Economy / China Economy

Techno-nationalism: US-China tech war to be ‘defining issue of this century’, despite signing of phase one trade deal

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• Trade deal and tech war are in ‘parallel universes’ with minor progress on tariffs a mere sticking plaster in wider deterioration, academic says

• Report states that decoupling is inevitable in the crucial semiconductor space, with a ‘new era of techno-nationalism’ set to shake up global value chains

Forget the phase one deal, a bitter superpower tech war will overshadow any minor progression in US-China relations emanating from this week’s trade agreement.

That is the message contained in a new report to be released on Monday, the author of which says that tariffs are “a subset in a much larger, overarching, systemic rivalry between two superpowers, which is the defining issue of this century”.

“The trade deal, which is focused on tariffs, is in a completely different space,” said Alex Capri, a visiting senior fellow at the National University of Singapore. “These are in parallel universes – we have tariffs on one side then we have the US-China tech war on the other. These are two completely disjointed, totally divergent issues.”

Capri wrote the report, subtitled How a New Era of Techno-Nationalism is Shaking up Semiconductor Value Chains, for Hong Kong’s pro-trade Hinrich Foundation. It says we are in “a new strain of mercantilism that links tech innovation directly to economic prosperity, social stability and to the national security policies”.

US-China tech war overshadows ‘phase one’ trade deal

At ground zero of this conflict are semiconductors, which provide the vital materials and circuitry for microchips, “the central nervous systems and brains inside all new age technology”. And on this front, decoupling between the United States and China is inevitable, the report said, and it will “have a traumatic impact on the entire technology industry, and alter the global economic landscape”.

“Even if the two superpowers are able to repair ongoing trade tensions and hammer out a series of trade deals, there will be no turning back from the pervasive effects of techno-nationalist policies,” read the report.

Even while pursuing a trade accord on one hand, the US has been actively trying to reduce technological integration with China on the other.

As US President Donald Trump and China's Vice-Premier Liu He were signing the phase one deal in the White House, the US was lobbying Britain to ban Huawei from its "critical national infrastructure" and considering plans to invest at least US$1.25 billion "in Western-based alternatives to Chinese equipment providers Huawei and ZTE".

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The US has already used export controls to ban Chinese firms from accessing vital US technology [1] and as smart devices, 5G and the internet of things become more pervasive, the definition of "dual use goods", commercial products that can be used for military purposes, will widen.

This leaves more scope for authorities prevent perceived bad actors or rivals from acquiring their goods, while the US government has provisions – such as the International Traffic in Arms Regulations – that can completely block the export of technology to designated buyers, at even the most minimal level.

"While there are changes to some Chinese technology policies, phase two is unlikely to make much progress in addressing the two countries' rivalry," said Chris Rogers, Research Analyst at Panjiva, S&P Global Market Intelligence.

At the root of it is China's near total dependence on foreign-made semiconductors. China imported more semiconductors than oil in 2018, with "China depending almost entirely on American and other foreign companies to supply its needs for integrated circuits". Without access to the foreign-made products, its hi-tech industrial plans would be completely derailed.

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The US, meanwhile, owns 45 per cent of the global market share in semiconductors, with Korean firms in second place accounting for 24 per cent. Government efforts to decouple the tech economies of the US and China will therefore hurt American firms that are dominant in the Chinese market.

"More than 60 per cent of Qualcomm's revenue came from China in the first four months of 2018; for Micron, over 50 per cent; for Broadcom about 45 per cent," read the report.

A ban on Huawei buying US tech combined with the overall market uncertainty from the tech war led to Broadcom revising down its 2019 revenue estimate by US$2 billion.

However, given that the most advanced Chinese producers of semiconductor technology are two to three generations behind their US rivals, China would be the major short-term loser should decoupling continue, Capri said.

"It's not a zero-sum game, in the long term everybody loses, but in the short term particularly when speaking of semiconductors, if you have the application of export controls applied by the US and EU together, and potentially by the Taiwanese, Japanese and others, the short term loser is absolutely China," he said.

Unpacking the 'phase one' deal for the US-China trade war
The new report builds on a growing library of evidence in the decoupling story. US venture investment in China is expected to plunge to a six-year low for 2019, to less than US$4 billion, just

one year after peaking at US$17.4 billion, it was reported this week.

China, meanwhile, is searching for ways to become technologically self-sufficient, pumping tens of billions of dollars into its domestic tech sector, and looking to lure overseas developers to the mainland to help with the drive.

And while Beijing has attempted to play down the controversial “Made in China 2025” blueprint for industrial upgrade, a former minister this week outlined plans for 75 per cent of all chips used in China to be domestically made.

China is aiming to increase its reliance on domestic production for key components, including chips and controlling systems, to 75 per cent by 2025, the former minister said.

Domestic production can currently only provide around a third of the key components required by China, but Li Yizhong, the former industry and information technology minister, said that the level would be lifted to 40 per cent by 2020 and 75 per cent by 2025.

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• South China Morning Post, Published: 7:30pm, 17 Jan, 2020: https://www.scmp.com/economy/china-economy/article/3046562/us-china-tech-war-be-defining-issue-century-despite-signing

This article appeared in the South China Morning Post print edition as: looming superpower tech war seen as defining issue of the century.

