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A Parametric Test of Ground Zero – Sino-US Trade War

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Abstract:

On $34 billion worth of Chinese goods, including flat-screen televisions, aircraft parts, and medical devices the trump administration imposed sweeping tariffs. The goods marked for tariffs will now face a punishing 25 percent border tax when they will be imported into the US. It is done to penalise China by making Chinese products more expensive for American consumers and businesses to buy. If Chinese products suddenly become more costly, they'll buy those same products from somewhere else, and Chinese businesses will lose money in the market. China immediately accused the US of starting "the largest trade war in economic history to date" and responded by imposing 25 percent tariffs on $34 billion worth of US goods, including soybeans, automobiles, and lobsters.

China External Debt

China's External Debt reached 1,971.7 USD bn in Mar 2019, compared with 1,965.2 USD bn in the previous quarter. China's External Debt: USD mn data is updated quarterly, available from Jun 2003 to Mar 2019. The data reached an all-time high of 1,971.7 USD bn in Mar 2019 and a record low of 182.6 USD bn in Jun'2003.

In the latest reports of China, Current Account recorded a surplus of 49.0 USD bn in Mar 2019. Foreign Direct Investment (FDI) increased by 47.6 USD bn in Mar 2019. China's Direct Investment Abroad expanded by 21.0 USD bn in Mar 2019. Its Foreign Portfolio Investment increased by 35.7 USD bn in Mar 2019. The country's Nominal GDP was reported at 3,164.3 USD bn in Mar 2019.

China's foreign debt has been rising rapidly, and that's becoming an increasingly big problem —for the country and, potentially, the world. Officially, China lists its outstanding external debt at $1.9 trillion. For a $13 trillion economy, that's not a major amount. But focusing on the headline number significantly understates the underlying risks.

The Prior Events

In thinking about the current contested state of global capitalism, and what to do about it, much can be learned from the debates I heard at the recent Harvard Business School conference, Seeking the Unconventional in Forging Histories of Capitalism, which assembled a stellar and diverse cast of historians, management researchers, and others.

Too often scholarly–and other–critiques of capitalism and big business resort to stereotypes and generalizations, sweeping the good, the bad, and the ugly into an amorphous single entity. Engaging seriously with the past can be liberating and provide a refreshing lens to think about the future.

Mao and fake capitalists

Mao's China cultivated a small group of so-called Red Capitalists who were fake capitalists, but used to show off to foreign visitors as if they were real. In the early 20th century, the expected and natural color of American food became standardized through the use of dyes and adroit consumer marketing. The natural color of food became a fake color; and the fake became real as people came to expect it to be a natural color. Dominant narratives in history can also be significantly myopic, sometimes accidently, as sources are written in languages not easily understood. The globalization of the world in the 19th century, as a third speaker discussed, has been written from a Euro-centric perspective. In reality, the bazaars and local merchants of the India Ocean were co-creators of a global trading world along with Western firms.

"MAO'S CHINA CULTIVATED A SMALL GROUP OF SO-CALLED RED CAPITALISTS WHO WERE FAKE CAPITALISTS, BUT USED TO SHOW OFF TO FOREIGN VISITORS AS IF THEY WERE REAL."

Does any of this matter now? I took away that the answer is probably yes. Stories might be fake, but they can become real. And there are real consequences. When Deng Xiaoping began to plan the re-opening of China in 1978, he assembled five geriatric fake capitalists in a big meeting to get it all started. The close reading of historical documents, and unconventional ways of analyzing them, can help us see the past and the present with fresh eyes.

