RAYMOND YEUNG

CHINA'S TRUMP CARD

CRYPTOCURRENCY AND ITS GAME-CHANGING ROLE IN SINO-US TRADE

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This edition first published 2020

Registered Office(s)

John Wiley & Sons, Ltd.,

Editorial Office

111 River Street, Hoboken, NJ 07030, USA

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Library of Congress Cataloging-in-Publication Data

Names: Yeung, Raymond Y. T., author.
Title: China's Trump card : cryptocurrency and its game-changing role in
Sino-US trade / Raymond Yeung.
Description: First edition. | Hoboken : Wiley, 2020. | Includes
bibliographical references and index.
Identifiers: LCCN 2020025712 (print) | LCCN 2020025713 (ebook) | ISBN
9781119699125 (hardback) | ISBN 9781119699149 (adobe pdf) | ISBN
9781119699156 (epub)
Subjects: LCSH: China—Commerce—United States. | United
States—Commerce—China. | Tariff—China. | Tariff—United States. |
China—Foreign economic relations—United States. | United
States—Foreign economic relations—China. | Trump, Donald, 1946-
Classification: LCC HF3838.U6 Y46 2020 (print) | LCC HF3838.U6 (ebook) |
DDC 382.0951/073—dc23
LC record available at https://lccn.loc.gov/2020025712
LC ebook record available at https://lccn.loc.gov/2020025713

Cover Design: Wiley
Cover Images: Dragon © ly86/Getty Images,
Cryptocurrency icon © Puwadol Jaturawutthichai/Shutterstock, Cardboard paper © koosen/Shutterstock

Set in 11.5/14pt BemboStd by SPi Global, Chennai, India

Printed in Great Britain by CPI Antony Rowe, UK

10 9 8 7 6 5 4 3 2 1

To all the victims who have suffered from the deadly coronavirus. To all the medical heroes who fought selflessly in the front line.

Contents

Acknowledgments

This book could not have been completed without the help of many awesome individuals. My beloved wife Theresa read the first draft of the manuscript while serving me a bowl of noodles when I was burning the midnight oil. A special appreciation to my niece Tiffany Kwok, a smart, passionate student in political science at the University of Toronto who served as my secret "reviewer" and offered me helpful comments.

Thanks to everyone on the Wiley team, notably Gladys (Syd) Ganaden, Purvi Patel, and Karen Weller, who helped me so much in the publication process.

I thank my employer, Australia and New Zealand Banking Group Limited (ANZ) for approving this external engagement with Wiley. I am indebted to Richard Yetsenga, ANZ's Chief Economist, for supporting this endeavor and my personal development. Richard and many colleagues I've collaborated with closely during the past decade are an integral part of my career development.

This book covers a very complicated subject. I have benefited from many knowledgeable individuals in the business community, institutional investors, and policymakers. Many of them have significant stakes in the Sino–US economic relationship. They've offered me many different perspectives in analyzing this trillion-dollar question. I can only express my gratitude to them anonymously.

Last, but not least, without God's provision I wouldn't be able to do any of this when the world is beset by pandemic and other socio-chaotic woes.

All views expressed in this book are neither my employer's nor the aforementioned parties. All errors are solely my responsibility.

About the Author

Raymond Yeung graduated with a PhD in Economics from Queen's University in Canada and is a holder of the Financial Risk Manager (FRM) certification. He began his economist career one week prior to the Asian Financial Crisis in 1997. He is currently Chief Economist Greater China at Australia and New Zealand Banking Group Limited (ANZ), leading an award-winning team covering the region's macroeconomic and financial market research. His insights have received strong following, including institutional investors, corporate treasurers, and central banks. He speaks frequently in industry conferences and shares his views on Bloomberg, Financial Times, CNBC, Di Yi Cai Jin, and Caixin. Prior to joining ANZ, Raymond was Deputy Head of Economic Research Asia at Swiss Re. He is a Council member of China Chief Economist Forum and a columnist in the Chinese media.

Preface

When I submitted the manuscript to the Wiley team, China and the rest of the world were battling against the COVID-19 pandemic. To prevent the virus from spreading, the Chinese government imposed a lockdown policy unprecedentedly. Economic activity was weighed down acutely. Supply chains were interrupted. The global situation was also alarming as the virus cases soared in other countries, including the US. In response to the negative economic impact, the Federal Reserve reduced policy interest rate to zero and restarted quantitative easing. Other central banks also followed the Fed and eased their monetary policy.