Trade war: China, US face tough reality ahead after the pomp of phase one deal signing

• US and Chinese camps send differing signals over prospect of a phase two deal, while many wonder if China can keep to its phase one commitments

• After trade deal, average US tariffs on Chinese goods will be 19 per cent compared to 3 per cent before the trade war, with European Union already voicing fears

A US-China trade deal that had long been in the works was signed with all the pomp we have come to expect from President Donald Trump, and for some the setting was fitting as this has been billed as a victory for style over substance.

While Trump proclaimed it “a momentous step – one that has never been taken before with China”, it had long been clear that this phase one deal would be lightweight in the grand scheme of trade agreements, which often run to thousands of pages compared to just 86 in this case.

After talks dramatically collapsed in April last year, it was determined that the more difficult elements would be shifted into a second phase of negotiations. The document, then, is seen to contain the low-hanging fruit – items both sides could bear to agree on as their broader geopolitical relationship continues to deteriorate.

As it was signed [2], the US was continuing to tighten the screw on Chinese technology giant Huawei, successfully lobbying ally Britain to keep the company out of its "critical national infrastructure". This is just one area with the potential to upend the trade truce over the coming months.

But for now, both sides were keen to spin the story in their own favour. Washington released an English version of the text soon after it was signed in the East Room of the White House by Trump and China's lead negotiator and Vice-Premier Liu He.

"What the hell. This is a big celebration," Trump said, as he launched into lengthy introductions of gathered business and political luminaries, including Henry Kissinger.

Beijing tightly controlled the narrative domestically, with the language in state media more muted and a Chinese version only appearing on the Ministry of Finance's website eight hours after the signing ceremony.
In China, It was spun as "win-win" – a phrase which has popped up continually over a tumultuous year and a half of negotiations and which Liu also used as he spoke at the dais after Trump and US Vice-President Mike Pence.

What the hell. This is a big celebration
Donald Trump

Beijing was eager to assert that it had not capitulated, with state-owned tabloid Global Times writing that it should not be viewed as a "one-sided win". The official Xinhua News Agency said it showed both sides are looking for "a more reasonable approach" to managing their differences.

As for the contents, there were few surprises. As reported, China will buy an additional US$200 billion of US goods and services over two years, which will "require US exports to China to grow 40 per cent in 2020 and an additional 40 per cent in 2021 – implausibly large increases", said David Dollar, senior fellow covering China at the Brookings Institution.

Other provisions include an intellectual property (IP) chapter which was "surprisingly comprehensive", said Bryan Mercurio, a law professor specialising in IP at the Chinese University of Hong Kong, who added that it "has a mix of commitments and demonstrable results", and a currency chapter that was dismissed by Brad Setser at the Council on Foreign Relations as "a reiteration of China's [International Monetary Fund] and existing G20 commitments".

The US cancelled a tariff planned for December on Chinese-made consumer goods, and will halve a 15 per cent tariff on US$110 billion worth of products as of February 14.

However, rafts of tariffs remain in place. The average US tariff on Chinese products will be 19 per cent after the deal is implemented, compared to 3 per cent before the trade war, research by the Peterson Institute for International Economics showed.

An enforcement mechanism means the US can unilaterally resurrect the tariffs should it deem that China has not upheld its side of the bargain.

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political and social system.
Yiwei Wang, Renmin University

American markets rallied, despite the fact that the signing had been diarised for weeks, with all three major benchmarks reaching record intraday highs. The Dow and S&P 500 closed at record highs, while Hong Kong's Hang Seng Index closed higher for the first time in three days.

Chinese markets, on the other hand, retreated for a third day, as traders looked past the tentative truce to focus on lingering issues that could still fray the relationship between Beijing and Washington.

This tense outlook means that expectations are low for a phase two deal. Trump said negotiations would begin immediately, but Liu said he did not "think it is a wise choice to impatiently launch new stages of talks" – another sign of how the differently each camp views this deal.

"Phase two is more difficult because it is about more so-called structural reform, related to China's political and social system. The early stage is easy to reach, because it's about trade issues," said Yiwei Wang, a professor at Renmin University.

For China, a ceasefire with the US may lead to skirmishes elsewhere, as switching its imports to the US, it risks angering its other trading partners, with the initial reaction suggesting this is the case.

The purchase element of the deal represents "managed trade, meaning the US tells China" what to buy, leaving European firms to "wonder where our place is", Joerg Wuttke, president of the EU Chamber of Commerce in China, told a press conference in Beijing on Thursday.

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Additional reporting by Simone McCarthy and Wendy Wu.

• South China Morning Post, Published: 10:00pm, 16 Jan, 2020:
https://www.scmp.com/economy/china-economy/article/3046425/trade-war-china-us-face-tough-reality-ahead-after-pomp-phase

This article appeared in the South China Morning Post print edition as: harsh realities loom after pomp of signing

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Footnotes

[1] https://www.scmp.com/tech/start-ups/article/3032026/chinese-tech-champions-denounce-us-blacklisting-foreign-ministry

[2] https://www.scmp.com/economy/global-economy/article/3046427/china-phase-one-deal-us-will-allow-chance-domestic-reform