CCG | 全球化智库
CENTER FOR CHINA & GLOBALIZATION
http://www.ccg.org.cn/

CCG Report

Issue 7 of Volume 25
September 2018

# China-US Trade Relations and Challenges: Past, Present, Future and Policy Options

## Executive Summary

This year marks the 40th anniversary of China's Reform and Opening-up and 40 years since the establishment of US-China diplomatic ties. The trade and economic relationship has served as a ballast in US-China relations, helping the two countries navigate through difficult waters and providing great prosperity to both societies. Cooperation between the two countries on trade and investment is built on their respective comparative advantages. The last 40 years witnessed the continued growth of interdependent and mutually beneficial ties between China and the United States despite ups and downs in the bilateral relations. The trajectory of China-US commercial relations has set an example for countries with different development stages and distinctive social systems to maximize economic efficiency for mutual gain.

The relations between the world's two largest economies, however, are now at a crossroads, beset by the escalating trade conflict. Following the USTR's Section 301 investigation, the first round of punitive tariffs imposed on USD 50 billion worth of Chinese goods went to effect in August. The tensions intensified in September when a 10% duty on the USD 200 billion worth Chinese goods was confirmed by the White House with a 25% rate to follow in 2019. President Trump has also threatened to add an additional USD 267 billion goods to be taxed, which would amount to all Chinese exports to the US. The American actions were met with tariff retaliation from the Chinese government. So far, the crosshairs between the two sides have generated damage to both China and US jobs and economies .

To assess this highly tenuous development, this report puts forwards an analytical framework of trade war depicting three potential outcomes - the first (best-case) scenario in which the two sides reach an agreement and subsequently halt the tariff measures; the second (medium) scenario forecasts a longer-term trade conflict that is nevertheless measured and contained; and

the third (worse-case) scenario projects continued escalation into an all-out trade war. Given the potential for further escalation, it is important that the US government looks at possible outcomes and assess the Chinese government's intentions, the lost opportunities and benefits, and the detriment to the health of both economies and the wider global economic system.

As the world's two largest economies, the US and China collectively account for almost half of global GDP, underwriting global prosperity. A trade war between the two will inevitably lead to a lose-lose outcome, harming not only both countries but also the global economy at large. While the specter of competition between these two powers cannot be easily dispelled, the bilateral economic relationship needs not be zero-sum. An all-out trade war resulted from unbridled strategic mistrust between the two great powers will behoove either side and pose a threat to global welfare. Washington should not lose sight of the fact that China is not adopting a more confrontational stance toward the US and is always seeking ways to foster win-win cooperation with America to serve its development goals. Drawing on the past four decades' success of bilateral economic partnership, the current trade dispute should be approached from both sides' focusing on making the economic pie bigger.

To that end, CCG puts forward the following recommendations for both China and US policymakers:

1. Build on the agreements already reached through bilateral negotiations and work to increase Sino-US bilateral trade and opportunities in services trade.
2. Forge a new bilateral agreement on intellectual property rights (IPR).
3. Increase opportunities for US companies in China Manufacturing 2025.
4. Seek further tariff reduction through bilateral negotiations and re-engage in BIT talks.
5. Build on the foundation of domestic reforms to rebalance the Chinese and US economies as ways to achieve trade balance.
6. Update the way that Sino-US trade is measured to more accurately reflect the value derived by each side.
7. Expand cooperation in infrastructure and explore creating a Sino-US infrastructure investment fund.
8. China and the US can work together to reform the WTO.
9. Strengthen Sino-US cooperation between provinces and states.
10. Develop the role of Track II diplomacy and promote bilateral dialogue.

## I. 40 years of Sino-American Trade and Economic Relations

This year marks the 40th anniversary of China's Reform and Opening-up program and almost 40 years since the establishment of US-China diplomatic ties. China is now the world's second-largest economy and the third-largest market for American exports. In the past four decades, Sino-US economic cooperation has served as a ballast in bilateral relations, helping the two countries navigate through difficult waters and providing great prosperity to both societies. Trans-Pacific trade helped China lift hundreds of millions of people out of poverty. At the same time, Chinese-made goods kept American inflation low while US multinationals profited from China's cheap labor supply and vast market. However, relations between the world's two largest economies are now at a crossroads. Looking back at the vicissitudes of Sino-US economic ties provides a necessary historical perspective and context to inform the current bilateral negotiations.

The historic landmark of the Third Plenum of the Thirteenth CCP Central Committee at the end of 1978 was followed by President Carter's decision to establish diplomatic ties with China on January 1, 1979 and Deng Xiaoping's subsequent visit to the US in the same month. America was the very first country to which the Middle Kingdom opened its gates in modern times. After the relationship was normalized, the US gradually opened its domestic market by granting China Most Favored Nation (MFN) status. In 1981, the Reagan administration created a separate trade category for China to exempt it from trade restrictions applied to other communist countries. After a decade or so tussles over the annual renewal of MFN, the Clinton administration finally granted China permanent normal trade relations in 2000 ahead of China's WTO entry in 2001 – a milestone that would not have been possible without the support of the US government and business community.

When President Nixon visited Beijing in 1972, China-US annual bilateral trade was less than USD 100 million and bilateral investment was close to zero. Economic ties have grown steadily in the years since, with bilateral trade reaching USD 121.5 billion in 2000, making China the US' fourth largest export partner at that time. In 2017, bilateral trade in goods reached USD 710.4 billion, over 232 times larger than in 1979. [1] Two-way growth in trade and investment has brought mutual benefits and become a cornerstone for bilateral cooperation. Since China joined the WTO, US exports to China have increased by 500 percent, far exceeding the 90 percent increase in American exports to the rest of the world over the same period.[2] In 2017, the United States exported more goods to China than ever before, exceeding USD 127 billion. US exports of goods to China have grown by 86 percent over the last decade, vastly outpacing US exports to the rest of the world which grew by only 21 percent. Meanwhile, US exports of services to China increased more than 300 percent in the same period while services exports to the rest of the world increased about 50 percent. In 2016, US services exports to China totaled more than USD 52 billion.[3]

Investment by US firms in China has brought significant gains for both countries. According to the Chinese Ministry of Commerce, cumulative foreign direct investment (FDI) from the US has reached USD 82.5 billion, with 68,000 companies set up in China. This inward investment has brought China capital, technology, expertise, tax revenues, and provided a positive impetus for China's economic development. At the same time,

---

[1] Office of the United States Trade Representative figure

[2] Research Report on China-US Economic and Trade Relations, *Ministry of Commerce of China*, May 25, 2017

[3] State Export Report, *US-China Business Council*, April 2018

China has become an important production base, growth engine, and source of profits for US multinationals. US companies generate nearly USD 500 billion in sales annually in China.[4] As of July 2016, there were 243 million iPhone users in mainland China, accounting for 33 per cent of the worldwide total of 728 million at that time.[5] Regarding the auto sector, in 2017, General Motors sold 70 percent more cars in China than in the US, and China is Cadillac's largest market.[6] Turning to aviation, China bought 7,000 of 41,000 new Boeing aircrafts.[7]

Under the current system of global value chains, US and Chinese production are interlinked so that Chinese manufacturers often use components imported from the US, while many American exports assembled in China. According to China's Ministry of Commerce, in 2017, 59% of China's trade surplus came from the export processing trade, 57% of which was accounted for by foreign companies. In a highly-globalized world, Sino-US economic cooperation is an inevitable outcome of international division of labor and resource allocation. With the vertical integration of industry value chains and cross-border development of supply chains, the US economy has oriented towards high value-added research and design activities while China tends to carry low-cost production. According to a 2011 OECD project, for all Chinese exports in electronics and optical equipment manufacturing, domestic value added share of gross exports is only 46 percent. In 2016, 77 percent of high-tech exports were manufactured by foreign-invested enterprises.[8]

In the case of Apple, assembly in China accounts for only 3-6 percent of the USD 370 manufacturing cost of an iPhone X with the bulk of the value added going to the American tech giant.[9] The US and China are sharing more bilateral business interests beyond goods trade. Morgan Stanley estimates that the US firms' revenue exposure to China reached around USD 400 billion in 2017, about 3 times more than its exports to China. US firms have benefited more from producing and selling products within China rather than by exporting to China.[10]

[4] Arthur Kroeber, "An Irresistible Trade Policy Meets Immovable Interests," *Gavekal Dragonomics*, September 12, 2018

[5] Bien Perez, "Apple's China sales grow for second straight quarter on strong iPhone demand', *South China Morning Post*, February 02, 2018

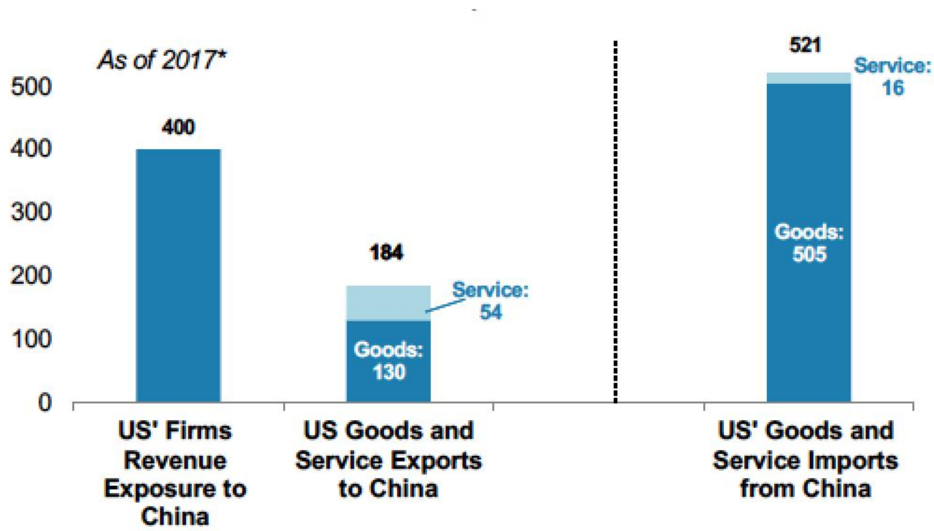
[6] "GM China Sales Top 4 Million Vehicles for the First Time in 2017," *GM Corporate Newsroom*, January 04, 2018

[7] Research Report on China-US Economic and Trade Relations, *Ministry of Commerce of China*, May 25, 2017

[8] Mary E. Lovely and Zixuan Huang, "Foreign Direct Investment in China's High-Technology Manufacturing Industries," In US-China Economic Relations: From Conflict to Solutions, *CF40-PIIE Joint Report*, June 2018

[9] Philippe Legrain, "Why China will Win the Trade War," *Foreign Policy*, April 13, 2018.

