

US-China Trade Relations: Tectonic Changes and Political Risk in the Global System – National Security, Industrial Policy, and Protectionism

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There has been a tectonic shift in the trade relationship between the United States (US) and China. This can be seen in the passage of new US legislation, recent US trade restrictions on exports and investment transactions with China, and worsening US relations with the World Trade Organization (WTO), particularly with its dispute resolution system. The Trump administration initiated a haphazard tariff and trade war with China, reversing decades of US trade policy pursuant to its long-standing stances of supporting free trade. To the dismay of many in the trade community within the US and globally, the trade actions by President Trump have been significantly extended and broadened by the Biden administration in its first two years, despite the expectation that it would reverse many of Trump's policies. In this article, I present seven observations concerning President Trump's and President Biden's trade policies.

Keywords: Biden and Trump, US–China Trade, National Security, US Legislative Measures, Political Risk Analysis and Geopolitics, Globalization

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1. Introduction

There has been a tectonic change in trade relations between the United States (US) and China. This can be seen in the passage of new US legislation, recent US trade restrictions on exports and investment transactions with China, and worsening US relations with the WTO, particularly with its dispute resolution system. The following are seven observations concerning President Trump's and President Biden's trade policies.

2. Trump's Haphazard Tariff War with China

The Trump administration initiated a haphazard tariff and trade war with China, reversing decades of US trade policy pursuant to its long-standing policies of supporting free trade in the post-war multilateral system and the World Trade Organization (WTO) in negotiating and adjudicating trade rules. President Trump's view that China pays US tariffs and not US importers or consumers is simply outrageous. President Trump's trade war with China seemed to be an aberration at the time, and many hoped that the new Biden administration would reverse Trump's policies. Unfortunately, the Trump administration only began a historical reversal of the US trade policy toward globalization with China and the WTO, which the Biden administration is now extending.

The globalization boom that began in the 1990s did not happen by itself. Rather, it was lubricated by the biggest economies' willingness to write, enforce, and obey shared rules of engagement. That consensus is now crumbling. The WTO, the embodiment of this rules-based order, has increasingly been sidelined as countries turn to export controls, subsidies, and tariffs to promote domestic industries or kneecap adversaries. Many blame this on the US, as first President Trump and now President Biden rejected the WTO's authority and enacted tariffs and subsidies that riled trading partners.¹

The prevailing US notion was that free trade was always the best trade policy. However, this "changed in 2018, when Robert Lighthizer, the U.S. trade representative under President Trump, levied tariffs on China, a move that triggered a broader debate about decoupling, the relationship between trade and diplomacy,

and what the post-neoliberal world should look like.”²

3. Trump’s New Reliance on National Security as the Basis of Trade Policy

President Trump uniquely relied upon national security and unilateral retaliation as a basis for tariffs with China. In particular, he relied upon Section 232(b) of the Trade Expansion Act of 1962³ and Section 301 of the Trade Act of 1974.⁴ His reliance on national security to impose tariff and trade restrictions was a historical shift from prior administrations. Although many in the US questioned this use of the national security rationale, the federal courts continued to uphold it, even though the Court of International Trade indicated some hesitancy.⁵ However, federal courts today continue to hear challenges to President Trump’s Sections 232(b) and Section 301 tariffs. In 2020, I concluded the following:

Donald Trump’s methods of operating and conducting national security and foreign policy are exactly the same as they would be if he was engaged in real estate transactions and deals. To Donald Trump, trade policy, foreign policy, and national security policy are transactions and zero-sum games.⁶

The post-war world was anchored by the US and its belief that economic interdependence and multilateral institutions would benefit all nations and ultimately promote peace. This view changed under President Trump, who chose a narrower focus on national security and the US national interest. The narrative that free trade was in the overall interest of the US began to change, especially due to China’s increasing competition and confrontation. A new paradigm emerged, as the US policy began to focus more on confronting the consequences of China’s economic assertiveness and rising military capabilities.⁷

4. The US Backlash Against the WTO and China.

The US has recently lost several WTO cases, with the most notable being the one brought forth by China concerning national security and the US steel import

restrictions.⁸ China filed a newer case pertaining to restrictions on the export of semiconductor chips from the US to China.⁹ This has created an even more significant backlash against the WTO within the US. A recent working paper published by the Peterson Institute for International Economics stated:

A major obstacle to the United States accepting any resolution (concerning the WTO dispute resolution system) ... is settling the issue of whether claims of national security to legitimize trade measures are reviewable. This is a red line for the United States, which argues this claim is nonreviewable. In the emerging area of great power competition, the United States is unlikely to accept a return to fully effective WTO settlement absent a compromise that finds determinations of national security nonjusticiable.¹⁰

It is important to note that during the WTO's first case concerning the security exception brought by Ukraine against Russia in 2019,¹¹ the Trump administration supported Russia's position that the security exception was nonjusticiable. However, the WTO panel ruled it was justiciable and, surprisingly, upheld Russia's defense. "The U.S. claim that the national security exception is non-justiciable [in the subsequent Chinese case against the US] was clearly undercut by the panel report."¹²

This dispute over the justiciability of national security as a defense in the WTO, as well as the larger issue of restrictions on China trade, has pitted the national security establishment in the US against the trade establishment to a considerable extent.¹³ The trade debate in the US has become politicized, toxic, and anti-China.

