

DECODING U.S. – CHINA TRADE

GREAT DECISIONS | WORLDREGION | 2/15/2019

Key Points of Haft Thesis

- Traditional national income accounting methods (GDP) overstate the comparison of size and vitality of U.S. and Chinese economies. Chinese numbers are opaque and of questionable integrity. Many issues related to population demographics, environment and arable land, among others, require a more dynamic analysis.
- Traditional balance of trade analysis overstates the bilateral deficit and understates the foreign share of value-added (inputs, software, services) embodied in Chinese assembled exports and importance of global supply chain relationships.
- Policy decisions (tariffs aimed at deficit reduction) which ignore these supply chain relationships will cause significant, unintended trade disruption. Address a political symptom, not a core problem.
- Solutions proposed include bolstering Chinese safety protocols (closer monitoring of supply chain/use of blockchain protocols); incorporating negative externalities (CO2 emissions) into pricing of traded goods and revising trade statistics to reflect value-added of foreign inputs.

U.S. China Trade Facts

- U.S. goods and services trade with China totaled an estimated \$710.4 billion in 2017. Exports were \$187.5 billion; imports were \$522.9 billion. The U.S. goods and services trade deficit with China was \$335.4 billion in 2017 (projected to exceed \$400 billion in 2018 – highest ever).
- China is currently our largest goods trading partner with \$635.4 billion in total (two way) goods trade during 2017. Goods exports totaled \$129.9 billion; goods imports totaled \$505.5 billion. The U.S. goods trade deficit with China was \$375.6 billion in 2017.
- Trade in services with China (exports and imports) totaled an estimated \$75.0 billion in 2017. Services exports were \$57.6 billion; services imports were \$17.4 billion. The U.S. services trade surplus with China was \$40.2 billion in 2017.
- According to the Department of Commerce, U.S. exports of Goods and Services to China supported an estimated 911,000 jobs in 2015 (latest data available) (601,000 supported by goods exports and 309,000 supported by services exports).



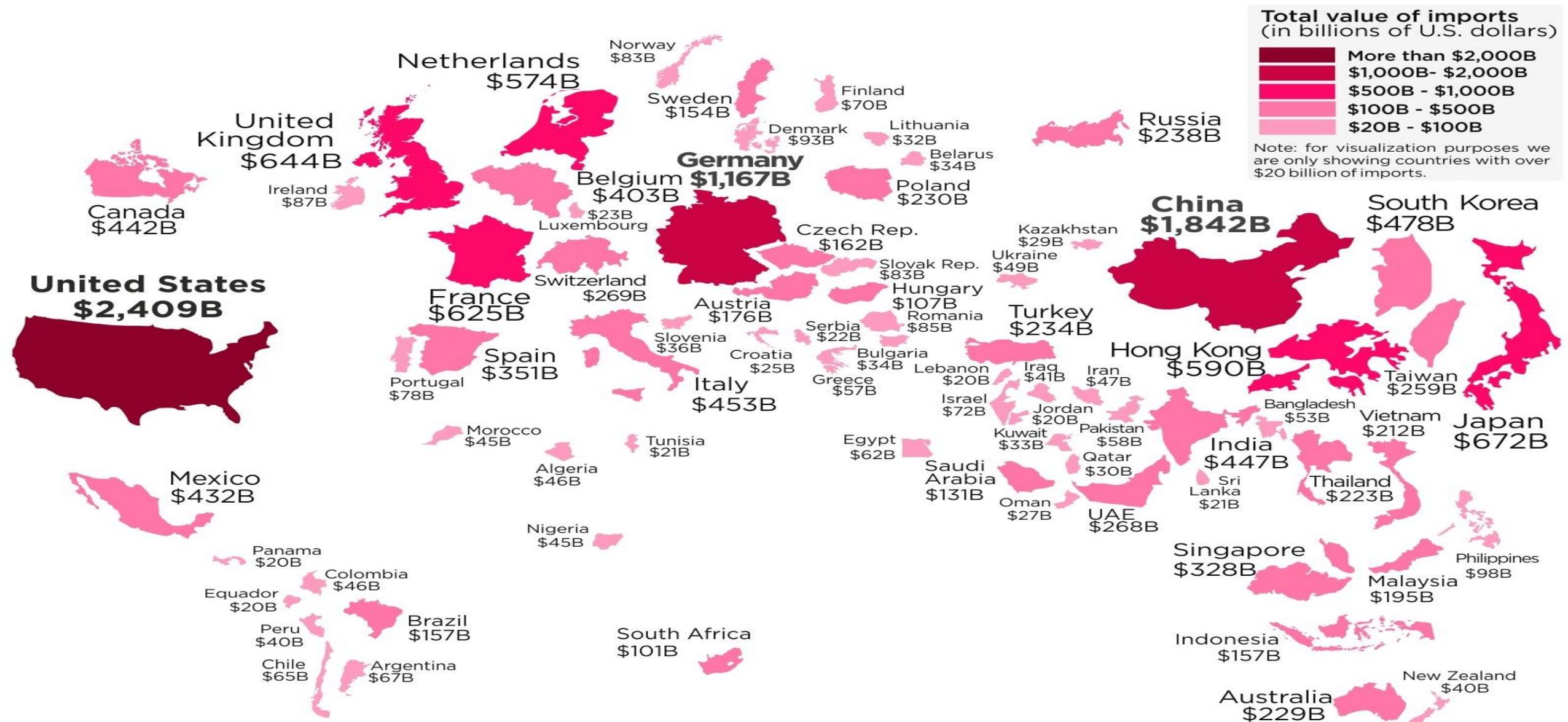
How to read this map: The size of the country and the color correspond to the value of its exports according to the WTO.