[10] "Trade Tensions: Lingering for Longer," *Morgan Stanley,* July 11, 2018

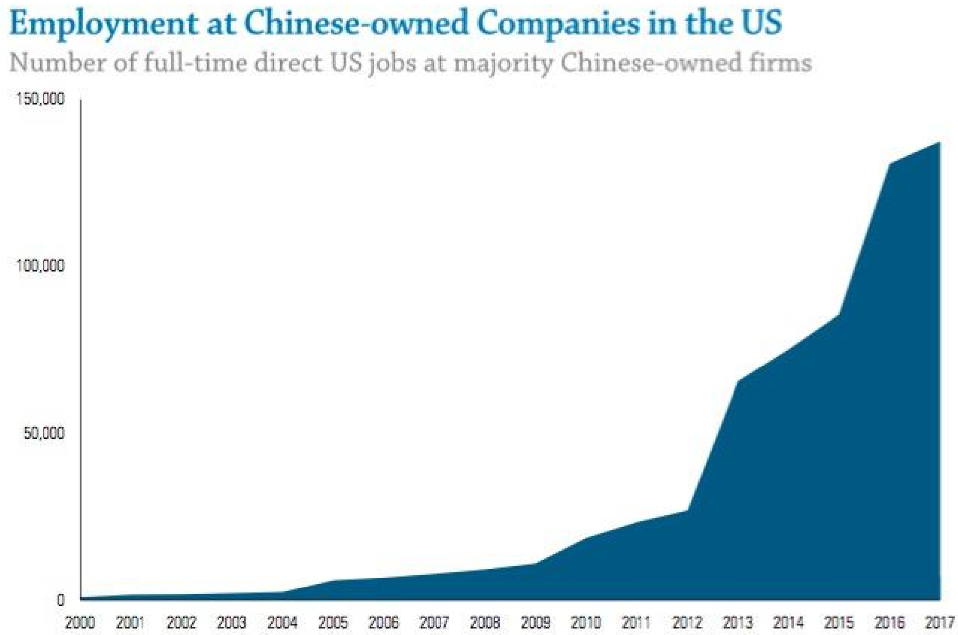



*Source: Morgan Stanley, 2018*

**Fig 1. US business interests in China**

Citizens of both countries have benefitted from growing US-China bilateral cooperation. Inflation in the US, which averaged 5.4% from 1963 to 1989, fell to just 2.5% from 1989 to 2015, in large part due to growing imports of consumer goods from China. The US-China Business Council (USCBC) estimated that Chinese products saved the average US household USD 850 each year.[11] An earlier USCBC study shows that in 2015, US exports to China and US-China two-way investment contributed USD 216 billion to US GDP, supporting 2.6 million American workers. While only a handful of American jobs relied on business with China in 1972, Rhodium Group reports that today, Chinese firms have cumulatively invested over USD 140 billion across 46 US states, creating over 140,000 jobs. Over the years, the investments in the US made by Chinese enterprises have contributed to local economies, employment and tax revenue. For example, Wanxiang Group has invested in nearly 30 factories across the US, creating 12,500 jobs. More recently, China's Fuyao Glass, announced last year that it was ready to increase its investment in its US production facilities up to USD 1 billion with thousands of more job opportunities to offer to local residents.

11 "Understanding the US-China Trade Relationship," *US-China Business Council by Oxford Economics*, January 2017




*Source: Rhodium Group*

**Figure 2. Employment at Chinese-owned Companies in the US**

From a historical perspective, US-China trade friction is nothing new. As early as 1979, the US unilaterally imposed quotas on seven categories of Chinese textile exports. In 1983, in response to US curbs on imports of Chinese textiles, China announced it would retaliate by halting purchases of US cotton, chemical fibers, and soybeans. The annual renewal of China's MFN status by the US congress prior to China's WTO entry was a recurrent irritant in the bilateral relations. As the trade deficit with China continued to widen, the US has launched trade sanctions against China including the Section 301 investigation over intellectual property and WTO cases in sectors such as auto parts, rare earths, and credit card payments. To summarize, over the last four decades, there have been periodic trade spats between the US and China, but the two sides have always managed to find ways to resolve their differences for mutual gain.

Many fear that the current trade tensions might be the prelude to a "decoupling" of the two economies, concerns exacerbated by the trade war drums currently sounding in Washington. However, extensive exchanges at the people-people level are bringing the two countries ever close together. Take tourism for instance, in 2016, about 3 million Chinese citizens visited the US, contributing USD 33 billion to US GDP. For eight consecutive years, the US has remained the top destination for Chinese citizens studying abroad. In 2017, over 350,000 Chinese students enrolled in US universities and colleges, spending an estimated USD 16 billion on education related expenses.[12] Of those who earned bachelor's degrees in science and engineering in 2006, China occupied first place in terms of those remaining in the US as of 2011.[13] The circulation of talent between China and the US will continue to provide both countries with a "talent dividend."

[12] 2018 Annual Bluebook on Development of Chinese Students Studying Abroad, *Center for China and Globalization*

[13] Oak Ridge Institute for Science and Education 2012

The above review shows that the US and China have played a positive role in advancing both countries' economies. Cooperation between the two countries on trade and investment is built on their respective comparative advantages. The last 40 years witnessed the continued growth of interdependent and mutually beneficial ties between China and the United States despite ups and downs in the bilateral relations. Each major crisis and breakthrough has helped push economic relations between the two countries to a new level. The evolution of Sino-US economic relations has shown how countries at different stages of development and with distinctive social systems can cooperate to maximize economic efficiency for mutual gain. This trade and investment relationship has been a stabilizing force helping both sides to weather the storms encountered in the Sino-US relations, thus serving as the bedrock for the world's most consequential bilateral relationship.

## II. Development of the US-China Trade Conflict

"America First" has been the principle underlying the Trump Administration's foreign policy platform. According to US Department of Commerce, in 2017, the US trade deficit reached a nine-year high of USD 566 billion with a gaping USD 375.23 billion deficit in goods trade with China. President Trump has made resetting trade policy toward China one of his top foreign policy initiatives. In August 2017, he authorized a USTR probe into China's intellectual property under Section 301 of the Trade Act of 1974. Following the release of the 301 investigation findings in March 2018, a list of 1,333 Chinese high-tech products worth USD 50 billion subject to a 25% punitive tariff was released. Immediately, China retaliated with its list of 106 products covering USD 50 billion of Chinese imports from the US.

The first round of tariff crossfire has all been implemented since August 23 when the two sides began collecting taxes on affected goods worth USD 50 billion. In addition, President Trump requested the USTR to identify USD 200 billion worth of Chinese goods for additional tariffs of 10% on June 18 and the list of products was published on July 10. China's Ministry of Commerce released a rebuttal in response and made an additional charge to the WTO against the US's unilateral tariff actions. Later in August, the Ministry of Commerce proposed a range of additional tariffs of 5% to 25% on American exports to China worth USD 60 billion in reaction to a 25% rate increase on the USD 200 billion proposed by President Trump. The trade war drums intensified in September, when a 10% duty on the USD 200 billion worth Chinese goods was confirmed by the White House with a 25% rate to follow in 2019. President Trump has also threatened to add an additional USD 267 billion goods to be taxed, which would amount to all Chinese exports to the US.


*Source: PIIE*

**Figure 3. US tariffs on Chinese imports: product composition shifts between lists**

Thus far, the two sides have attempted to de-escalate the trade tensions by launching multiple rounds of talks and negotiations. A group of President Trump's economic advisors came to Beijing in early May and a few weeks later, Chinese vice premier Liu He visited the US for the same issue and reached an agreement but later turned down by President Trump. In late August, China's vice commerce minister Wang Shouwen met with his American counterpart David Malpass in Washington DC to discuss ways to resolve the deepening trade conflict. However, there was no breakthrough from the meeting. It is reported that Steven Mnuchin, US Treasury Secretary was pushing to meet vice premier Liu He to defuse the escalating tariff spats and the faint hope of trade war truce was dampened by President Trump's decision on the USD 200 billion tariffs.

The Chinese government has been consistent on its position over the developing trade frictions. Various Chinese leaders and ministry spokespersons have reiterated that China does not want a trade war with the US but is not afraid of fighting one. While aware of potential spillover effects of tariffs into economic areas beyond trade with the US, the Chinese government however, is confident in its ability to stave off the tariff pressure. Across the Pacific, there is growing domestic opposition to the Trump administration's trade policies. With midterm elections approaching, many US companies are emerging to testify as to how tariff sanctions against China yield undesired lose-lose outcome.

