IMF. https://blogs.imf.org/2019/05/23/the-impact-of-us-china-trade-tensions/, https://www.weforum.org/agenda/2019/05/the-impact-of-us-china-trade-tensions/

[115] Christine Lagarde: How to Help, Not Hinder Global Growth, 5 June 2019, https://blogs.imf.org/2019/06/05/how-to-help-not-hinder-global-growth/

would disrupt global supply chains and low the spread of new technologies, ultimately lowering global productivity and welfare. More import restrictions would also make tradable consumer goods less affordable, harming low-income households disproportionately. This type of scenario is among the reasons why the International Monetary Fund referred to 2019 as a delicate year for the global economy. Furthermore, based on the current tariff levels as of June 2019, Bloomberg Economics' modelling suggested that in two years output in China and the United States would be lower by 0.5% and 0.2% respectively. Global output would also come slightly down (Figure 25. Output Based on the Current Tariff Levels).[116] On the other hand, a study by the Organization for Economic Cooperation and Development estimated that current combined US$ 360 billion and threatened further the United States and China tariff hikes could reduce the United States and China's GDP by 0.9% and 1.1%, respectively, by 2021- 2022 (relative to its baseline).[117]

Figure 25. Output Based on the Current Tariff Levels (https://www.bloomberg.com)



As evident from various analysis, however, a protracted and expanding the United States and China trade conflict could sharply reduce bilateral commercial ties, disrupt international supply chains, and diminish global economic growth. These are self-inflicted wounds that must be avoided, by removing the recently implemented trade barriers and by avoiding further barriers in whatever form. The fact is that protectionist measures are not only hurting growth and jobs, but they are also making tradable consumer goods less affordable, and disproportionately harming low-income households. The immediate priority is to resolve the current trade tensions, while stepping up the modernization of the international trade system.[118] This includes building consensus across countries on how to strengthen the World Trade Organization's rules, especially on subsidies, intellectual property, and trade in services. The goal is to create a more open, more stable, and more transparent trade system, one that is well-equipped to serve the needs of twenty-first century economies. For example, the International Monetary Fund's research shows that liberalizing trade in services could add about US$ 350 billion to global GDP in the long run. These types of gains are critical if trade is to play its role in lifting living standards and creating new jobs with higher wages. As countries are fixing the trade system, they also need to work together to reform international corporate taxation, strengthen

[116] https://www.bloomberg.com/graphics/2019-us-china-trade-war-economic-fallout/
[117] Wayne M. Morrison: Enforcing U.S. Trade Laws: Section 301 and China, U.S. Congressional Research Service, Updated 26 June 2019, https://crsreports.congress.gov/
[118] Christine Lagarde: How to Help, Not Hinder Global Growth, 5 June 2019, https://blogs.imf.org/2019/06/05/how-to-help-not-hinder-global-growth/

the global financial safety net, and tackle the existential threat of climate change. In conclusion, the economic effects of this trade conflict are limited with the exception of a number of sectors in China and the United States. The Chinese GDP loss will eventually increase, and the GDP loss for the United States will be small due to its market power. Other countries, including the European Union, will even benefit from reduced trade between the United States and China. However, the initial indirect benefit for the European Union will largely disappear when the United States decides to levy import tariffs on cars. At the sector level, the trade conflict will lead to significant shifts, especially in the United States and China, in electronic equipment sector, machine equipment sector, and agriculture. At the multilateral level, the main priority is for countries to resolve trade disagreements cooperatively, without raising distortionary barriers that would further destabilize a slowing global economy.

14. OVERVIEW OF ECONOMIC CAPABILITIES OF THE UNITED STATES AND CHINA

A comparative review of key macroeconomic indicators between the United States and China provides better understanding of their economic capabilities. While reviewing key metrics, C. Fred Bergsten[119] notes that there has not been a widespread decline of the United States in absolute terms. Indeed, the United States economic and military superiority remains overwhelming since the end of the Cold War. It is argued that any deterioration in the United States potential for global economic leadership stems from a decline in its will rather than in its capability. However, the main reason for the United States' decline in relative terms is the dramatic rise in China's capability. The United States and China are now largely equal on several key macroeconomic indicators. In fact, China has been successfully maintaining the status of the world's second-largest economy since 2010, when China surpassed Japan as the world's second-largest economy. In 2018, China with GDP annual growth rate at 6.6%, in comparison with the Unites States, had an impressive more than twofold higher the world average growth rate at 3.035% in 2018. China has been able to maintain higher growth rates for past four decades. On the other hand, the United States has been struggling to keep its growth going on the right path during the same period. In 2018, the United States GDP annual growth was at 2.857%, slightly below the world average growth rate at 3.035% in 2018. In 2018, China's GDP was valued at US$ 13.608 trillion, after the United States at US$ 20.494 trillion. By comparison, in 2018, China's GDP adjusted to PPP (purchasing power parity) was valued at US$ 25.362 trillion, above the United States at US$ 20.494 trillion. By comparison, in 2018, the United States' federal government debt was 99% of GDP, while China's government debt was 47% of GDP. With healthy national balance sheet, China can spend additional money for solving its challenges.

[119] C. Fred Bergsten: China and the United States. The Contest for Systemic Leadership, Chapter 5. US-China Economic Relations: From Conflict to Solutions, China Finance 40 Forum - Peterson Institute for International Economics, June 2018.

Table 10. Data Comparison on Population, Territory and Macroeconomic Indicators between the United States and China (2018) (http://data.imf.org; https://www.census.gov/; https://tradingeconomics.com/; https://howmuch.net)

		UNITED STATES	CHINA
1	Population	327,167,434	1.393 billion
2	Area	9,147,420 square kilometers	9,388,211 square kilometers
3	GDP growth (annual %)	2.857 %	6.6 %
4	GDP (current US$)	20.494 US$ trillion	13.608 US$ trillion
5	GDP, PPP (current international $)	20.494 US$ trillion	25.362 US$ trillion
6	GDP per capita growth (annual %)	2.222 %	6.115 %
7	GDP per capita (current US$)	62,641 US$	9,770 US$
8	GDP per capita, PPP (current international $)	62,641 US$	18,210 US$
9	Current account balance (Balance of Payments, current US$)	-488.48 US$ billion	49.092 US$ billion
10	Net trade in goods (Balance of Payments, current US$)	-891.322 US$ billion	395.171 US$ billion
11	Net trade in goods and services (Balance of Payments, current US$)	-622.115 billion	102.921 US$ billion
12	Central government debt, total (% of GDP)	99.017 %	47.6 %
13	Gold Reserves	8,133 tons 373,430,444,426 US$	1,885 tons 86,568,279,703 US$
14	Total reserves (includes gold, current US$)	449.907 US$ billion	3.168 US$ trillion
15	Liquidity Reserves	115 US$ billion	3.09 US$ trillion
16	Crude Oil Reserves	36.5 billion barrels (Gbbl)	25.6 billion barrels (Gbbl)

