

## CCG Report

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# Understanding the US-China Trade War: Analyses and CCG Recommendations



### Abstract

China and the US are the world's largest economies and positive relations between these two countries are key for global stability, development, and prosperity. However, Sino-US ties are currently beset by escalating trade tensions.

The current trade deadlock has attracted significant attention from around the world and raised key questions. What are the causes of this situation, and what has propelled the Trump administration to persist in its tariff attacks towards China? How should China respond? These issues have prompted much discussion.

There is a need for Chinese and US think tanks to deepen their research and analysis to find empirically-grounded ways of understanding the trade dispute, as well as strengthening channels for bilateral dialogue to forge consensus on how to resolve the trade war.

Against this backdrop, this report by the Center for China and Globalization (CCG) aims to present a systematic assessment of the various dimensions of the Sino-US economic dispute. It covers factors that caused the tensions, drivers of US policy, the future trajectory of the dispute, as well as recommendations on ways to overcome the deadlock.

The report finds that the current Sino-US trade imbalance is 1) caused by deep underlying structural factors; 2) significantly overestimated by conventional measurements; and 3) cannot be resolved by erecting trade barriers.

The Chinese and US economies are deeply intertwined, so using traditional metrics leads to a severe misreading of the true bilateral economic relationship. Given that, moving forward, economic relations between the two countries are destined to be characterized by both cooperation and competition, it is in the interest of both sides to find ways to expand and deepen cooperation.

The trade war is not a zero-sum game. It will hurt not only both economies but likely also the rest of the world. There are many voices in that oppose the trade war, including in both US houses of Congress. There is also an uptick in opposition in the US more generally, and international opposition against this form of protectionism. This increases the likelihood of reopening dialogue.



**I. Causes of the trade imbalance and dispute**

According to new figures from the US Department of Commerce, in 2017, the US trade deficit reached a nine-year high of USD 566 billion. Total US-China trade in goods was USD 635.97 billion, with US exports to China of USD 130.37 billion and US imports from China at USD 505.6 billion, leaving a trade imbalance of 375.23 billion. Can this large trade deficit according to US figures be attributed to unfair trade practices by China? By looking to the principles of trade economics and the realities of Sino-US economic interaction, we can identify the following factors that shape the trade imbalance.

RANK	COUNTRY	2017	2016	CHANGE	BIGGEST IMPORT
1	China 	\$375.2	\$347	+28.2	Consumer electronics
2	Mexico 	\$71.1	\$64.4	+6.7	Autos, electronics
3	Japan 	\$68.8	\$68.8	0	Autos, electronics
4	Germany 	\$64.3	\$64.7	-0.4	Autos, transportation
5	Vietnam 	\$38.3	\$32	+6.3	Rice, crops
6	Ireland 	\$38.1	\$36	+2.1	Chemicals, drugs
7	Italy 	\$31.6	\$28.6	+3	Machinery
8	Malaysia 	\$24.6	\$24.8	-0.2	Consumer electronics
9	Netherlands 	\$24.5	\$23.6	+0.9	Chemicals, machinery
10 (tie)	India 	\$22.9	\$24.4	-1.5	Manufacturing, clothes
10 (tie)	South Korea 	\$22.9	\$27.6	-4.7	Autos, electronics

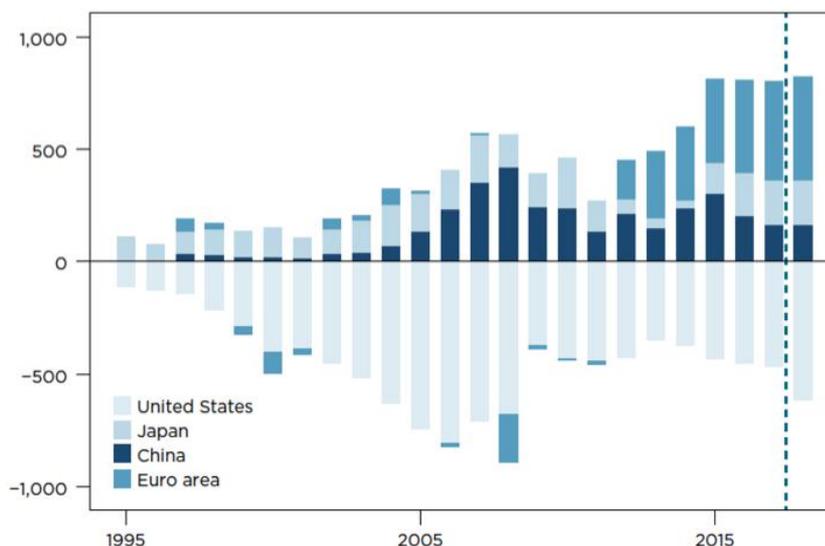
Source: Bureau of Economic Analysis, U.S. Census

**Figure 1:** Biggest U.S. trade deficits, by country  
2017 deficit in goods, in billions (services are excluded)

**a. Structural issues caused by rapid development of the global economy**

i. The trade deficit is an inevitable result of the dollar’s status as the global reserve currency

US national investment exceeds national savings, meaning that funds must be absorbed from abroad to plug the gap, creating a trade deficit. In addition, due to the dollar global reserve currency system backed by the US government, the US has been able to print dollars to allow the US economy to maintain a consumption level greater than domestic production without fear of inflation. Meanwhile, the dollar has served as a public good supporting the international economy.

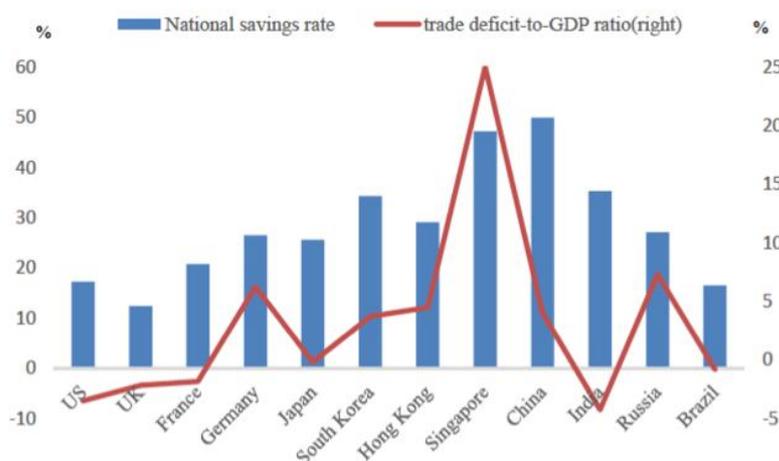


Note: 2018 is IMF forecast.  
Sources: IMF Balance of Payments and World Economic Outlook databases.