For example, several states within the US have gone out of their way to restrict foreign (Chinese) ownership of US farmland, even though foreign ownership of US farmland is about 3%. This has become a rallying cry for many in the Republican party.¹⁴ My state of Virginia has recently imposed new restrictions on foreign farmland ownership, even though foreign interests own less than 1%, and Chinese firms own less than, 5%.¹⁵

5. President Biden has Accentuated Trump's Trade Policies

Earlier this year (2023), I wrote the following:

As the Biden administration succeeded President Trump's chaotic and undisciplined trade and investment policies toward China, the last six months of 2022 have seen significant development in US trade law and economic policy toward China. These legislative and regulatory developments bring into sharper focus a broader and more aggressive US legal and regulatory structure fostering industrial policy and confronting China. This change is worrisome.¹⁶

A year earlier (2022), I wrote the following:

After President Biden's first year in office, one big question is whether Biden's trade policy differs from Trump's chaos. My answer is no. I would consider Biden's trade policy to be Trump without the tweets.¹⁷

The trade actions by President Trump have been significantly extended and broadened by the Biden administration in its first two years, to the dismay of many in the trade community within the US and around the globe. Many had hoped that the Biden administration would reverse much of President Trump's policies. However, this did not happen, and the first two years of the Biden administration have proven to be a grave disappointment.

President Biden has extended criticism of China to include human rights violations (forced labor), claiming that China was responsible for destroying US industries, which has hurt both American workers and the middle class. Biden's trade policy is meant to protect the workers and the middle class, ensure critical production, and secure supply-chain; it is not focused on opening markets and promoting global commerce. Jake Sullivan, National Security Adviser, recently called for a new foreign policy for the middle class.¹⁸

Ever since the Biden administration passed the Inflation Reduction Act and the Chips and Sciences Act for clean energy and tech last year, there has been a mutinous mood among some American allies in both Europe and Asia at the scale of the new US subsidies. What the US sees as a strategy to reverse deindustrialization in deprived areas, allies have interpreted as a thinly veiled exercise in protectionism ...¹⁹

6. Fading the US Support for the WTO and Globalization

In the US, there has been a significant fading of support for both the WTO and globalization. The “Washington Consensus” of 2001 that supported China’s membership in the WTO has dissipated. The foreign policy and trade elites in the US hoped that China’s WTO membership would create a free market economy in China. This view no longer exists. One writer commented that America is now “suffering from buyer’s remorse.”²⁰ Another writer succinctly summarized the factors for the declining US support for the WTO and globalization:

Two factors have contributed to the sharp deterioration in US leadership. The first is a bipartisan, ardent anxiety over China. Inside the Beltway, it is widely held that China has somehow rigged the multilateral trading system, shirked its responsibilities, and gamed the dispute settlement function. Such reasoning is flawed and not fully supported by the facts. But it can be attributed to the growing Cold War mentality gripping Washington these days. Less easy to comprehend is the decades-old populist animosity towards trade on the left and right. The starting points for this antipathy vary depending on where on the political spectrum the thinking originates. But the bottom line cited by such advocates is that trade destroys jobs, particularly manufacturing jobs, and that every trade deal into which the United States has entered has been a bad one.²¹

The Director-General of the WTO has recently defended global trade again, arguing that globalization needs to be reimagined.²² He notes that the post-war international economic architecture was based on economic interdependence. Now that this vision is under attack, an alternative narrative has evolved, asserting that countries need independence, not interdependence. This debate is still heated and, in many ways, fuels toxic debates over national security, industrial policy, and new protectionism.