By comparison, in 2018, China was the largest foreign holder of the United States Treasury securities at US$ 1.113 trillion, equivalent to 17.3% of the total amount of treasury securities issued to foreign countries, which amounts to US$ 6.433 trillion, and followed by Japan at US$ 1.064 trillion, equivalent to 16.5%. This gives China leverage of the United States because China has the ability to unload that debt in massive amounts, thus considerably increasing the market supply with the United States treasury securities and pushing down the United States bond prices, increasing yields and potentially discouraging the free flow of credit in the United States. By comparison, in 2018, China held a total US$ 3.168 trillion reserves, including gold and foreign currencies, mostly US$, while the United States held a total US$ 449.90 billion. If China were to sell off its US$ 3.09 trillion of US$ liquidity reserves, which is much higher than the United States reserves of US$ 115 billion, it would have cascading effects on the United States economy, including driving up the United States interest rates. With such large liquidity reserves, China can also influence the value of its own currency – the yuan. While the United States remains the largest holder of gold with 8,133 tons of the precious metal, China is the sixth largest holder of gold with 1,900 tons, which provides both countries a safe haven and a stable asset during uncertainties in stock market and currencies.

C. Fred Bergsten[120] argues that China is likely to continue growing (4% to 7%) at double or triple the United States rate (2% to 3%) for at least the next decade or

[120] C. Fred Bergsten: China and the United States. The Contest for Systemic Leadership, Chapter 5. US-China Economic Relations: From Conflict to Solutions, China Finance 40 Forum - Peterson Institute for International Economics, June 2018.

two, as its much lower per capita income offers sizable scope for further convergence to the United States frontier. China's GDP, measured in PPP (purchasing power parity) terms, which passed the United States in 2010, will probably double that of the United States by 2030 and triple it by 2040–50. China's trade level will probably also double the United States level by 2030 and triple it by 2040. China's GDP at market exchange rates will probably exceed the United States GDP by 2030 and do so by 50% by 2040. Furthermore, Goldman Sachs predicts that China is on track to overtake the United States as the world's number one economy by 2027[121]. By 2050, the world's economic environment will be transformed, and PwC forecasts that six of the seven largest economies in the world are projected to be emerging economies in 2050 led by China (first) and India (second), while the United States could be down to third place in the global GDP rankings and the European Union's share of world GDP could fall below 10% by 2050[122]. On the other hand, greater size does not certainly confer China a dominant position in the world. The United States will most likely remain a very large economy and with very large trade and international investment levels. Because the United States has built a formidable array of alliances and international institutions grounded in its own norms, the United States will remain a powerful force in global economics in future. However, China's prospective growth to levels that may well be multiples of the United States on several key variables over the next few decades, clearly provides it with the necessary capabilities to exercise much greater international role, especially, if the United States will seek retreat to the sidelines. Against this backdrop, the United States seems to vastly overestimates its international economic power in present circumstances, as indicated by the resolute opposition of China as the main trade target. The United States will try to convince its allies to take active measures to counter China, but that strategy's effectiveness will likely be unsuccessful as China will not allow the United States to cage it. China will most likely use its significant economic weight to influence the United States allies and potential regional partners to accede to its needs.

15. POTENTIAL SCENARIOS OF COMPETITION BETWEEN THE UNITED STATES AND CHINA

Against this backdrop, C. Fred Bergsten[123] proposes three potential scenarios for the evolution of global economic leadership over the next decades. Shaping this outcome is far more important for the United States, China, and certainly for the world as a whole, than whether the United States and China can correct their current international imbalances or even avoid a trade war. The first and most likely outcome is a systemic stalemate that emerges without effective leadership from either China

[121] U.S. Relations with China, 1949 – 2019, Council on Foreign Relations, https://www.cfr.org/timeline/us-relations-china
[122] The World in 2050. The long view: how will the global economic order change by 2050? PricewaterhouseCoopers LLP, February 2017, https://www.pwc.com/world2050#download, https://www.weforum.org/agenda/2017/02/a-prediction-the-worlds-most-powerful-economies-in-2030
[123] C. Fred Bergsten: China and the United States. The Contest for Systemic Leadership, Chapter 5. US-China Economic Relations: From Conflict to Solutions, China Finance 40 Forum - Peterson Institute for International Economics, June 2018.

or the United States, or anybody else. This G0 world could have harmful consequences. The classic model is the "Kindleberger trap" of the 1930-s, which deepened the Great Depression when the declining United Kingdom no longer had the capability to lead and the rising United States did not yet have the will to do so. No one provided the open markets, lending, and liquidity needed to avoid international economic conflict and downward spiral. The second scenario envisages a rise of China to lead a new G1 system. The combination of China's rising capabilities and the possible abdication of the United States leadership suggest that such an outcome is possible. But it also faces huge obstacles, especially acceptance by others of China's political system and values. There are two critical variables under this consideration. One is timing. Many believe that a gradual assumption of global leadership by China over a decade or so, as its economic power and influence continues to grow, is inevitable. China envisages its return to a central global position by mid twenty-first century (2050), thirty years from now. But, the unexpected loss of leadership role by the United States could sharply accelerate this timetable. The second key variable is directly related to the question on whether the United States would accept China's rise more or less gracefully or would it fight to avoid losing its traditional top position. In this situation, a gradual loss of controlling power would seem more likely to be met by consent, whereas a surge of China to dominance, would be much more likely to induce a hostile and confrontational reaction. The evolving situation suggests that the United States will not give way quietly. It is argued that the United States will indeed seek to block any further assertion of global economic leadership by China. The United States has already taken a tough stance toward China by targeting its economy and strategic interests globally, which manifested in their trade, investment and technology relationships. The United States could also veto any further increase in China's share of the International Monetary Fund. However, these steps are more likely to lead to new conflict and confrontations with China. It is argued that the United States current strategy, including trade assaults, investment reviews and export controls, to compel China is falling short. Thus, it is expected that the United States will move beyond its current reactive and defensive strategy to adopt policies that reflect a more sustainable path to effective competition with China, perhaps using other non-economic means, including challenging China's claim to sovereignty over Taiwan, military posturing in the South China Sea, arms race, and support for internal destabilization (unrest in Hong Kong), etc. It is argued that South China Sea could be a future flashpoint between two countries. Since 2013, China has built and fortified artificial islands on seven sites in the Spratly Island chain in the South China Sea. To challenge what the United States considers excessive maritime claims, the United States military undertakes both freedom of navigation operations and presence operations in the sea, and undertakes Air Force bomber flights over the sea. China argues that such operations infringe on its sovereignty and undermine peace, security, and order.[124] The United States is increasingly concerned that its ability to maintain dominance in the region will be limited or reduced by China's growing economic and military capabilities. Thus, in June 2019, the United States came up with the Indo-Pacific strategy, which is essentially a follow-on to the National Security

[124] Susan V. Lawrence, Wayne M. Morrison, Jonah Langan-Marmur: U.S.-China Relations, U.S. Congressional Research Service, 11 April 2019, https://crsreports.congress.gov/