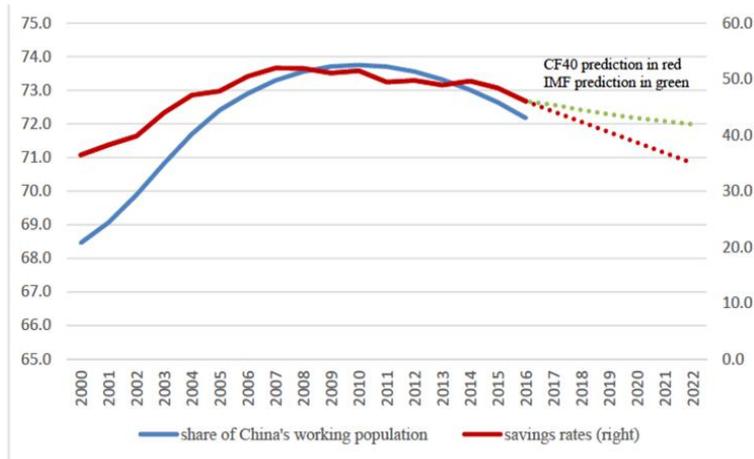
**Figure 2:** Current account Imbalances widening again, 1995 to 2018  
(billions of US dollars)

ii. Declining US household savings and rising national debt have exacerbated the trade deficit.

The US household savings rate has continuously fallen over the past 20 years, from 8% in the 1990s to 1.75% in 2006, dropping to negative in 2007 H1. US federal debt dropped from 49% in 1994 to 34% in 2006 but then shot up to 70% by 2006. In 2017, US household savings dropped again to 3.6%, and US federal debt exceeded 100% of GDP.



**Figure 3:** Average national savings rates and trade balance to GDP ratios (2007-2019)



Sources: Wind, World Bank

Figure 4: Share of China's working population and China's saving rates

iii. The international division of labor shapes the trade deficit

The US has a comparative advantage in capital-intensive industries, while China's comparative advantage lies in labor-intensive sectors. Primary industries account for 8% of China's GDP and just 1% of the US economy, while secondary industries make up 20% of China's economy and 12% in the US. In China, the tertiary sector makes up just over half (53%) of GDP, while this figure is 79% in the US. From this structure, we can see that China's economy is based on agriculture and manufacturing, in contrast to the US where services are the driving force of the economy.