Martin Wolfe’s warning in the *FINANCIAL TIMES* concerning the dangers of shifting geopolitics to globalization is straightforward:

How might globalisation end? Some seem to imagine a relatively peaceful “decoupling” of economies until recently stitched so tightly together. But it is likely that the fracturing of economic ties will be both consequence and cause of deepening global discord. If so, a more destructive end to globalisation is likely.²³

7. The US Turning to Increased Protectionism and Industrial Policy

Criticism of free trade has increased since the Clinton administration, with people generally arguing that those promoting it never realized that many countries have other priorities and moral standards. For example, a recent article in *FOREIGN AFFAIRS* stated:

The notion that trade should be a handmaid to domestic policy interests fell out of favor during the Clinton administration when the United States struck a series of trade deals and pushed for China's entry into the WTO. That latter development was a seismic shift that removed the guardrails from the global economy. Adam Smith, the father of modern capitalism, believed that for free markets to function properly, participants needed to have a shared moral framework. But the United States and many other liberal democracies were suddenly enmeshed in major trade relationships with countries - from Russia and the petrostates of the Middle East to numerous Latin American dictatorships to the biggest and most problematic trading partner of all, China - that had fundamentally different moral frameworks, to say nothing of their economic ones.²⁴

The US trade policy today has become more of an extension of the US domestic policy than seen since the 1930s. Domestic policy is now the primary driver of US trade policy. Recent US legislation under the Biden administration has promoted semiconductor research and electric battery production, clearly showing a turning of domestic economic policy towards protectionism and an adoption of an industrial policy based upon subsidies and Buy American restrictions. For example, the Ford Motor Company is set to receive a USD 9.2 billion loan to finance battery plants in the US.²⁵ Most recently, Congressional committees began investigating Ford Motor for planning to employ hundreds of Chinese in its new battery factory in Michigan.²⁶

These domestic policies of providing huge loans and subsidies have encouraged foreign investors, both European and Asian, to establish plants in the US. These policies distort global trade in violation of international trade rules concerning state subsidies. Moreover, the Biden administration is not interested in concluding broad new trade agreements. For example, it has refused to join the new Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).²⁷ Biden's policies risk a more significant threat of trade wars, particularly with China, as

unilateral trade restrictions and subsidies spur more retaliatory ones globally. China has already imposed new trade sanctions restricting the import of Micron chips, claiming that they threaten its national security.²⁸

This newest turn of domestic economic policy towards government intervention in the marketplace, especially to address national security concerns and promote the interests of the middle class, has been termed “Bidenomics.” Gillian Tett has described this as the “Hegelian Dialectic” to the era of “Reaganomics” and its aggressive embrace of free markets and free trade.²⁹

In a recent assessment of “Bidenomics,” the FINANCIAL TIMES made three excellent points.³⁰ Firstly, one of the main drivers of the shift in Washington, recognized by both political parties, is the need to compete with China. Secondly, new US legislation providing massive subsidies and loans represents a profound shift in economic thinking. Lastly, Bidenomics is a fundamental break from the economic theory that prioritized opening foreign markets rather than protecting and promoting the rights of the middle class.

8. Geopolitics is Rewriting Trade Relations and the World of Political Risk Analysis for Corporations

The US–China trade and geopolitical rivalry drives much of this global change and uncertainty in global trade relations. International business is only now grasping this changed circumstance and uncertainty. This is particularly true for US semiconductor chipmakers.³¹ The world of “political risk analysis,” which is historically grounded in issues of nationalization, sovereign bond defaults, and currency fluctuation, has been transformed to include a world of vastly different variables and unknowns.³²

Trade sanctions, import restrictions, export controls, and threats of retaliation (including those of broad nationalizations) have increased. For instance, Russia has threatened to nationalize US property as retaliation against US sanctions over its invasion of Ukraine. Russia has already nationalized local operations of large European firms.³³ Global trade and investment flows have already been altered. Additionally, a significant amount of manufacturing has moved from China to Vietnam. Nevertheless, much more systemic changes are likely.

A glaring example of the impact of changing geopolitics on global investment

transactions in prominent US firms is the recent decision of Sequoia Capital, a global venture capital firm with USD 56 billion in assets in China, to spin its Chinese unit into an independent company.³⁴ The Government of Germany has recently requested that German firms “derisk” by carefully considering its transactions with China.³⁵ Global companies are already separating their Chinese technology systems from their global systems in response to China’s anti-espionage and stringent data laws.³⁶

9. Conclusion

Janet Yellen’s recent trip to China in July demonstrated the potential for ongoing trade and economic cooperation between the US and China. Specifically, she wanted to allay concerns about possible national security actions impacting the Chinese economy and trade.³⁷ At the time, these talks seemed to bolster efforts to repair the US–China ties.³⁸ However, newly proposed US investment restrictions (on outbound investments) and export controls (on advanced chips) could escalate competing restrictive measures.³⁹ China has already pledged retaliation against any new US sanctions.⁴⁰ A recent economic study concluded:

Policymakers, therefore, need to interpret even this preliminary evidence of some US–China “decoupling” with extreme caution. Policy decisions made today to reduce economic interdependence between the two countries will have profound implications for both economies, and neither will escape unscathed.⁴¹

The US-China trade and geopolitical relations will be complex in the foreseeable future. Currently, the US-China decoupling has a specific political and commercial momentum.⁴² Hopefully, these countries can construct a more stable balance between national security and economic interests. World peace depends on their success.

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