The virus shock represented an unpredictable "Black Swan" event in a fashion similar to Trump's initiated trade war. When the 45th US president took over the White House in early 2017, not too many people treated his "America First" claim seriously. His tweets, his tariff, and his "friendship" with president Xi Jinping stirred up market volatility. When he started the trade war in 2018 shortly after hosting Xi in Florida, exporters were caught off guard. Many people in the financial markets regarded the trade war as the "black swan" of the year.

In this book, however, I argue that this US–China trade war is not a black swan. Unlike coronavirus, the trade tension is predictable. When the trade war was looming in July 2017, a high-profile editorial in *People's Daily* warned that China should be on guard against not only the black swan but also the "grey rhino." The Chinese government was pointing the latter to the lingering concern of a financial bubble, equivalent to a national security issue as I interpreted in a Bloomberg interview on July 19, 2017.

"Grey rhino," a concept coined by Michele Wucker in light of the Global Financial Crisis (GFC), refers to event risks that are impactful, obvious, and predictable. To Wucker, the US housing bubble in 2008 should have been foreseeable. The crisis was due to policymakers' lack of guts to right the wrong. When the GFC broke out, the market thought it was random and unpredictable. In hindsight, the policymakers should have noticed the danger and fixed it.

Likewise, the tension between the US and China was so obvious. The trade war was a "grey rhino." Three years prior to the GFC, Ben Bernanke agreed that the rising US current account deficit stemmed from a global saving glut. What he did not admit was that the only way to stop it was to take away the "exorbitant privilege" of the dollar. The then chairman of the US Fed printed money seemingly unlimitedly to save the US financial markets. China stocked up the US government debts and funded the ever-widening US–China trade gap. Trade imbalance was actually a monetary phenomenon. People said the trade war was a "black swan." Beneath the swan's feathers was actually a "grey rhino."

This book proposes a way to break the tie between the China–US trade imbalance and the global addiction to the US dollar, i.e. an outcome of the Triffin Dilemma. As the trade war is the onset of deglobalization, de-dollarization inevitably becomes a natural consequence. Cryptocurrency signals the need to reform the global monetary system. Just when China and the US are competing in the technological realm, Blockchain provides a perfect alternative to the current system of global foreign reserve. In 2009, Zhou Xiaochuan requested a reform of the dollar-based regime. In 2019, Mark Carney responded to his question and agreed to develop a "synthetic hegemonic currency."

In the first chapter, I review the causes, the impact, and the outlook of the trade war. On the surface, the US was frustrated with China's track record of intellectual property rights and forced technology transfer, offering an excuse for the US to act. However, behind the conflict seemed to be the crash between the ideologies of "China Dream" and "America First." Import tariff is just smoke and mirrors. The US administration decided to attack the global supply chains. Prohibiting US companies from business transactions with some Chinese companies could paralyze their production line. It was an alternative way to drag China's exports to the US. This trade war is unconventional.

In **Chapter 2**, I argue that, no matter how unconventional they are, the trade measures and even trade agreements cannot reduce US current account deficits. Due to the "exorbitant privilege" of the US dollar, the US lacks an incentive to manage its fiscal and external balances. China, a country having USD 3 trillion of savings in foreign currency, has recycled its export surplus into US dollar assets. This loop, I call it "factory dollar recycling," resembles what oil-exporting countries have been doing after the Nixon shock. Even without gold backing, the US dollar continues to secure the advantage of network externalities. The problem of trade imbalance is chronic. Neither import tariff nor currency revaluation can fix it.

Is the leading position of the US dollar unshakable? **Chapter 3** searches for an answer from history. The interchanging position between pound sterling and the dollar in the Interwar Period offered many important insights. In my discussion, I stress that globalization, financial integration, and dollarization are interlinked. When deglobalization begins, as the trade war is signaling, populism and protectionism also question the role of financial integration, especially after a financial crisis. As the global market is divided, the dollar's monopolistic position is not invincible.

Naturally, the protagonist in the trade war is the one eager to de-dollarize, as I explain in **Chapter 4**. In 2005, China began to unpeg the renminbi from the greenback. In 2009, the authorities kicked off a high-profile campaign of currency internationalization. By Mundell's impossible trinity, a more flexible exchange rate regime will allow China to hold less foreign reserve. Using the yuan as a trade currency also allows China to distance itself from the US dollar. This policy preference may also be revealed by the currency allocation of China's sovereign wealth funds. Contrary to the topic of RMB internationalization, China's reserve management has not received much coverage in the existing literature. But it is a critical part of reforming the global monetary regime.