Article & Sources:

<https://howmuch.net/articles/largest-exporting-countries-2017>

<https://www.wto.org>

howMUCH net



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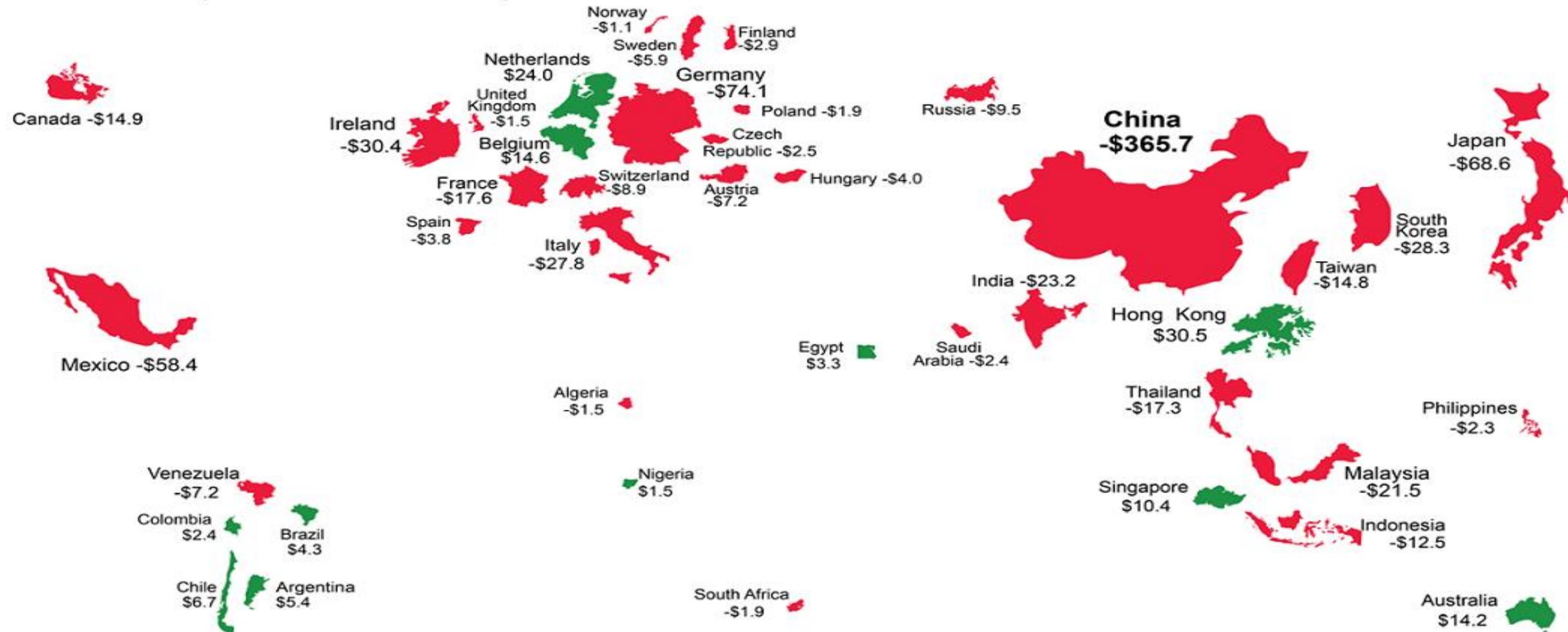
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<https://www.wto.org>