Citing potential economic damage and job losses, many economists and industry experts have warned of substantial losses to the US economy and employment. It is reported that more than a thousand American economists, including 14 Nobel laureates, signed a joint letter to the president in May 2018, urging him not to make the same mistakes that led the US into the Great Depression in the 1930s[14]. Multiple institutions have forecasted significant losses from engaging in a trade war. For example, 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

[14] "More Than 1,000 economists Warn Trump His Trade Views Echo 1930s Errors," *The Guardian,* May 03, 2018

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.[15]

The National Association of Chemical Distributors released a study this month that predicted nearly 28,000 chemical distributor and supplier jobs would be eliminated because of higher prices due to the USD 200 billion round of tariffs.[16] The US Chamber of Commerce estimated that as many as 2.6 million jobs could be threatened by the Trump administration's trade policies.[17] An Axios analysis claims that the retaliatory Chinese tariffs would affect 11 million American workers concentrated in rural, deeply red, already-struggling parts of the US.[18] Forecasting sectoral employment impacts under a full trade war scenario, the Peterson Institute for International Economics (PIIE) expects large employment decline to occur. Even short-term aborted trade war could lead to private sector employment falls of 1.3 million.[19] The chief economist of Moody predicts 150,000 fewer jobs in the US if current and proposed tariffs are continued.[20] More than 60 US industry groups launched a coalition called Americans for Free Trade, comprising thousands of companies, farmers and manufacturers, arguing that the trade war will kill US jobs and raise prices for US households.[21]

Given the potential negative impacts to US companies in the US, China, and around the world, US businesses are playing an increasingly active role in trying to prevent the trade war. In a USTR hearing held in August on the proposed 25% tariffs on USD 200 billion worth of Chinese exports, 90 percent of the 350 enterprises that participated opposed the measures.[22] In an earlier July hearing on the proposed tariffs on USD 16 billion worth of Chinese products, out of 82 speakers, only 6 supported the measures. US firms stand to lose in several ways from a trade war. Agricultural products like soybeans, automobiles and Boeing aircraft sales are among the first list of targeted sectors subject to punitive taxes. Members of congress representing affected agricultural areas such as the mid-West were quick to air opposition.[23]

The US auto sector, which exported USD 15.9 billion in auto products to China in 2017 including USD 13.1 billion in finished cars, would incur heavy losses due to the 25% tariffs proposed as part of Chinese countermeasures released on July 6. Following the release of this tariff list, Tesla said the price of its models would rise from RMB 140,000- 250,000 and announced that it will build a production facility in Shanghai.[24] Leading US automaker GM has also expressed strong concern at plans to escalating the trade war, saying that it could hurt US competitiveness and threaten US growth prospects. Senior executives of the aircraft manufacturer Boeing were busy working to persuade the government to avert trade war escalation.[25]

Goods originating in China will also become more expensive, pushing up costs for both businesses and consumers. Apple sent a letter to the USTR highlighting how the upcoming tariffs on USD 200 billion Chinese

---

[15] "Tracking the Economic Impact of U.S. Tariffs and Retaliatory Actions," *Tax Foundation,* June 22, 2018

[16] "Trump Hits China with Tariffs on $200 Billion in Goods, Escalating Trade War," *New York Times*, September 17, 2018

[17] "Trump Trade Policies Threaten 2.6 Million Jobs, Chamber of Commerce Says," *CNN Money Report,* May 31, 2018

[18] Lazaro Gamio, "11 Million U.S. Workers are in the Trade War's Crosshairs", *Axios,* September 9, 2018

[19] Marcus Noland, Gary Clyde Hufbauer, Serman Robinson, and Tyler Moran, "Assessing Trade Agendas in the US Presidential Campaign", *Peterson Institute for International Economics,* September 2016

[20] "U.S. May Lose up to 150,000 jobs from Trade Tension: Economist," *Reuters*, March 7, 2018

[21] "US Companies in China are Suffering in Trade War, Survey Says," *The Washington Post*, September 13, 2018

[22] "US Companies Oppose Tariffs on 1st day of 301 Hearings," *CGTN*, August 21, 2018

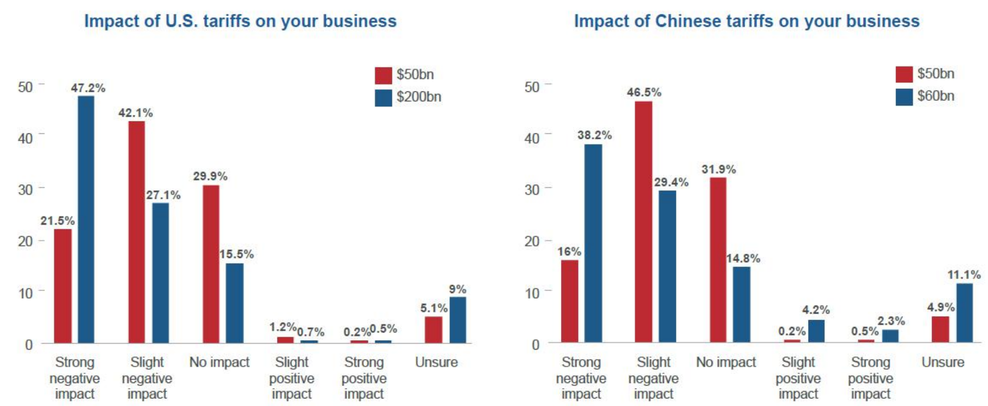
[23] "'No One Wins in a Trade War.' Ag Advocates Urge Trump to End Tariffs Standoff", *The Fresno Bee,* August 15, 2018

[24] "German Cars and American Steak: The Early Trade War Victims Emerge," *Bloomberg*, July 9, 2018

[25] "Boeing Works to Avert US-China Trade War Escalation," *Financial Times*, July 16, 2018

goods would "increase the cost of our US operations, divert our resources, and disadvantage Apple compared to foreign competitors."[26] Intel pointed out that many products in the list have final assembly or testing done in China, but chips will be subject to tariffs on the full value. Intel estimates it would cost USD 650-875 million to relocate a chip factors away from China. Tech companies Dell, Hewlett-Packard and Juniper Networks have raised similar concerns about harm to US companies, workers and consumers from applying tariffs to networking products and accessories.[27]

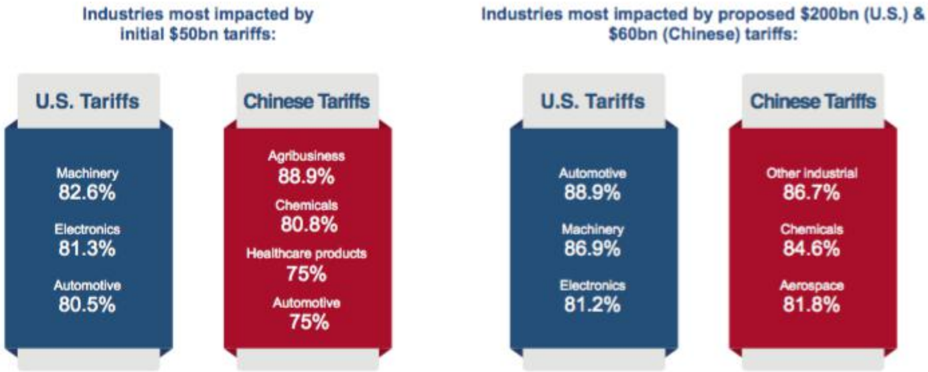
It is also worth noting that around 59% of the products in the first list subject to tariffs are produced by foreign companies, according to China's Ministry of Commerce.[28] Of these, over 70% are accounted for by US companies engaged in processing trade in China. AmCham China and AmCham Shanghai recently conducted a joint survey of member companies to measure the impact of tariffs imposed by both the US and Chinese governments. The survey finds that over 60% of American companies in China say the initial USD 50 billion list of tariffs from both the US and China negatively impact their businesses. Over twice as many firms anticipate a "strong negative impact" if the second round of tariffs are implemented.[29]




*Source: Amcham China and Amcham Shanghai)*

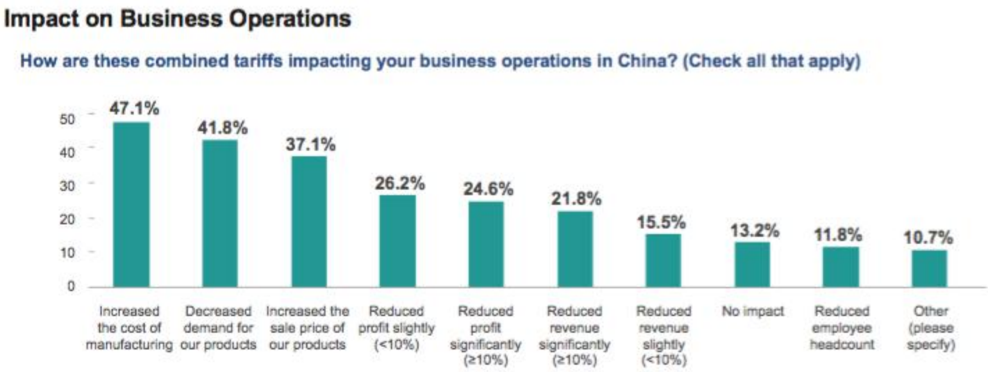
**Figure 4. Impact of U.S. tariffs and Chinese tariffs on business of American companies in China**

[26] "America, China and the Route to a Trade War," *Financial Times*, September 12, 2018
[27] "US Tech Groups Seek Key Product Protections from China Tariffs," *Financial Times*, September 7, 2018
[28] http://english.mofcom.gov.cn/article/newsrelease/press/201807/20180702766291.shtml
[29] "*Impact of U.S. and Chinese Tariffs on American Companies in China,"* Amcham China and Amcham Shanghai September 13, 2018




