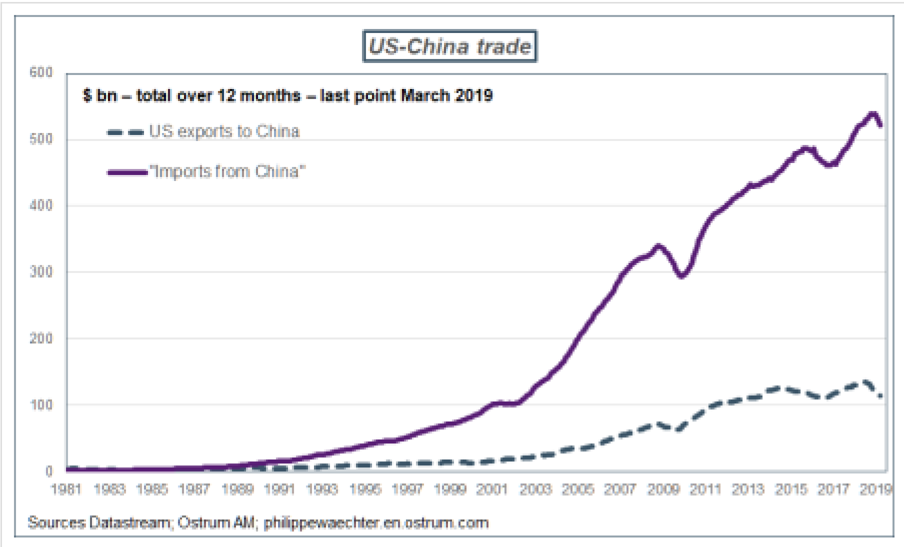
US-Chinese tension makes for a fascinating time in history

Posted on **May 20, 2019** by **Philippe WAECHTER**

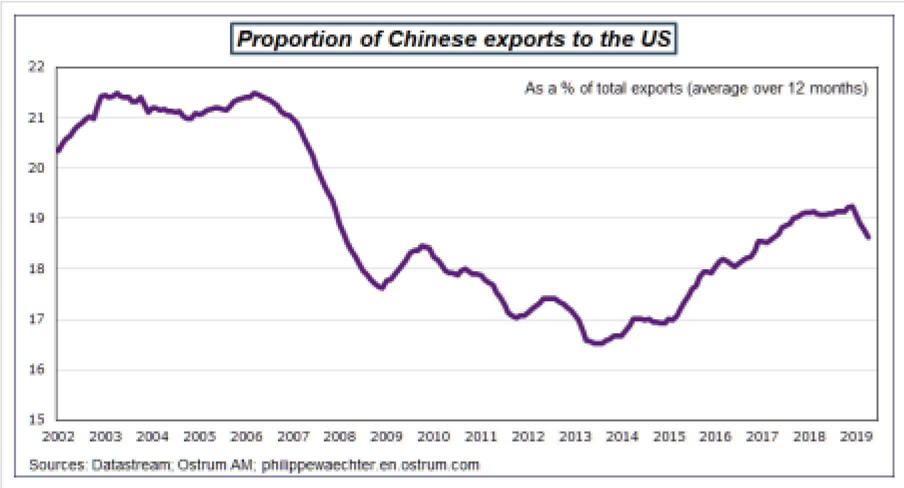
Donald Trump's tweets on May 5 fueled tension between China and the US, dramatically triggering renewed speculation on the conditions of any fresh trade deal. China retaliated to fresh US border tariffs on its goods by applying taxes to US imports. This move interrupts a long period of calm that had kicked off after the G20 meeting on December 1 (see my blog post dated February 21 2019 **here**)