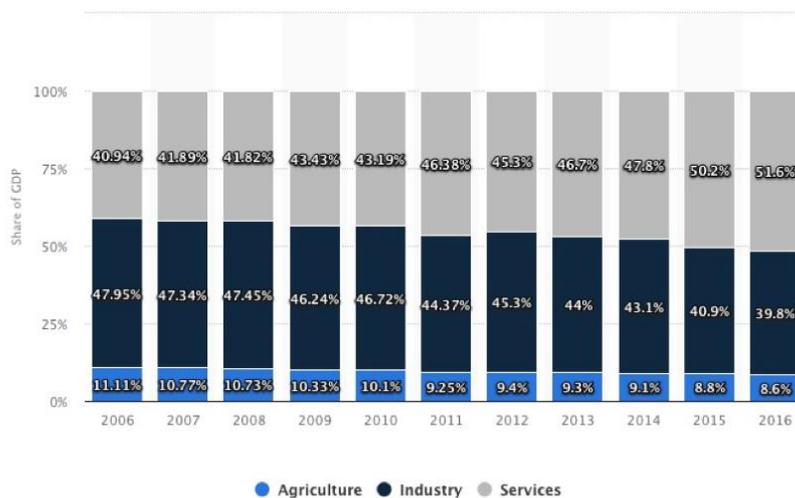


Figure 5: Share of GDP by sector (China), from 2006-2016

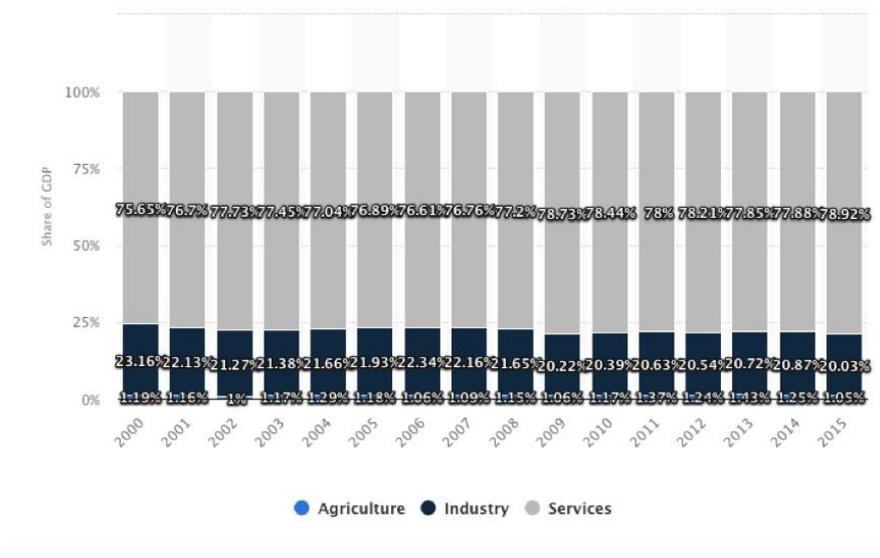


Figure 6: Share of GDP by sector (US), from 2000-2015

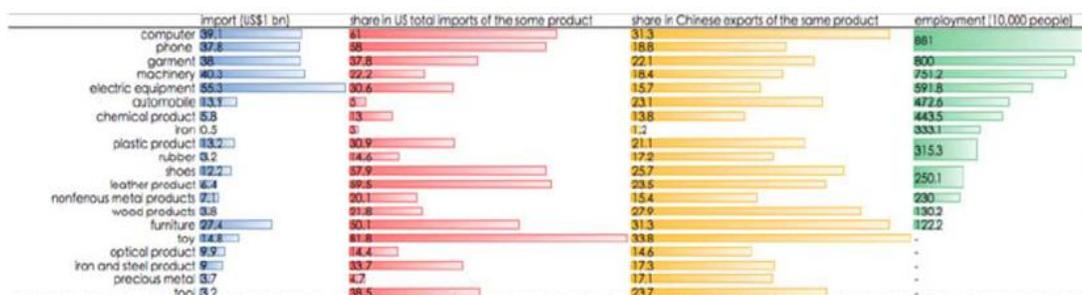
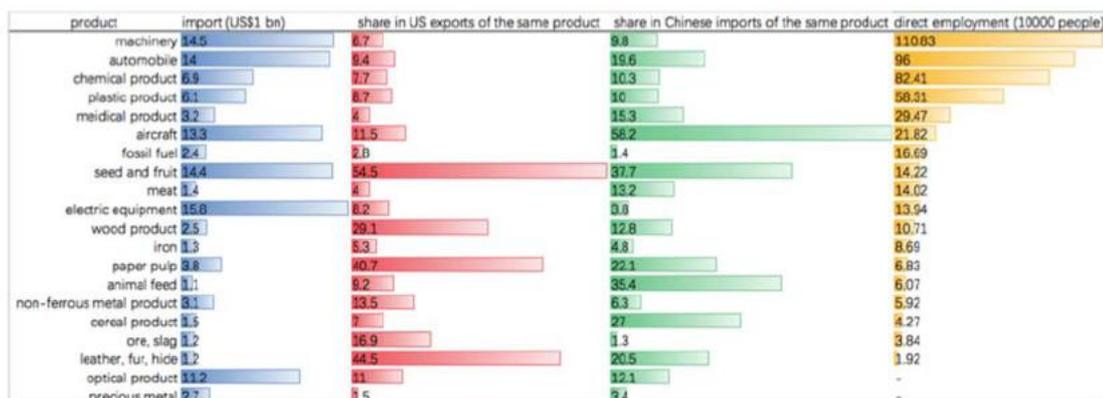


Figure 7: US imports from China, by product



Sources: Deutsche Bank, CEIC.

Figure 8: China's imports from the US, by product

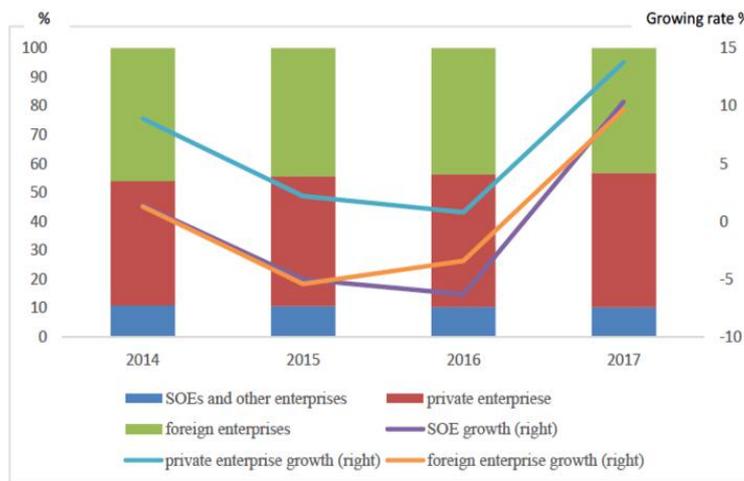
iv. US export restrictions exacerbate the US-China trade deficit

The US decision to retain restrictions on exports of high-technology products to China is another factor that contributes to the US-China trade imbalance. In 2001, imports from the US accounted for 16.7% of China’s imports of technology products, but by 2016 this ratio had fallen to 8.2%. This trend is not fitting with the US’ status as a technology power and key economic partner of China.

**b. Conventional measurement methods misjudge the US-China trade deficit**

i. Chinese and US economic interests are deeply entwined through the global value chain system

According to a report released by the US Congress in March of this year, under current global value chains, US and Chinese production are deeply linked so that often Chinese products use US components, while US products use Chinese components. In a highly globalized world, Sino-US economic interaction is an inevitable outcome of international patterns of division of labor and resource allocation. While the US tends to occupy a mid-to-high level in these global value chains, China tends towards the mid-to-low end. With the vertical integration of industry value chains and cross-border development of supply chains, the US has oriented towards high value-added research and design activities, while China tends to carry out low-cost production. Such linkages and chains become denser and more intimately linked with each passing year. As the US dominates high-value-added activities such as product design, production of core components, and marketing, US companies extract the lion's share of the profit from these value chains.



Source: Wind

Figure 9: Share in total exports by corporate ownership

ii. US trade measurement methods do not capture the full picture of the trade relationship

The Trump administration has continuously held up the supposed USD 375.2 billion US-China trade deficit as “just cause” for launching the trade war. It is worth re-assessing this figure according to empirical data. Firstly, there are large discrepancies in estimates of the trade deficit. Secondly, according to US “country of origin” principle, the US has a trade surplus of \$32 billion with Hong Kong and exports over \$100 billion worth of goods to mainland China via ports such as Hong Kong and Macau. However, these figures are not accounted for in the US-China trade balance. In addition, if trade figures were measured according to the “value added” principle, China’s trade surplus would shrink significantly.



Figure 10: China and US trade measurement have fundamental differences

Source: Wind, Bureau of economic analysis, Hengda Research Institutes

iii. US enterprises earn the overwhelming majority of profits from the Sino-US trade relations

According to MOFCOM data, in 2017, 59% of China’s trade surplus came from the export processing trade, and 57% was accounted for by foreign companies. Foreign companies also dominate Chinese exports to the US. 2010 research findings from the Asia Development Bank show that in sectors such as clothing, textiles, shoes, and accessories, US companies and retailers claimed around 90% of the profits from US imports from China. Under global value chains, China enjoys a surplus in trade but the US acquires the real surplus in profits.

iv. The US surplus in services trade is large and growing

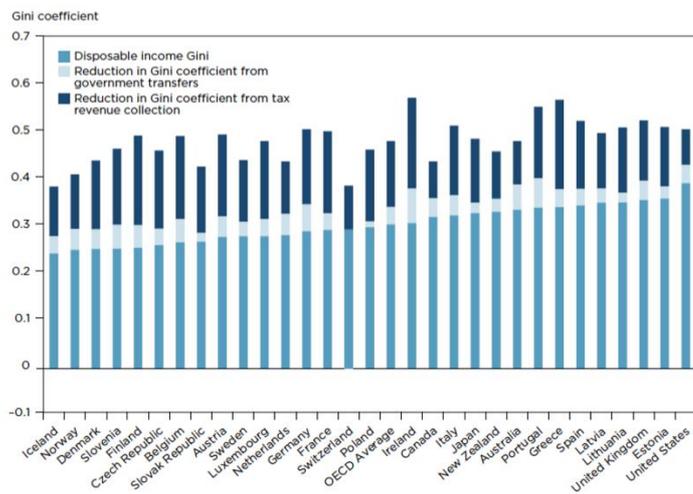
The US trade balance calculation based on exports minus imports takes no account of the growing bilateral trade in services. Over the past ten years, US exports of services to China have increased five-fold. In 2017, Sino-US trade in services reached USD 118.2 billion, of which USD 90 billion was US services purchased by China. However, this figure does not show up the official US-China trade balance. The US-China Business Council points out that China is the second largest destination for US exports and calculates that the US enjoyed a trade surplus in services of 53 billion (\$54.7 billion according to Chinese figures) over China in 2017. This surplus is typically ignored in discussions on the bilateral trade balance.