World Map of U.S. Trade Balance

Trade in Goods (in billions of dollars)



How to read this graph:

Countries in red colour show where U.S. has a trade deficit.

Countries in green colour show where U.S. has a trade surplus.

The size of the countries represent a higher or lower trade deficit/surplus.

e.g. U.S. has the highest trade deficit with China and the highest trade surplus with Hong Kong.

FAIR TRADE?

In America's perception of trade relationships, China is enemy #1

While most Americans aren't experts on trade, the general sentiment of the population is important – particularly as feelings translate into votes and support for policy.



Gallup's 2018 poll on trade policies shows a broad shift in sentiment among the American population.

American perceptions of fairness in trade relationships



EUROPEAN UNION



According to the results, a majority of Americans believe they're getting the short end of the stick in their trade relationship with China.

Source: Visual Capitalist

WALMART NATION

Walmart is the largest private employer in 21 states

- 21 WALMART
- 16 HEALTHCARE
- 8 EDUCATION
- 5 OTHER COMPANY

TOP PRIVATE EMPLOYERS IN EACH STATE



SOURCE: 24/7 Wall St, Walmart, Governing

visualcapitalist.com



30 Years of U.S. - China Trading 1985



Lies, Damn Lies and Statistics

- "the bilateral trade number fails to fully explain the impact of trade with China on the US economy. As it plugs into the global industrial supply chain, China is the “Great Assembler.” The OECD estimates that about one-third of the content of Chinese exports is foreign, compared with just 15 percent of US exports..... the latest data suggests that even in key growth markets—computer equipment, electronics, and electrical machinery—the foreign content of goods assembled and re-exported from China is still roughly 50 percent." (Source: Oxford Economics, "Understanding the US-China Trade Relationship," January 2017)
- While US import data reflect the retail cost of a phone as coming entirely from China, only a small portion of its value is actually added in the country, as the phones are assembled in Chinese factories from products sourced from across the world. Most of the profits also go to Apple, a US company, rather than its Chinese suppliers..... “It’s easier to count a physical good going into the US and an email attachment going out,” he said. “A chip is counted as an export. Software isn’t. But they do the same job.” (Financial Times "Hidden value in phones could ‘cut US trade deficit in half”, 2/11/2019)
- However, although the total U.S. goods trade deficit with Asia (including China) has been increasing, the Asian share (including China) of the U.S. goods trade deficit as a whole has been steadily declining since 1991, now standing at around 65 percent, despite China’s rise as the largest supplier of goods to the U.S. In other words, the rise of China since the late 1980s—especially after joining the WTO in 2001—has not increased the total share of Asia’s contribution to the U.S. trade imbalance; China simply substituted out other Asian economies by taking their positions. That is, even though China’s share in total U.S. trade deficits has been increasing rapidly from around 15 percent in 1991 to 45 percent around 2016, it has not increased the total share of Asia’s trade position with the U.S. (<https://www.stlouisfed.org/publications/regional-economist/third-quarter-2018/understanding-roots-trade-deficit>)