Strategy and National Defense Strategy, two documents that put the threat from revisionist great powers, especially China, at the center of the United States policy. The strategy describes the Indo-Pacific as America's "priority theater", because that region is likely to be the engine of economic growth and the epicenter of geopolitical rivalry in the twenty-first century.[125] It is thus possible that there is a "Thucydides trap" for the global economic order.[126] In relation to the rise of China, Graham Allison explains the size, speed and scale of China's rise that, in just a single generation, has emerged like a rocket to displace the United States as number one in many areas. As a consequence of this rise, it is noted that Chinese leaders have become unsatisfied with the inherited world order designed by the United States in the aftermath of the Second World War, thus having deployed a clearly revisionist strategy. In this regard, it is argued that through the use of hard instruments of soft power and economic instruments (from trade and investment policy to sanctions, cyberattacks, and foreign aid) to achieve geopolitical goals, China is spreading its economic network across the globe, altering the international balance of power in a way that causes even the longtime United States allies in Asia to move from the United States toward China.[127] There may be an inherent dynamic through which clashes between the declining hegemon and the rising power become inevitable during the transition period, with the latter induced to move prematurely and the former unready to accept demotion. As Robert D. Kaplan[128] argues China does not pose an existential threat. The possibility of a war between the United States and China is extremely remote. However, there is a military threat from China, but it is indirect. This potentially disastrous outcome points the way towards a third, and probably most desirable, scenario: a restoration of the United States will to lead, which, accompanied by its continued or even reinvigorated economic dynamism, provides the foundation for a cooperative G2, at least for a prolonged transition period, between the United States and China. The present period, when China and the United States are roughly equal on some of the key economic metrics, might be a favorable time to pursue that alternative. Despite the "hegemonic stability" theories of Kindleberger and a number of more recent political scientists, Barry Eichengreen and others have demonstrated that multipolar leadership has proved successful in several historical periods. In the contemporary context, such a G2 would function within a broader multipolar and institutional framework. It would attempt to lead other countries and the relevant organizations in two complementary directions: maintaining an orderly world economy within the existing norms and modifying those norms in a deliberate manner to reflect the changing balance of power among the key actors mainly the G2

[125] https://www.bloomberg.com/opinion/articles/2019-06-18/u-s-indo-pacific-strategy-isn-t-going-to-scare-china ; https://media.defense.gov/2019/Jul/01/2002152311/-1/-1/1/DEPARTMENT-OF-DEFENSE-INDO-PACIFIC-STRATEGY-REPORT-2019.PDF

[126] The Thucydides's Trap Case File presents summaries of sixteen cases, which are featured in Graham Allison's book Destined for War: Can America and China Escape Thucydides's Trap? Using the cases, Allison illustrates how tension between rising and ruling powers has often led to war—while also showing how war was avoided in the four rivalries that did not end in violence. (https://www.belfercenter.org/thucydides-trap/case-file)

[127] Hugo Bras Martins da Costa: Destined for War: Can America and China Escape Thucydides's Trap? Book review, 11 October 2018. (http://www.scielo.br/scielo.php?script=sci_arttext&pid=S1981-38212018000300600)

[128] Robert D. Kaplan: The revenge of geography. What the map tells us about coming conflicts and the battle against fate. The Random House Publishing Group, New York, United States, 2013.

themselves. The latter part of that equation would be extremely difficult. The United States, based on a major alteration in the domestic political landscape, would resume international economic cooperation and take several tangible steps such as: joining the Asian Infrastructure Investment Bank (AIIB)[129], participating in the Belt and Road Initiative (BRI)[130] through both public institutions and private firms and supporting truly proportional representation for China (and other rapidly emerging markets) in the International Monetary Fund and other international institutions. All these steps would require the right combination of reinforcing traditional norms and institutions, where they can be widely endorsed, and creating new norms and institutions to more accurately reflect the preferences of ascending economic powers. It would require changes in the mindset of the United States and China. The latter would have to win acceptance of the changes that it views as most important, especially to head off the conflict with the United States that could otherwise emerge all too easily. A dramatic way to address these issues, and to establish a G2 with its systemic implications, would be for the United States and China to launch negotiations for a Free Trade Agreement between them, or modernize the existing international trade arrangements, such as the World Trade Organization. On the monetary side both countries could use the renegotiation of the International Monetary Fund's quotas to start establishing a G2 or create a new Special Drawing Right Council to bring together the five designated reserve currency issuers (the United States, eurozone, the United Kingdom, Japan, and China) to do so. The current trade confrontation between the United States and China may provide an opportunity to start fashioning a functioning G2. If both countries can put aside the rhetoric and posturing, and work out a practical new agreement that averts a trade war, they will have exercised positive systemic leadership, which could be the start of something lasting.

16. CONCLUSION

The United States and China relations have evolved from tense standoffs to a complex mix of intensifying diplomacy, growing international rivalry, and increasingly intertwined economies. In 1979, the United States and China re-established diplomatic relations and signed a bilateral trade agreement, providing mutual most-favored-nation treatment, which allowed to substantially expand their economic relationship with increasing cooperation at higher levels since then. The United States and China managed to forge a mutually beneficial and win-win relationship with strong complementarity and interlinked interests, benefiting not only the two countries but also the entire world for a long time. Given the differences in stage of development

[129] The Asian Infrastructure Investment Bank (AIIB) is a multilateral development bank with a mission to improve social and economic outcomes in Asia. Headquartered in Beijing, China, it began operations in January 2016 and have now grown to 100 approved members worldwide.

[130] China's Belt and Road Initiative (BRI) is an ambitious programme to connect Asia with Africa and Europe via land and maritime networks along six corridors with the aim of improving regional integration, increasing trade and stimulating economic growth. The BRI comprises a Silk Road Economic Belt – a trans-continental passage that links China with south east Asia, south Asia, Central Asia, Russia and Europe by land – and a 21st century Maritime Silk Road, a sea route connecting China's coastal regions with south east and south Asia, the South Pacific, the Middle East and Eastern Africa, all the way to Europe.