After the Nixon shock, the US secured the fate of its currency through semi-pegging with Saudi Arabia's oil reserve. In the twenty-first century, what kind of tie should the Chinese yuan develop? In **Chapter 5**, I argue that technological development is the only way for the country to beat the middle-income trap. "Go digital" is a development strategy many countries have adopted in order to stay competitive. China has already held a leading position in e-commerce and internet connectivity. Belt and Road (supposedly) has become an opportunity to extend this connectivity globally. In the last few decades, petroleum was backing the global influence of the US dollar. In digital times, 5G will very likely support China's total factor productivity. In this century, China's position in the digital economy defines the value of the renminbi.

Can the Chinese yuan replace the US dollar in the digital economy? The answer is "possibly." The pound lost its global position after a series of shocks during the Interwar Period. Similarly, another shock is required to trigger a reform in the international monetary system. In my view, blockchain is the trigger. In **Chapter 6**, I offer my two cents on cryptocurrency from an outsider's point of view. My wish is for the readers to appreciate that, based on blockchain, cryptocurrency is technically capable of being a secured form of payment. My discussion in this chapter focuses on the micro foundation of cryptocurrency. In contrast to our money-and-banking system, distributed ledger technology is disintermediating. The architecture is completely different from sovereign money, be it the yuan or the US dollar. However, distributing the trust across participating members does not disqualify its legitimacy as a form of money.

In **Chapter 7**, I lift the discussion of cryptocurrency to the macro level. The international monetary system is sovereign-based. The system is rule-based, as the Balance of Payment Manual states the foreign reserves have to be denominated in currency of the legal tender. Well, gold is exceptional. But, in my view, there is no reason not to expand the list of exceptions. Facebook's introduction of Libra has prompted regulators to quicken the development of central bank digital currency. Zhou's request was met with a cold shoulder. Satoshi Nakamoto's invention was regarded as a cult. Eventually, Carney's call for going digital will likely receive a red-carpet treatment.

In the **final chapter**, I propose a practical solution that takes Carney's idea one step forward. The digital currencies issued by different central banks are largely an electronic version of M0. They are still fiat money. To preserve the spirit of blockchain, global policymakers should develop an official cryptocurrency that can also overcome some operational issues of private coins, such as governance of reserve or AML/CTF. I name this coin the World Crypto Currency (WCC). Given its official status, the WCC could also be a reserve currency for China to consider. Don't be afraid, China. The new system will facilitate your reserve diversification. The WCC is not a yuan competitor. It is a venue to support the value of the renminbi.

Lastly, I definitely need to underscore certain caveats here. This book is perhaps the first attempt to integrate several seemingly unrelated economic topics into a single coherent theme: the US–China trade war, the economic history of globalization, digital economy, cryptocurrency, and monetary economics. My broad and superficial knowledge does not qualify me an expert in any of them. The thoughts presented in this book do not form any base for an investment recommendation. I do not have personal holdings in cryptocurrency (as of March 2020). My hope is for this book to offer some food for thought in the era when the new international economic order begins.

Chapter 1

An Unconventional Trade Feud

1.1 Thanos and Trump

Beware readers, spoiler alert ahead.

> *"I thought by eliminating half of life, the other half would thrive . . . with the stones you've collected for me, create a new one teeming with life that knows not what it has lost but only what it has been given. A grateful universe. . . . I am inevitable."*
>
> *Thanos,* Avengers: Endgame.

On June 20, 2018, I came across an interesting headline, "Avengers star Josh Brolin explains how Trump is similar to his 'Infinity War' villain Thanos," on an online business magazine.[1] In his interview with

[1] *Insider.* "Avengers" star Josh Brolin explains how Trump is similar to his "Infinity War" villain Thanos. *Insider* (June 20, 2018). (https://www.insider.com/josh-brolin-avengers-infinity-war-thanos-donald-trump-stephen-colbert-video-2018-6).

