

Trade war between the USA and China: Who gains? Who loses?

Does Malaysia stand a chance to benefit?

“Currency-dominated countries can always influence the economic prosperity, financial security and social stability of other countries by controlling the cost of capital.”

— “Currency Wars 3”

Preface

I have seen many essays that are full of data and numbers. To make the essay easier to read, I tried to write everything like a story and put the evidences inside the footnotes as a reference. Now, let’s walk with me into this rare show.

The Last Supper

Before the trade war broke out, Chinese industry was almost enjoying tax free in exporting to the US in those days¹; with a low standard of living and low exchange rate in China, giving the “Made in China” to have a great competitive advantage². As a result, most of the MNEs (Multinational Enterprises) set up their factories in China.³ According to the Balance of Payments, although the US was having a great trade deficit against China, it was covered by its financial and investment accounts, which is gained from two major wildcards: US treasuries and US dollars⁴. By holding them, the US economy seems to relax, but the US’s industry was gradually hollowing out. To this day, however, China’s manufacturing has expanded dramatically, so called the “China Shock”, due to its efforts⁵.

¹ USTR : Industrial Tariff, “The United States currently has a trade-weighted average import tariff rate of 2.0 percent on industrial goods. One-half of all industrial goods entering the United States enter duty free.”

Available on : <https://ustr.gov/issue-areas/industry-manufacturing/industrial-tariffs>

² Investopedia, “Why China is the ‘World’s Factory’”

³ USITC Executive Briefings on Trade “THE SIZE & COMPOSITION OF U.S. MANUFACTURING OFFSHORING IN CHINA”

⁴ TheNewYorkTimes: “Want to Rev Up the Economy? Don’t Worry About the Trade Deficit”

⁵ David H. Autor, David Dorn, and Gordon H. Hanson, “The China Shock”

The Rise of the Trade War

In 2017, The Trump administration successively launched Sections 232, Section 201 and Section 301 tariffs. The results of the section tariffs indicated that a surge in imports poses a threat of serious damage to U.S. industry, threaten U.S. national security and showed signs that a U.S. trading partner engaging in discriminatory or unreasonable practices that burdened U.S. commerce⁶. In 2018, Trump firstly imposed “global safeguard tariffs” – placing a 30 percent tariff on all solar panel imports, except for those from Canada, and a 20 percent tariff on washing machine imports⁷. Then, on July 6, his administration implements first China-specific tariffs, kicked off the trade war.

Perspectives of Both Sides

On the Chinese side, as mentioned in the bestselling book “kicking away the ladder”, the developed countries used protectionism policies to build its strong MNEs in 1800s. Once they were strong enough, they forced other countries to “free trade” with them, which was quite ridiculous⁸. So, the Chinese could only use bureaucratic capitalism to build its own MNEs⁹.

On the US side, Trump exclaimed that they were having “unfair trade practices” with China. There are two things they want: to fix the trade deficit (\$378.6 billion in 2018¹⁰) and to curb IP (Intellectual Property) theft (between 225 billion to 600 billion lost¹¹). The “trade deficit” is also aimed at bringing back manufacturing capacity to reduce imports and create jobs. The aforementioned IP theft included low enforcement IP law and forced technology transfer. Other than those two surface goals, one more ultimate goal is to ensure the unipolar dominance of the US, which is currently highly threatened by the “Made in China 2025¹²” and “One Belt One Road Initiative¹³”

Combine them together, the crisis today was shaped.

So, who gains, who loses? How about Malaysia?

⁶ Trump Administration Tariff Actions pg2

⁷ The US-China Trade War: A Timeline

⁸ Ha-Joon Chang : “Kicking Away Ladder”

⁹ Jeff Spross, “China isn't cheating at trade. It's just running America's old plays.”

¹⁰ USTR official website > U.S.-China Trade Facts “U.S. goods and services trade with China totaled an estimated \$737.1 billion in 2018. Exports were \$179.3 billion; imports were \$557.9 billion. The U.S. goods and services trade deficit with China was \$378.6 billion in 2018.”

¹¹ Ip commission report pg9:

“We estimate that the annual cost to the U.S. economy continues to exceed \$225 billion in counterfeit goods, pirated software, and theft of trade secrets and could be as high as \$600 billion”

¹² SCMP, “How ‘Made in China 2025’ became a lightning rod in ‘war over China’s national destiny’”: “This Chinese industrial modernisation programme is merely the big bone of contention in the Washington-Beijing trade battle”

¹³ TheDiplomat, “What Does China’s Belt and Road Initiative Mean for US Grand Strategy?”: “the BRI could threaten the very foundations of Washington’s post-WWII hegemony”

Both sides' gaining potential

“Trade wars are good and easy to win”

After Trump posted this tweet, people started to shell, thinking that trade war will only be a lose-lose situation. In my opinion, the trade war is breaking the trend of the globalization, wrecking the social welfare, and causing negative effect on the economy (GDP decreasing¹⁴). But in the long-term, it is good to the US, albeit in a small way; it will cause great damage to Chinese, but lets other developing countries benefit.