The Gang that Couldn't Shoot Straight or Tariffs and Retaliation (outside of WTO remedies)

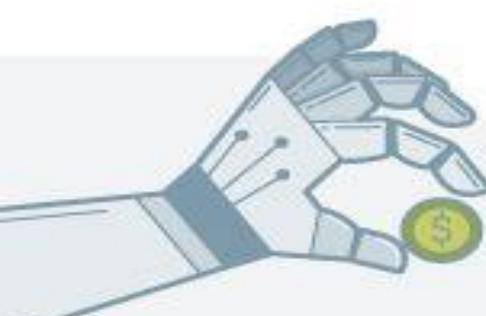
- Haft example of Chinese solar panels and demise of the photovoltaic polysilicon industry in the U.S. which supplied China's panel makers.
- Chinese retaliation against U.S. soybean and pork producers (resonating with bankruptcies throughout the Midwest).
- Ford and General Motors executives each expect that steel and aluminum costs will be \$1 billion higher next year than this year. Suppliers' profitability will suffer from these increasing costs. Smaller suppliers are already dealing with pressure from higher materials costs, which they cannot pass on to their customers under their fixed-price contracts.
- New research by US analysts shows that Chinese steel producers are enjoying more exemptions from U.S. tariffs on steel than those from US allies Canada, South Korea, Spain and the United Kingdom. (Mercatus Centre at the George Mason University)
- Potential local impact of escalation – Intel chips (China our largest market in tech global supply chain), consumer reaction against Nike in their largest overseas market, Boeing local supply chain—including Precision Castparts.

Haft's Solutions Address Haft the Problem but Multilateral Instincts Are Good

- Enhancing safety protocols important but commercial solution within supply chain (blood diamonds, ivory, tantalum precedents)
- Pricing in negative externalities requires multilateral consensus and China will play long game especially since U.S. left Paris Accord on Global Climate Change.
- Modernizing trade statistics to account for value added is critical to improving policy debate but Haft misses the growing importance of the role and proper valuation of IP and services in global trade and in the current U.S. China conversation.
- WTO disciplines on Trade Related Investment Measures (TRIMs) and Trade Related Intellectual Property Rights (TRIPs) were developed to address many of the practices that China has traditionally been accused of since its accession in 2001, but WTO members and their business communities had not reached a critical mass to address these issues through dispute settlement. System in need of repair – U.S. part of the present problem.
- U.S., European and Asian corporations benefitted from use of China as an export platform, access to a growing market and enhancing their manufacturing partners capabilities – creating their own future competition.
- The role of the Chinese government in providing incentives for foreign investment and technology licensing, generous credit and venture capital financing, support for IP theft through weak laws and enforcement and more recent allegations of industrial espionage require both bilateral and multilateral efforts.

Coherence Might Work (and a commitment to worker training)

- Revising trade statistics with a more modern accounting would put the trade and supply chain relationship in a more accurate perspective and reduce scope for hyperbole (depending on the audience).
- Be aggressive with WTO consistent trade remedies (the U.S. has scores of cases against China under our anti-dumping and countervailing duty laws). End the abuse of the “national security” exemption being used for the steel and aluminum tariffs which has aligned most of our trading partners against us and failed to address Chinese production over-capacity – an issue requiring a multilateral solution.
- Use the WTO to address market access practices affecting IP theft and services market access. Seek new WTO disciplines where state actors might be involved in industrial espionage – encourage member governments to act collectively in criminal prosecutions and procurement practices where allegations are proven.
- Expand scope for more services trade from reducing barriers to global data transfer and financial flows to increased tourism and educational exchanges.
- NAFSA, a nonprofit group that supports international education, estimates that students from abroad created or sustained more than 455,000 jobs in the United States, almost nine times the number of American coal miners. The value of education is almost double the revenue from America’s top agricultural export in 2017, soybeans (\$21.6 billion). When other student spending is factored in – food, cars, clothes – education’s total export value rivals that of pharmaceuticals (\$51 billion) and automobiles (\$53 billion).” (NY Times Magazine, “One of America’s Most Vital Exports, Education, Never Goes Abroad, but It Still Faces Threats”, Joyce Larmer 1/3/2019)