Stephen Colbert, Brolin hilariously read Trump's tweet in Thanos's tone. The Hollywood star, whose character erased half of the galaxy's population to fulfill his own political belief, said Trump's public policies were akin to what Thanos did in the Marvel trilogy. His own planet, Titan, ran out of resources due to overpopulation. In response, Thanos thought the resource imbalance problem facing the universe could be addressed through massacring half of the creatures. He was addressing an economic problem. He tried to search for an equilibrium, and he called it "balance." "When I'm done, half of humanity will still exist. Perfectly balanced, as all things should be."

What was Thanos's plan? The *Avengers* villain offered "a peaceful way" to finish people's lives painlessly and indiscriminately. He collected six Infinity Stones, snapped his fingers, and turned many superheroes into ashes—a very sad ending, surprising the audience that walked out of the cinema. Handling the Infinity Stones was not an easy task. The gems were full of gamma rays. Anyone who held the stones needed a strong will to do so. Thanos believed he was the chosen one to fulfill his "destiny." He said, "I'm the only one who knows that. At least I'm the only who has the will to act on it." He even sacrificed his beloved daughter Gamora in exchange for the soul stone. "The hardest choice requires the strongest will." Do Thanos's words sound like a president who claimed he was the designated one to lead his country to greatness again?

Donald Trump thought flagging a trade war could restore the trade balance of the US. He could order his administration to severely penalize China. Lifting import tariff rates from 0% to 25% on Chinese goods in a flash caught the world off guard. Half a million factory workers were affected. China was labeled a currency manipulator even though everyone knew the country actually wanted a stronger rather than weaker currency. Trump's trade measures hurt many American companies and US consumers. But he did not care. He had a strong will like Thanos and he decisively went his own way. "We reject globalism and embrace the doctrine of patriotism," he said, delivering his second address to the United Nations in November 2018.[2]

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[2]Trump, D. (2018). Speech presented at the 73th regular session of the United Nations General Assembly (September 25). (https://www.whitehouse.gov/briefings-statements/remarks-president-trump-73rd-session-united-nations-general-assembly-new-york-ny/).

At the same time, there are still believers in free trade. Germany, Canada, Mexico, Korea, Japan, and other countries have risen to prosperity in the past few decades. They prefer globalization of some sort. The G20 Summit in Hamburg 2017 issued a heroic declaration to defend the prevailing international arrangement: "Globalization and technological change have contributed significantly to driving economic growth and raising living standards across the globe. However, the gains from globalization have not been shared widely enough. By bringing together developed and emerging market economies, the G20 is determined to shape globalization to benefit all people. Most importantly, we need to better enable our people to seize its opportunities."[3]

China was the top winner in globalization. In 1979, the Middle Kingdom decided to open up, fueling the world with a massive supply of labor. After 40 years of strong growth, the country became the production line for the world, receiving orders from the US, Japan, and Europe. Its ability for mass production was unchallengeable. The quality and technological content of Chinese products improved rapidly in the past few years. It began to develop its own brand. China became a prime target of Trump's new trade policy.

Meanwhile, China was also faced with many structural economic issues, namely a notably aging population and debt pileup. President Xi Jinping saw the urgency to upgrade the economy. He wanted China to become a tech-driven economy by the middle of this century. His "China Dream" was seen as a threat to the Western-centric world. Xi vowed to bring prosperity to Eurasia via his Belt and Road campaign. He played as a champion for globalization. He wanted more countries to use the renminbi (RMB). Perhaps Trump thought if he didn't stop China now, it would be too late. Maybe the trade war was meant to safeguard the global dominance of the US. Whatever his initial motivation, the battle has begun. A new economic order is evolving.

This chapter reviews the causes, the impact, and the outlook of the trade war. In Section 1.2, I discuss several possible reasons for the trade war. Trump's policy stance clearly showed a discontent with globalization. All the disputes he created with other countries pointed to a rising era of unilateralism and neo-nationalism. Since China represented almost

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[3] G20 (2017). Leaders' Declaration: Shaping an Interconnected World (July 8). (http://www.g20.utoronto.ca/2017/2017-G20-leaders-declaration.html).

two-thirds of the US total trade imbalance, treating China harshly was tactical. The US was frustrated with China's track record of intellectual property rights and forced technology transfer. This seemed to offer a legitimate reason for the US to act. However, underlying the trade tension appeared to be a rivalry between the China Dream and America First. China threat theory has become increasingly popular under the current political climate.[4] In a nutshell, the trade war is not an issue of trade imbalance.

