

A photograph of Donald Trump and Xi Jinping in conversation. Trump is on the left, wearing a dark suit and a blue tie. Xi is on the right, wearing a dark suit and a patterned tie. They are standing in front of a backdrop that includes the text 'K A' and '2019'. The flags of the United States and China are partially visible in the background.

## The spiralling effects of the Sino-American trade war

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### RECOMMENDATIONS

- The ongoing Sino-American trade war needs to be understood as one not just about competing economic interests, but about eventual primacy in global markets.
- Preliminary bilateral trade agreements, and the receding of the coronavirus crisis, may create a short-term respite for the conflict, but the broader issues of competing economic powers will be more resilient. These matters will need to be addressed via multilateral dialogue, given the poor short-term possibilities of renewed Sino-American economic cooperation.
- Many of the world's economies will need to better prepare for dramatic and unpredictable 'decoupling' effects as both great power seek to assert greater control over their own economic assets.

Almost two years ago, China and the United States instigated a trade conflict which has had serious international effects, a situation since exacerbated by the COVID-19 pandemic. What has truly made a solution to this conflict elusive, however, is that its origins lie well beyond questions of trade deficits and fair competition, and are instead based on the looming question of a power transition between the two states. The effects of this divergence are beginning to be observed in several economic realms, including the financial and the technological. Many other actors in the global economy have begun to experience the side effects of this completion, and may now have to face difficult choices about how to balance between these two emerging poles in the current fragile global economy.

### Introduction: When Two Elephants Fight...

In July 2018, The US government officially announced tariffs on Chinese goods, thus setting off the current 'trade war' which produced in reciprocal steps from Beijing, followed by a pattern of retaliation. This cascade effect was briefly

paused in January 2020 with the signing of a ‘phase one’ agreement, which almost immediately began fraying at the edges as relations between the two great powers cooled further due to the spread of the COVID-19 virus. Over the past two years, this trade conflict began to coalesce as an overt competition between an American government which at times has demonstrated an extremely poor grasp of basic political economy, and a Chinese administration which has based much of its legitimacy on maintaining steady economic growth under progressively more adverse conditions, including the pandemic and its devastating impact on global markets.

Even before the trade conflict began, it was apparent the US government was preparing itself for a protracted dispute with China in the name of benefitting American companies and jobs. An opening salvo was a tweet by President Donald Trump in March 2018 that ‘trade wars are good, and easy to win’, an assertion which flew in the face of two centuries of evidence to the contrary. Not helping the American case was frequent use of false information relayed by the Trump government regarding the conflict, including the insistence that China was paying the tariffs and not US consumers, and that the US economy would be largely untouched by the conflict. There had also been mixed signals from Washington as to exactly what Beijing needed to do in order to reduce tensions.

Even before the outbreak of the pandemic, warning signs were appearing that the United States would be unable to sustain strong economic growth while simultaneously fighting a trade war of this magnitude. By December 2019, Washington had imposed tariffs on more than US\$360 billion in Chinese goods, and China retaliated with tariffs on more than US\$110 billion in American products. While the January 2020 phase one trade deal included a promise by Beijing to purchase an additional US\$200 billion worth of American goods and services, once the coronavirus began to take hold, Beijing’s ability to accomplish that was called into question. Moreover, the deteriorating situation between China and the United States during mid-2020 over assigning blame for the pandemic outbreak and the political crises in Hong Kong raised the possibility that the Trump government might reignite the trade conflict for political gain, drawing negative comparisons with the infamous US Smoot-Hawley tariff in 1930, widely blamed for creating a chain reaction of economic tensions on a global scale, and ultimately worsening the Great Depression.

In examining the rationales behind this trade war, it is necessary to look at three elements of competition underway. These are, respectively, the desire to rebalance Sino-US trade volumes, the question of which country assumes the lead in the development of new technologies and their standards, and whether a power transition may take place between the two states. Only when all three of these areas are addressed can the stage be set for a de-escalation.

### Trade practices and zero-sum games

President Trump has accused China of circumventing international trade rules, maintaining an oversized trade deficit with the US, keeping its currency artificially low,

and engaging in repeated acts of intellectual property theft. He has also pointed to the trade deficit with China as inherently damaging to the American economy. As a result of punitive trade measures, the US-China trade deficit in goods fell from US\$419.2 billion in 2018 to US\$345.6 billion the following year, yet the initial effects on the overall US economy, including GDP growth, were minor. Moreover, the US tariffs have had a negligible effect on bilateral disputes over intellectual property theft, which has been a sore point in Sino-American economic relations since at least the 1990s. The issue of whether the renminbi has been kept purposely undervalued in relation to the dollar has also been a longstanding issue in the economic relationship, with the Trump government officially labelling Beijing a currency manipulator in 2019, despite signs that the Chinese government was becoming more willing to engage in a ‘managed float’ renminbi policy versus the US dollar. The ‘currency manipulator’ designation was removed in January 2020 as a good faith measure before the phase one trade agreement, suggesting the US was using the label primarily as a political tool.