Let's see the first goal: trade deficit.

Some products that Trump put on tariffs are specific to China. So, if the MNEs wants to choose a new place to settle, it may be any other developing countries, but not the US. Even if there is no offshoring wave, the profit will only be turned to other countries, such as Vietnam¹⁵. This will not help in fixing the trade deficit.

But some of the products, like laundry machines are affecting all countries. In short-term, it is not likely to respond to the US that fast, and after some time, the Americans will take back jobs and reduce imports. But due to the strong currency and retaliatory tariffs, it is still impossible to raise exports¹⁶, so the benefit might not be that big.

Turning to the IP part,

In the IP law, China is revising its patent law, which will give a heavier punishment for law-breakers¹⁷. Since Chinese nationals' innovative ability has grown, IP protection is more likely to be enhanced. For the forced technology transfer, on the other hand, it depends on the negotiation. If that works, it will really be a gospel to US technology companies.

Moving to the ultimate goal, the way to gain is easy; if China loses, US gains.

If we look at a bigger picture on China, its GDP and net exports growth has slowed down for years (view Charts 1 &2). But to maintain GDP growth, the Chinese government increased the government spending on infrastructure (view chart 3) and financial subsidies (including expandatory fiscal and monetary policy) to try covering it¹⁸, which caused overcapacity¹⁹, like ghost cities, excessive steel and so on and pushing both government and corporations debts higher²⁰ (view chart 4).

¹⁴ IMF World Economic Outlook, Jan 2019

¹⁵ Patrick Van den Bossche, A.T. Kearney partner and co-author of the study "A.T. Kearney U.S. Reshoring Index": "Rather than incentivizing companies to reshore, the trade war with China has simply accelerated an already ongoing shift toward manufacturing in lower-cost countries such as Vietnam"

¹⁶ AT Kearney: Reshoring Index Declines Again Despit America's New Trade Policies

¹⁷ TheStraitsTimes, "Revision of China patent law lauded"

