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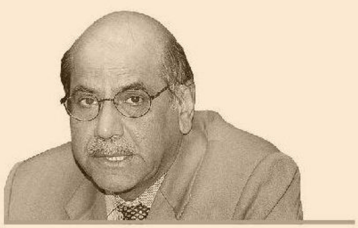
US-China trade war: Prospects for world

China will be looking for ways to cope with the consequences of the trade war. India may begin to look like an attractive economic partner



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There are two aspects of the ongoing US-China trade war. One relates to trade in goods where the US has been suffering from a persistent and significant deficit. There is room for accommodation here, with China assuaging the US by making some big-ticket purchases such as of US-made civilian aircraft, agricultural commodities like soybeans and wheat, and high-end consumer devices. This has been done in the past but trade tensions eased only temporarily. Recently, China organised a very ambitious import fair in Shanghai where President Xi Jinping himself spoke about China's commitment to free trade. He announced, though without specifics, China's intention to import $30 trillion in goods and $10 billion in services over the next 15 years. These are very impressive numbers but are unlikely to impress China's major trade partners.

Two, there are issues relating to intellectual property and industrial policy where China will resist US demands. For example, the Made in China 2025 initiative, which seeks to establish China's dominance in new sectors such as artificial intelligence, quantum computing, electric vehicles and advanced robotics through state-supported private and state-owned corporate champions, is unlikely to be on the agenda of the US-China negotiations. US pressures on this are leading to China doubling down on the initiative. There are calls for technological self-reliance and domestic innovation in the face of the US and Western countries putting in place stricter technology denial regimes. China may declare that it will no longer insist on technology transfer as a condition for market access by Western firms but this may not be enough to satisfy Western concerns over leakage of intellectual property. Therefore, when US President Donald Trump meets Xi Jinping on the margins of the G-20 summit in Argentina (November 30-December 1, 2018) there may well be a temporary truce on the trade front but the more fundamental divergences are likely to persist.

The US, Japan and the European Union have recently agreed on a common initiative for the reform of the World Trade Organization (WTO), focusing on market-distorting practices through the use of subsidies and promoting state-owned enterprises as industrial champions through various incentives and support measures. Stricter reporting commitments and penalties for non-reporting and non-compliance are proposed. Stronger provisions are envisaged on the intellectual property-related issues, prohibiting technology transfer demands in return for market access. State-owned enterprises will be under greater scrutiny. Overall, there will be a push for much greater policy and process transparency. It is obvious that these measures are mainly directed against China and it is now unlikely that Chinese demand to be declared a market economy will be conceded anytime soon.

The issue of intellectual property has acquired a sharp security dimension and this also makes it unlikely that a compromise is possible. There was a recent report arguing that in high-tech areas, China has brought about civilian-military integration, with intellectual property ostensibly acquired for civilian purposes from Western companies being applied to its growing defence sector. Chinese investment in a range of start-up entities in Silicon Valley and also in the UK and Germany allows access to cutting-edge technologies, which may benefit both civilian and defence industries in China. This avenue is sought to severely restricted, if not closed altogether, in the coming months. The same report indicated that currently in the US alone, there are 25,000 Chinese pursuing higher studies in advanced science and technology and will add to the pool of highly qualified personnel for both civilian and defence-related industries. The US has recently made a strong representation to its close ally, Israel, to prevent the acquisition of high-tech items by Chinese companies.

In the past, it used to be argued that supporting China's economic development through significant infusions of capital and technology and enabling unimpeded access to Western markets would nudge China towards the familiar East Asian trajectory of higher levels of prosperity, leading to more open markets and expanded democratic freedoms and polity. The establishment of dense economic interdependence between the West and China was expected to restrain potential security competition between them. These expectations have been belied, particularly since Xi Jinping has become China's undisputed leader. Trade has become an instrument in the security competition between the US and China. It is no longer a moderating factor.

As this trade war plays out what will be the likely impact on the global economy?

There is little doubt that the global economy will be subjected to significant disruptions as existing trade and investment flows are interrupted and altered. China is the final assembly point of several supply chains, which link it with a number of Southeast Asian economies. The final products are exported to markets in the US, Europe and Japan. If Chinese access to these markets is adversely impacted, there will be cascading effects on these supply chains. These may be reconstituted with the Chinese segment migrating to other destinations in Southeast Asia, such as Vietnam or Indonesia. China itself may invest in setting up such facilities in other countries to escape trade barriers in Western markets. India is not a part of these supply chains, except in automotive parts and pharmaceuticals. But this may be an opportunity for the Indian industry to integrate itself in these supply chains as they begin to be reconstituted. We should look at our participation in the Regional Comprehensive Economic Partnership (RCEP) as a potential opportunity to achieve this.

The changed global economic and trade environment will undoubtedly compel China to review its own trade and investment strategies. It will be looking for ways in which it can cope with the consequences of the trade war and maintain its economic growth momentum. In this context, India may begin to look like an attractive economic partner in the changed circumstances. Perhaps it may be worthwhile to shed our diffidence and engage China in a serious conversation on developing a mutually productive trade and investment partnership. Who knows, this may actually turn out to be the "win-win" partnership the Chinese keep professing endlessly.

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