*Source: Amcham China and Amcham Shanghai)*

**Figure 5. Industries most impacted by $50bn tariffs, $200bn (U.S.) and $60bn(Chinese) tariffs**




*Source: Amcham China and Amcham Shanghai)*

**Figure 6. Impact of tariffs on business operations of American companies in China**

Concerns about the negative consequences of protectionist trade policies have been growing in Congress. On July 11, the US senate by an overwhelming majority of 88 to 11 passed a non-binding motion to give Congress a role in decisions to impose tariffs for national security reasons.[30] Later, over 140 House members wrote a letter to the US Commerce Secretary advising against imposing tariffs on imports of autos and auto parts, citing the potential harm to the US auto industry.[31] Multinationals headquartered in key states have criticized Trump's protectionist trade policies, such as GM, Ford and Chrysler (Michigan); Procter & Gamble and American Electric Power (Ohio); and Apple and Disney (California). Following the July visit of the mayor of Chicago signing a "Five-year Cooperation Plan" with China,[32] the California Assembly passed a resolution in

[30] "Senate Overwhelmingly Rebukes Trump on Tariffs - But the Measure Won't Limit His Powers," *CNBC,* July 11, 2018

[31] "Representatives oppose tariffs on automotive industry," *Transportation Today,* July 24, 2018

[32] "Mayor Emanuel Announces Success of Trip to China To Secure Upcoming Chicago Rail Factory And Hundreds Of Jobs," *Office of the Mayor, City of Chicago,* July 07, 2018

August to actively support increased cooperation with China.[33]

**III. The Future of the US-China Trade Conflict**

Going forward, where does the trade conflict lead? It is widely understood in China that the midterm elections feature prominently in President Trump's decision to wage a trade war against China even if doing so hurts American industries and workers. Given the current strength of the US economy, the administration may assess that some localized pain is tolerable and bet on a tough stance towards China will help mitigate negative impacts of the president's legal troubles. From a broader perspective, it is also worth noting that among wider circles of the US establishment and policymaking community, there has been a bi-partisan souring on the strategy of economic engagement with China favored by previous administrations.

Given the potential for further escalation, it is important that the US government looks at possible outcomes and assess the damage to the health of American growth and the wider global economy. To assess this highly tenuous development, this section uses an analytical framework depicting three potential scenarios of the trade war. In the first (best-case) scenario, the two sides reach an agreement and subsequently halt the tariff measures; the second (medium) scenario forecasts a longer-term trade conflict that is nevertheless measured and contained; finally, the third (worse-case) scenario projects continued escalation into an all-out trade war.

*First (Best-case) Scenario – agreement reached and the trade war averted*

This best-case scenario predicts that the trade war will be contained with an agreement reached between Beijing and Washington in 2018. Difficult it is to achieve a breakthrough in 2018, as many have foreseen, yet the potential for both sides to cooperate with each other is undeniable. For starters, the history of US-China trade relations witnessed disputes of even higher magnitude over 301 Investigation with all of them resolved through negotiations. And thus far, the two sides have all expressed willingness to engage in talk. President Trump once said, "Hopefully, this trade situation will be resolved, in the end, by myself and President Xi of China, for whom I have great respect and affection."[34] Even if the desired outcome would require a change of Mr. Trump's basic stance but it is not impossible, as the President has surprised markets in the past. He reached an agreement with Mexico and declared victory even though there are no substantial Mexican concessions to the US.

Politically, if the trade war against China is mostly a move designed for midterm elections, there remains probability for the president to tack after Americans go the polls on November 6. Regardless of results, Mr. Trump would have to re-focus on his domestic and international agenda over which China might prove to be a desirable partner, say, the USD 1 trillion infrastructure plan and North Korea. The post-midterm president might need to gain broader support from across the aisles and ease the trade pressure on China. Recession risks are being forecasted for 2019 due to the US business cycle and the economic headwind could exacerbate the pain caused by the tariffs. Given the mounting farmers' concern about losing the market they've been cultivated for over 30 years for good, it makes sense for President Trump in 2019 to tune down on the trade war to avoid the US multinational firms' rebellion that could hurt his political base. As early as the end of November this year, Mr. Trump may signal reconciliation and goodwill in meeting with President Xi at the G20 summit in Argentina,

---

[33] "California Seeks Strong Ties Despite Tensions," *China Daily,* August 02, 2018

[34] "Statement from the President," *White House*, September 17, 2018

paving the way for reaching agreement between the two largest economies in the world.

On the other hand, the Chinese position has always been that China does not want a trade war but not afraid of fighting one. President Trump has yet articulated a clear objective for the trade sanction against China. Nevertheless, from previous negotiations, four issues have surfaced as points of contention that locked the two sides in the stalemate – trade deficit, market access, forced technology transfer and intellectual property protection, and the industrial policy known as Made in China 2025. Although China stands firm on making no concessions to "trade bullying," however, from the Chinese perspective, Beijing has in fact made positive gestures to address the American concerns in the negotiations.

First off, on the issue of trade deficit, during the round of trade talk in June, Chinese vice premier and chief negotiator Liu He had offered to buy USD 70 billion worth of US agricultural and energy products while the Trump administration pressed China to cut its trade surplus with the US by USD 100 billion earlier in March. The gap was not unbridgeable from the beginning, not to mention the deal worth USD 250 billion signed during President Trump's state visit to China last November. Furthermore, US restrictions on exports of technology products to China is an important factor that contributes to the current trade imbalance. According to a study by Carnegie Endowment for International Peace, a third of the deficit with China could be reduced by lifting export control to China to a level equivalent to France.[35]

Secondly, since President Xi Jinping vowed to further open China's market at Boao Forum for Asia, there have been significant moves made by the Chinese government to materialize reform measures. For instance, a timeline for implementing the 11 items of financial opening was announced in April. In June, the State Council's directive on foreign investment was followed by a new negative list released by the National Development and Reform Commission and the Ministry of Commerce cutting almost one fourth of the restrictive regulations in 22 sectors. Tariff cuts on automobile products went into effect on July 1 along with some 1700 other American consumer goods. Several days later, Shanghai issued a program consisted of 100 policy items pushing to increase market access for foreign companies. Tesla's Shanghai plant, for example, is a wholly foreign-owned enterprise, not a joint venture.

Thirdly, on the touchy issue of forced technology transfer, the Chinese government has made it clear it would by no means tolerate such behavior. Premier Li Keqiang said the authorities would push prosecution of any single case identified.[36] The White House report targeting China's "economic aggression," however, built the case of forced technology transfer solely on a USCBC survey in which only 19% of its member companies complained about the practice compared to 81% of those didn't. Among the companies that did complain, two thirds identified their Chinese business partners as the party requested technology transfer rather than any government authority, as one senior Chinese trade expert observed.[37]

As China seeks to develop a more advanced economy, protecting intellectual property serves its own interest. Therefore, there is no irreconcilable difference between the two sides. As a matter of fact, the Chinese

---

35 Li Bin and Yang Xiao, "Political Barriers in U.S. Exports to China and U.S.-China Trade Deficits," *Carnegie Endowment for International Peace*, April 10, 2017

36 https://cn.reuters.com/article/china-likeqiang-ip-protection-0828-idCNKCS1LD11N

37 "2017 Annual Member Survey," *US-China Business Council,* Dec. 6, 2017. This point has been repeatedly made by Mr. He Weiwen, a retired senior trade diplomat and a senior fellow of CCG.

government has made substantial progress on intellectual property protection over the years. In 2017 alone, China paid a total of USD 28.6 billion in loyalties and license fees for foreign proprietary rights, 15 times increase from the amount committed since the WTO accession in 2001.[38] The IP judicial system was further reformed, establishing three intellectual property courts in Beijing, Shanghai and Guangzhou with cross-regional jurisdictions in 15 cities, and a national level appeal mechanism is under process.[39]

According to an article published in *The Diplomat*, foreign companies fare just as well in enforcing IP rights in trial as privately-owned Chinese firms. Today win rates for foreign companies bringing patent infringement cases in China average around 80 percent and injunction rates average around 98 percent. In terms of policy, in Dec. 2017, China finished a four-month nationwide campaign and coordinated 12 government agencies to protect the IP rights of foreign firms.[40] The State Council has also set up a National Leading Group for Combating IRP Infringement and Counterfeits under the lead of a vice premier to actively promote a long-term enforcement mechanism.[41] As Premier Li Keqiang vowed recently, "we will further strengthen law enforcement and introduce a more rigorous mechanism of punitive compensation for IPR infringements to deter violations and better protect innovators from all sectors."[42]

Lastly, China will not yield its right to upgrade its industry for sure but it does not mean the Made in China 2025 should be viewed through the prism of Cold War. Originated in the Ministry of Industry and Information Technology, the initiative was presented as a vision rather than the sort of Five-Year plan supported by concrete administrative measures and budgetary allocation. From the Chinese perspective, the initiative has attracted much undeserved attention. Made in China 2025 is neither a Chinese plan to seek technology primacy nor is it upheld as a distinctive model of innovation. In fact, the Chinese government has unequivocally welcomed the participation of foreign companies.

China's vast market demand for American imports means a better deal is always on the table. In 2017, Chinese consumers bought 1.21 million cars imported from the US, nearly one tenth of all automobiles manufactured in the US. A research team at Tsinghua University estimates that an increase of 3 million US auto imports would result in a USD 100 billion reduction in the deficit and revival of auto industry and jobs in places like Detroit along the so-called "rust belt."[43] In May, China pared down import taxes on cars from 25% to 15%. Chinese initiative to further lowering tariffs could be could be achieved as China furthers its reform.