and economic and political systems, it was foreseeable that these differences would bring certain tensions in their relationship. Thus, their economic and political frictions culminated in a trade conflict beginning in March 2018. According to information from the Office of the United States Trade Representative[131], the United States trade in goods and services with China totaled an estimated US$ 737.1 billion in 2018, respectively exports totaled US$ 179.3 billion and imports totaled to US$ 557.9 billion. As a result, the United States trade deficit in goods and services with China was US$ 378.6 billion in 2018. China is currently the United States' largest goods trading partner with US$ 659.8 billion in total (exports and imports) goods trade during 2018. Goods exports totaled US$ 120.3 billion; goods imports totaled US$ 539.5 billion. The United States goods trade deficit with China was US$ 419.2 billion in 2018. Trade in services with China (exports and imports) totaled an estimated US$ 77.3 billion in 2018. Services exports were US$ 58.9 billion; services imports were US$ 18.4 billion. The United States services trade surplus with China was US$ 40.5 billion in 2018. According to the United States Department of Commerce, the United States exports of goods and services to China supported an estimated 911,000 jobs in 2015 (latest data available), whereas 601,000 supported by goods exports and 309,000 supported by services exports. Between 1980 and 2018, the United States and China trade rose from US$ 4.9 billion to US$ 737.1 billion[132], making them each other's largest trading partners on a country basis. Globalization, industrial revolution and trade liberalization provided the opportunity for many developed countries to shift from manufacturing economy to service economy in recent decades. Out of this process, however, China emerged as the world's second largest economy. In 2010, China surpassed Japan as the world's second largest economy. Moreover, China became the world's largest manufacture of goods. China's share of global manufacturing gradually increased from 2.7% in 1990 to 25% in 2017. At the same time, China's share of global GDP has risen from 1.8% in 1990 to about 16% nowadays[133]. China's competitive and low-cost manufacturing sector also helped to make the country the largest trading nation in the world. According to the World Trade Organization, in 2018, world merchandise exports totaled US$ 19.48 trillion, and went up by 10% from 2017. China's share of merchandise exports and imports by value was 12.8% and 10.8% of the world's total in 2018, which ranked number one and number two after the United States. China has grown faster for longer than any other country on record as a result of gradual economic reform over forty years. Even though China's growth rate has declined since the recent global financial crisis, it has

[131] https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china#

[132] According to China's General Administration of Customs, the trade in goods between China and the United States grew from less than US$ 2.5 billion in 1979 when the two countries forged diplomatic ties to US$ 633.5 billion in 2018, a 252 fold increase (Reference: China's Position on the China-US Economic and Trade Consultations, the State Council Information Office of the People's Republic of China, 2 June 2019, http://english.gov.cn/archive/white_paper/2019/06/02/content_281476694892692.htm). However, according to the United States Department of Commerce data this figure was up to US$ 737.1 billion. Such a huge discrepancy can be attributable to different statistical calculation methods including factors relating to transit trade and service trade. These methods also affected their trade deficit calculation, as the United States showing higher and China showing lower figures for their bilateral trade deficit.

[133] China Economic Quarterly Q1 2019, https://www.pwccn.com/en/research-and-insights/china-economic-quarterly-q1-2019.html

continued to make a disproportionately large contribution to the pace of global expansion. Trade liberalization and high volume of international trade also created trade imbalances between partners. Some countries are concerned that large and rising size of trade imbalances are the result of uneven measures that distort international trade. The United States, for instance, runs the world's largest trade deficit over the past four decades. However, the size of the United States merchandise deficit with China became a major concern for the country. Between 1990 and 2018, the United States merchandise trade deficit with China rose from US$ 10.4 billion to US$ 419.3 billion. China's large merchandise trade surpluses and some trading practices with the United States have also strained both countries relations. Thus, their bilateral trade balances have come under scrutiny recently. In 2018, China was the largest foreign holder of the United States government debt at US$ 1.113 trillion. Moreover, China's emergence as a major economic power poses number of challenges for the United States, which include China's efforts to become more technologically advanced in a number of dual-use industries, attempts to use its financial resources to advance its interests globally such as through the Belt and Road Initiative and the Asian Infrastructure Investment Bank and promote its soft power, and attempts to present China's economic model of state-guided capitalism as an alternative to the United States economic model. The rising China's economy set off alarm bells amongst advanced economies, particularly the Unites States. Thus, their bilateral trade balances have come under scrutiny. Previously, the United States and China used to manage their trade frictions using diplomacy, bilateral dialogues, the World Trade Organization's dispute settlement system, and domestic trade remedies. Recently, trade tariffs, as an instrument of trade and foreign policy, have returned to mainstream politics in the United States, raising fears of resurgence of protectionism. The United States imposed tariff hikes on US$ 250 billion worth of Chinese products, while China retaliated with tariff hikes on US$ 110 billion worth of the United States products. Their rivalry began playing out in the crucial technology sector. The ongoing trade conflict between the world's two largest economies, which account to 40% of global GDP, had increased fears that further escalation would harm the global economy. In 2019, the International Monetary Fund reported that the United States and China tensions have negatively affected consumers and producers in both countries. Although the imposed tariffs have reduced trade between them, their bilateral trade deficit remained broadly unchanged, while the impact on global growth was relatively modest, however disruption risks remained for the global supply chains. Also, it is evident that tariff-induced change in trade balance between the United States and China tends to be offset by changes in bilateral balances with their other partners through trade diversion, with little or no impact on the aggregate trade balance. Macroeconomics drives trade, thus most of the changes in bilateral trade balances can be explained by the combined effect of macroeconomic factors, which include fiscal policy, credit cycles, and, in some cases, exchange rate policies and widespread subsidies to tradable sectors. It is argued that trade wars are not easy to win, even for large economies such as the United States. China has the tools to manage the economic blow. Thus, the United States and China will eventually reach a deal to lift some of their reciprocal tariffs, but their economic competition will persist as the United States strategy evolves beyond tariffs to counter China's emergence as

an economic, military, and political peer. It is argued that both countries might be falling in a "Thucydides trap", when a major rising power challenges a major ruling power. In June 2019, at the G20 summit in Osaka of Japan, the United States and China agreed to a truce in their trade war and vowed to restart trade negotiations. The United States has agreed to delay indefinitely placing more tariffs on imports from China, including the pending tariff measures on US$ 300 billion worth products, and lift some of its export controls on the Chinese firm Huawei Technologies. In return, China will consider buying more agricultural products form the United States. Both counties have re-started their trade talks, but signs are showing a comprehensive deal could be a long way off, tense with many sticking points. After all, both the United States and China have agreed to two such temporary agreements before, and both eventually broke down, as many key demands from each side remain unresolved. Nevertheless, it appears that the United States may be willing to weaken some of its demands to get a deal with China. The latest trade cease-fire between the United States and China gives the perception that trade wars are not easy to win, even for such a powerful country as the United States. The reason might also be that China has already developed necessary capabilities to compete on an equal footing with the United States. Nevertheless, the United States and China trade war will enter a period of negotiation and renewed hope for a deal, thus the global economy could feel relieved for, at least, the time being. In the end, the current trade conflict between the United States and China obscures a more fundamental and much more important issue between them: the long-term systemic contest for leadership of the world economy.[134] That contest has numerous dimensions. The economic policy, and to an important extent ideological, dimension will determine whether the Washington Consensus of market economics or the Beijing Consensus centered on state-guided capitalism turns out to be more successful and more likely to be adopted by others.

