

Interview with Dr. Junhua Wu, Research Director & Chief Senior Economist of the Japan Research Institute

Struggle for Global Hegemony — Real Implications of the China-US Trade War

By Japan SPOTLIGHT

When China joined the World Trade Organization (WTO) in 2001, it was a symbolic development signifying a change in the progress of globalization. The perceived decline in US global leadership and the rising power of China are now in collision in the form of a trade war. This is a geopolitical crisis rather than an economic crisis, since a political and ideological confrontation from rivalry to be the largest superpower in the world lies behind the trade war. Therefore, conventional economic theory advocating for free trade and a market economy will not work well as a remedy. Both nations have their own structural backgrounds that have led to this stage and thus this trade war should be examined from a broader and historical perspective. In other words, it would be wrong to consider the US-China trade war as a transitory phenomenon.

We had a chance to interview an expert on China-US relations, Dr. Junhua Wu, research director and chief senior economist at the Japan Research Institute, a Tokyo-based think tank. She provided us with a structural and long-term perspective on this issue.

(Interviewed on Sept. 12, 2018)

Introduction

JS: Could you please introduce yourself briefly, and in particular your specialty?

Wu: I joined the Japan Research Institute in 1990 after finishing my studies at a graduate school. Then I was stationed overseas from 1995 until 2016, first in Hong Kong, then Shanghai and Washington, DC. In 2016, I came back to the headquarters in Tokyo. I started my professional career as an economist specializing in the Chinese economy, but since 2005 I have been looking at China from a wider perspective, including political aspects apart from economic aspects, and gradually expanding my interest towards the relationship between the United States and China. At this moment, my main focus is US-China relations.

The reason that I expanded my interests is that figuring out the direction of China has been my ultimate goal. I started my career as a China watcher right after the Tiananmen Square incident took place. At that time, I believed that the economy would be the key factor determining the future of China. That's why I became an economist. However, around 2005, I found that domestic politics would have more impact on China's future than the economy. So I expanded my interest to politics. Then, in the wake of the global



Dr. Junhua Wu

financial crisis, the relationship with the US developed into a crucial factor for China, and eventually US-China relations became one of my subjects.

Assessment of the Impact of Trade War Between China & US

JS: As an expert on US-China relations, how do you assess the global impact of the current US-China trade war as well as its impact upon both nations?

Wu: The current US-China trade war is not only the result of economic friction but can also be interpreted as the two nations' struggle for hegemony in the world, which

I called the Cold-Peace War. While there are certain similarities between the Cold-Peace War and the Cold War between the US and Soviet Union, it's not a simple copy of the Cold War. As we all know, during the Cold War era the two opposing sides were completely separated from each other — not only militarily but also politically and economically. Thus their interests did not overlap. By contrast, China and the US share common interests in many areas now and that makes the competition between the two countries much more complicated. That's why I put the word "peace" after "cold" to describe this feature of the current relationship of the US and China.

In 2015, when I was still in Washington, DC, I saw a significant momentum that transformed the people's recognition of China. Seeing China as a strategic rival to the US became not only the view of the so-called Dragon-Slayers but also many of the so-called Panda-Huggers. Although there have been growing economic and geopolitical interests between the US and China, many Americans realized that it's highly unlikely that a transformation of the political system will happen in China along with economic growth.

Moreover, as a result of engagement policy, which has been implemented for decades, China has developed to be the biggest if not the only challenger to US global hegemony, not only economically but also militarily and ideologically. Thus, I believe the trade war was not started because of the protectionist attitude of the current administration and President Donald Trump. It seems that it's the inevitable result of the manner of China's rising.

On the assumption that the above judgement is correct, it might be considered that starting such competition in the domain of the economy would be rational since a comprehensive ideological and military struggle for hegemony would cost much more for both nations and the rest of the world.

As the Chinese economy is a principal part of the global supply chain, it is certain that this trade war will have a significant impact on the global economy, including the Japanese economy. Given that the Chinese economy is currently not in perfect health, the negative impact of the trade war will be more significant from now on and have longer-term effects.

JS: There is a view of that there would be no significant impact from the trade war, such as a drastic decline in GDP growth. But you believe that a trade war will have significant negative impacts on the economy.

Wu: Yes, I believe a trade war with the US would cause China fundamental damage to its economy because its large trade surplus with the US has been built on the Chinese economic growth formula. It is indeed true that raising tariffs may not help the US economically. It is also true, however, that raising tariffs is a method that is most likely to function effectively, if not the only method for the US to make China listen to it, though I am not sure whether Trump himself is aware of it or not. In other words, in terms of competition for global hegemony, the current US trade policy may work in countervailing China because China's emerging has been particularly backed by its fast-growing economy.

