

China US Trade War, Trade – War

I have argued since 2013 that the world had been in a trade war since at least 2009, perhaps 2007. This war was fought at various times in the FX theatre and through the re-shoring of manufacturing. Re-shoring represented a reorganization of global supply chains to locate them in the countries of the parent companies. For the US, the main re-shorer, President Obama led a campaign to help facilitate and encourage re-shoring.

The Trump Presidency has been a more belligerent actor in the trade war essentially transforming it from a Cold War to a Hot one. The weapons of choice of the Trump administration are tariffs. Tariffs differ from re-shoring in some respects. In a globalized industrial system, a product begins life in one country and encounters various transformations and value additions in various countries before finding its way to the hands of consumers in a range of countries. Re-shoring aimed to bring supply chains back to the country of origin. Under this policy, an iPhone would be designed and built in America with American components. It would then be sold domestically and abroad, representing exports. In a globally optimized supply chain, an iPhone uses components and intellectual property sourced globally from companies sourcing for components and intellectual property globally. The finished product is shipped from the final fabrication locations, and there can be several, to customers globally. The complex supply chains and end markets result in complex trade relationships, forex flows, and current account dynamics.

Tariffs are a blunt instrument as they tax imports regardless of the multiple nodes of the supply chain, nodes which could reside in the country imposing said tariffs, and its trade allies. Also, it is trivially evident that import tariffs are

paid by the residents of the tariff imposing country. Tariffs are also incendiary and invite retaliation. As tariffs proliferate they encourage companies to reorganize their supply chains. This can resemble re-shoring but whereas re-shoring involves bringing manufacturing capacity back to the home country, tariffs encourage companies to produce within the trade blocs of their target end customers. The potential for duplication of resources is high.

At risk of over generalization, in a world of increasing globalization, efficiency is rising and robustness is declining. (By robustness we refer to resilience against supply chain shocks.) In a world of declining globalization, as is likely under a trade war, efficiency is falling and robustness is increasing. Adoption of global standards becomes more difficult. Technologies and industries dependent on global standards and scale may face challenges. Balkanization of industries is a risk which can lead to duplication or incomplete networks. There is a tendency towards higher inflation as sub optimal supply chains are developed around policy and regulation. Cross subsidies of redundant capacity also raises prices.

Declining interdependency further weakens the tendency towards cooperative behaviour raising the risk of international conflict. The trade war between China and America is but one dimension of a wider competition, one for global hegemony. The nature of the competition has until the Trump Presidency been a state of Cold War and passive aggression with both countries engaging throughout their mutual competition. The Trump doctrine seems to suggest a disengagement approach. This approach appears to be part of a wider approach to dealing with the outside world as the US has engaged in various trade disagreements with Europe, Mexico and Canada. The stated intention to reduce participation in the affairs of the Middle East is further evidence of a new insularity. This approach to dealing with China is risky. It risks miscommunication and

escalation at the governmental and social level.

The Chinese approach is to build bridges while America builds walls. The insular approach of President Trump represents an opportunity for China to grow its influence. Only the size and inertia of the Chinese status quo has prevented China from furthering its influence and challenging the American hegemony. As the US abandoned the TPP, China could have replaced it, thus confounding and co-opting a project started by then President Obama to counterbalance Chinese influence. The size and depth of SOE penetration in the economy prevented China from complying with TPP standards sufficiently quickly to join the coalition. China has on its side, time. Term limits on the Chinese President have been repealed. China is not a democracy and is ruled by a single party giving it the resolve to pursue long term policies beyond the terms of any Western government. That said, on the US front, the Trump administration's position on China is largely accepted by the Democrats as much as the Republicans. This makes the China US Cold War durable. Détente is possible but improbable. The challenge for China is maintaining a coherent policy of competitive engagement with a variable US executive. The challenge for the US, is maintaining policy coherence through potentially variable domestic politics, in the face of a consistent and determined Chinese government.