Section 1.3 identifies the features of this conflict. Compared with other trade disputes, this US–China trade war is unconventional. An import tariff only serves as an appetizer but is not the main course itself. The US administration clearly understands how globalization works and decides to attack the global supply chains. Prohibiting US companies from business transactions with some Chinese companies can paralyze their production line. China can also retaliate by limiting the supply of rare earth. The tit-for-tat actions of both countries are strategic, calculative, and innovative.

In Section 1.4, I propose the possible outcomes of this trade war. The central theme of this book is that trade measures will not address the fundamental causes of the US trade imbalance. Import tariffs and investment restriction will hurt the economic interest of the US as importers will probably pass the cost to consumers. China will hedge the risk of excessive trade exposure and focus on developing its domestic economy. Europe and Japan would benefit from a closer economic tie with China. Trump's policy, which aims to make "America great again," would probably backfire on his country.

1.2 What Causes the Trade War?

1.2.1 Trump's Unilateralism

We have probably reached an inflection point in modern economic history. As the world's economic superpower, the US decided to change its

[4] Ciovacco, C. (2018). Understanding China threat. *The National Interest* (November 29).

course. After President Donald Trump took over the White House, his administration changed its approach to dealing with global economic affairs. The 45th president of the US paid no respect to the prevailing international order that seemed to have functioned well. Immediately taking over the White House, the US was pressing Mexico and Canada to renegotiate the North American Free Trade Agreement, one of the most significant trade bloc agreements in the world since 1994. Stepping into the second year of his tenure, his administration embarked on a trade war with China. By citing that China had stolen American jobs, the populist president posed a serious challenge not only to the trade partners of the US but also the long-held belief in globalization of other countries.

With hindsight, Trump's trade policy shouldn't have surprised anyone. In the early days of his election campaign, the Republican candidate had already revealed his controversial plan to build a "great wall" along the US–Mexico border. He wrote a two-page memo to the *Washington Post* in March 2016 and vowed to execute his plan to build a 1,000-mile border fence.[5] He threatened to halt remittance transfers to Mexico, sent by Mexican immigrants in the US, which amounted to nearly USD 25 billion a year. Trump said the border wall that would cost USD 8 billion should be paid for by the Mexican government. In addition, he also planned to restrict Mexican imports, halt legal immigration, and increase fees for visas and green cards. On the issue of illegal immigrants he said, "We have the moral high ground here, and all the leverage."

In the past few years, the world has witnessed his unconventional approach to managing economic affairs by the populist ideology. He evaluated the positions of his counterparty and his own in a holistic manner. The bilateral issues under his radar were not necessarily confined within trade and investment. In his game, everything, such as climate change and international security, could be monetized and bargained. Typically, American politicians saw North Korea as a national security issue. But Trump said he would consider withdrawing US military stationed in South Korea unless the latter paid for the defensive support. In his campaign, he described the US–Korea Free Trade Agreement that

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[5] *Washington Post.* Trump reveals how he would force Mexico to pay for border wall. (April 5, 2016). (https://www.washingtonpost.com/politics/trump-would-seek-to-block-money-transfers-to-force-mexico-to-fund-border-wall/2016/04/05/c0196314-fa7c-11e5-80e4-c381214de1a3_story.html).

was launched in 2007 as a "job-killing trade deal." He began to renegotiate this shortly after his arrival at the White House.

Many political scholars suggested that Trump's "America First" could be inherited from the unilateralist–isolationist tradition dating back to the 19th century. Trump's presidential election might mirror the surge of a "Jacksonian," or populist, view of world politics (Mead 1999). The Jacksonian approach combined elements of ethno-nationalism, anti-elitism, and strong commitment to the values of the American "folk community." This approach tended to see the US as a loser in opening the economy to the world.[6] Nonetheless, the development in the past few years indicated that unilateralism had been increasingly adopted by some governments in dealing with global affairs. Hirsh (2016) warned that the global trend of neo-nationalism would continue to last, as there was a parallel development not only in Trump's trade policy but also Boris Johnson's attitude in Brexit.

The Jacksonian stance was well reflected by the list of international agreements withdrawn by the US (Fehl and Thimm 2019). They included the Paris Agreement on Climate Change, the UN Human Rights Council, and the UN Educational, Scientific and Cultural Organization (UNESCO) to more obscure treaties such as the Universal Postal Union. In his 2017 and 2018 speeches at the UN General Assembly, Trump announced his unrelenting position to "defend America's interests above all else"[7] and "choose independence and cooperation over global governance, control, and domination."[8] This was probably one of the most undiplomatic expressions ever voiced from any US president. Trump also threatened to withdraw the US from the World Trade Organization (WTO), stating that "If they don't shape up, I would withdraw from the

[6]Spatafora, G. (2018). The Jacksonian Foundations of Trump's American Foreign Policy. The Oxford University Politics Blog (January 12).