Outlaw capitalism

As the day progressed, we heard other stories about the challenges of understanding what is really going on. Mao's China not only had fake capitalists, but tens of thousands of illicit capitalists engaged in forbidden exchanges. Police records and other, unconventional, records are being used by one speaker to uncover the scale of their activities, and argue that basically China already had an entrepreneurial class ready and waiting when Deng began opening China. Another speaker, on what he termed "outlaw capitalism," explored how early modern pirates in Asia can tell you as much about mercantile capitalism of the era as the activity of ostensibly regular merchants. He applied the same logic to hackers and data capitalists of today. In 1970s California, capitalist enterprises became entangled with feminist movements, public policies, and identity politics. In San Jose, many women were elected to political positions. As state governments cut funding for schools, they turned to Silicon Valley firms for philanthropy, unintentionally handing control of public goods to unelected white men.

Much of the story of the growth and impact of global capitalism has focused on the West. The capitalism which is now under so much criticism is American capitalism, or more specifically a form of American capitalism which became dominant from the 1980s.

The School's extensive Creating Emerging Markets project is designed to help correct this bias by recovering the lives of key business leaders across Africa, Asia, and Latin America. We learned of different sorts of capitalism in a session devoted to this endeavor to create a whole new archive of data. Indian business leaders were inspired by Gandhi's notion of trusteeship. African business leaders prioritized the use of capitalism to lift up Africans, and the African continent. Family values, not share prices, were what drove the big Latin American business houses. These projects together show the much broader role of business in society than simply making profits.

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Unconventional techniques

Fresh thinking requires fresh methodologies, and a session was devoted to unconventional research techniques. One speaker explored thousands of contracts in early modern China to show how tree plantation was managed through market mechanisms rather than state dictates as in the West. Another speaker used appointment diaries of prominent political figures as a new way to highlight networks and relationships, and how they change over time. A third paper used address books to trace the longevity of firms in 20th century Turkey, shedding new light and hard evidence on the government's policies to favor Muslim business over those of Armenian, Greek, and Jewish minorities. These new data sets and analytical techniques, enabled by new tools in computational data science, have potential to broaden and deepen our understanding of how capitalism has evolved and its impact.

"THESE PROJECTS TOGETHER SHOW THE MUCH BROADER ROLE OF BUSINESS IN SOCIETY THAN SIMPLY MAKING PROFITS."

A final session proposed novel takes on capitalism by looking at unconventional individuals. Reverting to the argument that English-speaking capitalism, often embodied by Adam Smith, is but one type, the French mercantilist Jean-Baptiste Colbert was re-invented as a pioneer of market capitalism. Through a number of court cases and contention over the serial litigant Clarence Venner in the early 20th century United States, we learned about the complex relationships between private and public parties. Private parties sometimes acted as public regulators, and public regulations relied on private parties to enforce and advance certain regulatory policies. Meanwhile, the unlikely influence on ecological and socially responsible business of the Austrian philosopher Rudolf Steiner, who in 1913 founded Anthroposophy—a "science of the spirit," provides further evidence on alternative capitalisms to the American capitalism of today. Steiner and his followers created a new way of doing business based on distinctive (some would say highly odd) beliefs which sought to restore harmony between humans, and especially between the natural and spiritual worlds.

Business history at Harvard Business School has been unconventional since it began in the 1920s. After all, it was unconventional of the Dean Wallace B. Donham to create the new discipline at a business school. In our contested world of today, there has never been a better time to promote unconventional thinking which can take us out of our comfort zones, challenge us to think about the contested nature of authenticity, and offer a path out of the intellectual straightjackets which academics, practitioners and others all too often find comfort in.

Surplus Trading

In the past decade China's foreign debt balance has surged. According to official data, short-term debt accounted for 62 percent of the total as of September, which means $1.2 trillion will have to be rolled over this year. The speed of increase is just as worrying: In the past year, total external debt has increased 14 percent and 35 percent since the beginning of 2017. External debt, which stood at just over $3 trillion at the end of November is no longer a trivial slice of China's foreign-exchange reserves, little changed from two years earlier. In September, short-term foreign debt increased to 39 percent of reserves, from 26 percent in March 2016.

