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THE IMPACT OF THE US-CHINA CONFRONTATION ON THE WORLD

Toshiya Tsugami

- In addition to the US-China trade war, the Chinese economy faces serious domestic problems, including balance sheet adjustments after the investment bubble and structural discrimination against private companies. The government's strong grip on the economy will hold it up for the time being, but maintaining growth in old-fashioned ways will make the future even more difficult.

- The United States is engaged in two wars against China: a trade war and a high-tech cold war. Both have negative impacts on the international trading system that the United States has built and maintained, and will harm the national interests of the United States.

- It is wrong to justify China's industrial policy with “other countries are also doing it” because of China’s enormous economic power. Now that China has become a major power, it should graduate from the traditional mentality of “catch-up”. If the Chinese government continues to lead the country with this mentality, it could adversely affect the international order in the long-run.

China's economy continues to slow, but the US-China trade war is only one of the causes of the slowdown. There are two other reasons that are internal and more important.

First, the balance sheet recession that followed the investment bubble is coming to China.

In the 10 years from 2009 to 2018 after the collapse of Lehman Brothers, China invested an excessive amount of 446 trillion yuan (≒70 trillion USD) in fixed assets. This overstretch has resulted in a decline in investment efficiency and a deterioration in its balance sheet. This is the root cause of the recent rapid debt increase. Balance sheet deterioration must be contained, but restrained investment will further slow growth. This difficult paradox will continue for a long time.

The second challenge is the plight of private companies.

The private sector, which is the main driver of the new economy, is highly efficient and already plays a majority role in the flow of the economy, such as added value production and employment. On the other hand, the government and the state-owned sector, which represent the old economy, account for more than half of the wealth in terms of ownership and distribution of wealth despite their low efficiency. Without correcting this asymmetry, China will not be able to sustain its growth, but its vested interests are preventing reform.

The trade war between the United States and China unfortunately came in the midst of the economic downturn after the above two chronic diseases afflicting the Chinese economy.

The United States is waging two wars: a trade war led by President Trump and a high-tech cold war by a bipartisan China-hawk-led Congress.

On the trade war front, the United States and China, which account for nearly 40% of the world's gross domestic product, are imposing tariffs of more than 20% on the majority of bilateral trade, reminiscent of the Smoot-Hawley Act of the 1930s.

On the high-tech cold war front, a trade ban based on the idea of "don't sell or buy in China." is increasingly preventing technology outflow and decoupling the high-tech economies of the US and China, disrupting the global supply chain of the ICT industry.

The confrontation between the United States and China will be a war without a winner, as the textbook says.

The long-term future of the Chinese economy is not bright at all, but the strong economic power of the Chinese government, especially the customarily hidden government guarantees, can sustain it for the time being. In addition, President Trump's spectacular performance has mitigated the responsibility of the Chinese government, which is not managing the economy well in China, and helped strengthen national unity.

However, the more China maintains its old ways, the more serious the two chronic diseases become.

The world is also not entitled to criticize China for its excessive credit expansion. Declining demand in China, fears of a trade war and supply chain disruptions have made the world economy increasingly uncertain, and moves to forestall new business and investment are spreading around the world. While the real economy thus continues to deteriorate, the global financial market remains calm as monetary easing continues. It seems to be a critical patient who is escaping pain through large doses of sedatives.

The United States is shaking the international trading system that it has established. At the end of this year, the WTO Appellate Body in charge of resolving the dispute will cease to function due to US sabotage. Although the United States' security concerns about the ICT industry are widely shared, the policies that are being planned and implemented now are all moves that run counter to economic principles and will hurt its own interests.

China also has problems.

First, the Chinese government often argues that it is unfair to only criticize Chinese industrial policy while other countries are also implementing industrial policies, but it forgets that its economic power is incomparably stronger than that of other governments.

Second, even though China is now the world's second-largest economy and has grown to become a major power that threatens the status of the United States, it still maintains a strong "catch-up" mentality with which a lagging developing country is typically occupied. If Beijing continues to drive its people and economy toward catch-up goals with its powerful economy, advanced countries including the United States will be less willing to support the current international trading system. Such a move is about to begin with the collapse of the international trading system, and it could adversely affect the entire international order in the long-run. If China does not correct its excessive catch-up mentality, it will be seen as an accomplice that helped bring about the collapse of the international order.

What should Japan do? For Japan, which is in a security alliance with the United States but whose economic ties with China are crucial, it would be a disaster to be forced to make a choice between the two countries due to the escalating conflict. The situation will be similar for many countries in East Asia.

No country other than the United States and China themselves can change their course, but Japan should make it clear to the United States that “decoupling” from the Chinese economy would seriously affect the Asian, including Japan’s, economic ecosystem. It should also tell China that maintaining its current national goals will make the world unhappy. Japan should keep its position firmly in keeping its principles clear and pointing where the world should return after the upheaval.

Toshiya Tsugami is Visiting Research Fellow at the Japan Institute of International Affairs.