c. Changes in the domestic and international political/economic environment are a key factor in recent

trade frictions

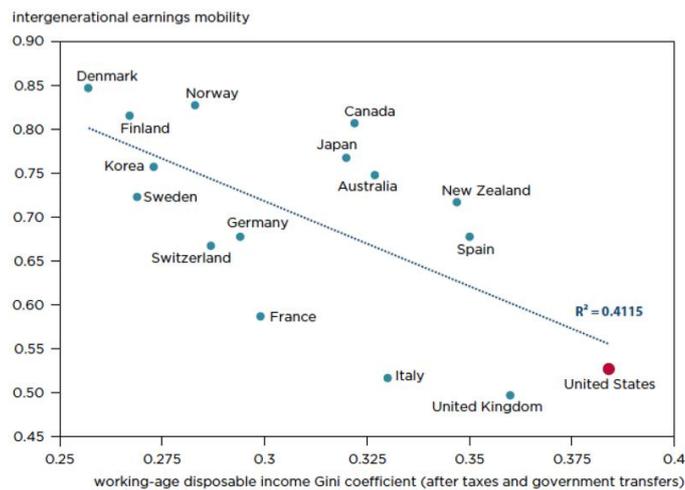
i. Changes in US domestic politics are a major cause for current tensions

Recent trade frictions are closely linked to changes in the political underpinnings of Sino-US economic relations. Harvard economist Dani Rodrik emphasizes how trade policy impacts the distribution of income within a country. Economic globalization has created both winners and losers within the US, and over many years the cumulative impacts of income distribution patterns have created a deep rift between economic elites and those that feel left behind in the US, a rift that played into the election of President Trump. Thus, to a certain extent, Trump is a reflection of popular discontent in the US.



Note: Combined height of stacked bar = market income Gini coefficient. Source: Kirkegaard (2017).

Figure 11: Reduction in Gini coefficients from tax system, 2014

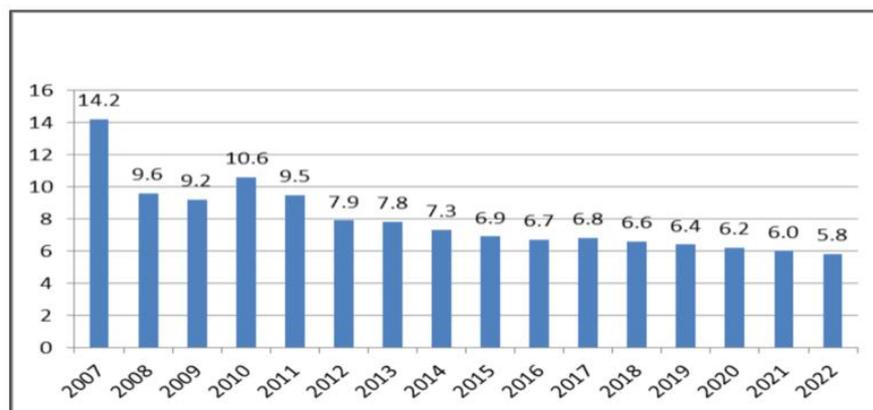


Note: x axis shows 0 = perfect income equality/1 = perfect income inequality. y axis is defined as 1 - intergenerational earnings elasticity. Source: OECD (2017).

Figure 12: Income Inequality and Intergenerational earnings mobility, early 2010s

ii. Direct drivers of the rapid structural shift in Sino-US economic relations

In 40 years of the Reform and Opening-up period, China’s economy has shifted from a planned economy to a market economy. This transformation, which will see consumption replace investment as the major driver of economic growth, requires continuous optimizing of the industrial structure and industrial upgrading via technology and innovation so that China can climb up the global industrial chain. This transformation is taking place as China’s economy shifts from “high-speed” economic growth to “high-quality” economic growth.



Source: IMF, WEO.

Figure 13: China’s Real GDP Growth 2007-2017 and Projections through 2022 (percent)

On the other side of the Pacific, the US also faces economic headwinds. Trump’s initiatives to revive US manufacturing, seen by many as out of sync with the realities of the US economy, is an attempt to rectify the wrong course that some see globalization as having led the US economy down.

iii. Competitive-cooperative relations in the new era

In the 1990s, the US contributed 29.1% to global growth, while Western developed economies contributed 76%. By comparison, in this period, China and emerging markets/developing economies (EMDEs) overall contributed 9% and 23.9% respectively to global growth. For the period 2008 to 2016, contributions by the US and group of developed countries to global growth fell to 7.4% and 23.9% respectively, while the share contributed by China and EMDEs rose to 35.6 and 77.7% respectively, reflecting the relative shift of economic gravity from West to East.

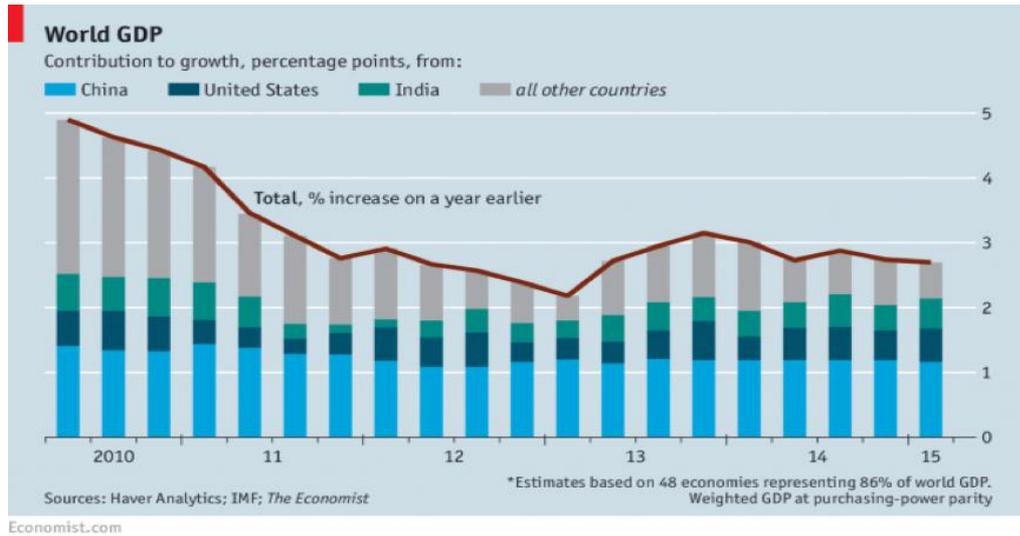


Figure 14: World GDP Contribution to growth (percent)

Metric	China	United States
GDP (market exchange rates; trillions of dollars)	11.2	18.6
GDP (PPP exchange rates; trillions of dollars)	21.3	18.6
GDP per capita (PPP exchange rates; thousands of dollars)	15.4	57.6
Trade (trillions of dollars)	3.7	3.6

PPP = purchasing power parity

Sources: IMF World Economic Outlook Database, October 2017; IMF Direction of Trade Statistics.