Estimated Debt

For the past couple of years China's foreign-exchange reserves have stagnated. The true picture may be more precarious. In an August report China's external debt was estimated at between $3 trillion and $3.5 trillion by Daiwa Capital Markets. In other words, total foreign liabilities could be understated by as much

as $1.5 trillion after accounting for borrowing in financial centers such as Hong Kong, New York and the Caribbean islands that isn't included in the official tally.
Circumstances aren't moving in the favor China. The nation's companies rushed to borrow in dollars when there was a 3 percent to 5 percent spread between Chinese and U.S. interest rates and the Yuan was expected to strengthen. Borrowing offshore was cheaper and offered the additional bonus of likely currency gains. Now, the spread in official short-term yields has shrunk to near zero and the Yuan has been depreciating for most of the past year. Refinancing debt in dollars has become harder, and more risky.

Beijing's policies have exacerbated the buildup of foreign debt. To promote the president's landmark foreign policy endeavor; Xi Jinping's Belt and Road Initiative, China has been borrowing dollars on international markets and lending around the world for everything from Kenyan railways to Pakistani business parks.

China faces dollar funding pressure, with this year and 2020 being the peak years for repayments. In order to repay their dollar debts, Chinese firms will either have to draw from the central bank's foreign-exchange reserves (a prospect Beijing is unlikely to allow) or buy dollars on international markets. This creates a new set of problems. There are only 617 billion Yuan ($90 billion) of offshore Renminbi deposits in Hong Kong available to buy dollars. If China was to push firms to bring debt back onshore, this would necessitate significant outflows that would push down the Yuan's value against the dollar.

International dollar investors need to be wary of Chinese-linked investments. Local government financing vehicles and belt-and-road borrowers may seem quasi-sovereign quality, but any shift in the willingness to roll over dollar debt could create a funding crunch. With the U.S. Federal Reserve raising rates and reducing its balance sheet, Chinese companies could face paying more for capital in dollars than in Yuan.

Bulls have long argued that China's financial risks are contained because of the country's low levels of external debt and large foreign-exchange reserves. That has now changed. China's external debt has been increasing by an average of $70 billion per quarter since the beginning of 2017. If it keeps rising, Beijing will have the unpalatable choice of burning through its reserves or letting the Yuan fall, both of which would carry additional risks. China and the world need to think clearly about this growing dollar debt dependence. Any cessation of funding could have unforeseen and severe consequences.

Factor Trumponomy
It only took a small taste of what a U.S. recession might be like for President Donald Trump to suggest that he wants a trade deal with China. The Dow Jones Industrial Average plunged 800 points in its worst rout of the year after the gap between the two-year and 10-year Treasury yields turned negative for the first time since 2007. The last seven recessions in the U.S. has been preceded by an inverted yield curve.

This inverted yield curve has preceded the last seven U.S. recessions ever sensitive to stock movements, the president tried to calm the markets after the close. Abandoning his hawkish trade rhetoric, Trump extended an olive branch to Chinese President Xi Jinping in a series of tweets, calling him a great leader and a good man. He ended his posts with personal meeting without specifying whether he was proposing a summit.
The question is how Xi will respond to Trump's overture? Who's more desperate for a trade deal right now?

China and the U.S. are in their respective business cycles. Since the trade war started, American consumers have sat tight and enjoyed their prosperity just as Trump has boasted. China's economy, by contrast, has been having a much tougher time. In the past year and a half, Beijing has had to deal with all sorts of credit issues that could escalate into a wider economic crisis.

Examples abound. Last year, as the stock market suffered one of the world's worst routes, regulators changed margin-financing rules. The declines stemmed partly from listed companies pledging shares as collateral to secure short-term bank financing. This spring, the People's Bank of China undertook the first commercial bank seizure in two decades and was forced to calm ensuing jitters in the interbank market. Meanwhile, Beijing has had to deal with periodic peer-to-peer lending crises and bond defaults by state-affiliated entities. This might sound bad, but it helps China now. If a fireman has to put out fires every day for a year, he gets more proficient. That's where Beijing is now.