China's ever growing appetite for energy products points to another reason that the trade war escalation can be contained. US oil exports are exceeding those of the OPEC countries due to the advancement of fracking technique. China was the third-largest customer for US LNG in the first half of 2018 with vast potential to increase purchase. A study commissioned by the Trump administration in July concluded that higher LNG export volumes would accelerate American growth. A proposed 25% duty on US LNG in response to the USD

---

38 "China's MOC issues statement on US Section 301 investigation," *MOFCOM, PRC*, July 13, 2018

39 Shen Liu, "Latest Progress in China's Intellectual Property Protection," *Lexology,* May 16, 2018

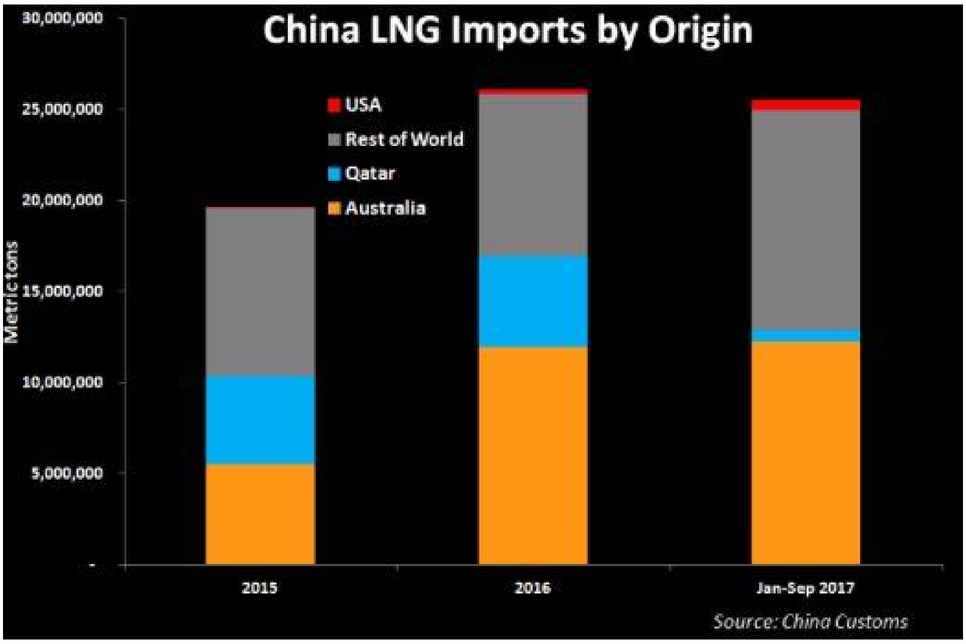
40 William Weightman, "China's Progress on Intellectual Property Rights (Yes, Really)," *The Diplomat*, January 20, 2018

41 "Guangdong Launches Campaign against Infringements and Counterfeits", *The State Council Information Office of the People's Republic of China*, November 12, 2015

42 "Chinese Premier Li Keqiang's speech from #AMNC18," *World Economic Forum*, September 20, 2018

43 Report on Strategies for the Sino-US Trade and Economic Relations, *Center for China and World Economy of Tsinghua University*, July 2017

200 billion list could depress LNG exports to China and inflict a real cost to the US economy.[44] The USD 250 billion deal offered to President Trump during his state visit to Beijing in November 2017 included a USD 65 billion LNG project in Alaska and a USD 83.7 billion investment in West Virginia's shale gas development and chemical engineering manufacturing. The opportunities in US energy sector lost in the bilateral trade tensions could be recovered to slow down the spiral of escalation.




*Source: Reuter*

**Figure 7. China LNG Imports by Origin, as of September 2017**

Considering that the differences between the two sides are not unbridgeable if China's efforts to improve its business climate for foreign business are properly registered, a superior scenario is still a possible outcome under which China commits to further opening its service sector and increases imports from the US, while also investing in job-creating manufacturing sector and helping the US upgrade its infrastructure. This outcome is the most rational and desired outcome for both sides and considerable attention will be placed on the prospective meeting between the two leaders at the multilateral G20 setting in late November this year.

*Second (Medium) Scenario – periodic escalation and de-escalation into the future*

Another likely outcome of the trade conflict – of equal probability, is a "muddle through" situation in which the two sides neither reach an agreement nor engage in an all-out trade war. In this scenario, the current trade conflict between the two countries is likely to linger into the future, turning into a "new normal" in the

44 "Trade war with China threatens US gas ambitions," *Wall Street Journal*, September 18, 2018

bilateral relations. The next few years will probably see periods of escalation alternating with times of conciliation under rounds of threats and talks. On the one hand, as basic economics reveals, US trade deficit with China is shaped by macroeconomic factors and the structure of the world economy. The task of achieving trade balance is neither sensible nor feasible within a short period of time. If President Trump's metrics for reaching an agreement with China remains reducing the US-China deficit down to zero, that is indeed a mission impossible. He has already indicated that he has "no time frame" to end the trade war and he expected the conflict to be "a long horizon." On the other, China has been identified by the administration as a strategic rival to the United States. The American anxiety over China's technological rise could find its way into the trade dispute, exacerbating it into a protracted conflict.

As the trade conflict drags on into a prolonged escalation-de-escalation cycle punctuated with temporary tension and relief, the Chinese government will likely grow to respond to the president's brinksmanship with more ease. Given the complexity of trade between the two countries, China's retaliatory measures could go beyond tariffs. For example, according to a retired Chinese finance minister, halting exports to the US of components that are crucial to American company's supply chains is one of the options.[45] US multinationals in China that produce computer and electronics exports locally, already a victim of the first round of tariffs targeting China's high-end manufacturing sector, will face a more precarious regulatory environment.

Moving production out of China will take years of planning and negotiations, in some cases cost billions of dollars and significant loss of Chinese market share. According to the studies released by the National Committee on U.S.-China Relations, the amount of the US investment in China reached USD 14 billion in 2017, an increase of USD 200,000 since 2016.[46] US firms investing in China generate nearly USD 500 billion in sales annually. For many of them, China is their biggest and fastest growing market. In a growing number of sectors, it is simply not a viable strategy to shun the Chinese market, according to a research consultancy.[47] The huge stake means this group will be a critical mass keeping the trade dispute from spinning out of control.

China's own drive to deepen its Reform and Opening-up program is another de-escalatory factor. Domestic discourse on the US-China trade war reflects a near consensus within China's elite circles that the best response to American pressure is for the policymakers to concentrate on domestic reforms that would in the end reinvigorate the private sector to redress the structural imbalance in the Chinese economy. At a recent conference attended by vice premier Liu He, a group of heavyweight economists and government officials publicly debated about the role of the state in China's economy.[48] The annual high-level China Development Forum held in mid. September saw a rare gathering of heads of the NDRC, finance ministry, PBOC, and commerce ministry talking about tax reform, financial liberalization, market openness and other issues central to the reformist agenda.[49] Premier Li Keqiang reaffirmed in his speech at the World Economic Forum in Tianjin that the Chinese government will "further widen market access, raise policy transparency, and exercise fair and impartial regulation to create a market environment in which companies of all ownerships, be they Chinese or

---

[45] "Trump Hits China with Tariffs on $200 billion in Goods, Escalating Trade War," *New York Times*, September 17, 2018
[46] "American companies in China have much at stake in the trade dispute," *CNBC,* April 10, 2018
[47] Arthur Kroeber, "An Irresistible Trade Policy Meets Immovable Interests," *Gavekal Dragonomics*, September 12, 2018
[48] http://finance.sina.com.cn/zt_d/50ren20th/?vt=4&pos=108&his=0
[49] http://sd.ifeng.com/a/20180327/6460269_0.shtml

foreign-owned, are treated as equals and compete on a level playing field."[50]

*Third (Worst-case) Scenario – escalation into a full-blown trade war*

President Trump has already threatened a further round of tariffs on US$267bn of Chinese goods, in addition to the levies on US$200bn and US$50bn executed. If materialized, the taxes will cover the entire volume of Chinese exports to the US. Such an escalation would provoke further retaliatory measures from China. As the world's two largest economies, the United States and China collectively account for almost 40% of GDP and contribute over 40% to global growth. A full-scale US-China trade war will not only produce negative impacts on the two respective economies but also greatly disrupt the global value chains and stunt much-needed global growth.

Scenario analysis by Morgan Stanley predicts that if US tariffs of 15%, 30% or 45% are applied to all products of Chinese origin, the resultant decline in Chinese exports to the US would be 21%, 46% and 72% respectively, while China's total exports would fall by 4%, 8%, and 13%. Industrial Securities estimates that if tariffs of 30% are applied, the negative impact to China's GDP will be 0.64 percentage points. If the trade war continues to escalate, it could cause a significant shock to the Chinese economy, potentially dragging annual growth down to 5%.[51] Morgan Stanley estimates the direct negative impact of the trade war on US economic growth to be between 0.3 and 0.4 percentage points – no less than the impact on China, and potentially more severe. In July, the average forecast of economists put the probability of the US economy entering a recession next year as the highest since November 2016. 69% of economists think the economy is facing downside risks due to the threat of a trade war.[52]

US consumers also stand to lose. Notably, the list of products that could be targeted by the USD 267 billion round of tariffs includes more consumer products such as furniture, luggage, inflatable vessels, bicycle parts and burglar alarms. If imposed, these tariffs would have a larger impact on American consumers than the tariffs already implemented, which focus on manufacturing components.