Figure 15: Selected economic metrics for China and the United States, 2016

China’s GDP overtook the UK in 2005, Germany in 2007, and Japan in 2010 to become the world’s second-largest economy. In 2012, China’s economy was around half the size of the US economy, but by 2017, it had reached two-thirds the size. Although there remains a large gap between the two countries regarding GDP per capita, they are converging in terms of GDP, with China catching up to the US in terms of technological development and exerting a growing influence on the global stage. In the eyes of US elites and the public, China has been clearly branded as a competitor of the US.

#### iv. Structural tensions behind the Sino-US economic dispute

One cannot escape the deep structural tensions that exist in the Sino-US relationship. Some commentators doubt whether the two countries can get along with each other under the existing international order and worry that they may fall prey to the Thucydides Trap. In light of geopolitics and the experience of rising great powers, some Western scholars believe China and the US could fall into a new Cold War and see the trade war as part of efforts to contain China's rise. In reality, there is a qualitative difference between now and the Cold War between superpowers the US and USSR. First, at that time, the economies of the US and USSR were separate from each other, whereas today, US and Chinese economic interests are deeply intertwined. Secondly, amidst the superpower rivalry, the USSR used its armed might to expand outwards, whereas China adheres to a path of peaceful development and does not seek hegemony but rather strives for a new type of great power relations with the US that avoids conflict and seeks mutual benefit. In addition, although Sino-US competition is marked by differences of economic system and developmental model, it does not involve the type of deep-seated ideological conflict that characterized the US-Soviet Cold War.

## II. Analyzing the impact of trade frictions on both sides

Trump has previously tweeted that "trade wars are good, and easy to win." In his eyes, trade wars are a zero-sum game of "you lose, I win." In fact, the trade balance that Trump demands between the US and China does not accord with economic principles and would not be beneficial to either country. Effectively, the US and China now find themselves in a Prisoner's Dilemma, where both sides raise tariffs to inflict damage on the other, when in fact both would be better off by cooperating and canceling tariff measures. However, neither side is able or willing to call a truce unilaterally as this would result in a larger loss. Ultimately, this drags both sides into a trade war in which both sides lose.

### a. Impact on China's economy

#### i. Detrimental to China's long-term interests

While China is not afraid of engaging in a trade war, this action would entail costs that go against national interests. A MOFCOM official points out that, to a certain degree, China's trade surplus with the US indicates that it is more reliant on the US market than vice versa. This puts China at a disadvantage in Sino-US trade relations and means that China may suffer more if the two economies are to de-couple.

## ii. Limited impact on China's GDP growth

As the dark clouds of trade war gather, financial institutions at home and abroad are trying to gauge the losses China would incur due to a trade war. In scenarios under which the US applies tariffs of 15%, 30%, or 45% to all Chinese goods, what would the relative damage be to Chinese exports to the US and total exports? Morgan Stanley estimates that the relative decline in exports to the US under the three scenarios would be 21%, 46%, and 72% respectively; while total exports from China would fall 4%, 8% and 13%. Similarly, Industrial Securities estimates that if tariffs of 30% are applied, the negative impact to China's GDP will be 0.64 percentage points.

## iii. Impediment to China's deepening reform and economic upgrading

Aside from the impact of reduced exports and deferred investment, China's central bank has implemented "targeted easing" measures three times since January to aid financing of small- and medium-sized enterprises. Some observers worry that such liquidity easing in an underdeveloped financial market will increase the risk of asset bubbles. Given the "impossible trinity" that exists between stimulating domestic demand, de-leveraging, and stabilizing the Chinese Yuan, there is a risk that an intensifying trade war could derail China's economic transformation and upgrading.

## **b. Impact on the US economy**

### i. Reducing the major contributions of Sino-US trade to the US economy

From China's WTO entry in 2001 to 2016, US exports to China have increased by 500%. According to economic principles, any country that escalates tariff measures will hurt its own citizens and also cause unemployment through the impact of retaliatory measures. Ultimately, those that pay the cost of Trump's trade war are US consumers and workers.

### ii. US multinationals become victims of the trade war

A trade war would severely hurt the interests of US companies in China. Recently, the US Chamber of Commerce openly criticized President Trump's approach in provoking the trade war and opposed the administration's threats to impose major tariffs measures on imports from China, which could hurt the interests of US consumers and US companies investing overseas while substantively distorting US trade relations with other major economies.

In 2016, China imported \$16 billion worth of US movies. This year, China and the US will reopen negotiations on a 2012 WTO movie agreement. Originally, the US film industry had expected to increase the quota for US movies to enter the Chinese market, but it now seems that Hollywood too has become a

victim of the trade war, to the extent that it may even be the target of retaliatory measures.

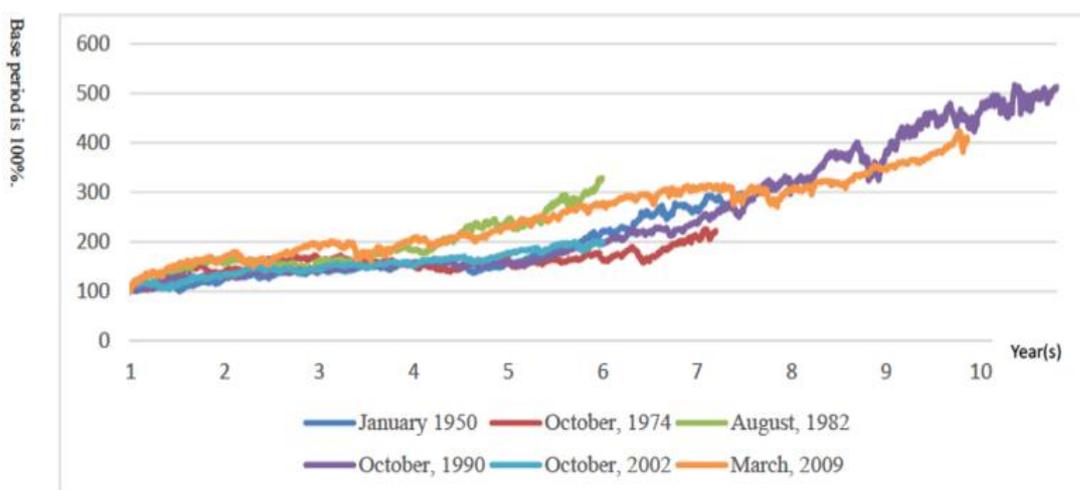
The trade war will likely impair US competitiveness in new emerging markets. In 2016, Chinese consumers bought 44.9 million Apple iPhones and a total of 510 million cars from the big three US automakers of GM, Ford, and Chrysler, accounting for 21% and 33% of global sales of Apple and these automakers respectively. Sales of GM’s Buick brand in China reached \$42 billion, higher than the \$39 billion achieved in the US, while Apple’s sales in China came to \$46 billion, making China the second largest market for Apple after the US. GM has already publicly expressed opposition to the trade war, concerned that it will impair US competitiveness.