Another aspect of this dispute is China’s ‘developing’ status, as despite the policies of ‘deep reform’ of the country’s economic system since the 1990s, there remain many areas of the Chinese economy which are still considered in need of modernisation. Chinese President Xi Jinping has called for his country to become a ‘moderately prosperous society’ by 2021, (which is unlikely to happen given current domestic socio-economic circumstances), and to achieve ‘moderately developed economy’ status in 2049. Yet, the development of the Belt and Road Initiative (BRI) by the Xi government since 2013 has already upended traditional trade patterns and placed China much closer to the centre of the global economy, a position which stands at odds with President Trump’s calls for renewed American economic supremacy. As well, in 2018 the figure for Chinese goods trade as a percentage of total goods trade was estimated at 12.4%, surpassing the US total of 11.5%. During that year, the United States recorded a goods trade deficit with China totalling US\$419.2 billion, but a surplus in services trade worth US\$40.5 billion.<sup>1</sup>

As China appears to be on track to emerge from the pandemic earlier than the United States, this may place Beijing in an even stronger position within the global economy. The withdrawal of the United States from the Trans-Pacific Partnership (TPP) free trade agreement in the Asia-Pacific in 2017, as well as American trade friction with allies, including Canada and the European Union, and US antipathy towards the World Trade Organisation, will further hamper Washington’s efforts to affect Chinese trading practices.

### The question of technological superiority

Until very recently, the Chinese economy was often stereotyped as being dominated by low technology manufacturing, as well as a reliance on shanzhai (山寨) or counterfeit products. This is no longer the case. Although the Chinese manufacturing sector is still large, the country has made dramatic leaps in numerous high technology sectors as a result of an economic policy of ganchao (赶超), meaning ‘to catch up and surpass’. The concept was

first employed by the Mao Zedong government in relation to the Soviet Union during the cold war and is now being applied to reducing American technological dominance. Ongoing US opposition to the Chinese flagship firm Huawei, positioned to set guidelines for fifth generation (5G) telecommunications standards, is only one small aspect of the emerging technological competition between Beijing and Washington.

Beijing has placed great emphasis, including via a central government policy named 'Made in China 2025', to achieve greater self-sufficiency in high-tech sectors and to potentially challenge the United States' ability to set standards for these emerging technologies. These areas include agriculture, communications, medicine and transportation, but also so-called 'DARQ technologies',<sup>2</sup> referring to distributed ledger technology, (also known as blockchain), artificial intelligence (AI), extended reality applications and quantum computing. Earlier this year, the Chinese government was reported to be planning a follow-up policy, 'China Standards 2035', which may set further goals for 5G development, as well as proposed standards for AI, the 'internet of things' (IoT), and cloud computing.

Beyond these areas, China has also made advances in financial technology (fintech) and e-commerce applications such as Alipay, WeChat Pay, and Ant Financial, (the latter including an online service for microloans), online to-offline (O2O) shopping and service applications like Alibaba, Taobao, JD, Pinduoduo, Meituan-Dianping and Didi Chuxing, as well as information platforms such as Baidu and Tuotiao. The Chinese firm Bytedance is the owner of Tik Tok, a video clip app which has exploded in popularity as many countries faced lockdowns due to the pandemic. As of 2019, China had the largest number of technology 'unicorns', meaning start-up firms valued at over US\$1 billion. As well, the People's Bank of China has sought a digital currency since 2014, and this year preparations are being made to launch a blockchain-based digital currency electronic payment (DC/EP) standard which may soon achieve the goal of creating a Central Bank Digital Currency (Zhongyong Yinhang Shuzi Huobi 中央银行数字货币), similar to Facebook's Libra project.<sup>3</sup> China has over 904 million internet users as of March 2020, and is now in a far better position to guide many future online innovations.

Also of concern is Chinese surveillance and e-commerce technology which has made it possible for Beijing to collect information on citizens, leading to the development of a 'social credit system' (shehui xinyong tixi 社会信用体系) whereby persons, as well as domestic and foreign firms, may be evaluated according to state-sanctioned proper and improper behaviour. A variation of this system was introduced in early 2020 in the form of an app to track people who may be at risk of contracting COVID-19, with information forwarded to authorities and people's movements regulated via a red/yellow/green designation for virus risk.

Beijing has accused the US of instigating the trade war to, at least partially, dismantle China's burgeoning tech sector, and so far the Trump administration has concentrated on

thwarting Chinese access rather than preparing American firms for emerging tech competition. Recent US measures have included calls for restrictions on computer chip and chip-making tools to Chinese firms, and a controversial May 2020 policy of curtailing Chinese student access to sectors considered strategically sensitive. These measures may lead to the emergence of competing tech standards which will affect much of the global economy at a difficult time.