[7]Trump, D. (2017). Speech presented at the 72nd regular session of the United Nations General Assembly (September 19). (https://gadebate.un.org/sites/default/files/gastatements/72/us_en.pdf).

[8]Trump, D. (2018). Speech presented at the 73th regular session of the United Nations General Assembly (September 25). (https://www.whitehouse.gov/briefings-statements/remarks-president-trump-73rd-session-united-nations-general-assembly-new-york-ny/).

WTO" and claimed that "[the US] lose the lawsuits, almost all the lawsuits in the WTO."[9]

Trump's anti-multilateral approach shocked his US allies in Asia-Pacific. He walked away from the Trans-Pacific Partnership (TPP) trade agreement. The trade pact, originally proposed by a group of Pacific countries back in 2016, was considered a move to counter China's growing influence in the region.[10] Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, and the US (President Barack Obama) signed the deal on February 4, 2016. After Trump's withdrawal, the agreement could not enter into force. In December 2018, the remaining signatories renamed the new deal as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, forming a trade pact of much smaller scale without the participation of the US and China.

As a unilateralist, Trump believed the US could gain more from squeezing the last penny from other countries' wallets. He dealt with every country individually. Sachs (2018) pointed out that Trump's policies were based on a mindset of zero-sum game. Even though free trade helped the world reach another equilibrium at which the US has gained more, the unilateral approach might have held appeal to politicians who focused narrowly on the second-best outcomes under a political cycle. Indeed, political analysts proposed that unilateralism could be a rational course of action for the major powers and was often a preferred approach of the hegemonic state. Tago (2017) wrote, "A powerful state that can achieve its policy goals using its own resources without the need of international support can pursue a foreign policy that would not follow accepted international norms."

1.2.2 A Stubbornly Large China Deficit

Back in 2009, former US president Barack Obama and former Chinese president Hu Jintao established the US–China Economic and Strategic Dialogue at the G20 Summit in London. There was an Economic Track in

[9]BBC News. Trump threatens to pull US out of World Trade Organization (August 31, 2018). (https://www.bbc.com/news/world-us-canada-45364150).

[10]Naughton, B., Kroeber, K., Jonquières, G.D., Webster, G. (2015). What Will the TPP Mean for China? Foreign Policy (October 7).

the dialogue for bilateral economic issues. Even though the two countries had agreed with the US–China Comprehensive Framework for Promoting Strong, Sustainable and Balanced Growth and Economic Cooperation in 2011,[11] the annual meetings could not reduce the trade imbalance. Trump said, "And I blame us, I don't blame them. I don't blame President Xi. I blame all of our presidents, and not just President Obama. You go back a long way. You look at president Clinton, Bush—everybody. They allowed this to happen, they created a monster. . . . We rebuilt China because they get so much money."[12]

Of all the US trading partners, China was the most visible one. Their trade flow represented the largest factory and largest buyer in the world. After China's opening up to the US and other investors, the two countries were deeply integrated. "Doing business in China" was the popular theme in MBA programs specializing in International Business. Excluding intra-EU trade, China represented 16.2% of the world's total exports and the US accounted for 16.6% of the world's total imports in 2018, according to data from the WTO. The bilateral goods and services trade was worth USD 737 billion in 2018 (see Table 1.1). It was the largest country–country trade flow in the world, more than the size of the Switzerland economy (the 20th largest economy in the world).

Of all countries registering trade surplus with the US trade, China stood out. In 2018, the US reported a trade deficit in goods of USD 880.3 billion. China alone accounted for 48% of the total, which was USD 419.6 billion (see Figure 1.1). If trade in services was included, the deficit with China was USD 380.0 billion or 66% of the total. The trade deficit on goods and services with China was three times the combined amount of Germany and Japan. If Trump could reduce the US trade deficit with China by 20%, the size could offset the entire trade deficit with Mexico. Closing the trade gap with China could have improved the overall trade balance of the US materially.