### iii. Impact on US industries and employment

Conservative US think tank the Tax Foundation claims that the trade war has already lowered US worker’s wage levels by 0.3 percentage points while reducing 365,000 job opportunities, with the new round of tariff measures announced in July estimated to be equivalent to 40% of the impact of the Tax Cuts and Jobs Act promoted by conservatives. The US Chamber of Commerce has warned that 260,000 jobs could be at risk. These impacts are due to the double shock of downwards pressure on exports and upwards pressure on costs.

### iv. Shock to the US financial system

Since the second quarter of 2017, the US PCE (personal consumption expenditure) indicator has been rising. The Federal Reserve predicts that it will reach 1.9 and 2.0 in 2018 and 2019 respectively. Inflation caused by rising tariffs could force the US Federal Reserve to increase the interest rate to 3.5% in 2019, impacting US capital markets. The trade war will also hit stock markets and impact US investors.



Source: Wind

**Figure 16:** The current bull market is the second longest after World War Two

	China	US
<b>Composition of household assets (%)</b>		
<b>Non-financial assets</b>	6	6
<b>Real estate</b>	54	24
<b>Financial assets</b>	41	71
<b>Composition of household financial assets (%)</b>		
<b>Cash and savings</b>	75.7	14.4
<b>Stock shares</b>	15.5	21.7
<b>Wealth management products of banks and funds</b>	6.5	10.2
<b>insurances</b>	-	28.9
<b>Others</b>	2.3	24.8

Sources: Wind, US Federal Reserve, 'China Household Finance Survey 2017', Morgan Stanley

**Figure 17:** A contrast of household asset structure in China and the US

v. Increasing costs and impeding US innovation

According to estimates in a recent report by the Information Technology and Innovation Foundation (ITIF), imposing tariffs of 25% on US imports from China of information and communications equipment will cost the US economy \$332 billion over the next ten years. The intensifying US-China trade war is casting a shadow over technology talent of Chinese descent in the US. While China’s drive for entrepreneurship and innovation is a pull factor attracting Chinese talent back to China, pressure and restrictions on Chinese technology talent and overseas study students constitute a push, expanding the flows of talent back to China. Talent is the driving force of US innovation, and negative impacts on this dimension due to a trade war should not be overlooked.

vi. Impact on the global economy and multilateralism

Uncertainty creates problems for transnational production, forcing business leaders to consider political factors as well as economic efficiency when configuring global supply chains. This impacts the workings of the global economy and may even lead to serious global recessions. Trade wars hit the confidence of investors and could weaken the foundations of global growth, potentially leading to large-scale unemployment.

### III. Great potential for Sino-US cooperation

While China and the US are currently locked in a trade dispute, the potential that both sides have to cooperate with each other is undeniable.

Sino-US cooperation is an important contribution to the shared destiny of mankind. As the world's two largest economies, these two countries account for almost 40% of GDP and contribute over 40% to global growth. Both China and the US have benefitted from globalization and multilateralism. Together they make up a critical mass in terms of decision-making and have a responsibility to prevent the trade war escalating or widening. Weighing US-China trade frictions from a purely economic perspective is not enough, one needs to adopt a global perspective and consider the impact on all of the world both now and in the future.

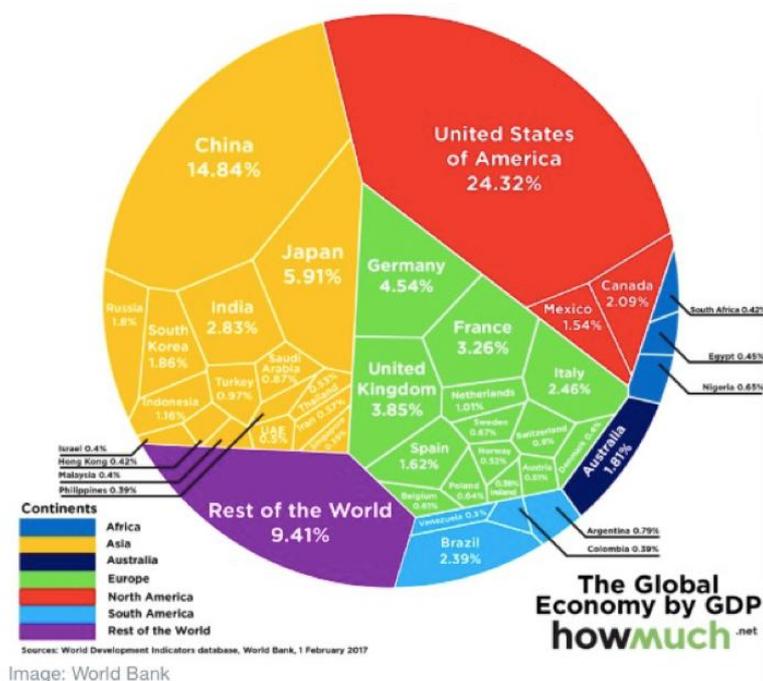


Figure 18: The Global Economy by GDP

Source: World Economic Forum

To reiterate, if the US and China strengthen cooperation they will be able to incrementally reduce the trade deficit and resolve the current trade dispute. There are several promising sectors in which deeper Sino-US cooperation could help reduce the trade deficit, including tourism, overseas study, the movie

industry, e-commerce, autos, crude oil, and natural gas. As Forbes has pointed out, in the coming five to ten years, China's middle class will reach 600 million, equal to twice the population of the US – in other words, China will return the gift that the US gave China.

In addition, diverse views on the trade war have emerged in the US across political circles, the business community, and at the state level. Voices that are opposed to the trade war can help to create opportunities for Sino-US cooperation.

