

## **The Sky Won't Fall – The China–U.S. Trade War and Future Economic Relations\***

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*Lawrence J. Lau:*

*The China–U.S. Trade War and Future Economic Relations*

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Lawrence J. Lau, the author, has been teaching as an economist at Stanford University since 1966. In 2004, he returned to Hong Kong to serve as the president of the Chinese University of Hong Kong. Between 1992 and 1996 he was the associate director of the Asia-Pacific Research Centre (APARC) at the Stanford University, and between 1997 and 1999 he was the director of the Stanford Institute for Economic Policy Research (SIEPR). In 2004 he became the deputy chancellor of The Chinese University of Hong Kong and he held this position until 2010. His field of research is clustered around economic development, economic growth and East-Asian economies including China. He is also known as the first developer of the econometric model of China in 1966.

He has been studying Sino-US trade relations for a long time. As early as the 1990s, he cooperated with Professor Feng Guozhao and took the lead in conducting adjustment studies on the official differences between China and the United States in the Sino-US trade balance; these results were cited by former Chinese Premier Zhu Rongji. In the 2000s, Professor Lau proposed using domestic value-added generated by exports rather than the total value of exports between the two countries to measure the trade balance between China and the United States. The study, conducted by a team of the Chinese Academy of Sciences led by Professor Chen Xikang and Professor Lau, found that the US-China trade deficit was nearly one half smaller than the original figure.

Sino-US relations are undoubtedly the most important and most critical bilateral relationship in the world today. The book is written by the author in the context of the Sino-US trade war. The author clarifies three main issues in this work. First, the

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\* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

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author clarifies that, although the actual impact of the Sino-US trade war in 2018 cannot be ignored, it is still relatively controllable for China, and especially for the United States. Even if the US new tariffs eventually cover all products imported from China, there is no need to panic. Second, the author discusses the potential economic and technological competition between China and the United States behind the trade war, as well as the rise of populism, isolationism, nationalism and protectionism around the world, especially in the United States. Competition between China and the United States is inevitable and may become the new normal. However, the author's analysis shows that, although China's total real GDP may surpass that of the United States at some point in the 2030s, it is still far behind in terms of per capita level, and it may not be possible to side with the United States until the end of the 21st century. There is still a huge gap between China and the United States in terms of the overall level of technological development and general innovation capabilities. At a time when exclusivity is on the rise in both countries, it is the responsibility of both governments not only to use words but also to prove through action that international trade and direct investment do not necessarily lead to any damage, and that there is a large enough overall benefit to make everyone profit. Third, the author demonstrates that cooperation between China and the United States in the economic field is a potential positive-sum game, that is, it achieves a win-win situation. For the complementarity between these two major economies, this cooperation is of great benefit to both parties through trade exchanges, direct and indirect investment, especially through improved economic cooperation, and the full development and utilization of the current idle or underutilized resources of the other side. It is possible to achieve a trade balance between China and the United States, and promoting mutual economic interdependence will help build trust and reduce potential conflicts in the future.

In the book, the author first introduces Sino-US relations and the growing Sino-US trade war. The author points out that, although China and the United States are each other's largest trading partners, there are major frictions and potential conflicts in the economic exchanges between the two sides. This has caused many complaints from the US: the favourable trade balance for China, undervaluation of the RMB exchange rate, the difficulty for US companies to enter the Chinese market, unfair market competition in China, bias towards state-owned enterprises, and national security concerns. These complaints eventually led to the decision by President Trump in 2018 to impose new tariff sanctions on imported goods from China in three rounds, with a total value of USD 250 billion, triggering a trade war between the two countries. The Sino-US trade war has disturbed international trade and investment, and its impact is not limited to the Chinese and US economy, due to the global supply chain that has emerged in the past decades. The trade war has

brought enormous uncertainty to the consumption and investment decisions of corporate entities in all parts of the world, and may lead to a permanent change in Sino-US relations.

In the second chapter, the author discusses the important moments in the history of Sino-US relations, and exchanges between the two countries, which began with trade between China and the United States in the late 18th century, highlighting the explosive growth of China's exports to the world and the United States after China's accession to the WTO in 2001. Thanks to the surge in exports, a large volume of surplus labour in China's rural areas can be transferred to coastal cities and work in export-oriented light industrial enterprises, lifting as many as 800 million people out of poverty. Although China's export growth to the world and the United States has slowed significantly since 2012, the economic achievements of China's accession to the World Trade Organization cannot be underestimated.

In the third chapter, the author re-estimates the US-China trade deficit, showing that the US deficit with China in 2017 was just USD 111 billion in terms of total added value (or GDP), far from the USD 376 billion often mentioned in terms of total export value. It is entirely possible to expand US exports to China by USD 111 billion in terms of total added value, which is equivalent to only USD 125 billion because of the relatively high domestic value added (GDP) of existing and potential US exports.