[50] "Chinese Preimer Li Keqiang's speech from #AMNC18," *World Economic Forum*, September 20, 2018

[51] "Rising Risk of Protectionism: Measuring the Impact," *Morgan Stanley*, January 2017; "Trade Tensions: Lingering for Long," *Morgan Stanley*, July 2018

[52] "Economists Worry a Trade War Could Derail US Growth," *The Wall Street Journal*, March 15, 2018

*Source: PIIE*

**Figure 8. US tariffs on Chinese imports: product composition for the $267bn list**


*Source: Bureau of Labor Statistics via FRED*

**Figure 9. Trends in the change of Consumer price**

The fallout from a full-scale trade war could also be intensified by weaker levels of business investment and higher borrowing costs as central banks raised interest rates, compounding the hit on growth. Bank of America Merrill Lynch has warned that a trade war would disrupt supply chains and decline in confidence, amplifying the trade shock and potentially leading to a global recession. Some analysts point out that the shock to asset markets is likely to be more serious in the US than China. While China's stock market is low, the US stock market has risen rapidly since the 2008 global financial crisis. US publicly-listed companies are far more dependent on profits from China than Chinese companies are on US profits. According to estimates by Capital Economics, if a full-scale trade war were to impact US GDP by around 1 percentage point, the profits of US multinationals would suffer by a much higher proportion.[53]

This vulnerability was reflected by the evaporation of more than USD 1 trillion value of US companies between March 1 and April 6 of this year following the imposition of steel and aluminum tariffs and corresponding countermeasures by other countries. Since the second quarter of 2017, the US PCE (personal

[53] "It's Time for Republicans to End Trade War" *The Week*, July 12, 2018

consumption expenditure) indicator has been rising. Inflation would be boosted by a tenth of a percentage point by this time next year if a full 25% levy on USD 200 billion of Chinese goods is imposed. If taxes to a further USD 267 billion of Chinese imports slapped, inflation would be boosted by a total of a quarter point.[54] 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 current US bull market is the second longest since the WWII. Data shows that US households are far more dependent on financial assets than Chinese households, meaning that those in the US would suffer more due to negative impacts on share prices.[55]


*Source: Bureau of Labor Statistics via FRED*

**Figure 10. Personal consumption expenditure price index in 2018**

Weighing the trade war from a purely national economic perspective is not enough, one needs to adopt a global perspective and consider the impact on the rest of the world both now and in the future. China is at the end of many global value chains, which include inputs from countries and regions such as the US, Japan, South Korea and Taiwan. This means that tariffs against China will also hurt economies that feed into China through upstream supply chains. For example, China is a major destination for Korea exports of components, meaning that if Chinese exports to the US were to fall by 10%, Korea's exports to China would fall by around USD 28 billion. A recent survey by the European Union Chamber of Commerce in China finds, the US-China trade war is causing significant disruptions to global supply chains and is seriously impacting companies that are neither Chinese nor American.[56]

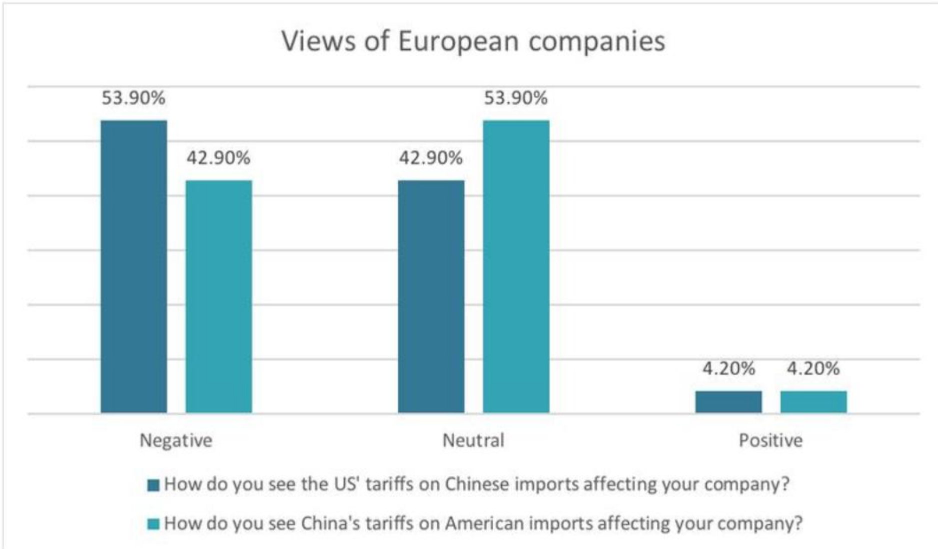
---

[54] "US port weighs cost of Donald Trump's trade war," *Financial Times*, September 20, 2018

[55] Ha Jiming and Deng Yangmei, "China-US Trade Conflict and Its Impact on the Two Economies," in *US-China Economic Relations: From Conflict to Solutions*, CF40-PIIE Joint Report, June 2018

[56] "European Union Chamber Survey and Analysis on US-China Tariff Effects," *The European Union Chamber of Commerce in China*, September 13, 2018

Survey results and analysis




Source: European Union Chamber of Commerce in China)

**Figure 11. Views of European companies on the China- US trade war**

In September, IMF Managing Director Christine Lagarde warned that as well as triggering vulnerabilities in China's Asian neighbors, a US-China trade war could also deliver a shock to already struggling emerging markets such as Turkey, Argentina, and Russia via a domino effect on global value chains and the impact on risk appetite around the world.[57]

Analysts also point out the danger of contagion and spreading use of tariff measures if the US strengthens its protectionist stance. JP Morgan Chase developed three models under which the US is assumed to raise tariffs on all imports by 10 percentage points. The first model assumes no retaliation; in the second, countries targeted by US tariffs impose matching tariff increases on imports from the US; in the third model, a full trade war, all countries raise tariffs by 10 percentage points. Under these three models, the resulting decline in global GDP growth is 0.2, 0.4, and 1.4 percentage points respectively.[58] The OECD has issued a similar warning, saying that if the US, China and EU raise trade costs for all partners on all goods by 10 percentage points, it is estimated that global GDP would fall by 1.4% and global trade would fall by 6%.[59]

Work by the IMF predicts that if threatened trade barriers are implemented, each country could see the cost of imports rise by 10%, leading to a 15% contraction in global trade over five years and 0.5% fall in global output compared to the projected level by 2020.[60] The European Central Bank and Bank of Korea have already revised down their growth forecasts for the Euro area and Korea respectively due to the introduction of tariff measures.

---

57 "US-China Stand-off Poses Risk to Developing World, Warns Lagarde," *Financial Times*, September 12, 2018
58 "What a Full-out Trade War Would Cost the Global Economy" *CNBC*, July 2, 2019
59 "Making Trade Work for All," *OECD*, May 2017
60 "Trade War Imperials World Growth as IMF Sees 'Complacent' Markets" *Bloomberg*, July 16, 2018

A report by the Brookings Institution forecasts that a relatively minor global trade war where tariffs rise 10% would reduce GDP of most countries between 1 and 4.5%. The authors of the report warn that a 40% hike in tariffs could cause a deep global recession akin to the Smoot-Hawley tariff of 1930.[61] Meanwhile, Roberto Azevêdo, director general of the World Trade Organization, emphasizes that a trade war would hurt people all over the world, citing research that found that the poorest consumers could lose up to 63% of their spending power.[62]

**IV. CCG Recommendations on Resolving the US-China Trade Dispute**

The preceding sections outline how economic cooperation between the US and China has brought significant benefits to both countries and their citizens over the past four decades; how the ongoing trade conflict has incurred damage to US, China and world economy; and how the future of the trade conflict will play out in three possible scenarios. As the world's two largest economies, the US and China collectively account for almost half of global GDP, underwriting global prosperity. A trade war between the two will inevitably lead to a lose-lose outcome, harming not only both countries but also the global economy at large. While the specter of competition between these two powers cannot be easily dispelled, the bilateral economic relationship needs not be zero-sum.

To foster mutual understanding on resolving the trade conflict, CCG puts forward the following recommendations.

***1. Build on the agreements already reached through bilateral negotiations and work to increase Sino-US bilateral trade and opportunities in services trade***

During the third round of talks in early June 2018, China committed to import USD 70 billion worth of US agricultural, energy and manufactured products in the first year of the agreement being implemented. Both sides should make a concerted effort to address the current trade imbalance, with China increasing imports of US goods and the US loosening export restrictions that currently depress sales of certain products to China. The US and China should adhere to the consensus reached in the June agreement. As China stands by its USD 70 billion commitment to increase imports from the US, in turn, the US should return to the negotiating table. The US-China trade imbalance is not an issue that can be resolved overnight and must start by taking these initial steps to gradually redress the trade imbalance.

In 2017, the consumption sector contributed RMB 36.62 trillion (approximately USD 5.3 trillion) to the Chinese GDP, compared to the RMB 15.33 trillion (approximately USD 2.25 trillion) by exports. With the growing spending power of China's expanding middle class, the US strengths in services will likely translate into an ever-growing US surplus in trade in services with China. Regarding tourism, the annual number of visits by Chinese citizens to the US is almost 3 million, contributing USD 33 billion to American GDP. Increasing the number of US-bound tourists would boost the American tourism economy.[63] Chinese students studying in the

[61] Warwick J. McKibbin,"How Countries could Respond to President Trump's Trade War," *Brookings Institution*, March 5, 2018
[62] "WTO Head Offers to Mediate Between China and US over Trade War," *The Guardian,* September 19, 2018
[63] "China Claims Its Citizens are 'Reluctant' to Travel to US Given Trade War, Safety Concerns," *CNBC,* July 12, 2018

US are estimated to contribute up to USD 40 billion to US annual GDP.[64] There is a fertile ground for Sino-US cooperation in the field of education. For example, the private Chinese company VIPKID has invested USD 500 million in the US employing 60,000 American teachers while helping to cultivate cultural ties between China and the US.[65]

China's online retail market is the world's largest with approximately USD 630 billion of sales in 2015.[66] According to China's Ministry of Commerce Retail web sales totaled RMB 7.18 trillion yuan (USD 1.149 trillion) in 2017, an increase of 32% from RMB 5.43 trillion yuan (USD 869 billion) in 2016.[67] In 2016, the value of cross-border e-commerce, including the purchases from consumers and companies, accounted for 27% of total trade and the number of Chinese online shoppers who purchased from overseas websites topped 42 million in 2016.[68] The vast appetite of over 400 million Chinese consumers for fine imported products is poised to accelerate the growth of trade via cross-border e-commerce between China and America, reducing the trade deficit while creating related jobs such as logistics and operations in the US. For instance, Alibaba Founder Jack Ma previously promised to create 1 million jobs in the U.S., which was recently repealed due to the trade war.[69] China and the US can unlock this potential by actively pursuing a bilateral CBEC agreement to address issues such as customs clearance for CBEC shipments and coordinate relevant standards and trade facilitation measures.