Congressmen from both parties are voicing opposition to the trade war and striving to limit President Trump's powers to impose tariffs. There are also differing views within Trump's team itself, with Secretary of Commerce Wilbur Ross and US Ambassador to China Terry Branstad being seen in the more dovish camp, while the Treasury Secretary Steven Mnuchin is seen as occupying a more centralist position. Derek Scissors of the American Enterprise Institute notes that regarding trade policy towards China, Trump still does not have a coherent strategy because of differing opinions in government.

Many economists and industry representatives from various sectors have repeatedly warned against launching a trade war. Before the trade war, it was reported that 1,140 US economists, including 14 Nobel Prize winners, had jointly signed a letter urging Trump not to make the same mistakes that lead the US into the Great Depression.

Not long ago, 25 leading retailers including Walmart, Macy's and Best Buy co-signed a letter to Trump urging the US government not to impose additional tariffs on imports from China. 45 industry associations representing interests in retail, tech, agriculture and other consumer products have expressed that imposing tariffs will increase costs for US manufacturers, disrupt supply chains, and hurt both the competitiveness of US manufactured exports and US jobs.

US state and local governments have also expressed concern and increased communication with China. On July 11, the same day that the list of \$200 billion worth of Chinese products to be subject to tariffs was announced, a delegation representing the city of Chicago visited China, not only signing the "Five-year Cooperation Plan," ensuring that investments will not cease, the mayor of Chicago also publicly declared his hope to increase trade cooperation with China. Many states are displeased with President Trump's trade stance. Multinationals headquartered in key states have criticized Trump's radical trade policies, such as GM, Ford and Chrysler (Michigan); Procter & Gamble and American Electric Power (Ohio); and Apple and Disney (California).

#### **IV. Recommendations to resolve trade frictions**

This year marks 40 years since the launch of Reform and Opening-up and almost 40 years since the restoration of Sino-US diplomatic ties. When ties were restored in 1979, July saw the signing of the

Sino-US Trade Agreement, opening the US market to China. Growing bilateral cooperation has brought great benefits to citizens of both countries over the last four decades. At the present moment, when China is in a crucial phase of economic transformation and seeking to leap the middle-income trap, the intensifying Sino-US trade frictions have provoked a serious debate on a range of issues such as pressure points of the reform process, China's industrial policy, and innovation methods. Many of the issues that both sides are paying attention to amidst the current trade frictions, such as deeper opening up of the Chinese economy, reducing tariffs, and intellectual property protection, are not a case of winners and losers, but are aligned with China's Reform and Opening-up objectives. On the basis of this analysis, CCG puts forward the following recommendations.

***i. China and the US should accelerate the restructuring of their own economies, building on the foundation of domestic reforms to bring about a joint improvement in the trade imbalance.***

China can use the impetus of the trade war to accelerate structural supply-side reforms, continuing to reduce taxes and fees, reducing costs for enterprises and creating a more business-friendly environment. At the same time, China should continue to open up its markets, implementing the promise made by President Xi at the 2018 Boao Forum for Asia to significantly relax market entry, create a more attractive environment for investors, strengthen IP protection, and increase imports.

The US should also change its previous views towards China, working to expand exports to China, and relaxing restrictions on exports to China. At the same time, the US should adjust its attitude towards Chinese products and investment, such as ensuring fair treatment of Chinese investments by the Committee on Foreign Investment in the US (CFIUS).

China and the US are the world's two largest economies, which enjoy a considerable amount of complementarity. The two countries should seek to put ideological differences aside and avoid letting trade become ruled by geopolitics. Beijing and Washington should take the welfare of mankind as their starting point and seek to build a shared community of destiny by innovating the global governance system.

***ii. The way that Sino-US trade is measured should be reformed and updated***

New measurements should be adopted to capture the real value of trade in the 21st century. US and Chinese measurements of the Sino-US trade deficit diverge due to differences in the way they are calculated.

The trade deficit between the US and China is shaped by international patterns of the division of labor and respective positions in the value chain. In an age of global value chains, many goods are produced in multiple countries, but under traditional accounting methods all the value is attributed to the exporting country.

In future, methods of calculating the US-China trade imbalance should take into account the

configurations of global value chains to more accurately and fairly reflect the gains that each country makes from trade. China has long occupied the lower rungs of global value chains. While it is known as the “factory of the world,” much of this production is concentrated in labor-intensive activities, while those supplying branding and technology are foreign companies.

In future, valuations of Chinese exports to the US should take account of items such as third-party patent royalty payments and branding costs. China should update methods of calculating bilateral trade and disseminate information on the realities of Sino-US trade, ultimately gaining the recognition of policymakers and the public.

***iii. China and the US should work to expand bilateral trade in services, including tourism, education, exchange of talent, investment migration, infrastructure construction, and e-commerce***

The US enjoys a large surplus in trade in services over China, reaching \$55.7 billion in 2016 – 23.1% of China’s overall balance in trade in services. With growing middle class spending power and demand for services, it is likely that given the US advantage in services this surplus will continue to expand.

The US has 7 Nobel Prize winners of Chinese descent and over 300 NASA scientists. Of students that achieved bachelor’s degrees in science and engineering in 2006, China occupied first place in terms of the proportion remaining in the US as of 2011. Migrants have contributed impetus to US technology and innovation. The circulation of talent between China and the US will continue to provide both countries with a “talent dividend.”

In addition to highlighting these contributions to the US and public, China should actively seek to undertake reforms in relevant fields to attract more US students, tourists and entrepreneurs. Such measures include improving Chinese education, making the environment for tourism and investment more appealing, and improving relevant services.

In addition, China and the US should explore creating a Sino-US infrastructure investment fund to deepen bilateral cooperation in this field, which has great potential under President Trump’s infrastructure plan for the US. In the past ten years, China has invested over \$11 trillion, around 11 times the total of Trump’s \$1 trillion infrastructure investment plan. Chinese capital can play a role in realizing Trump’s infrastructure investment plans, helping to spur US economic growth. Sino-US infrastructure cooperation can also boost the development of companies engaged in fields such as equipment manufacturing, engineering and high-technology, while helping to tap market opportunities through public-private partnerships.

Cross-border e-commerce (CBEC) is another area with great potential for Sino-US cooperation. China’s 400 million-strong middle class have strong demand for imported goods and trade via CBEC has grown by over 50% annually for the past three years, with over 80% growth in 2017. CBEC can be used to connect the Chinese and US markets, boosting bilateral trade while bringing benefits to consumers and companies in both countries. Both sides can help to unlock this potential by actively pursuing a bilateral CBEC

agreement that allows for the coordination of relevant standards and trade facilitation measures. This would accelerate the growth of trade via CBEC, helping to reduce the trade deficit and create jobs, reducing the employment pressures on both governments and reducing political friction.

