Can America Quit China?

A growing discussion.

By Greg Mastel

For at least twenty years, many have enthusiastically declared this century to be the Chinese century. In 2001 when China joined the World Trade Organization, many predicted that China would pass the United States to become the economic and political leader of the world—setting the example for others to follow.

Of course, much of that rhetoric proved overblown. China will likely soon pass the United States to become the world's largest economy, its 1.4 billion population and even a reduced economic growth rate virtually guarantee that. From almost every other perspective, however, China is anything but a world leader.

Recent moves to crush democratic progress in Hong Kong and new details of Beijing's concentration camps for ethnic and religious minorities in Xinjiang only confirm that it remains a brutal authoritarian power. China's efforts to seize control of the South China Sea, recently renewed military threats toward Taiwan, and ongoing military build-up underline that it is a growing threat to its neighbors and the United States. The Chinese Communist Party's continued emphasis on protectionism and nationalistic industrial policy—as seen in "China 2025"—has proven that it wants to ensure that the fruits of that success are enjoyed to the greatest extent possible by China, not by western companies or its trading partners. China's shameful efforts in regard to the Covid-19 pandemic, including threatening supplies of medical equipment to the United States, have

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brought overdue focus on the risk of depending on Beijing for critical supplies.

In general, despite the grandiose statements, China's success has been good news for China and bad news for almost everyone else. The long list of examples in which China's emergence has threatened the interests of the United States has led many, including the Trump administration, to raise the question of whether the United States would be better off shifting away from commercial reliance on China.

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U.S. ECONOMIC TIES WITH CHINA

Total goods and services trade between the United States and China in 2018 reached almost $740 billion—by far the largest two-way trade between any two countries in history. It is worth noting though that China has enjoyed essentially a three-to-one trade surplus with the United States, which was also the largest trade imbalance between any two countries in world history. Also in 2018, Chinese investment in U.S. securities totaled $1.6 trillion—not the largest foreign source of such investment, though obviously significant. Total U.S.-China foreign direct investment—essentially controlling stakes in business operations in the other country—reached $60 billion in 2016.

Four years ago, those economic ties seemed so significant that neither side could really afford to break with the other, but Trump administration policies have demonstrated that a shift is possible. Driven by policy changes by both governments, FDI has dropped about 60 percent. More dramatically, the United States has imposed retaliatory tariffs on $550 million in Chinese goods in response to Chinese protectionism, theft of intellectual property, disruption of steel and aluminum markets, and technology trade concerns. Though its actions are less transparent, China threatened tariffs on about $185 billion, or nearly all, U.S. exports to China. Bilateral trade has declined sharply in both directions, though business contracts, decisions to try to "wait out" tariffs, and transshipment of goods have all slowed the drop. Still, efforts to move suppliers out of China and back to the United States or to other friendlier foreign countries are furiously underway in most industries.

QUITTING CHINA?

There are several rationales for reducing economic ties with China. For obvious national security reasons, trade and economic ties never bloom between two countries when they are at war. Similarly, if two countries are engaged in the global military and diplomatic competition that is often referred to as a "Cold War," robust trade and investment serves to strengthen the adversary. The United States and the Soviet Union retained some trade and economic ties throughout their Cold War, but both sides imposed hard limits. The current economic, technological, and military competition between the United States and China is not at the level as that between Washington and Moscow in the 1970s and 1980s. But if you track events in China's state-controlled press, which daily paints the United States as a grave threat to China and routinely belittles U.S. leaders by name, the comparison is unmistakable.

Economically speaking, ties between the United States and China are still quite significant, but that does not mean they are necessarily in mutual interest. The U.S. trade and investment dollars that flow to China in the hundreds of billions help to support a regime that is unapologetically authoritarian, poses a growing military threat to its neighbors and the United States, and deeply opposes western-style democracy and liberal thought. It seems almost impossible that at least some of those dollars could not be better spent elsewhere.

China's commitment to a still largely state-run economy, protectionism, and theft of intellectual property suggest that anything approaching free and fair trade with the current Beijing regime is impossible. True free trade can only take place between free markets—something Beijing is not and openly does not aspire to be.