The same can't be said of the U.S. The slide in its sovereign long-term bond yields a measure of investor confidence has been fast and furious. When Federal Reverse Chairman Jerome Powell described the U.S. rate cut as a mid-cycle adjustment, the gap between the 2-year and 10-year bond yields was still 21 basis points. In Asia, the 30-year yield, which more reflects traders' view of the overall health of the economy rather than the depth of the current easing cycle, fell to a record low below 2%.

China's economy is slowing gradually: Industrial output growth is at its weakest since 2002. But digging deep into the data, the picture that emerges is of a government that's measured and confident. For instance, some of the weakness in the July data reflected moves to rein in shadow financing and restart property deleveraging. If Beijing wants better-looking industrial output numbers, it just needs to reopen the liquidity taps. No signs of panic was showed by the PBOC. The central bank rolled over 383 billion Yuan ($54 billion) of medium-term facility loans with unchanged interest rates. While the world's largest central banks are racing toward zero rates, the PBOC has been sitting on the sidelines, saving its firepower for later.

When it comes to economic management China's system has its advantages, as I've mentioned. The ability of ministries to co-ordinate their policy responses means China can practice the ultimate in modern monetary theory, which is probably what the U.S. needs right now to restore its yield curve.
So while Trump may think his olive branch is a big deal, the message to Washington goes: Don't think you've got China on the ropes. Xi was panicking a year ago; he can afford to wait now.

Bilateral trade deficit by $200bn

The Trump administration has presented China with a list of hardline trade demands, including requiring Beijing to cut their bilateral trade deficit by $200bn, in a clear sign the White House intends to escalate its brinkmanship despite rising international fears of a trade war. The demands, produced as part of Beijing talks with a US delegation led by Treasury secretary Steven Mnuchin, included opening up China further to US investment and a removal of the country's foreign-ownership caps, according to documents seen by the Financial Times. Beijing has responded with a matching stance of its own, calling on Washington to drop its longstanding objections to China being treated as a market economy in the World Trade Organization and threatened to retaliate by treating the US as a non-market economy if it did not comply. The US demands amount to a call for unilateral Chinese disarmament ahead of a potential trade war and for Beijing to abandon key elements of its industrial policy, which have led Washington to grow increasingly wary of China as a long-term economic rival. They are unlikely to be agreed to by President Xi Jinping or his economic team, though in a draft declaration offered by the Chinese and seen by the FT, Beijing said it was prepared to increase its purchases of US goods as long as Washington lifted some of its own export controls.

Washington insists that intellectual property theft, forced technology transfers, and joint venture requirements affecting foreign investment amount to a systematic effort to erode US leadership in strategic sectors. Donald Trump has been ratcheting up his anti-China trade rhetoric for weeks, announcing sweeping tariffs on steel and aluminum imports and threatening separate duties on as much as $150bn in Chinese goods. But the new demands presented to Chinese authorities mark a significant escalation. Previously, the White House had insisted China cut the bilateral deficit by $100bn in the next year. The new demand for a $200bn cut is to be achieved by 2020. According to US data the US's goods and services deficit with China was $337bn last year. The document also seeks that Beijing refrain from any retaliation against US trade and investment measures aimed at China's intellectual property regime and drop challenges at the WTO. The US is also seeking a cut in import tariffs in non-strategic sectors to levels at or below those imposed by the US.

Washington has requested Beijing publish a so-called negative list of restricted sectors singling out industries still covered by duties. Among Beijing's demands is an end to restrictions on US exports of sensitive high-tech products and the lifting of a recent ban on telecommunications maker ZTE sourcing parts in the US.