***iv. Strengthen the role of economic ties as a ballast in the bilateral relationship and forge consensus among US interest groups such as multinational corporations***

US multinational corporations have a significant influence on US politics. As of the end of 2017, the US had invested a total of \$82.5 billion in China. China has become an important growth engine and source of profits for US companies. Moving forward, China should continue to improve the foreign investment environment and attract US companies to China, further intertwining US and Chinese interests and strengthening the role of economic ties as a ballast in the Sino-US relationship.

This entails working through American multinationals, trade associations, think tanks and lobby groups to strengthen communication channels with US policymakers. China could strengthen engagement with US companies that would suffer through a trade war, improving understanding of their situation and helping to forge consensus that can filter up to the US policymakers, helping to overcome the current deadlock and bring about a return to the track of dialogue and negotiations.

***v. Strengthen Sino-US cooperation between provinces and states, set up a Sino-US state government infrastructure fund***

US states and cities have a high degree of decision making power with respect to their own economies. These entities play an important role in interaction with China and can serve as a stabilizing force in bilateral relations. China could encourage local governments to deepen engagement and collaboration with states and municipalities in the US, including via annual Sino-US summits at both the gubernatorial and mayoral level. In addition, both sides could work together to create new platforms for cooperation at the local level and province-to-state cooperation for infrastructure funding.

In June 2017, China and California signed an agreement on climate and clean technology. In July 2018, Chicago and eight Chinese cities signed the 2018-2023 Five-year cooperation plan for key industries, creating a platform for industry-driven investment cooperation in fields such as healthcare, advanced manufacturing, and high tech.

These examples highlight the potential for US local governments to cooperate with China. China should seek to fully understand the logic and workings of US politics and align its strategy accordingly. Against a backdrop of Trump's tax reductions and the gradual phasing out of quantitative easing, US state governments are eager for outside investment, including Chinese greenfield investment.

***vi. Carrying out appeals and consultation under the WTO framework***

China and the US are WTO members and should seek to undertake relevant consultations under the WTO framework. China could file appeals against the US and undertake negotiations under the WTO, providing a space for productive discussion. Under the WTO, China could file group actions with major trading powers such as the EU and Japan against US moves to impede free trade to overturn US measures.

At the same time, China and the US remain within the WTO multilateral system and could undertake bilateral negotiations under its framework, such as consultations on IP protection under TRIPS. Issues that fall outside the scope of the WTO can be resolved through bilateral negotiations.

***vii. Relax US export restrictions, in particular concerning high-tech exports to China***

For a long time, US export policies towards China have been overly conservative, particularly concerning high-tech products. This means that some US products have no chance to break into the Chinese market, meaning significant lost profits for US companies. Relaxing these export restrictions would both increase sales of US companies in China and also help to reduce the trade deficit.

While increasing imports from the US, China should also actively work to persuade the US to relax export restrictions, highlighting the lost potential gains for both sides.

***viii. Revive talks towards the Bilateral Investment Treaty (BIT) and explore a new Sino-US Free Trade Agreement (FTA)***

China and the US have entered a new age of “reciprocal investment” that benefits both countries. However, bilateral investment flows are restricted by the international environment and the economic policies of both sides.

A fully-realized US-China Bilateral Investment Treaty (BIT) could bring significant benefit for both sides. On one hand, it would encourage US enterprises to invest in China and share China’s “reform dividend.” On the other hand, it would help to boost Chinese investment in the US, helping to reinvigorate the US economy. The BIT can serve as an important foundation to ensure stable future economic relations between China and the US.

The US-China BIT has completed 34 rounds of talks with negative lists swapped three times. However, talks have been shelved under the Trump administration. Both sides should work to find an opportune time and way to restart BIT talks or explore a bilateral FTA. This would help to reduce barriers to bilateral investment and promote greater mutual openness. Moving forward, China can encourage manufacturing firms to make greenfield investments in the US, helping to solidify bilateral investment relations and provide good prospects for investors.

***ix. Uphold multilateral mechanisms and promote the free trade system***

Multilateral mechanisms will have an important role to play for a long time to come. China should work with developed economies such as the EU and Japan to uphold the current multilateral system. China should work through multilateral bodies such as the UN, WTO, IMF and G20 to make its voice heard and offer Chinese solutions to current challenges. For example, if China can demonstrate its progress in IP protection through the UN World Intellectual Property Organization, this will help to change international stereotypes of China and establish the country as a global IP power.

At the same time, China should seek to promote multilateralism in the Asia-Pacific region and accelerate the building of regional FTAs, working for a timely conclusion of the Regional Comprehensive Economic Partnership (RCEP). Meanwhile, China can also consider joining TPP and strengthen cooperation with TPP members such as Japan, using economic impetus to boost cooperation in other fields as well.

Moving forward, China could promote the merging of TPP and RCEP to form the Free Trade Area of the Asia Pacific (FTAAP). China should not place its eggs in one basket and should strive to enlarge its friendship circle by working with a variety of partners, including neighboring countries, Africa, APEC members, and BRICS nations.

***x. Develop the role of Track II diplomacy and promote bilateral dialogue***

Both sides should work to strengthen the role of Track II diplomacy in facilitating bilateral exchange. Supporting exchanges among think tanks and nonprofit organizations across the Pacific will create effective bridges for dialogue, help to dispel miscommunication, and generate positive plans to resolve differences.

At the same time, China should increase the transparency and openness of its cultural diplomacy to avoid raising negative suspicions. Non-profits such as think tanks have a role to play in this international engagement. US think tanks such as the Hudson Institute, The Heritage Foundation, the American Enterprise Institute, and Council on Foreign Relations have an impact on US policymaking, with some officials in the Trump administration hailing from these organizations. Dialogue with these organizations can help to overcome economic and political barriers and forge bilateral consensus that helps both governments reach agreement. To play this role effectively, Chinese think tanks need to retain a global perspective and absorb best practices and experiences from international think tanks so that they can provide solid support for policymaking.



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**Global Vision for China, Chinese Wisdom for the World**

**ABOUT CCG**

The Center for China and Globalization (CCG) is a leading Chinese independent think tank based in Beijing. It is dedicated to the study of Chinese public policy and globalization. Boasting a strong research team, it enjoys an impressive record of publications and events with broad public policy impact. CCG's research agenda centers on China's growing role in the world, drawing from issues of global migration, foreign relations, international trade and investment, homegrown MNCs and other topics pertaining to regional and global governance.

According to the "2016 Global Go To Think Tank Index" by the University of Pennsylvania Think Tank and Civil Society Program (TTCSP), CCG ranked 111th of the top think tanks worldwide and was one of the world's top 40 independent think tanks. The TTCSP along with several Chinese academic institutions rank CCG as China's premier independent think tank.