***2. Forge a new bilateral agreement on intellectual property rights (IPR)***

IPR protection is one of the key points of the current US-China trade dispute. On this topic, there is no fundamental disagreement between the US and China: both sides support the protection of IPR and prohibit forced technology transfer. In his speech at Boao Forum for Asia in April 2018, President Xi Jinping called to strengthen protection of IPR and highlighted the reform of China's State Intellectual Property Office, which will strengthen IPR enforcement powers. China and the US could forge a new agreement on IPR protection to establish a long-term bilateral mechanism for IPR rights enforcement. At the same time, while they remain within the WTO multilateral system, the two sides can undertake bilateral negotiations under the Trade-Related Intellectual Property Rights (TRIPS) framework to further cooperate on IPR issues.

***3. Increase opportunities for US companies in China Manufacturing 2025***

China's industrial policies such as Made in China 2025 are commonly misunderstood by foreign observers. The 2025 strategy is launched by the Ministry of Industry and Information Technology. It's not like the one like the 13th Five-Year Plan and a common technological approach to update its industries as many countries including US usually do. In fact, China's push to upgrade industry and develop advanced manufacturing brings a range of opportunities for US companies with aligned strengths to participate in this development. For example, several US companies supply parts for the COMAC C919, China's first jetliner. China can help explore ways for foreign investors to participate in the initiative and highlight potential opportunities for US investors, while

64 "China Embraces WTO Rules with More Balanced Foreign Trade," *China Today*, August 21, 2018

65 VIPKid Company Profile, https://www.vipkid.com.cn/beimeishizi

66 Kevin Wei Wang, Alan Lau, and Fang Gong, "How Savvy, Social Shoppers are Transforming Chinese E-commerce", *Mckinsey&Company*, April 2016

67 "Online retail sales in China soar past $1 trillion in 2017", *Digital Commerce 360,* February 8, 2018

68 Ibid.

69 "Alibaba Founder Jack Ma Just Backed Down From His Promise of 1 Million New U.S. Jobs. Here's Why," *Fortune,* September 19, 2018

promoting free market mechanism to ensure that the initiative is in line with international norms. The US government should reconsider its export control of high-tech products toward China as well as the CFIUS reform targeting Chinese acquisitions of US companies.

***4. Seek further tariff reduction through bilateral negotiations and re-engage in BIT talks***

The economies of the US and China are deeply intertwined. Mutually reducing tariffs will stimulate economic growth in both countries and help to redress the bilateral trade imbalance. To this end, the US and China should explore avenues towards a free trade agreement, as has been initiated between the US and EU. This will help towards liberalizing both economies and resolving the US-China trade dispute by reducing the bilateral trade deficit. The US-China BIT has completed 34 rounds of talks with negative lists swapped three times. Under the BIT framework, non-tariff barriers can be addressed without curtailing prospects for continued two-way flows of capital between China and the US. The Chinese authorities can also set up an agency equivalent to the Committee on Foreign Investment in the US (CFIUS) to ensure fair treatment of US investments.

***5. Build on the foundation of domestic reforms to rebalance the Chinese and US economies as ways to achieve trade balance***

As a former vice foreign minister said, "Some requests raised by US companies, …, dovetail with recommendations from China's leaders. … Chinese reformers can turn outside pressure to their advantage, using it to bust through internal resistance to necessary changes."[70] China can in fact use the impetus of the trade war to accelerate the process of economic liberalization, including measures to reform state-owned enterprises and reduce transaction costs resulted from the state's administrative power. At the same time, China should continue to open 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.

To solve the deficits seen by the Trump administration as a big problem, the US government should consider measures to address macroeconomic factors such as increasing household savings rate and curbing national debt. The US household savings rate has continuously fallen over the past 20 years. 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 left behind in the US, a rift that played into the rise of populism and protectionism. To some extent, the trade war waged by Donald Trump is only a symptom of popular discontent in the US. Policymakers in the US should focus on domestic initiatives such as redistribution and workers retraining programs.

***6. Update the way that Sino-US trade is measured to more accurately reflect the value derived by each side***

Today's official statistical information systems, designed to measure economic activity in a pre-globalization world, can be misleading. New accounting methods should be adopted to capture the real value of Sino-US trade under 21st century configurations of global value chain development. At present, US and Chinese measurements of the Sino-US trade deficit diverge due to differences in the way they are calculated. As

---

[70] Fu Ying, "How should China respond to a changing U.S.?" *Bloomberg*, September 10, 2018

China has become an integral part of the global manufacturing supply chain, much of its exports are comprised of foreign-produced components delivered for final assembly in China. US trade deficit with China drops 30-40% in value added terms from the traditional calculation.[71] If the value of these imported components is subtracted from China's exports, the US trade deficit with China is reduced by half, to about 1 percent of GDP—about the same as the US trade deficit with the European Union, according to a study by Oxford Economics.[72] In future, methods of calculating the US-China trade imbalance should factor in global value chains to more accurately and fairly reflect the gains that each country makes from trade.[73]

***7. Expand cooperation in infrastructure and explore creating a Sino-US infrastructure investment fund***

There is great potential to expand Sino-US cooperation in infrastructure, particularly given the match between the Trump administration's large scale infrastructure plan and China's financial resources and considerable experience in this field. China and the US can work together to expand funding for infrastructure and promote cooperation between Chinese and US firms on infrastructure projects in the US and third countries. Lessons can be drawn from the EU's success in attracting foreign firms and capital to participate in infrastructure construction, helping to improve the operating environment for innovative models such as public-private partnerships (PPP), and building support for joint US-China projects through cooperation on breakthrough flagship projects. China and US can work together in establishing an infrastructure fund to help upgrade US roads and bridges through investment in bonds issued by local governments in the US.

***8. China and the US can work together to reform the WTO***

As WTO members, China and the US should conduct appeals, consultations, and negotiations under the WTO framework. If the US decides to leave the WTO, give up multilateral trade negotiations, and pursue bilateral talks, it will soon lose Most Favored Nation (MFN) status with the over 100 members of the WTO. At present, the US has Free Trade Agreements (FTAs) with only 14 countries, and these do not include the US' most significant trading partners, the EU, Japan or China. It is in the interest of the US to remain within the WTO multilateral system, and work with China to address issues that fall outside the existing scope of the WTO through bilateral negotiations. China can invite the US to establish a joint working group to modernize WTO agenda as it did with the EU earlier in July with a commitment to joining the Government Procurement Agreement.

**9. *Strengthen Sino-US cooperation between provinces and states***

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 and the US should deepen engagement and collaboration at the sub-national level, including

[71] Global Value Chain Development Report 2017, World Bank Group, IDE-JETRO, OECD, UIBE, WTO

[72] "Understanding the US-China Trade Relationship," *US-China Business Council by Oxford Economics*, January 2017

[73] According to a Deutsche Bank report, the aggregate sales of Chinese companies to the US (defined as Chinese exports to the US plus sales in the US by subsidiaries of Chinese companies) in 2015 amounted to US$402 billion (US$393 billion in exports and US$10 billion in subsidiary sales). In contrast, the aggregate sales of US companies to China in the same year were US$372 billion (including US$150 billion in exports and US$220 billion in sales by US subsidiaries in China). In other words, the US deficit with China in 2015 amounted to only US$30 billion in terms of aggregate sales. Ha Jiming and Deng Yangmei, "China-US Trade Conflict and Its Impact on the Two Economies," in *US-China Economic Relations: From Conflict to Solutions*, CF40-PIIE Joint Report, June 2018

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, especially in the field of infrastructure funding.

### *10. 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 will create effective bridges for bilateral dialogue, help to dispel miscommunication, and generate positive plans to resolve differences. Think tanks in both countries have a role to play in this engagement. To play this role more effectively, the Chinese and US think tanks can work together through regular visits, studies and reports, so that they can provide solid support for policymaking.

As President Xi Jinping once said, “There is no such thing as the so-called Thucydides trap in the world. But should major countries time and again make the mistakes of strategic miscalculation, they might create such traps for themselves.”[74] An all-out trade war resulted from unbridled strategic mistrust between the two great powers will behoove either side and pose a threat to global welfare. Washington should not lose sight of the fact that China is not adopting a more confrontational stance toward the US and is always seeking ways to foster win-win cooperation with America to serve the interests of both countries. Drawing on the past four decades’ success of bilateral economic partnership, the current trade dispute should be approached from both sides’ focusing on making the economic pie bigger. America and China are often described as a proverbial couple – conflicts and altercations are normal, a divorce hurts both. Perhaps this is the reality that will ultimately set in.