Labor-cost arbitrage

18%

of goods traded

Exports from countries whose GDP per capita is one-fifth or less than the importing country.



This trend may be amplified in the future by technological developments, as automation and AI reduce labor inputs in manufacturing.

Other factors

82%

of goods traded

These include:

- Access to skilled labor
- Access to natural resources
- Proximity to customers
- Quality of infrastructure



Source: McKinsey.com/globalization

A different mix of countries, companies, and workers will benefit from the next chapter of globalization.



Which countries are likely to benefit from these shifts?

Advanced economies



Strengths in innovation, services, and highly skilled talent put advanced economies in a strategic position.

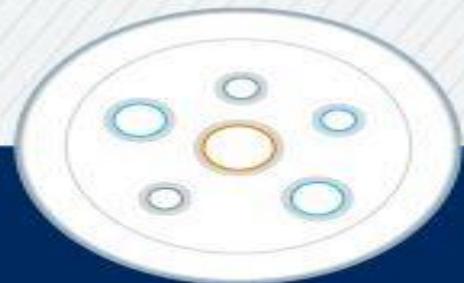
Developing economies with close proximity to large consumer markets



As production moves closer to consumers, well-located developing economies can take advantage.

Which countries will need to adapt?

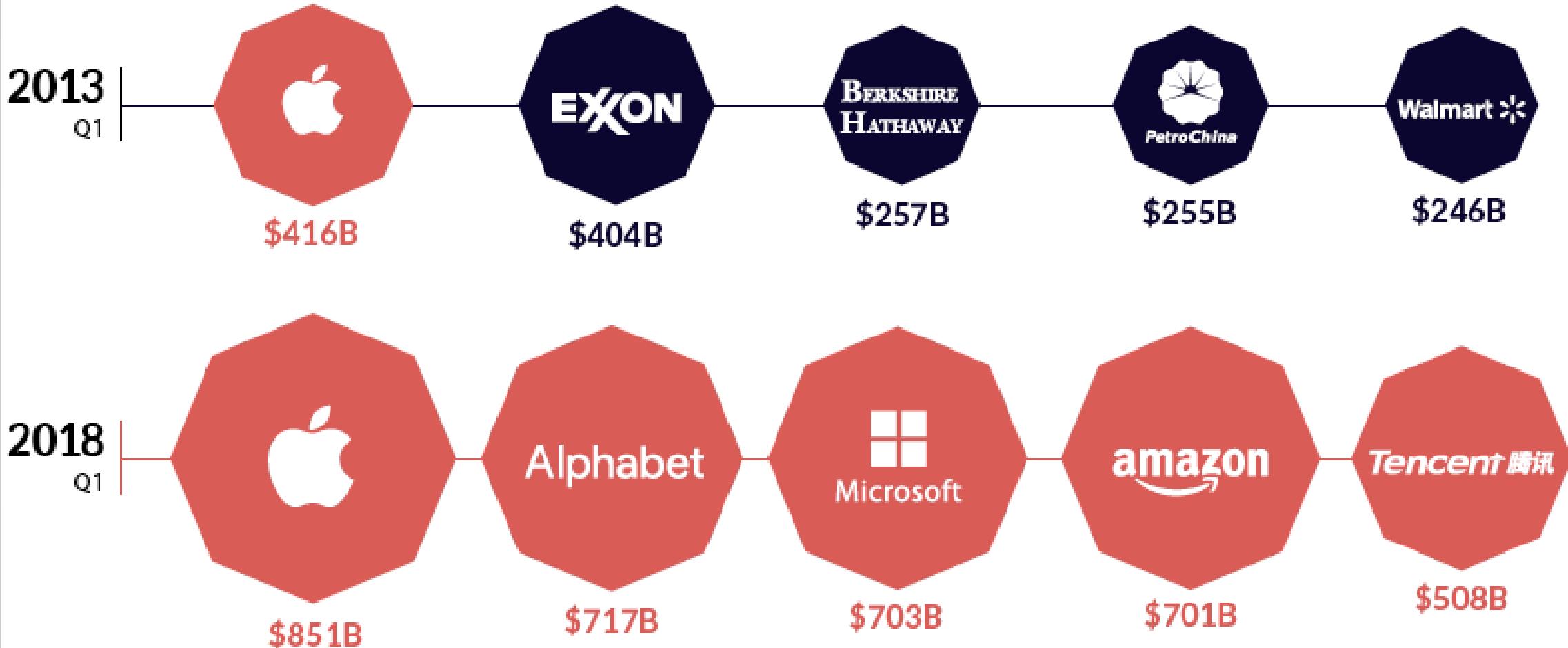
Developing economies that are less connected