A policy of planned reduction in commerce and economic reliance on China should not be an actual embargo. Eliminating all trade and commerce with China would be a painful overreach—difficult to enforce and far beyond what is necessary to achieve the desired economic and strategic gains. In fact, it could well be that the combination of something like the current level of trade, technology, and investment restrictions and a clear message to U.S. businesses to seek opportunities elsewhere is all that is needed to establish a rebalanced U.S. economic relationship with China.

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China does provide the United States with a few hard—though not impossible—to replace imports, such as rare earth metals. But China also relies on the United States for even more critical imports, such as high-end semiconductors, that are difficult to replace. The struggles of China's technological champion, Huawei, in the face of U.S. sanctions suggests that the United States still maintains a strong upper hand in technology trade.

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THE COSTS AND THE BENEFITS

As has been clear over the last four years, a policy of reducing trade and commerce with China will have its critics. Certain economists in the United States have already leveled inflated estimates of the costs of using tariffs to shift away from low-priced Chinese imports. And to be clear, there is no doubt that—particularly in the short term—there will be costs due to shifting away from China. U.S. consumers for a short time could see their bills climb perhaps a few hundred dollars per year. Beijing exports to the United States a dizzying array of generally low-tech consumer products and industrial inputs. Almost all of those imports, however, could be produced elsewhere after a short transition. Some of those goods might be produced in the United States to support domestic employment.

More likely, many of the relatively low-technology inputs and products produced in China will simply be produced in Mexico, Kenya, South Korea, or one of many other U.S. trading partners. In a short period of time, those trading partners could produce the same products that China does today with relatively little impact on long-term U.S. consumer costs. In many cases, that transition is already underway thanks to U.S. tariffs. And each of those countries has better records of purchasing U.S. goods than China, so more prosperous allies—in many cases free-trade agreement partners—would likely be much better and fairer markets for U.S. exports.

Even if we were to find that shifting away from China has little long-term effect on the overall U.S. trade balance, prosperous democratic allies are much more in the U.S. national interest than prosperous authoritarian adversaries.

The flip side of this analysis might be that China would also find other markets for the roughly $560 billion it was exporting to the United States at peak, blunting the impact of U.S. policy change. It is inevitable that China will find some replacement markets for the products it has been sending to the United States. It is, however, beyond reason to say China will find more than half a trillion dollars in new export markets to replace the United States. That is simply too much to be absorbed easily by other global markets. And the largest of those markets—Europe and Japan—have demonstrated no tolerance for running the massive trade imbalances with China that the United States has long tolerated. Beyond that, Europe, Japan, and most other countries might well be persuaded, at least to an extent, that an ever-stronger China is not in their national interests any more than it is in the U.S. national interest.

As it has already demonstrated, Beijing would inevitably retaliate against U.S. restrictions on Chinese exports and commerce with restrictions on U.S. exports to China. Again, the enormity of China's trade surplus with the United States means there are limited actual targets for such retaliation. Still, farmers producing crops, such as soybeans, that are exported to China have and would continue to feel some pain. In the long term, agricultural commodity markets are globalized; meaning that China's efforts to, for example, purchase soybeans elsewhere would only open new markets for U.S. farmers that would otherwise have been served by the soybeans China begins purchasing to replace U.S. shipments.

Transitional assistance as has already been extended to farmers or other U.S. exporters hurt by Chinese trade retaliation would continue to be appropriate under a scenario like that described here.

THE 2020 ELECTION

The subject of relations with China has already been an important topic of the 2020 U.S. presidential election. It is notable, however, that neither candidate has argued that the pre-2017 relationship with China should be reestablished. If President Trump wins reelection, the readjustment of U.S. policy toward China will likely continue. If former Vice President Biden prevails, it would be wise for the new administration to take note that some positive changes in reducing U.S. reliance on China are already underway and that reflexively going back to the way things were with an ever-growing Chinese threat would not be a sensible shift. With so much of the price of a major policy shift already paid, why waste the efforts already undertaken? ◆