¹⁸ Forbes, Why the US will Win the China Trade War

¹⁹ SCMP, Overcapacity a time bomb for china's economy

²⁰ IMF Country Report: People's Republic of China pg12, pg21

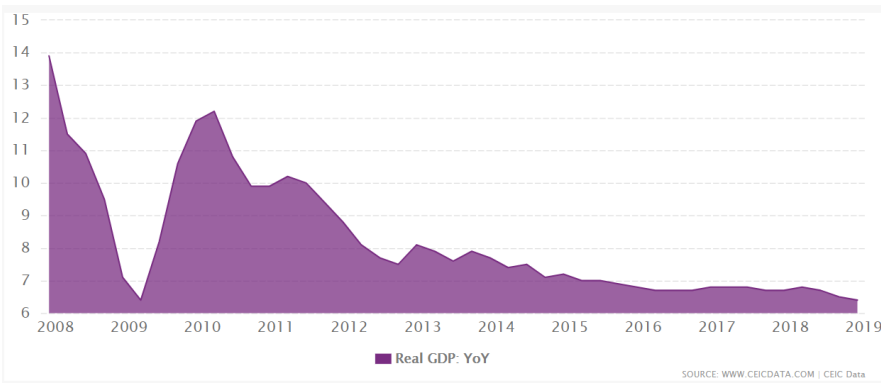


Chart 1 ²¹

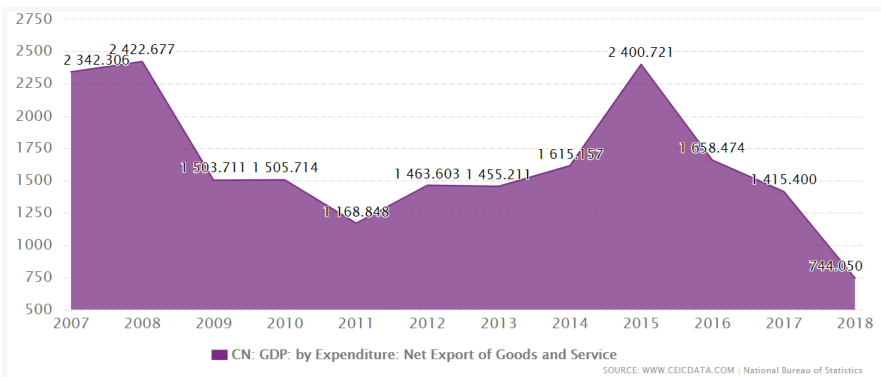


Chart 2 ²²

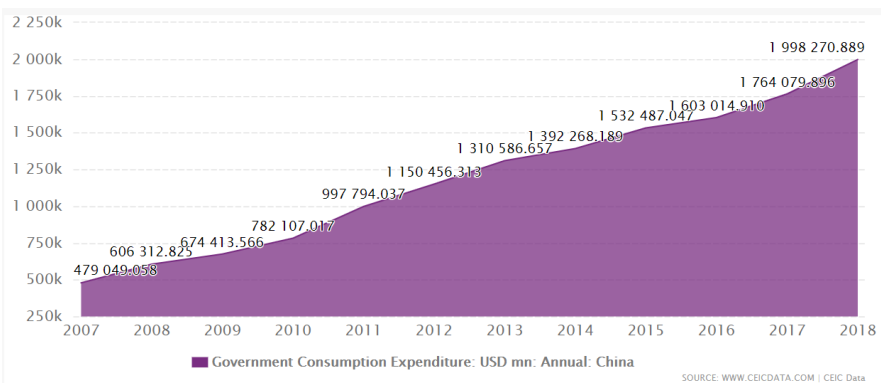
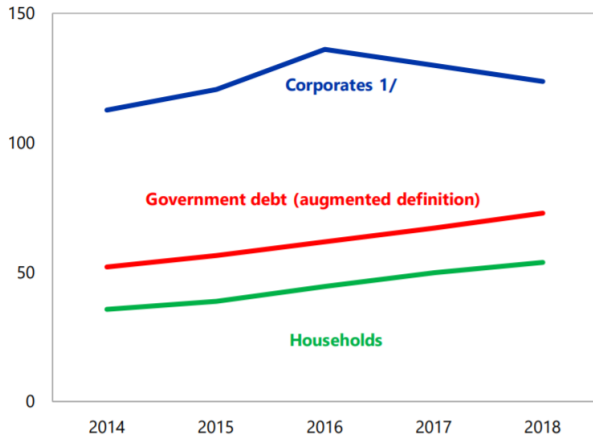


Chart 3 ²³

Household and government debt still rising

(In percent of GDP)



1/ Excludes LGFV.

Source: Haver Analytics and IMF staff estimates.

Chart 4²⁴

²¹ CEIC data, China's Real GDP Growth

²² CEIC data, China's Net Export of Goods and Services

²³ CEIC data, China's Public Consumption Expenditure

²⁴ Extracted from IMF Country Report: PRC pg12 (view footnote 16)

The combination of overcapacity and a high debt ratio is causing a bubble. That is why Xi Jinping had been pushing for deleveraging in 2017²⁵. But now, the appearance of trade war has created a new chaos.

Although state surveys say the unemployment rate is falling, most private surveys have the opposite answer. Whether it is the ZhaoPin agency²⁶, CIER index²⁷ or CICC²⁸ (China International Capital Corp), they have mentioned the drop of labour demand in China, which is due to the reduction of production and diversion.

To fix unemployment, China has given up deleveraging²⁹. This strategy is used to respond to the side effects of trade war, which means it doesn't help in fixing overcapacity and debt problem, but instead pushes them up.

Beijing seems to have run out of "ammunition" and uses its last skill, currency devaluation. It seems to be a good way to raise the competitive advantage, but it creates one harmful effect.

Nomura estimates that the value of offshore dollar bonds issued by Chinese companies has more than tripled since the end of 2014 to \$842 billion³⁰. The devaluation on yuan will increase their burden to pay off the debts.

According to CNBC report, the default wave has started since 2018³¹.

So, we can see that, all of these created a huge barrier stopping China from reaching its "Made in China 2025" goal, or even facing an economic collapse. If it does, US wins.

The best situation for China was everything before trade war, they took a lot of advantages at that time. Now, they will be only losing, having no possibility of gaining.

But the US will be able to gain something, whether big or small.

Malaysia

Malaysia was labelled as having the fourth beneficial country in the trade war³². It can gain from three sectors.

Firstly, import substitution. Some of our industry exports seem to be dropping (solar cells, LED), some seem to be rising (furniture³³, palm oil, pork³⁴...). According to Nomura's research (view chart 5), it can benefit.