The window is narrowing for low-income countries to use labor-intensive exports as a development strategy.

TOP 5 PUBLICLY TRADED COMPANIES (BY MARKET CAP)

 Tech  Other



Source: Visual Capitalist

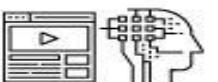
A Brief Introduction to BATX

Google?



BAIDU 百度

SEARCH • ARTIFICIAL INTELLIGENCE



Baidu is an Internet services company, that is roughly similar to Google in the United States.

BAIDU'S R&D EXPENSES, IN BILLIONS OF YUAN



Lately, Baidu has been ramping up R&D spending on artificial intelligence. In particular, the company is eyeing the autonomous driving market.

Amazon?



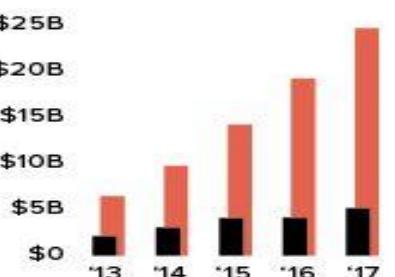
ALIBABA 阿里巴巴集团

E-COMMERCE • PAYMENTS • CLOUD



Alibaba is now the world's largest and most valuable retailer. The company also owns financial services company, Ant Financial, which is expected by many to IPO in 2018.

SINGLES DAY VS BLACK FRIDAY



Alibaba turned Singles Day – a holiday originally created by single university students – into a global shopping phenomenon. In 2017, Singles Day shoppers racked up over \$25 billion of purchases in 24 hours.

Facebook?



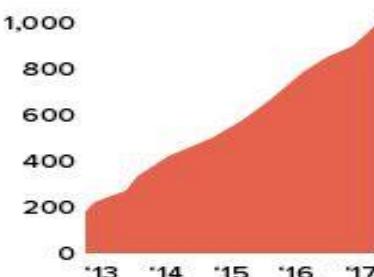
TENCENT 腾讯

SOCIAL • PAYMENTS • GAMING



Tencent, a conglomerate with a wide array of Internet and payment services, has become one of the largest tech companies in the world.

WECHAT MONTHLY ACTIVE USERS, IN MILLIONS



Tencent's WeChat has more than a billion users worldwide, and WeChat Pay has more than 200 million linked payment accounts.

Apple?



XIAOMI

CONSUMER ELECTRONICS



Xiaomi is one of China's top smartphone brands, and a major player in smart homes, IoT, smart wearables.

Xiaomi sold 92 million smartphones in 2017, an impressive 75% increase over the previous year.



In addition to brisk domestic sales, Xiaomi makes 3 of the 5 top-selling phones in India.

Source: VisualCapitalist