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APPENDIX

China's Position on the China-US Economic and Trade Consultations

(June 2019)

The State Council Information Office of

The People's Republic of China[135]

[135] Full text: China's Position on the China-US Economic and Trade Consultations, the State Council Information Office of the People's Republic of China, 2 June 2019, http://english.gov.cn/archive/white_paper/2019/06/02/content_281476694892692.htm

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Preface

The China-US commercial relationship serves as both the ballast and the propeller of the overall bilateral relationship. At stake are the fundamental interests of the two peoples, and the prosperity and stability of the world. Since the establishment of diplomatic relations between China and the US, bilateral trade and economic relations have come a long way, with expanding fields of cooperation at higher levels. A mutually beneficial and win-win relationship with strong complementarity and interlinked interests has been forged, benefiting not only the two countries but also the entire world.

Given the differences in stage of development and economic system, it is inevitable that the two countries will experience differences and friction in their commercial cooperation. The history of China-US trade and economic relations has seen twists and turns and difficult situations. By adopting a rational and cooperative attitude, the two countries have managed to resolve previous conflicts, bridge differences, and render the bilateral commercial relationship more mature through dialogue and consultation.

Since it took office in 2017, the new US administration has threatened additional tariffs and other measures and provoked frequent economic and trade friction with its major trading partners. In response to the economic and trade friction unilaterally initiated by the US since March 2018, China has had to take forceful measures to defend the interests of the nation and its people. At the same time, committed to resolving disputes through dialogue and consultation, China has engaged in multiple rounds of economic and trade consultations with the US in an effort to stabilize the bilateral commercial relationship. China's position has been consistent and clear – that cooperation serves the interests of the two countries, that conflict can only hurt both, and that cooperation is the only correct choice for both sides. Concerning their differences and frictions on the economic and trade front, China is willing to work together with the US to find solutions, and to reach a mutually beneficial and win-win agreement. However, cooperation has to be based on principles. There are bottom

lines in consultations. China will not compromise on major issues of principle. China does not want a trade war, but it is not afraid of one and it will fight one if necessary. China's position on this has never changed.

To provide a comprehensive picture of the China-US economic and trade consultations, and present China's policy position on these consultations, the Chinese government hereby issues this White Paper.

I. Economic and trade friction provoked by the US damages the interests of both countries and of the wider world

Trumpeting "America First", the current US administration has adopted a series of unilateral and protectionist measures, regularly wielded tariffs as a "big stick" and coerced other countries into accepting its demands. The US has initiated frequent investigations under the long-unused Sections 201 and 232 against its main trading partners, causing disruption to the global economic and trade landscape. Specifically targeting China, in August 2017 it launched a unilateral investigation under Section 301. Turning a blind eye to China's unremitting efforts and remarkable progress in protecting intellectual property and improving the business environment for foreign investors, the US issued a myriad of slanted and negative observations, and imposed additional tariffs and investment restrictions on China, provoking economic and trade friction between the two countries.

Box 1: China's technological innovation is based on self-reliance. Accusing China of intellectual property theft and forced technology transfer is utterly unfounded.

China is an innovative and diligent nation. It has created a highly-sophisticated civilization and contributed significantly to human progress over the course of 5,000 years. Since the founding of the People's Republic in 1949, and in particular since the beginning of reform and opening up in 1978, China's scientific and technological undertakings have passed through a series of phases. They started from a difficult beginning, forged ahead in the course of reform, and have now achieved multiple breakthroughs featuring a variety of innovations. These achievements have won worldwide recognition. Historical records confirm that China's achievements in scientific and technological innovation are not something we stole or forcibly took from others; they were earned through self-reliance and hard work. Accusing China of stealing intellectual property to support its own development is an unfounded fabrication.

China is fully committed to intellectual property protection. It has established a legal system for the protection of intellectual property that is consistent with prevailing international rules and adapted to China's domestic conditions. China values the leading role of judicial measures in protecting intellectual property, and has achieved impressive results. The understanding of the importance of intellectual property among the general public and business community in China has increased,

the value of royalties paid to foreign rights-holders has risen significantly, and the number of intellectual property applications and registrations has surged.

The effective impact of China's intellectual property protection has won broad international recognition. Former WIPO Director General Arpad Bogsch spoke highly of China's legal framework for intellectual property protection, noting that China's achievements are "unmatched in the history of intellectual property protection". The US Chamber of Commerce recognized that China is making concrete progress in creating an intellectual property environment appropriate to the 21st century.[136] In its 2018 China Business Climate Survey Report, the American Chamber of Commerce in China noted that among the main challenges facing its member companies operating in China, concern over intellectual property dropped from 5th place in 2011 to 12th place in 2018. An article in The Diplomat predicted that China will become a leader in global intellectual property. Many of the concerns raised by foreign firms doing business in China have already been addressed through judicial reform and a strengthened enforcement mechanism.

Respecting the laws of the market economy, China has been actively improving the policy system for innovation, continuously increasing investment in research and development, accelerating the development of innovators, and strengthening international cooperation on technological innovation in an all-round way. In terms of some key innovation indices, China is already among the world's leading players. As China continues to witness a series of major scientific and technological achievements, its industries are gravitating toward the middle and high end, and the country's international influence is markedly increasing. In 2017, total R&D investment in China reached RMB1.76 trillion, ranking second in the world. The number of patent applications reached 1.382 million, ranking No. 1 in the world for the seventh consecutive year. The number of invention patents granted reached 327,000, up by 8.2 percent year-on-year. China ranks third in the world in terms of valid invention patents held.[137]

China has always pursued international technical cooperation with mutual benefit and win-win as the basic value orientation. China's economic development has benefited from international technology transfer and dissemination. International holders of technology have also reaped enormous benefits from this process. China encourages and respects voluntary technical cooperation between Chinese and foreign firms based on market principles. It strongly opposes forced technology transfer and takes resolute action against intellectual property infringement. Accusations against China of forced technology transfer are baseless and untenable.

[136] In February 2018, the Global Innovation Policy Center of the US Chamber of Commerce published the International Intellectual Property Index 2018, noting that in 2018, China with a score of 19.08 rose to 25th among the 50 ranked economies, two places up from where it had been in 2017. http://www.theglobalipcenter.com/wp-content/uploads/2018/02/GIPC_IP_Index_2018.pdf

[137] On January 18, 2018, CNIPA press conference on key statistics of the work in 2017 and related updates. http://www.sipo.gov.cn/twzb/gjzscqj2017nzygztjsjjygqkxwfbk/

Turning a blind eye to the nature of the economic structure and the stage of development in China and the US, as well as the reality of the international industrial division of labor, the US insists that China's "unfair" and "non-reciprocal" trade policies have created a trade deficit in bilateral commercial exchanges that constitutes "being taken advantage of", leading to unilateral imposition of additional tariffs on China. In fact, in today's globalized world, the Chinese and American economies are highly integrated and together constitute an entire industrial chain. The two economies are bound in a union that is mutually beneficial and win-win in nature. Equating a trade deficit to being taken advantage of is an error. The restrictive measures the US has imposed on China are not good for China or the US, and still worse for the rest of the world.

Box 2: The Chinese and American economies are interlinked, and bilateral trade and investment are mutually beneficial

China and the US are each other's largest trading partner and important source of investment. In 2018, bilateral trade in goods and services exceeded US$750 billion, and two-way direct investment approached US$160 billion. China-US commercial cooperation has brought substantial benefits to both countries and both peoples.