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[11]U.S. Department of the Treasury (2011). U.S.-China Comprehensive Framework for Promoting Strong, Sustainable and Balanced Growth and Economic Cooperation. Press release (May 10). (https://www.treasury.gov/press-center/press-releases/Pages/TG1171.aspx).

[12]*Newsweek*. Donald Trump blames Obama, Bush, Clinton for China deficit. (May 20, 2019).

Table 1.1 Economic tie between the US and China.

Items at Stake	Activities in/from China	Activities in/from the US
Goods trade, 2018	Chinese exports to US: USD 540 billion	US exports to China: USD 120 billion
Services trade, 2018	Chinese exports to US: USD 18 billion	US export to China: USD 59 billion
Major items (USD billion)	Electrical machinery (152), machinery (117), furniture and bedding (35), toys and sports (27), plastics (19)	Aircraft (18), machinery (14), electrical machinery (13), optical and medical instruments (10), vehicles (9), agricultural (9)
FDI stock, 2017	US FDI in China: USD 108 billion	China's FDI in US: USD 40 billion
MNC foreign affiliates, 2016	US companies in China: Sales USD 55 billion	China companies in US: Sales USD 8 billion
Financial claims	China's holding of US government securities: USD 1.1 trillion (November 2019)	US banks' claims in China: Immediate counterparty basis: USD 87 billion (Q4 2018) Ultimate risks basis: USD 96 billion (Q4 2018)

Sources: USTR, US Treasury, BIS

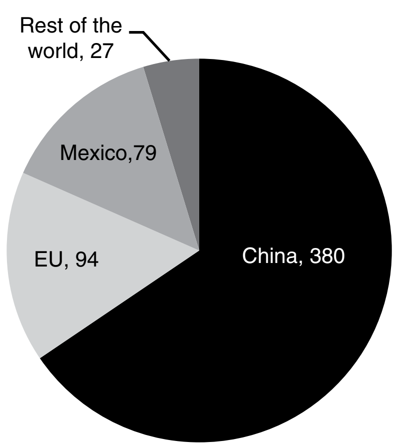

Figure 1.1 US trade deficit in 2018 in USD billion.
Source: US Bureau of Economic Analysis (US BEA)

Rather worryingly, the US trade deficit with China showed no sign of slowing. China was already an offshore production base of US companies. This relationship was irreversible. When China was admitted to the WTO in 2001, the trade deficit was USD 81.3 billion. In less than two decades, the gap had expanded more than four times to USD 380 billion in 2018 (see Figure 1.2). In the same period, the size of US GDP had only doubled from USD 10.6 trillion to USD 20.5 trillion in 2018, while China's GDP was 10 times larger than its original position (2001: USD 13.4 trillion). China's faster pace of economic expansion was perceived to have been a result of an unfair advantage over the US.

The reality is that the Sino-US economic tie goes beyond trade. The bilateral economic tie comprises both current account and financial/capital account transactions. Underlying the goods flows have been the massive investments by American companies in China. The US is a net foreign direct investor in China. American companies profit from their offshore operations in China. The US also receives net earnings from its service exports (2018: USD 38.8 billion), including spending by Chinese tourists and overseas students. On the financial side, China is the second-largest foreign holder of US government debts (November 2019: USD 1.1 trillion), almost three times the annual trade surplus China earned from the US.

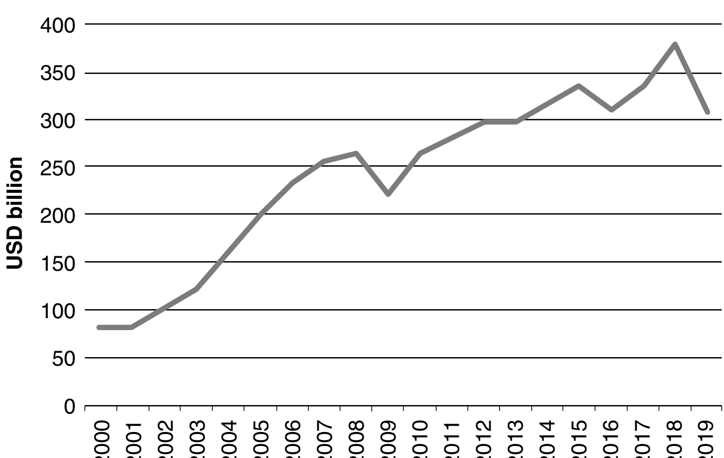

Figure 1.2 US trade deficit in goods and services with China 2000–2018.
Source: US BEA