There are two growing concerns about China. One is the way of China's economic development, which is widely called "party-state

capitalism". Some even worry if "market capitalism" can remain compatible with it. The other is the geopolitical impact of China's economic diplomacy, such as the "One Belt, One Road" initiative, the AIIB and significant aid provided to developing nations. Through these kinds of policy approaches China has enhanced its global influence. As is well known, China has been taking advantage of the WTO and gaining a huge trade surplus under the free trade regime supported by the WTO. This surplus is the source of the increased money supply that has enabled the Chinese government to enhance its investment for building up its infrastructures and eventually making its economy grow.

For decades, especially in the past 10 years, the trade surplus has played a major role in China's monetary easing. In China all foreign currency amounts must be converted into Chinese yuan. The trade surplus, which is the main source of capital inflows, has contributed to an increase of base money in the shape of "funds outstanding for foreign exchange" and most of China's trade surplus is with the US. For instance, this year, from January to August, the ratio of the trade surplus with the US to China's total trade surplus was 97%.

The Chinese trade surplus with the US is also a key to China's foreign currency reserves. Its cumulated trade surplus in goods and services with the US from 2001 until 2017 was \$4.1 trillion, while China's foreign currency reserves at maximum were \$3.9 trillion and are now \$3.1 trillion. Thus it is not too much to say that China's trade surplus with the US has made it possible for China to achieve investment-led economic growth and economic diplomacy.

There is a saying that there is no winner in a trade war. Probably, it's true. But it is also true that raising tariffs might be an effective lever to move the relationship between the US and China since the trade surplus with the US really matters to China's economy.

There is some concern that as a retaliatory measure China may sell US Treasuries. Yes, it might happen. For China, however, it's a double-edged sword because declines in US Treasury prices may also hurt China.

As I mentioned before, a trade war is only the first battle of comprehensive competition between the US and China. We are now standing at a critical historical turning point and thus we should look at the issue from a much broader and deeper perspective. The debate on the trade war and its possible economic consequences seems to be based upon a rather myopic viewpoint and too much engaged with only short-term aspects.

Possible Consequences of US-China Confrontation for North Korea

JS: This question might also be too myopic, but the US seems to be taking advantage of China's influence on North Korea to solve the issue of North Korea's denuclearization. Would this affect the US-China rivalry?

Wu: No, I don't think so. It's unlikely that the US would modify its tough policy against China for the sake of the complete denuclearization of North Korea. The issue of North Korea is certainly an important one for the peace of the Korean Peninsula, but it is of a different nature from the US-China competition. The two issues should not to be compared.

JS: Will there be any compromises in the trade war between the two nations?

Wu: China probably will offer more promises, such as protecting Intellectual Property Rights, reducing tariffs, and so on. But I am not so optimistic that the dispute between the two nations can be solved by those kinds of compromise.

A Transitory Period of Capitalism

JS: Are we living in a completely new age where "state capitalism" represented by China and "market capitalism" represented by the US are now in friction?

Wu: I am not sure if "state capitalism" is the best term to describe the state of the Chinese economy. We are facing an unprecedented situation in many senses due to the manner of China's emergence. I cannot find yet the best terminology for the Chinese way of developing and governing the economy. About 10 years ago, I created the term "bureaucratic-made capitalism" to describe the process of China's economic development since 1978 but have to admit that is not the perfect expression. The reason is "bureaucratic-made capitalism" may well describe the manner of China's economic development, but it covers neither its outcome nor its ambition. A mixed approach of market function and absolute party control makes China different from other economies. It's difficult for a conventional approach based on market capitalism and the rule of law to compete. So, from the point of view of traditional economic theory, what the current US administration is doing is not correct but might be useful.

JS: Do you think this Chinese approach and the common capitalism approach could converge eventually?

Wu: Unfortunately, I don't think so.

JS: How can we build an ideal world, then, where China and all other nations can collaborate and live together safely?

Wu: I wish we could, but wonder if the idea of building an ideal world is realistic.

Global Governance in a New Age

JS: Under current international politics where US leadership in global governance is less expected, how do you think East Asian countries can contribute to global governance?