The US demands are a signal that hardliners in the administration have been driving the negotiating process following the departure of leading internationalists like Gary Cohn, the former Goldman Sachs president who quit as Mr. Trump's chief economic adviser. Mr. Trump's aides have been divided over the approach, with some seeking a quick deal focused on reducing the deficit, while others have been pushing for the US to demand more systemic changes of China. The large size of the delegation to Beijing had been seen as a sign the divisions remained and a quick deal was unlikely. The delegation included seven senior officials, including Wilbur Ross, commerce secretary; Robert Lighthizer, US trade representative; and Peter Navarro, the White House's top trade adviser. The negotiations produced no breakthroughs, although one person briefed on the talks said had at least been cordial.

China's official Xinhua news agency reported the two countries ―reached some consensus on expanded US exports to China, bilateral services trade and bilateral investment but rather large differences remained on some issues. Among the demands made in the American document are for Beijing to eliminate all market distorting subsidies linked to its Made in China 2025 industrial policy. The plan is designed to promote Chinese leadership in advanced industries including aerospace, robotics and electric vehicles. The Trump administration is now preparing new investment restrictions aimed at limiting China's ability to buy US companies in strategic sectors, something that has become a broad area of concern for both security and economic policymakers and experts in Washington. In a speech, Mr. Xi said, China does not seek trade surpluses and would take the initiative to expand imports. But Chinese experts and officials have said that significant reductions in the bilateral deficit would require easing US restrictions on high-tech exports and building new infrastructure to support US exports of natural gas and coal.

A senior US business executive briefed on the discussions saying that the comprehensive set of demands came as a relief, given fears that Mr. Trump would reach for a quick win. We were worried Trump would reach a deficit reduction agreement and declare victory, said the executive, adding that US businesses were far more concerned about market access and intellectual property issues. Here's data from the U.S. Census Bureau on all of America's top trading partners.

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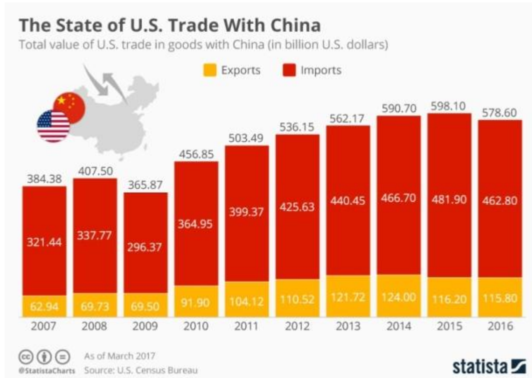

Unemployment, Under-employment and its Social Impact

In the US labour market, when employment rises, and the rate of unemployment falls, all the participants in the economic structure are not getting benefitted equally. The young employees experience high degree of under-employment. This can have a long-lasting effect on the employees as the spell of underemployment and unemployment in their early career can have a negative impact for their entire lifetime earnings. Widespread job insecurity, income loss and series of lost jobs have characterized the US economy in the last few decades. There are increased levels of displacement of workers due to recessions. All these are causing irregularity and negative effects in the social security system of the urban society. It has a far-reaching impact on their mental health, disrupting the person's status, competence and skill, as well as can cause acute stress interrupting their major social rules, along with chronic stress resulting from psychological anxiety. The displaced workers face higher levels of depressive symptoms, loss of self acceptance, self esteem, self confidence, social support, as well as sense of control.

Unemployment and underemployment impacts their well-being as it negatively affects their sense of purpose, giving rise to idleness, apathy, isolation, and the breakdown of their social personality as working in a work environment. They start to lose their sense of identity as they cannot relate themselves working in a routine work situation such as a time structure, economic security, using skills, exercising interpersonal socialization and also holding a position in the society. It also affects their family members, especially the children. There are possibilities for dropout, grade repetition or even suspension. Widespread unemployment will decrease the internalization of social stigma associated with loss of job. As unemployment increases as an aggregate, one's own unemployment will represent a smaller deviation from the established social norms. The sociologists and economists have studied this issue for a long time now. This is an unpredictable disruptive life situation that welcomes abrupt changes in the life of the employees throughout all the segments of workforce and it furthers the societal stigmas to the impacts of unemployment on life chances.