### Is a power transition underway?

The question of whether (and when) China might be ready to surpass American power, including economically, is not a new one, but both the trade war and the coronavirus crises have intensified this debate. Should Beijing be able to fully restart its economy in late 2020 as it recovers from the pandemic, this would inevitably strengthen the country's relative power vis-à-vis the United States. A window of opportunity for China may have appeared due to advance its economic interests, especially as US policy continues to devolve into unilateralism and protectionism, and has been widely seen as abdicating its global leadership as the pandemic worsened. However, there are suspicions in other economies about China's economic motives and its own initial underreporting of the virus, and a prolonged diplomatic conflict with the US under current conditions may eventually weaken the relative status of both powers.

Nevertheless, while the stage may have been set for a significant power shift between China and the United States, there are numerous variables yet to be considered before the prediction of a power transition can be accurately made. Both the 2008 global recession and the current pandemic have resulted in Chinese retreats from market economics out of concerns of an outside contagion effect from global markets. Connected to this has been the perpetual 'cake theory' (dangao lun 蛋糕论) debate within China over whether it is necessary to better distribute the country's wealth, ('cut the cake in a more equitable fashion'), or emphasise steps to increase Chinese wealth for the overall benefit of the country, ('bake a bigger cake'). As well the dissolution of presidential term limits 2018 means that Mr Xi will more directly shoulder the credit, or blame, for China's economic fortunes.

Conventional wisdom has been that China seeks political and economic stability so that further domestic reforms, including alleviating poverty, combatting corruption, and building a durable welfare state, can be achieved. The country began to experience an economic slowdown in 2015, but this took on the form of a gradual reduction in gross national product (GDP) growth, meaning a 'soft landing'. However, the effects of the pandemic in the first quarter of 2020 saw China's GDP shrink by 6.8%, the first time the country had recorded a loss since 1992. A recession, the first in modern Chinese history since the 1970s, is a real possibility, which may have profound effects not only on China itself but also its trade partners including those which have signed on to the Belt and Road. By the middle of 2020, BRI partners, especially in the developing world, were calling upon Beijing to provide debt relief as the pandemic began to take economic tolls. Moreover, even if China's manufacturing centres return

to full capacity in the short term, key markets including Europe, Japan and the United States may take longer to recover, and even then will not be in a position to purchase Chinese goods at 2019 levels.

At the same time, evidence is mounting that the Trump government is seeking to sever an economic relationship with China which has existed since the 1990s. Even before the pandemic, the prospect of a ‘decoupling’ of Sino-American economic ties was seen as a possible endpoint of the trade war. In August 2019, President Trump’s frustrations bubbled over with a tweet which ‘hereby ordered’ American companies to disengage from China, and in May the following year, the White House released a paper, ‘United States Strategic Approach to the People’s Republic of China’, which signalled further moves away from engagement with Beijing and towards unambiguous competition, including in the economic sphere. The notion of a quick and painless decoupling before the pandemic began was quixotic at best, but in the current situation, the probable emergence of a dual-track global economy represents rough and uncharted waters, affecting production chains, trade agreements, and innovation trends.

### Implications and Trends

Even before the pandemic struck, examples of collateral damage from the trade war were not difficult to find. Among the more prominent examples were a drop in international oil prices, economic slowdowns in leading economies such as Germany and Singapore, a debt default in Argentina, a spinoff trade conflict between Japan and South Korea, and instances of an ‘inverted yield curve’ (when short-term bonds began paying more than long-term versions), in Britain as well as the US. After the pandemic began, the question became how long the resulting recession would last, and instead of prompting an economic truce between Beijing and Washington, the international health crisis has been pulling the two great powers even further apart.

While it is assumed that the Sino-American trade war cannot continue indefinitely, there is no evident exit ramp to resolving the situation, and those agreements that have been made are looking ever more fragile. Even if the current trade war abates, China appears to be getting ready for a tantan dada (谈谈打打), meaning ‘talk-talk’ and ‘strike-strike’, relationship with the United States. Given the uncertainty surrounding the November 2020 US presidential election, it is likely that the Xi government will bide its time and wait for a more congenial atmosphere in bilateral relations. In addition to facing the pandemic, many third-party countries, including in Europe, are at growing risk of being caught in the crossfire of this dispute as it deepens and some may face the difficult prospect of choosing sides. To navigate this new economic reality, there must be the understanding that this conflict has many facets beyond trade disputes, involving a potential contested power transition which will be felt well beyond the two rivals.

### Endnotes

1. ‘Is China the World’s Top Trader?’ China Power. 28 March 2019. (Updated 17 March 2020), <<https://chinapower.csis.org/trade-partner/>>; ‘The People’s Republic of China: US-China Trade Facts,’ Office of the United States Trade Representative, 2020, <<https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china>>.
2. Paul Daugherty, ‘Understanding the DNA of DARQ,’ Accenture, 7 February 2019, <<https://www.accenture.com/us-en/insights/technology/new-emerging-technologies-darq>>.
3. Yuan Yang and Hudson Lockett, ‘What is China’s Digital Currency Plan?’ Financial Times, 25 November 2019.

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