Wu: Before I answer your question, I would like to say that I am not so confident in the argument that the decline of US leadership will continue. But whether the decline of US leadership will continue or not, it is a reality that the US is no longer able to bear alone the costs for global governance. Given that, it's time for East Asian countries to realize that there is no free ride anymore. Two choices remain: one is to share a certain burden of the costs which have been mostly borne by the US, and the other is to collaborate with China, if they believe they can go along with it well.

JS: What do you think about the role of APEC in achieving better global governance?

Wu: I am not an expert on APEC but believe that any effort for better global governance is worth it.

JS: What if East Asian countries take advantage of Chinese initiatives such as the AIIB and "One Belt, One Road", which are part of China's attempts to contribute to global governance? They could exploit natural resources in cooperation with China for infrastructure projects in resource-rich countries in Central Asia, and could also meet the growing need for infrastructure in Asia not only by ADB finance but also by AIIB finance.

Wu: If East Asian countries are certain that the AIIB and “One Belt, One Road” are win-win games, then do it.

Questions of Trade & Trade Policy

JS: On the issue of trade policy, how do you think we can avoid serious outcomes from the trade war? Would the WTO or TPP11 work to mitigate trade friction in the short term?

Wu: I am not optimistic about the future of the WTO. It should have been reformed long ago. As I just mentioned when we talked about APEC, however, any effort for a better world is worth making. I really hope that the US, Japan and the European Union’s agreement on WTO reform can achieve certain results, though I wonder if any meaningful reform can be made under the WTO’s current “consensus” decision-making regime.

JS: How about the role of regional FTAs in mitigating trade friction? If the TPP11, RCEP, China-Japan-Korea FTA or EU-Japan FTA all work well in promoting free trade, the US would have to reconsider its trade policies, since US companies would lose the benefits of trade by being outside of those FTAs.

Wu: If those FTAs could work well without the US, all those member nations would probably not mind if the US joins them or not. They could enjoy the benefits of free trade without the US. The problem is, however, it’s still hard to image that all those free trade frameworks can make real sense without the US.

The nature of globalization was changed along with the ending of the Cold War. During the Cold War era, globalization could only be promoted partially, among countries such as the G7 nations. In other words, at that time globalization was promoted by countries sharing the same values, democracy, rule of law and of course, market capitalism. After the Cold War, however, globalization has been expanded to countries that include those who don’t share these values.

This is one of the most important reasons why the WTO dispute settlement mechanism has not worked well since this dispute settlement mechanism functions on the premise of belief in the rule of law. Now you can see why the credibility of the WTO has fallen in the past two decades. It is because, as a result of the expansion of globalization during the post-Cold War era, the precondition of the WTO dispute settlement mechanism practically collapsed. It takes a

long time for the WTO to reach a consensus in making a decision and in addition, the WTO has no certain effective methods to force all members, including members who don’t share these values, to comply with the rules.

Another notable consequence of post-Cold War globalization is the reversion of capitalism. For a long time, I thought that “capitalism” was not the proper word to describe the developed economies because capitalism had been evaluated on the basis of criticism by Karl Marx. I didn’t ask why but just took it for granted. Now I realize that the evaluation of capitalism during the Cold War era was a result of the progress of liberal democracy. In a world that was divided into East and West, the Western corporates had no choice but to adjust their management compliance with the progress of liberal democracy, such as protecting labor rights, environment friendly management, and so on, because it was impossible for them to move out from the West.

But in the post-Cold War era, corporates could move anywhere in the world seeking profits mainly based on so-called comparative advantage. As a result, local communities such as the “Rust Belt” region in the US began to collapse.

From the viewpoint of economic rationality, we must say that what these corporates have done is to respond appropriately to increasingly intense competition. In fact, as an economist, until recently I was a story advocate of globalization. Nonetheless, in the face of the degradation of local communities in the developed world and the reality that China, as the biggest beneficiary of post-Cold War globalization, has emerged to be a major challenger to democracy and the market economy, my confidence in globalization has been upset. A simple question is this: is profit all the value of corporate existence, especially at a time that we are approaching a historic turning point?

There is a phenomenon that any argument or policy that is different from or against what the corporates and people did during the post-Cold War era is protectionism or populism. Is this right? Ignoring fundamental changes in the undercurrent of globalization during the post-Cold War era and then advocating globalization as an absolute good is at least a kind of negligence of thinking.

Yes, our democracy is facing a crisis but we also must remember that, in a democracy, the common people’s views must be respected. It’s certain that democracy needs to be reformed. Nonetheless, we have no choice but to overcome all the distortions and problems of democracy because “Democracy is (still) the worst form of government, except for all the others.”

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