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US-CHINA TRADE WAR: DANGERS OF VALIDATING THE 'CHURCHILL TRAP'

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Early in July 2018, the US imposed a duty of \$34 billion worth of products on Chinese goods jolting the two into a trade war. In retaliation the Chinese slapped an additional 25 percent tariff on US products including coal, bicycles, trucks, vehicle engines and chemicals.¹ The US Trade Representation (USTR) office held that these prohibitions came as a response to China's "unfair business activities" related to the American technology and forcible transfers of intellectual property, whereas the Chinese administration called these as 'unreasonable injunctions'.² Although much has been written about the need for avoiding the 'Thucydides trap'³, a greater challenge that faces US and China today— as also pointed out by Chinese scholar Yang Yuan— is how to avoid the 'Churchill trap',⁴ i.e. the recurrence of falling into long-term confrontation by repeating the mistakes made during the Cold War between the US and the USSR, when in the absence of destructive warfare between the two powers, the international

system took on a bipolar structure and the skirmishes played out under an economic garb.

The signs of a longer confrontation are already palpable with the US passing the CAATSA in August 2017, whereby it imposed sanctions against Russia, Iran and North Korea – which includes two of China's most steadfast allies. China, on the other hand, has defended that it is ready to fight a "protracted war", considering the US overtures had been aimed at crushing China's economic sovereignty coupled with economic slowdown and decline in stock markets and currency (though some weakening of the Yuan had been anticipated to support indigenous exporters). Manufacturing and agricultural sector along with dairy products have been severely hit in both countries as the US continues to pressurise China to rein in government subsidies for policies like 'Made in China 2025' which strives to pump money into industries such as robotics, electric cars and computer

chips.⁵ In fact, the technology sector has emerged as one of the major battle grounds, most prominently the Qualcomm and NXP Semiconductor deal – one of the biggest mergers of the semiconductor sector – has been adversely impacted.

Though Trump has claimed that the US has been winning the trade war and the taxes against the Chinese are working, a prolonged economic war might not be a desirable outcome for either of the parties involved. For one, the highly centralised and state-backed financial system in China gives the Chinese enterprises an advantage over the US stock markets, as was the case when the Yuan suddenly extended gains by a rally triggered by a surprise China central bank move to make it more expensive to bet against the currency.⁶ Secondly, while the US exports to China (\$115.6 billion in 2016) are outnumbered by Chinese exports to the US (\$462.6 billion in 2016), the US firms in China are worried about the negative impact on their on-ground operations as the US goods and services produced and sold in China are bigger in comparison to Chinese products made and sold in the US according to Nicholas R. Lardy of the Peterson Institute for International Economics. Moreover, tariffs on US' Soybean exports (worth \$12.7 billion in 2017) to China have hurt farmers in states like Iowa and Texas, which supported Trump's Presidency in 2016, thereby undermining his domestic support base. The Chinese investment in the US treasuries add to

China's resilience as it can threaten to liquidate the roughly \$1.5 trillion bonds at any time creating distress in the US market by pushing up interest rates and undermining global financial markets.⁷ This would be compounded by the fact that rates on mortgages and car loans would rise simultaneously.

Further, there is growing disgruntlement with US' policies across West Asia and Central Asian countries, led by Turkey, which has staged protests against the US' economic policies; China could use this discontent to garner more international clout against US restrictions. Australia, which has benefitted heavily because of Chinese imports of iron ore, copper, milk and wine, is likely to suffer major consequences due to tussle between these two giants. Trump has also been entangled in trade issues with allies like Canada and the European Union which are bearing damages from delay of investments with toughened customs enforcement and even stricter enforcement of advertising laws; this has dented business confidence. And though most East Asian countries depend on the US for security issues an economic engagement with China seems equally indispensable for them.

However not all is reassuring for China either. Despite the fact that China is the largest holder of US treasuries, its holdings amount to only 6 % of all treasury debt (all foreign entities combined hold only about 30 % of US debt). The Federal Reserve of the US could easily prevent crisis by weakening instead of tightening by

either buying treasuries itself or by gradually raising interest rates to reassure markets. In such a case China will have to look for new liquid investments to replace its massive treasury holdings, and the value of Yuan could rise impairing China's export economy and making US exports more competitive, thereby reversing the stakes. Moreover, as China exports \$478.8 billion worth of products to the US -its biggest trading partner, it is therefore heavily dependent on it.⁸

A palatable deal between the two then becomes even more necessary if the two have to avoid an economic debacle on a larger scale. While nuclear deterrence accumulated by these two powers has made the Thucydides trap an anachronism, the risk of an extended economic war becomes more prominent as the two countries become driven by simultaneous autonomist discourses under the America First and the Chinese Rejuvenation models respectively. It would therefore be prudent for the two to derive lessons from the US-USSR precedent to avoid the spread of two antagonistic hierarchical camps, aligning rather in provision of a New Type of Great Power Relations.

(Disclaimer: The views and opinions expressed in this article are those of the author and do not necessarily reflect the position of the Centre for Air Power Studies [CAPS])

Notes:

¹ The scale and number of tariffs and duties continue to change as the trade war escalates, currently stated at \$50

billion(wop) by the US and \$34 billion (wop) by China while another round of \$200 billion (wop) by the US and \$60 billion (wop) by China has been intimated.

²The decision was executed as a counter measure to the US goods and services trade deficit with China amounting to \$385 billion in 2016.

³It warns against the risk of war breaking out between the rising power and the ruling power.

⁴ See, Yang Yuan, "Escape both the 'Thucydides trap and the Churchill trap': Finding a Third type of Great Power Relations under the Bipolar system,"The Chinese Journal of International Politics, OUP, 2018, 193-235. Also see, Churchill delivers Iron-curtain Speech, web Accessed: <https://www.history.com/this-day-in-history/churchill-delivers-iron-curtain-speech>

⁵ Jethro Mullen, China: The US has started 'the biggest trade war' in history, CNN Money, 6 July 2018. Web accessed: <https://money.cnn.com/2018/07/06/news/economy/us-china-trade-war-tariffs/index.html>

⁶Prepared for long trade war with US: Chinese state media, Bloomberg, 6 August 2018, web Accessed : <https://timesofindia.indiatimes.com/business/international-business/prepared-for-long-trade-war-with-us-chinese-state-media/articleshow/65289694.cms>

⁷ Rick Newman, This is China's most dangerous trade-war weapon, Yahoo Finance, 17 August 2018.

⁸Source: Office of the United States Trade Representative, Web Accessed: <https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china#>