According to China Customs, the trade in goods between China and the US grew from less than US$2.5 billion in 1979 when the two countries forged diplomatic ties to US$633.5 billion in 2018, a 252-fold increase. In 2018, the US was China's largest trading partner and export market, and the sixth largest source of imports. According to the US Department of Commerce, in 2018 China was the largest trading partner of the US, its third largest export market, and its largest source of imports. China is the key export market for US airplanes, soybeans, automobiles, integrated circuits and cotton. During the ten years from 2009 to 2018, China was one of the fastest growing export markets for American goods, with an annual average increase of 6.3 percent and an aggregate growth of 73.2 percent, higher than the average growth of 56.9 percent represented by other regions in the world.[138]

Trade in services between China and the US is flourishing and highly complementary. The two countries have conducted extensive, in-depth, and mutually-beneficial cooperation in tourism, culture, and intellectual property. China is the largest destination for US tourists in the Asia-Pacific and the US is the largest overseas destination for Chinese students. According to Chinese figures, two-way trade in services rose from US$27.4 billion in 2006, the earliest year with available statistics, to US$125.3 billion in 2018, a 3.6-fold increase. In 2018, China's services trade deficit with the US reached US$48.5 billion.

Over the past forty years, two-way investment between China and the US has grown from near zero to approximately US$160 billion, and this cooperation has proved fruitful. According to MOFCOM, by the end of 2018 accumulative Chinese business

[138] USCBC: 2019 State Export Report, https://www.uschina.org/reports/2019-state-export-report, May 1, 2019.

direct investment in the US exceeded US$73.17 billion. The rapid growth of Chinese business investment in the US has contributed to local economic growth, job creation, and tax revenues. According to MOFCOM, the paid-in investment by the US in China was US$85.19 billion by the end of 2018. In 2017, the total annual sales revenues of US-invested companies in China were US$700 billion, with profits exceeding US$50 billion.

Therefore, if trade in goods and services as well as two-way investment are taken into account, China-US trade and economic relations are mutually beneficial, rather than the US "being taken advantage of".

(I) The tariff measures the US imposed harm others and are of no benefit to itself

The US administration has imposed additional tariffs on Chinese goods exported to the US, impeding two-way trade and investment cooperation and undermining market confidence and economic stability in the two countries and globally. The US tariff measures lead to a decrease in the volume of China's export to the US, which fell by 9.7 percent year-on-year in the first four months of 2019,[139] dropping for five months in a row. In addition, as China has to impose tariffs as a countermeasure to US tariff hikes, US exports to China have dropped for eight months in a row.[140] The uncertainty brought by US-China economic and trade friction made companies in both countries more hesitant about investing. China's investment in the US continues to fall and the growth rate of US investment in China has also slowed down. According to Chinese statistics, direct investment by Chinese companies in the US was US$5.79 billion in 2018, down by 10 percent year-on-year.[141] In 2018, paid-in US investment in China was US$2.69 billion,[142] up by only 1.5 percent year-on-year compared with an increase of 11 percent in 2017. With the outlook for China-US trade friction unclear, the WTO has lowered its forecast for global trade growth in 2019 from 3.7 percent to 2.6 percent.[143]

(II) The trade war has not "made America great again"

The tariff measures have not boosted American economic growth. Instead, they have done serious harm to the US economy.

First, the tariff measures have significantly increased production costs for US companies. The Chinese and US manufacturing sectors are highly dependent on each other. Many American manufacturers depend on China's raw materials and

[139] General Administration of Customs of China. http://www.customs.gov.cn/customs/302249/302274/302275/2418393/index.html, May 8, 2019.
[140] General Administration of Customs of China. http://www.customs.gov.cn/customs/302249/302274/302275/2418393/index.html, May 8, 2019.
[141] MOFCOM statistics.
[142] MOFCOM: National FDI Briefing for January to December, 2018. http://www.mofcom.gov.cn/article/tongjiziliao/v/201901/20190102832209.shtml, January 15, 2019.
[143] WTO: "WTO trade forecasts: Press conference", https://www.wto.org/english/news_e/spra_e/spra255_e.htm, April 2, 2019.

intermediary goods. As it is hard for them to find good alternative suppliers in the short term, they will have to bear the costs of the tariff hikes.

Second, the tariff measures lead to domestic price hikes in the US. The import of value-for-money consumer goods from China is a key factor behind the long-term low inflation in the US. After the additional tariffs were imposed, the final selling price of Chinese products increased, leaving American consumers effectively bearing some tariff costs. According to research by the US National Retail Federation, the 25 percent additional tariffs on furniture alone will cost the US consumer an additional US$4.6 billion per year.[144]

Third, the tariff measures have an impact on US economic growth and people's livelihood. A joint report by the US Chamber of Commerce and the Rhodium Group in March 2019 showed that, under the impact of China-US economic and trade friction, US GDP in 2019 and the next four years could decrease by US$64-91 billion per year, about 0.3-0.5 percent of total US GDP. If the US imposes 25 percent tariffs on all Chinese goods exported to the US, US GDP will decrease by US$1 trillion in the next ten years cumulatively.[145] According to a research report in February 2019 by Trade Partnership, an American think-tank, if the US imposes 25 percent additional tariffs on all imported Chinese goods, US GDP will decrease by 1.01 percent, with 2.16 million job losses and an additional annual burden of US$2,294 on a family of four.[146]

Fourth, the tariff measures lead to barriers to US exports to China. The 2019 State Export Report, published by the US-China Business Council on May 1, 2019, stated that in the ten years from 2009 to 2018, US exports to China supported over 1.1 million jobs. The Chinese market continues its importance to US economic growth. Forty-eight states of the US have increased their goods exports to China during the last decade – 44 of them by double digits – while in 2018, when economic and trade friction worsened, only 16 states increased their goods exports to China. Thirty-four states exported fewer goods to China, with 24 of them seeing a double-digit decrease. The Midwestern agricultural states were hit particularly hard. Under tariff measures, exports of American agricultural produce to China decreased by 33.1 percent year-on-year, including a 50 percent drop in soybeans. US businesses are worried that they might lose the Chinese market, which they have been cultivating for nearly 40 years.

(III) US trade bullying harms the world

Economic globalization is a firmly-established trend of the times. Beggar-thy-neighbor unilateralism and protectionism are unpopular. The trade protectionist measures taken by the US go against the WTO rules, damage the multilateral trading system,

[144] US National Retail Federation: "NRF Warns USTR Tariffs Would Cost Americans Billions, Releases New Study on Consumer Impact", https://nrf.com/media-center/press-releases/nrf-warns-ustr-tariffs-would-cost-americans-billions-releases-new-study, August 22, 2018.
[145] US Chamber of Commerce and Rhodium Group: Assessing the Costs of Tariffs on the U.S. ICT Industry: Modeling U.S.-China Tariffs, https://rhg.com/research/assessing-the-costs-of-tariffs-on-the-us-ict-industry, March 15, 2019.
[146] Trade Partnership: Estimated Impacts of Tariffs on the U.S. Economy and Workers (2019), https://tradepartnership.com/reports/estimated-impacts-of-tariffs-on-the-u-s-economy-and-workers-2019, February 5, 2019.

seriously disrupt global industrial chains and supply chains, undermine market confidence, and pose a serious challenge to global economic recovery and a major threat to the trend of economic globalization.