Donald Trump's drive to apply fresh tariffs on China reflects his



determination to bring jobs back to the US – especially in the manufacturing sector – and also ease the country's dependence on China.
The country had a $419bn trade deficit with China in 2018 due to hefty imports of goods into the US, while conversely American companies struggled to export sufficiently to China. The chart above makes for a perfect illustration of this tricky situation for the US.
The situation recently became a lot more challenging, as the flipside of this Chinese trade surplus with the US was its financing for the US economy via US Treasuries purchases in particular. This set-up worked for a long time and it acted as a way for the two countries to remain tied together, as Chinese goods found a market in the US while China financed the US economy to make up for Americans' insufficient savings. The US-Chinese relationship was based on a complementary approach, but this balance is shifting as China's contribution to financing of the US economy has been decreasing over the past several months. In March 2019, the proportion of US financial assets held by China as part of the United States' total external financing returned to lows witnessed in June 2006.
The balance between the two countries is changing and the US can no longer have the same influence on China that it had in the past. China is standing apart and wants to achieve greater independence.

The White House is also running out of patience with China taking its time to meet its requests. By taxing Chinese imports, Washington is seeking to dent economic activity in the country, and there is a danger that this will generate severe social tension and force the Chinese government's hand, as it did not want to take this social risk. Sluggish Chinese economic indicators since the start of the year could lend credence to Washington's approach, and prompt it to take an even harder line on trade, yet this approach is not necessarily the right one.



At the beginning of 2019, the weight of the United States in Chinese exports slowed down considerably. Chinese dependence on the US is reversing, while at the same time, the Chinese are relaunching the "Belt and Road Initiative" whose objective is to further diversify the Chinese market. China is expanding its markets and is effectively limiting the influence of the United States on its economy.

The other major disagreement between Washington and Beijing is on **technology,** andin my view, this is the **main bone of contention** between the two countries. China's technology has caught up very swiftly over the past twenty years via technology transfers and by setting aside substantial resources to facilitate this fast progress. This approach worked well, and China now has some headway over the US, particularly in 5G and artificial intelligence. The United States' loss of technological supremacy is a radical change as China has the resources to develop these technologies without US support. This kind of situation could have emerged with Japan a few years ago, but Japan always remained within the US sphere of influence… the same cannot be said of China. The country has a huge domestic market, while development outside the country is vast, so this can now generate self-sustaining technological momentum.

Washington has been particularly tense on this issue over recent months, with sanctions against ZTE in April 2018, and in particular against Huawei in December 2018 attesting to this strain. European governments have also come under pressure to steer clear of Chinese technology (read **here**). More recently, Donald Trump blacklisted Huawei (read **here** – *behind paywall*), while other Chinese companies no longer have access to the US market such as China Mobile (read **here** – *article in French*).

The stakes are very straightforward – the country that decides the standards for these new technologies will gain a massive competitive advantage and be able to more easily develop innovations using these technologies. This is the stumbling block for negotiations as China has invested substantial resources to notch up this technological advantage and does not want to be dictated to by the US. Similarly, it seems unthinkable that the US would spontaneously accept China's progress and be dictated to by the country in order to use its technologies.

This technological battle of wills will not be resolved by itself. Neither country is set to give in, so an agreement looks unlikely, unless the Chinese economy takes a severe downturn, but this is not part of our scenario.
However, it does not stop there. Development of 5G for example is at the heart of a number of innovations and countries outside China and the US are developing businesses that use this technology. This means that developing these innovations on a mass scale will probably require use of Chinese technology, and this is set to trigger more tension with the US. Emmanuel Macron has already made his position clear on this issue (see statement at the Vivatech event **here**).

The dynamics of the world economy are changing, but the new world order is not going to emerge straight away. This is the first time in history we have seen this kind of situation, and the first time that the world economy could shift towards a new region as a result of technological innovation. When the center of gravity of the world economy shifted from the UK to the US, there was still a degree of continuity, but the same cannot be said of today's situation. And Europe will also have to find its place in this new order.
This transformation will overturn the dynamics of the world economy and change the entire balance between the various regions of the world.
What a fascinating time to observe world events.

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