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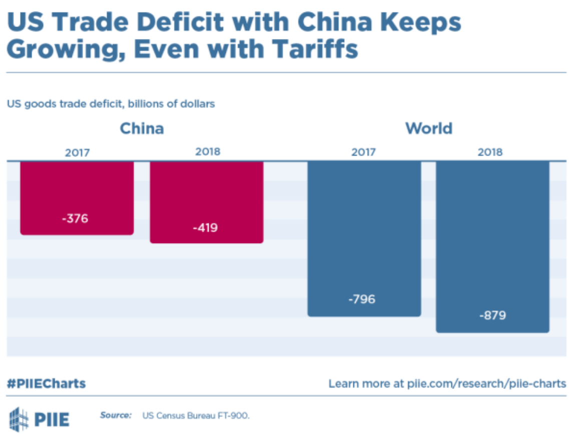


U.S. Trade Deficit

The United States has now run an annual trade deficit for 40 years in a row.

Last year was no exception, and in 2015 the U.S. had over $1.5 trillion in exports while importing $2.2 trillion of goods. The resulting trade deficit was -$735 billion. Keep in mind that a trade deficit also means an outflow of domestic currency to foreign markets, as the U.S. is spending more money abroad than it is bringing in.

Trade Imbalance and Currency Impact:

(largest negative trade balances)

1. China: -$365.7 billion
2. Germany: -$74.2 billion
3. Japan: -$68.6 billion
4. Mexico: -$58.4 billion
5. Ireland: -$30.4 billion

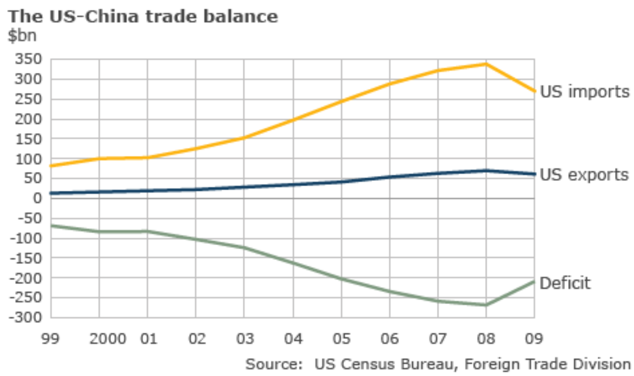
China alone represents about 50% of the total trade deficit. In comparison, Europe only adds up to 23% of the overall negative balance.

The United States also has smaller, positive trade balances with some nations.

1. Hong Kong: $30.5 billion
2. Netherlands: $24.0 billion
3. Belgium: $14.6 billion
4. Australia: $14.2 billion
5. Singapore: $10.4 billion

Even if the U.S. multiplied its largest positive trade balance (Hong Kong) by a factor of 12x, it would only just then be enough to even out the deficit with China.

US companies have long complained that China keeps its currency artificially undervalued, allowing a steady flow of cheap exports around the world.



Conclusion

Fast changing international economic and trading environment has shown a new direction towards the global economic cooperation. Since 1990s most of the developing countries of the world started economic reforms and liberalization policies to encourage growth rate and to further exploit their potential in the best way possible. The economic reforms in China began after the death of Mao in 1978. Liberalisation of foreign trade sector has been the mild stone of economic reforms in the Chinese economy. The country embarked on planned development almost at the same time with an emphasis on import substitution policies. At the beginning, the basic force of the country was on self reliance, but later it moved towards being market- oriented and having outward- looking policies. World Trade Organisation (WTO) since its establishment in 1995 has been playing a crucial role towards this direction and has prescribed rules and norms to restructure the trade and economic policies to integrate different economies with global economy. Indo- China bilateral trade developed slowly and steadily before 1995.

Hence, China should ensure that their rules of origin are transparent and are defined such that they do not have any restricting, distorting, or disruptive effects on bilateral trade. Frequency of direct shipping routes should be thereby increased.

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