The US-China trade dispute is like no other

Blog post by Chief Economist Gregor Irwin, 10 August 2018

US trade policy under Donald Trump has become volatile, noisy and aggressive. This makes it hard to follow policy developments, let alone to understand what is driving them. But the key to understanding the dispute with China is to recognise it is quite different from the disputes the US has provoked with other countries. In fact, it is not a conventional trade dispute at all.

The US is not attempting to renegotiate an existing trade deal with China, as it is with NAFTA and Mexico and Canada. Nor is it attempting simply to rebalance the trade relationship, as the US now appears to want to do with the EU, even though the US has long complained about imbalances in the relationship with China. Instead, the US wants China to change its industrial policy and its entire approach to economic development. This won't be easy.

A reminder of how we got here. In August 2017, Donald Trump asked his trade team to investigate under section 301 of the Trade Act of 1974 whether China is adopting policies or practices which are harming US intellectual property rights, innovation, or technology development.

The complaints are not new –previous administrations have criticised China for forced technology transfer and a failure to protect US intellectual property, as have US businesses. But the mechanism for addressing them is, as section 301 allows wide powers for the president to intervene to counter actions deemed "unreasonable or discriminatory".

In March this year, the US trade team issued its report. It's an excoriating analysis of China's industrial and development policies, which are geared to helping the country move up the value chain from low-cost manufacturing to become a global powerhouse in science, technology and innovation.

The report details policies which the US believes are unreasonable or discriminatory, including technology transfer requirements for foreign companies investing in China, discriminatory licensing conditions, state-backed outward investments aimed at acquiring technologies, and the theft of intellectual property through cyber hacking.

Following the report, the US introduced additional duties of 25% on $34bn of US imports from China containing "industrially significant technologies", including those related to the "Made in China 2025" industrial policy. The US has since announced it will impose similar duties on a further $16bn of imports.

China has responded in kind, announcing duties on $50bn of US imports, including coal, cars and medical equipment. And now Trump has threatened duties of up to 25% on further $200bn of Chinese imports. If the US goes ahead, it would mean additional duties on roughly half of bilateral trade.

How might the dispute be resolved? Not easily. There are problems with the politics, the process and the substance.

On the substance, section 301 report does not spell out what is required from China. But its detailed criticism of such a wide range of Chinese policies sets the bar high if China is to respond in a way which evidently addresses the problems identified.

On the politics, the problem is that targeting China is a vote winner for Trump. While higher duties on imports involve some pain for US consumers and businesses with Chinese supply chains, the notion that trade with China is unfair resonates widely.

On the process, there is none, or at least not one which is likely to produce results. Yes, there have been negotiations led by vice premier Lui He on the Chinese side and a clutch of cabinet officials on the US side. But these have lacked coherence, because it is not clear who, if anyone, speaks for the US president.

The US believes it has more firepower than China, because it imports from China so much more than it exports. This is true, but too simplistic. China can offset the effect of US duties by depreciating its currency, which has already dropped more than 7% against the dollar since the section 301 report was published in March. The US may also find at some point that its brands – not just its exports – end up being shunned by Chinese consumers, as Japanese firms have found before.

It will probably take a summit between Trump and his Chinese counterpart, Xi Jinping, to resolve the dispute. Until that happens, there is a risk of further escalation.