First, the US measures are undermining the authority of the multilateral trading system. The US has launched a series of unilateral investigations, including those under Sections 201, 232 and 301, and imposed tariff measures. These are a serious breach of the most fundamental and central WTO rules, including most-favored-nation treatment and tariff binding. Such unilateralist and protectionist actions have harmed the interests of China and other WTO members. More importantly, they have undermined the authority of the WTO and its dispute settlement system, and exposed the multilateral trading system and international trade order to peril.

Second, the US measures threaten global economic growth. With the shadow of the international financial crisis still lingering over the global economy, the US government has escalated economic and trade friction and hiked additional tariffs, provoking corresponding measures by the countries involved. This disrupts global economic and trade order, dampens world economic recovery, and undermines the development of companies and the well-being of people in all countries, plunging the world economy into the "recession trap".

Global Economic Prospects released by the World Bank in January 2019 revised its forecast for global economic growth down further to 2.9 percent, citing continuous trade friction as a major downward risk.[147] The International Monetary Fund also marked down its projection of world economic growth for 2019 to 3.3 percent from the 2018 estimate of 3.6 percent in its World Economic Outlook report published in April 2019, suggesting that economic and trade friction could further depress global economic growth and weaken already anemic investment.[148]

Third, the US moves disrupt global industrial and supply chains. China and the US are both key links in global industrial and supply chains. Given the large volume of intermediary goods and components from other countries in Chinese end-products exported to the US, US tariff hikes will hurt all the multinationals – not least those from the US – that work with Chinese companies. The tariff measures artificially drive up the costs of supply chains, and undermine their stability and security. As a result, some businesses are forced to readjust their global supply chains at the expense of optimal resource allocation.

It is foreseeable that the latest US tariff hikes on China, far from resolving issues, will only make things worse for all sides. China stands firm in opposition. Recently, the US administration imposed "long-arm jurisdiction" and sanctions against Huawei and other Chinese companies on the fabricated basis of national security, to which China is also firmly opposed.

[147] World Bank: Global Economic Prospects, https://www.worldbank.org/en/publication/global-economic-prospects, January 8, 2019.
[148] IMF: World Economic Outlook, https://www.imf.org/en/Publications/WEO/Issues/2019/03/28/world-economic-outlook-april-2019, April 2, 2019.

II. The US has backtracked on its commitments in the China-US economic and trade consultations

In response to the economic and trade friction started by the US, China has been forced to take countermeasures, as bilateral trade and investment relations took a hit. For the well-being of the Chinese and American people and the economic development of the two countries, both sides deemed it necessary to come to the negotiating table to seek a solution through consultation. Since they were launched in February 2018, the economic and trade consultations have come a long way with the two sides agreeing on most parts of the deal. But the consultations have not been free of setbacks, each of them being the result of a US breach of consensus and commitments, and backtracking.

(I) The first US backtracking

China had advocated resolving economic and trade friction through negotiation and consultation from the start. In early February 2018, the US government expressed the wish that China send a high-level delegation to the US to engage in economic and trade consultation. Demonstrating great goodwill and positive efforts, China held several rounds of high-level economic and trade consultations with the US, characterized by in-depth exchanges of views on trade imbalance among other major issues. The two sides made substantial progress as they reached preliminary consensus on expanding China's imports of agricultural and energy products from the US. However, on March 22, 2018, the US government unveiled the so-called report on Section 301 investigation of China, falsely accusing China of "IP theft" and "forced technology transfer", and subsequently announced an additional tariff of 25 percent on US$50 billion of Chinese exports to the US.

(II) The second US backtracking

Taking a big-picture view of the bilateral relationship, the Chinese government sent a working team again to the US to engage in genuine consultations. On May 19, 2018, China and the US issued a joint statement, agreeing to refrain from fighting a trade war, to continue high-level communications, and to actively seek solutions to respective economic and trade concerns. The US publicly announced that it would suspend the plan for additional tariffs on Chinese goods. On May 29, 2018, despite the opposition of its domestic business community and the general public, the US administration tore up the consensus just ten days after the joint statement, gratuitously criticizing China's economic system and trade policy, while announcing the resumption of the tariff program. Starting from early July 2018, in three steps, the US imposed additional tariffs of 25 percent on Chinese exports worth US$50 billion, and additional tariffs of 10 percent on US$200 billion of Chinese exports, which, according to the US, would be raised to 25 percent on January 1, 2019. In addition, the US threatened further tariffs on all remaining Chinese exports, leading to quick escalation of the economic and trade friction between the two countries. In defense of its national dignity and its people's interests, China had to respond in kind and raised tariffs on imports worth US$110 billion from the US.

(III) The third US backtracking

On November 1, 2018, US President Donald Trump had a telephone conversation with Chinese President Xi Jinping and proposed a summit meeting. On December 1 the two presidents had a meeting on the margins of the G20 Summit in Argentina. In accordance with their important consensus on economic and trade issues, the two sides agreed to halt new additional tariffs for 90 days to allow for intensive talks geared toward the full elimination of all additional tariffs. In the ensuing 90 days, the working teams of China and the US held three rounds of high-level consultations in Beijing and Washington D.C., reaching preliminary consensus on many matters of principle for the China-US economic and trade deal. On February 25, 2019, the US announced the postponement of the additional tariffs scheduled for March 1 on US$200 billion of Chinese exports to the US. From late March to early April, the working teams of the two countries held another three rounds of high-level consultations and made substantial progress. Following numerous rounds of consultations, the two countries had agreed on most of the issues. Regarding the remaining issues, the Chinese government urged mutual understanding and compromise for solutions to be found.

But the more the US government is offered, the more it wants. Resorting to intimidation and coercion, it persisted with exorbitant demands, maintained the additional tariffs imposed since the friction began, and insisted on including mandatory requirements concerning China's sovereign affairs in the deal, which only served to delay the resolution of remaining differences. On May 6, 2019, the US irresponsibly accused China of backtracking on its position to shift the blame for the inconclusive talks onto China. Despite China's fierce opposition, the US raised the additional tariffs on US$200 billion of Chinese exports to the US from 10 percent to 25 percent, which represented a serious setback to the economic and trade consultations. On May 13 the US announced that it had launched procedures to slap additional tariffs on remaining Chinese goods, which are worth around US$300 billion. These acts contradicted the agreement reached by the two presidents to ease friction through consultation – and the expectations of people around the world – casting a shadow over the bilateral economic and trade consultations and world economic growth. In defense of its own interests, China had to take tariff measures in response.