## CCG Research Team：

**Wang Huiyao, Miao Lu, Tang Beijie, Li Weifeng, Xu Haiyu, Nie Ligao, Li Yichao, Ying Heng, Ogborne Jung Yul Mark**


[74] http://international.caixin.com/2015-09-23/100855626.html

**Appendix：the Timeline of the unfolding the US-China trade war**

| | |
|---|---|
| April 6-7, 2017 | • President Trump and President Xi meet for the first time at Mar-a-Lago.<br>• New high-level dialogue framework established to replace the Strategic & Economic Dialogue. Covers four components: 1) diplomacy and security; 2) economics and trade; 3) law enforcement and cybersecurity; and 4) social and people-to-people exchange.<br>• The two sides adopt a 100-day plan to increase US exports to China and reduce the bilateral trade deficit. |
| May 5, 2017 | • US-China Economic Cooperation 100-Day Plan released. Among 10 agreed items, China commits to working to allow in US beef imports and allowing foreign payment providers to begin the licensing process for electronic payment services. |
| July 7-8, 2017 | • President Trump and President Xi meet after the closing ceremony of the G20 summit in Hamburg. |
| August 14, 2017 | • President Trump instructs USTR to launch the Section 301 investigation of China's unfair trade practices, in particular, whether China is infringing US intellectual property rights. |
| October 30, 2017 | • US Department of Commerce declines to grant Market Economy Status to China. |
| November 8, 2017 | • President Trump's visit to China, his first as president, sees 34 deals signed between US and Chinese companies, with a total value of USD 253.5 billion. |
| January 22, 2018 | • Trump administration applies tariffs to imports of washing machines and solar panels of 50% and 30% respectively. |
| February 16, 2018 | • Based on national security justifications, the Trump administration announces tariffs on imports of steel (25%) and aluminum (10%) under Section 232. |
| March 23, 2018 | • Based on Section 301 investigation findings, the Trump administration announces tariffs of 25% on Chinese imports worth USD 60 billion annually, including aeronautics, modern rail, new-energy vehicles and high-tech products. |
| April 1, 2018 | • China's Ministry of Commerce announces tariffs of 15% or 25% on 128 products imported from the US in response to Section 232 tariffs on steel and aluminum |
| April 4-5, 2018 | • China launches WTO dispute resolution procedure to initiate consultations on US Section 232 tariffs on steel and aluminum |
| April 10, 2018 | • At the Boao Forum for Asia, President Xi pledges that China will take major steps to open up, significantly reducing restrictions on market entry, creating a more attractive investment environment, strengthening protection of intellectual property rights, and actively increasing imports. |

| | |
|---|---|
| April 17, 2018 | • The US Department of Commerce announced measures to limit exports to ZTE, prohibiting ZTE from purchasing sensitive products from US enterprises. |
| April 19, 2018 | • China's Ministry of Commerce announces it is investigating the merger of Qualcomm and NXP |
| May 3-4, 2018 | • US economic policy team visits Beijing for trade talks, including Treasury Secretary Steven Mnuchin, Commerce Secretary Wilbur Ross, US Trade Representative Robert Lighthizer, White House Economic Council Larry Kudlow, Ambassador to China Terry Branstad, and White House Trade Advisor Peter Navarro |
| May 15-19, 2018 | • Chinese Vice Premier Liu He visits the US for trade talks with the US economic team |
| May 29, 2018 | • White House releases *Statement on Steps to Protect Domestic Technology and Intellectual Property from China's Discriminatory and Burdensome Trade Practices*, announcing it will implement specific investment restrictions and enhanced export controls for Chinese persons and entities related to the acquisition of industrially significant technology. The statement also says the US will impose a 25% tariff on USD 50 billion of Chinese goods containing industrially significant technology. |
| June 15, 2018 | • US releases first list of products of Chinese origin to be subject to tariffs, officially confirming tariffs of 25% on USD 50 billion worth of imports from China. |
| June 18, 2018 | • President Trump requests US Trade Representative to identify USD 200 billion worth of Chinese goods for additional tariffs of 10%. |
| June 27, 2018 | • White House publishes CFIUS reform plan, announcing that a strengthened national security review process will be used to scrutinize foreign acquisitions of sensitive American technologies |
| July 6, 2018 | • US begins collecting 25% tariff on 818 imported products valued at USD 34 billion, bringing into effect the first round of tariffs announced on June 15 |
| July 7, 2018 | • China responds to US tariffs by imposing 25% tariff on 545 goods originating from US. |
| July 10, 2018 | • USTR releases statement on Section 301 investigation. |
| July 10, 2018 | • US releases third list of products originating in China worth USD 200 billion that will be subject to a 10% tariff. |

| | |
|---|---|
| July 13, 2018 | • China's Ministry of Commerce releases a six point rebuttal statement in response the July 10 USTR statement on the 301 investigation. |
| July 16, 2018 | • China's Ministry of Commerce makes an additional charge to the WTO against the US for its Section 301 investigation and its suggestions to levy tax on USD 200 billion worth of products that originate in China. |
| July 20, 2018 | • President Trump threatens to apply tariffs to all products imported from China. |
| August 1, 2018 | • US Department of Commerce adds 44 Chinese entities to its export control list that pose a "significant risk" to US national security. |
| August 3, 2018 | • China's Ministry of Commerce proposes a range of additional tariffs of 5% to 25% on products originating from the US worth USD 60 billion |
| August 8, 2018 | • US releases a revised version of tariffs on a final list of USD 16 billion worth of imports from China to be subject to 25%.<br>• China's Ministry of Commerce announces a reciprocal 25% additional tariff on USD 16 billion worth of US exports to China. |
| August 14, 2018 | • China's Ministry of Commerce announces that a case has been lodged at the WTO against the US for its tariffs on solar panels |
| August22-23, 2018 | • US Treasury Under Secretary David Malpass and Chinese Commerce Vice Minister Wang Shouwen meet in Washington DC to discuss ways to resolve the deepening trade conflict and escalating tariffs. Discussions end with no major breakthroughs. |
| August 23, 2018 | • US implements a 25% tariff on products originating from China worth USD 16 billion<br>• China implements retaliatory tariffs of 25% on goods originating from the US worth USD 16 billion |
| September24 2018<br>September24 2018 | • US implements a 10% tariff on Chinese imports worth USD 200 billion<br>• China responds to new US tariffs by imposing 5%-10% tariffs on US imports worth USD 60 billion.<br>• Soon after the new tariffs imposed by the US and China take effect, China's State Council releases a white paper titled "Facts and China's Position on China-US Trade Friction". The paper outlines key facts and China's position on the trade dispute, stating that China believes "cooperation is the only correct option for China and the United States, and only a win-win approach will lead to a better future. China's position is clear, consistent and firm." |

# CCG China-US reports series

**December 2016** Understand the Anti-Globalization and Promote Inclusive Globalization

**December 2016** FTAAP: Past-TPP Era's Best Choice

**January 2017** Trump's Coming Era: Challenges, Opportunities and Policy Responses

**April 2017** Infrastructure Cooperation – New Opportunities for US-China Relations

**November 2017** 12 Suggestions for Building Stable, Balanced and Win-win Sino-US Relations Based on CCG Fieldwork in US

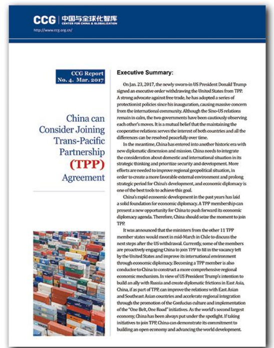
**March 2018** 10 Suggestions to Ease Tensions and Sustain a Stable Sino-US Trade Relationship

**July 2018** Understanding the US-China Trade War: Analyses and CCG Recommendations

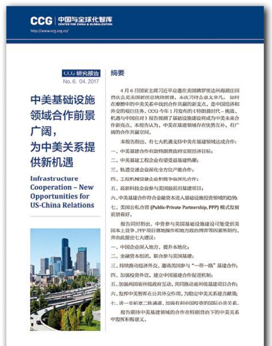
**September 2018** China-US Trade Relations and Challenges: Past, Present, Future and Policy Options

# CCG Related Reports

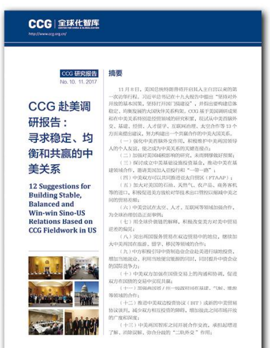


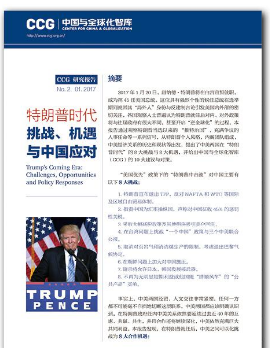











CCG | 全球化智库
CENTER FOR CHINA & GLOBALIZATION

Global Vision for China, Chinese Wisdom for the World

**ABOUT CCG**

The Center for China and Globalization is a Beijing-based premier Chinese independent think tank. Founded in 2008, today over 100 in-house researchers and staff serve this thinking hub with 5 regional chapters and 5 overseas representatives. CCG’s research agenda centers on globalization, global governance, international relations, and globalization of talent and Chinese enterprises. It has published numerous monograms, edited volumes, research reports and policy papers with broad public policy impact. The center is a magnate for a constellation of prominent figures from academia, business and policy-making communities at home and abroad.

In the 2017 “Global Go To Think Tank Index” by the University of Pennsylvania Think Tank and Civil Society Program (TTCSP), CCG ranked 92 of the top think tanks worldwide, representing the first Chinese independent think tank to break into top 100 in history. CCG has been consistently ranked by the annual Go To Think Tank Index along with several domestic research institutions as one of the highest ranking independent think tanks in China. CCG has been granted special consultative status by the United Nations ECOSCO.

Twitter
@CCG_org

Facebook
CCGthinktank

LinkedIn
https://www.linkedin.com/company/7439095

Hanwei Plaza, Room 15B5, No.7 Guanghua Road Chaoyang District, Beijing, China
Phone: 0086-10-65611038
Fax: 0086-10-65611040