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*The Rise of Trump and Its Global Implications*

## **US-China Economic Ties Under Trump: Need for More Balance**

*By Phidel Vineles*

### **Synopsis**

*The US under Trump bemoans its trade deficit with China as a serious economic threat. Should it be a justification for the Trump administration to impose protectionist measures against China?*

### **Commentary**

ON 6 APRIL 2017, United States President Donald Trump and his Chinese counterpart Xi Jinping met in Florida for a special summit. They trashed out key issues they assessed could lead to rising tensions between them. One of these was the trade imbalance between the two giant economies which both leaders agreed to address over the next 100 days.

The goal is to improve the trade balance by increasing US exports to China and not by limiting Chinese exports to the US. Although the 100-day plan could avert a trade war between the world's two largest economies, implementation of protectionist measures by the US is still a threat. US Secretary of Commerce Wilbur Ross said that if there are no tangible results in the first 100 days, the Trump administration will examine whether it is worthwhile to continue the plan.

### **What Is At Stake?**

According to the World Bank, US consumption is the biggest in the world, with more than US\$14.88 trillion household consumption expenditure in 2015. Meanwhile,

China has the biggest total export of goods amounting to more than \$2.14 trillion in 2015. The relationship between the two economic behemoths is clear: while the US is the largest consumer and China the biggest exporter, however, there is a change of direction in both countries. The US is sliding towards protectionism while China is heading towards a consumption-led economy.

A sudden change of direction in the US economy towards protectionism could prevent it having a balanced economic relationship with China. Indeed the proposed protectionist policies of the Trump administration could harm the US economy. Moreover, it could also brush aside a more balanced trade relationship between the two countries as agreed in the US-China Strategic and Economic Dialogue (S&ED). With these uncertainties, Trump's protectionism could possibly become a big threat to the US economy.

Trump's protectionist policies could definitely hit the US economy the hardest; however, it is still more likely that the US administration will impose the proposed protectionist measures. According to a recent research study from Wall Street investment banks and law firms, there is more than 50% probability that Trump will impose higher tariffs to discourage imports from overseas factories owned by US companies. Thus, the quadrupled profits of US companies in China from 2004 to 2012, as shown by a JPMorgan study, could significantly drop.

Moreover, the US economy could be in the doldrums because of these protectionist measures. If the Trump administration imposed tariffs on Chinese goods of 45%, it would result in higher prices of goods that could adversely affect American consumers and the country's export competitiveness.

China may also retaliate by reducing the holdings of US Treasury bonds and cutting imports of US products. There are also losses to US multinational companies (MNCs) due to the increase of production costs, as they have based their supply chains in China and other emerging economies in the region.

### **Understanding the Co-dependency**

Both countries are locked in their interdependency from which both benefit. China depends on the US market for its exports, which amounted to \$161.6 billion in 2015, while the US relies on China's purchases of US Treasury securities and other US dollar-based assets. Moreover, China is the second largest lender to the US government, accounting for \$1.115 trillion US debt to China as of October 2016.

Nevertheless, their interdependency benefits both countries. China's loans to US, through the purchase of US Treasury securities, which in turn provides funds to Federal Reserve and allows US to import Chinese products. However, the former Chairman of Morgan Stanley Asia and American economist Stephen Roach pointed out that China is in the direction of a major shift from an export-led and investment-led economy to an economic model which is more dependent on consumption and services sector. Hence, it's a conundrum how the US would respond to China's shift towards a consumption-led economy if the US is still reliant on cheap Chinese goods and capital.

China's economic shift towards increased consumption started in 2011 when the 12th Five-Year Plan was enacted, which provided a framework of structural rebalancing. Thus, significant economic reforms were ratified in 2013 to support the consumption-led economy shift. Some of the important economic reforms that were ratified were modifications to the one-child family policy and also a 30 percent tax on state-owned enterprise (SOE) profits.

Moreover, China had doubled the size of its services sector over the last two decades, which accounted for about 46 percent of GDP in 2013. In this context, US needs to have a symmetrical response with the ongoing economic transformation of China.

As Roach explained, the US has to increase its domestic savings because China's consumption-led economy shift will reduce China's purchase of US Treasury securities, and the reduction of China's purchase of US Treasury securities will lessen Chinese capital in the US market that would result in high interest rates. Moreover, US' overreliance on foreign countries' demand of US Treasury securities allows the country to fund its consumption binge beyond its means.

### **Need For More Balanced Relationship**

While every country has the right to assess its foreign policy through the lens of its national interests, the Trump administration should avoid focusing only on the friction of its relationship with China. It is essential for both economies to place their S&ED process at the centre of their bilateral relationship.

In 2011, both countries agreed in the third round of S&ED to promote a more balanced trade relationship. It was agreed that China should take necessary steps to increase its domestic consumption as stated in their 12th Five-Year Plan, while US should increase its domestic savings and exports under the U S' National Export Initiative.

S&ED will also serve as an instrument for discussion on how to cope with critical issues of trade, currency exchange rates, and business environments. It could also serve as an avenue for the two big economies to discuss their potential cooperation on infrastructure initiatives, in which Chinese companies could invest. This could be a huge achievement for the US since China is seeking financial and technological cooperation from industrialised economies for its One Belt, One Road initiative.

The Trump administration blames deficits with China as a serious economic threat. However, it puts the country in a blindfold from realising that they need a stronger macro economy and a more balance relationship with China. Hence, pursuing these policy measures rather than implementing protectionist policies could help "America to become great again".

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