Chapter four shows that the actual impact of the Sino-US trade war in 2018 will lead to a 1.12 per cent drop in China's GDP (assuming that half of China's exports to the US are stalled because of the new US tariffs). For China, which has an average annual growth rate of 6.5 per cent, this is relatively mild and controllable. The actual impact of the trade war on the US economy is even weaker, possibly causing its GDP to fall by a maximum of 0.30 per cent, while the long-term average annual growth rate of the United States is close to 3 per cent. The trade war has a negative psychological impact on China's stock market and the RMB exchange rate, but these effects may be temporary.

Chapter five presents the fact that China and the United States are highly complementary, and that trade and investment between the two countries should be very beneficial to both sides.

Chapter six discusses the inevitable competition between China and the United States, the two largest economies in the world, regardless of whether it is intentional or not. But in many ways, there is still a considerable distance between China and the United States.

Chapter seven analyses the potential technological competition between China and the United States from the perspective of economic and national security. Although China is catching up fast in the field of science and technology, there is still a significant gap between the two countries. Although China has made tremendous efforts to develop science and technology and has made remarkable achievements, it still lags behind the United States generally, except for a few subdivisions (such as high-speed trains and quantum communications). China is far away from the United States as a whole in terms of cutting-edge scientific and technological development, as confirmed by the fact that very few Chinese have won a Nobel Prize. It is very likely that at least one generation or two generations of time will be required for China to catch up with the United States' leading position in the field of science and technology.

Chapter eight points out that economic cooperation between China and the United States can be a win-win situation for both countries. Given the high degree of economic complementarity between the two countries, both countries will enjoy significant benefits by making fuller use of their resources such as American energy, land and water resources, China's human resources and savings-through mutual trade and investment. In addition, if the two countries work together, it is possible to basically achieve a long-term trade balance between goods and services within five years. The author also proposed a specific path to narrow the Sino-US trade deficit by increasing US exports of goods to China rather than reducing China's exports of goods to the United States (as well as imports of goods from the United States). In addition, there are also two different ways to allow the United States to increase commodity exports. The first is to shift American exports to other countries to China, and the second is to mobilize currently underutilized domestic resources to specialize in the production of new exports to China. The first approach is largely superficial, and even if the trade deficit between the United States and China can be compressed, GDP and jobs in the United States will not increase significantly. This generates little real net income for the United States (and therefore no benefit for China), but can be used to promote the successful reduction of the US-China trade deficit. The second approach can bring real growth to US GDP and employment, and increase the supply of goods that China needs. American producers, workers and exporters will benefit, as can Chinese consumers, producers and importers who use new imports, and both countries will be improved, which deserves serious consideration by both countries. Furthermore, by launching a project to deepen the long-term economic dependence of the two countries, mutual trust between the two sides will improve, and the probability of a potential conflict will drop significantly.

The ninth chapter mentions that one of the main reasons for the current trade war between China and the United States is not trade itself, but rather the

potential competition between the two countries for economic and technological dominance. Whether this competition is open or concealed, whether intentional or not, it did not begin with President Trump, nor will it end with his departure.

The tenth chapter looks ahead to the future of Sino-US relations. Whether it is friendly or not, the competition between China and the United States should be understood as a long-term phenomenon that is progressing and will become the new normal. Trade disputes are but one of the manifestations of potential competition between the two countries. It is also possible that this kind of competition will be transformed into an ideological battle. However, China should not want to change the institutional model of the United States, and the United States is unlikely to transform China into its own institutional model. The Chinese people may never become as individualistic as Americans. Due to reasons such as culture, history, and path dependence, democracy in China may evolve in different ways and take different forms than in the United States. What both countries should be able to do is to learn to accept and adapt to each other's particularities and exceptionality feelings.

The author believes that this is actually a good time for China to persist in promoting openness to international trade and investment (including inflows and outflows). For example, China can unilaterally reduce import tariffs on goods such as automobiles for all other countries that do not engage in a trade war, and can offer or accept concessions on trade and exchanges of all countries on a reciprocal basis. The author points out that international trade and cross-border direct investment are always win-win; domestic and international competition can improve efficiency and promote innovation, so it is possible to expand inclusiveness in international economic relations. Of course, Sino-US relations also involve issues other than the economy and must be handled cautiously by the future leaders of the two countries.

China and the United States are not destined to be enemies. They can be both strategic competitors and partners. The world is big enough to accommodate the continued growth and prosperity of both sides and to cooperate with each other in the common interests of the two countries and even for the benefit of the world. For the common benefit of both sides and all mankind, China and the United States will find ways to work together again, and the author is optimistic and hopeful.

This book analyses the background, causes and influence of the Sino-US trade war, in which the direct causes of the Sino-US trade war and the trade imbalance between China and the United States are studied in detail, and it is pointed out that competition in Sino-US relations will be the new normal in the future, which

provides a good perspective for us to understand and study the Sino-US trade war and Sino-US economic relations. This book provides a detailed analysis of the current disputes occurred between China and the United States. Readers will be convinced by his precise data and subdued by his incisive opinions, which helps readers have an in-depth understanding of new normal development of China and the United States, and how it will affect global political, economic and social development trends. This is a book not only suitable for professors and students in economy-related fields, but also for anyone who believes in a better future for the world that ought to read this excellent work carefully.