(IV) The US government should bear the sole and entire responsibility for this severe setback to the China-US economic and trade consultations

The US government accusation of Chinese backtracking is totally groundless. It is common practice for both sides to make new proposals for adjustments to the text and language in ongoing consultations. In the previous more than ten rounds of negotiations, the US administration kept changing its demands. It is reckless to accuse China of "backtracking" while the talks are still under way. Historical experience has proved that any attempt to force a deal through tactics such as smears, undermining and maximum pressure will only spoil the cooperative relationship. Historic opportunities will be missed.

A civilized country turns to forceful measures only when gentler approaches have failed. After the US issued the new tariff threat, the international community was

widely concerned that China might cancel the consultation visit to the US. It kept a close watch on the future direction of the China-US trade negotiations. Bearing in mind the broader interests of trade and economic relations between the two countries, China remained cool-headed, exercised restraint, and sent a senior delegation to the US, as agreed, for the 11th round of economic and trade consultation from May 9 to 10. In doing so, China demonstrated the greatest sincerity and a strong sense of responsibility for resolving trade disputes through dialogue. In the following candid and constructive discussions, the two sides agreed to manage differences and continue consultations. China expressed strong opposition to the unilateral tariff increase by the US and stated its firm position that it would have to take necessary countermeasures. China emphasized once again that trade deals must be based on equality and mutual benefit. China will never compromise on major principles concerning China's core interests. One prerequisite for a trade deal is that the US should remove all additional tariffs imposed on Chinese exports and China's purchase of US goods should be realistic while ensuring that a proper balance in the text of the agreement is achieved to serve the common interests of both sides.

III. China is committed to credible consultations based on equality and mutual benefit

The Chinese government rejects the idea that threats of a trade war and continuous tariff hikes can ever help resolve trade and economic issues. Guided by a spirit of mutual respect, equality and mutual benefit, the two countries should push forward consultations based on good faith and credibility in a bid to address issues, narrow differences, expand common interests, and jointly safeguard global economic stability and development.

(I) Consultations should be based on mutual respect, equality and mutual benefit

It is only natural for China and the US, the two largest economies and trading nations in the world, to experience some differences over trade and economic cooperation. What truly matters is how to enhance mutual trust, promote cooperation and manage differences. For the good of the common interests of the two countries and global trade order, and in a strenuous effort to push forward the economic and trade consultations, China remains committed to resolving issues through dialogue and consultation, responding to US concerns with the greatest patience and sincerity, properly handling differences while seeking common ground, and overcoming obstacles to practical solutions. During the consultations, in accordance with the principle of mutual respect, equality and mutual benefit, China's only intention is to reach a mutually acceptable deal.

Mutual respect means that each side should respect the other's social institutions, economic system, development path and rights, core interests, and major concerns. It also means that one side should not cross the other's "red lines". The right to development cannot be sacrificed, still the less can sovereignty be undermined. As regards equality and mutual benefit, we must ensure that the two sides in the

consultations operate on an equal footing, that results are mutually beneficial, and that any final agreement is a win-win one. Negotiations will get nowhere if one side tries to coerce the other or if only one party will benefit from the outcomes.

(II) Consultation involves working toward the same goal in good faith

Consultation calls for mutual understanding and genuine effort from both sides. Consultation is a process where the parties concerned seek consensus or make compromise through discussion. Many factors are at play in consultation. It is perfectly normal during consultations for the parties to react differently to various changes at different stages based on their own interests.

The Chinese government believes that economic and trade consultation is an effective way to solve issues. None other than engagement with goodwill and a full understanding of the other's position can contribute to success. Otherwise, it will be hard to reach a sustainable and enforceable deal as the parties will not find the ground for a long-term and effective agreement.

Good faith is the foundation of consultation. The Chinese government has engaged in these consultations with the US with the utmost credibility and the greatest sincerity. Attaching great importance to US concerns, China has worked hard to look for effective paths and find ways to address differences. The 11 rounds of high-level consultations have made significant progress. The outcomes of the consultations have not only served the interests of China, but also those of the US, as a result of both sides' efforts to pull in the same direction. China has kept its word during the consultations. China has emphasized repeatedly that if a trade agreement is reached, it will honor its commitments sincerely and faithfully.

(III) China will not give ground on issues of principle

Every country has its own matters of principle. During consultations, a country's sovereignty and dignity must be respected, and any agreement reached by the two sides must be based on equality and mutual benefit. On major issues of principle, China will not back down. Both China and the US should see and recognize their countries' differences in national development and in stage of development, and respect each other's development path and basic institutions. While no one expects to resolve all issues through one single agreement, it is necessary to ensure that any agreement will satisfy the needs of both sides and achieve a balance.

The recent US move to increase tariffs on Chinese exports does not help to solve bilateral trade issues. China strongly opposes this and has to respond to safeguard its lawful rights and interests. China has been consistent and clear on its position, that it hopes to resolve issues through dialogue rather than tariff measures. China will act rationally in the interests of the Chinese people, the American people, and all other peoples around the world. However, China will not bow under pressure and will rise to any challenge coming its way. China is open to negotiation, but will also fight to the end if needed.

(IV) No challenge will hold back China's development

China's development may not be all smooth sailing. Difficulties or even perils are inevitable. Whatever the future might bring, China is confident of meeting challenges head on, turning risks into opportunities, and opening new chapters.

China remains committed to its own cause no matter how the external environment changes. The fundamental solution to economic and trade tensions is to grow stronger through reform and opening up. With the enormous demand from the domestic market, deeper supply-side structural reform will comprehensively enhance the competitiveness of Chinese products and companies. We still have sufficient room for fiscal and monetary policy maneuvers. China can maintain sound momentum for sustainable and healthy economic development, and its economic prospects are bright.

China will continue to deepen reform and opening up. China's door will not be closed; it will only open even wider. President Xi Jinping announced in his keynote speech at the opening ceremony of the Second Belt and Road Forum for International Cooperation that China would adopt a number of major reform and opening-up measures, strengthen institutional and structural arrangements, and promote opening up at a higher level. Measures to be taken include expanding market access for foreign investment in broader areas, strengthening international cooperation on intellectual property protection, increasing imports of goods and services, implementing more effective international coordination on macro-economic policies, and putting more focus on the implementation of opening-up policies. A more open China will have more positive interactions with the world, which in turn will advance the development and prosperity of both China and the world.

Conclusion

Cooperation is the only correct choice for China and the US and win-win is the only path to a better future. As to where the China-US economic and trade consultations are heading, China is looking forward, not backward. Disputes and conflicts on the trade and economic front, at the end of the day, need to be solved through dialogue and consultation. Striking a mutually beneficial and win-win agreement serves the interests of China and the US and meets the expectations of the world. It is hoped that the US can pull in the same direction with China and, in a spirit of mutual respect, equality and mutual benefit, manage economic and trade differences, strengthen trade and economic cooperation, and jointly advance China-US relations based on coordination, cooperation and stability for the well-being of both nations and the world.