²⁵ BNP PARIBAS Asset Management: "China's Deleveraging Strategy and Evidence"

²⁶ SCMP, "What is China's unemployment rate? State survey says it's falling, private survey disagrees"

²⁷ SIA, "CHINA – DEMAND FOR LABOUR STUMBLES IN FOURTH QUARTER WHILE NUMBER OF JOBSEEKERS RISES"

²⁸ SCMP, "US trade war has cost China 'almost 2 million industrial jobs', investment bank CICC says"

²⁹ Bloomberg, "Debt is Roaring Back in China"

³⁰ Forbes, "Why US will win China trade war"

³¹ CNBC, "Chinese companies are defaulting on their debts at an 'unprecedented' level"

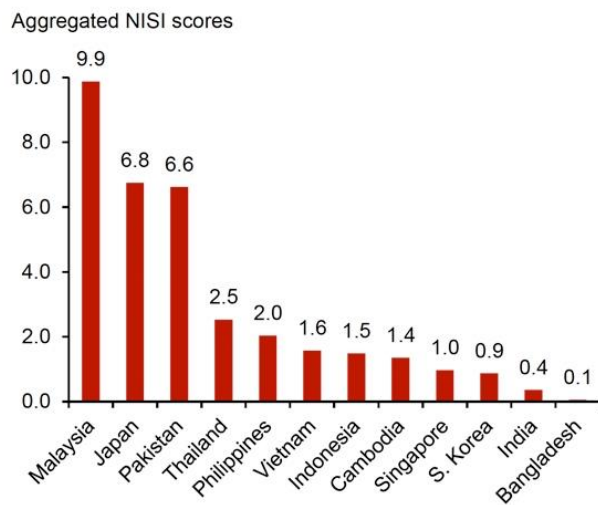
³² TheStar, "Nomura: M'sia 4th biggest beneficiary of trade war"

³³ TheEdge, "Malaysian furniture exports to the US seen growing 20% annually"

³⁴ NewStraitsTimes, "Impact of Trade War on Malaysia"

According to Affin Hwang Capital chief economist Alan Tan, it can drop 1-2 percent.³⁵ So, we don't actually have an accurate answer for it.

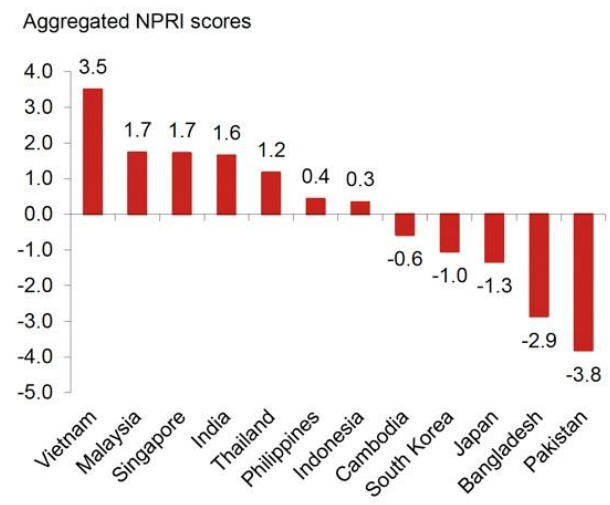
Countries that could benefit from import substitution by the US and China



Source: USTR, MOFCOM, UN Comtrade, ITC Trade Map, IMF, UNCTAD and Nomura Global Economics estimates.

Chart 5

Countries that could benefit from production relocation away from China



Source: UN Comtrade, Trade Map, AmCham, World Bank, IMF and Nomura Global Economics estimates.

Chart 6³⁶

Secondly, production relocation. According to Economic Affairs Minister Azmin, 24.7% of the companies stated their intention on SE country, including Malaysia.³⁷ According to Nomura, we have the second largest potential (view chart 6). But since our workers aren't perceived to possess higher productivity and aren't willing to accept lower wages, it lowers the possibility of being chosen³⁸.

Thirdly, diplomatic hedging strategy. When both superpowers fight, they call for allies, which gives our country a chance to gain. Just like the renegotiation of ECRL Project with China. This is one example shows that the current trading environment gives us more bargaining chips on the table.

In conclusion, China will only be losing, while US and Malaysia will have a chance to benefit. If we come out with better policies to attract foreign investors, it will be better.

Every challenge is an opportunity.

³⁵ Malaymail, "Full-blown US-China trade war will slow Malaysia's exports"

³⁶ NOMURA, "Not all a lose-lose outcomes for Asia"

³⁷ TheStar, "Malaysia has potential to profit from US-China trade war"

³⁸ Malaymail, "Possible but unlikely Malaysia will gain from US-China trade war"

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<https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china#targetText=The%20U.S.%20goods%20and%20services,was%20%24378.6%20billion%20in%202018.>

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