



# The War

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## That No One Really Wants

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The next world war might as well be fought on the drawing boards of major economies, rather than on the battlefields. The current trade war between the US and China, is having a profound effect on the lives of people in both these countries and across the world.

As we write this, the US has announced an aid to the tune of \$15 billion to American farmers affected by the trade war with China. Last year, the US Department of Agriculture spent another \$12 billion on farmers affected by loss of sales as a result of the tariff increases by China.



Quite clearly, the trade war with China is costing the US government a lot of cash. Does this mean that Trump's trade war strategy is dead wrong or misguided, at best? An ancient Chinese proverb exhorts, "When you cross the seas, do it in full view". To achieve success, one should not have to hide. Hiding in plain sight will do the trick instead.

This is precisely what China has been doing for several decades, as part of its soft war on the US. In fact, some say that the Chinese strategy has been so effective that it has lulled the US and the EU to sleep. While the US and EU slumbered, China grew its economy and bolstered its military strength annually, thereby increasing its global influence.

## China's Influence

A prominent former Malaysian politician remarked privately that before the 80s China had been a poor nation. "Some of its citizens were so poor that they had no money to even buy clothing for themselves!" However, after Deng Xiao Peng's economic reforms, China made giant strides to become a global economic superpower within three decades. In fact, it may have already surpassed the US as the largest economy in the world.





The Chinese Government has crafted a clear plan to develop state-of-the-art infrastructure, be it new airports, sea ports, high-speed rail networks, sea ways, or motor ways. This has made it possible to move goods and people all across the country in the most cost-effective manner. This has allowed for economic development in the most underdeveloped regions of China, as well.

In addition to hard infrastructure, the government focused on developing its digital infrastructure; 5G is being rolled out all across the country even as you read this. This will facilitate the leverage of high-end technologies in VR/AR, Edge Computing, Quantum Computing, and Big Data analytics for real-time monitoring and operational excellence. Mobile payment is on the rise, as more and more customers across the country are moving to digital wallets and online payments. China is expected to be the largest eCommerce market in the world.

China is no longer reliant on foreign direct investment (FDI). In contrast, it is now investing in other countries to further cement its global influence and expand interests via its strategic Belt and Road Initiative (BRI).

According to data from CEIC, China's investments overseas grew by \$22.6 billion in March 2019, compared to a growth of \$25.5 billion in the previous quarter. In 2015, China's investments reached its highest of \$66.6 billion. Just 15 years earlier, during the dotcom bust, China recorded its all-time lowest investment overseas of negative \$754 million.

On the other hand, China's FDI hit an all-time high of \$105.2 billion in December 2013. Just three years earlier, China had recorded its lowest FDI of \$6.6 billion in March 2000. More recently, in March 2019, China recorded a current account surplus of \$58.6 billion while its GDP chugged along at 6.4% in first quarter of 2019. In comparison, India, the second largest and populous country in the world, grew at 5.8% during the same period.

In contrast, the GDP posted by the European Union over the last five years has barely scraped by at 1.5%. Interestingly, the US government is improving its GDP performance under the Trump administration by posting 3.1% growth in the first quarter of 2019.

What does all this mean?



## The MFN Paradox

The emergence of China as a world economic superpower is mainly due to US investments in China. Despite various concerns regarding China's military expansion and human right abuses, the US continued to favour China by retaining its Most Favoured Nation (MFN) status during the Reagan, Bush Sr., Clinton, Bush and Obama eras, giving it preferential treatment on trade and tariffs.

Trade protectionism goes out of the window when a country receives the MFN status, as the status helps a developing country to its feet. Per the World Trade Organisation (WTO) agreement, MFN benefits must also be granted to all member countries of the WTO. However, developing nations do not have to return the favour by opening up their economy as well. This sort of helps a small country to continue to grow.



With MFN, China's production capacity and economies of scale, a domestic enterprise can be driven out of business by sheer volume and cost of production issues. Hence, a big country like China stands to benefit from the MFN status. The MFN granted China easy trade, by cutting down red tape and by offering lowest trade tariffs and even greater benefits via economies of scale.

The trouble is that some view China as a developed country, despite what Beijing's politicians claim.



However, Trump is grabbing the bull by the horns and wants fair trade with China. Clearly the MFN strategy to get China to open up its markets and be embraced by the rest of the world hasn't really gone according to plan.

While the World Trade Organisation (WTO), the EU and the rest of the world watches how this will pan

out, it is clear that a prolonged trade tension would benefit no one. In fact, it will be a lose-lose-lose situation. A loss for the US. A loss for China. A loss for the rest of the world.



Now is perhaps the best time to get trade issues and China's status straight. It is also time for China to open up its markets and allow foreign companies to set up shop there. This will be good for accounting and audit firms to operate without the need to partner with local firms. China should also get tough on respecting Intellectual Property rights, while the US should reciprocate by easing tariffs.

Over the last four decades, China has made significant progress in almost every part of the value chain, be it Biosciences, High Tech, Manufacturing, Food storage, or security. China has poured billions into developing AI capabilities across a wide spectrum of industries and applications so much so that it is likely to be the most advanced country in the world when it comes leveraging AI. China is quite ready to compete on a level playing field and perhaps lead the world.



## Trumponomics May Hold The Key

Despite its many progresses—space programs, R&D facilities, cutting-edge products, advanced solutions that make people's lives safer and more efficient—many are concerned about China's competence.

While most economists and analysts were quick to criticise the trade war initiated by the Trump administration, they are now sure that it has the attention of Beijing. They now understand that Trump means business. Trump insists, and rightfully so, that trade must always be done on a fair and just basis.

China too has reciprocated by increasing its tariffs on US-based products. Political posturing by the two world superpowers is causing the world markets to catch a cold. World markets are getting jittery and volatile, which may not necessarily be a bad thing altogether. Some correction in global trade is sometimes necessary for more sustainable growth.

However, should this mean a suspending of talks? After all, it will be in the best interest of both countries to talk and avert a global disaster. It is not a question of who is stronger or who is right, rather it is a question of who will take a wise step forward.



## Will India Emerge as a Challenger to China?

The US-China trade war is likely to create chaos and confusion in the supply chain. Goods will get more expensive to source and take longer to access. The average consumer and his pocketbook may end up paying a heavy price. Products have gone up by 15% to 25% across the board. The overall cost of construction in the US, has increased by about 20%. It appears it is a no-win situation in the short term. However, in the long term, this will force all countries (including China) to compete in an open playing field.



As in any dispute or disagreement, there will be others that might reap the benefit of such a situation. I think that this is just what may happen in the short term. Countries like India which have many of the same resources as China will be able to bridge the gap. The US may develop new supply chain routes with India, resulting in a big economic boost for the country. India will have to play its hand responsibly and effectively to make the best of the current global situation. In addition, India will need to work out its own long-term strategic plan to advance its economy.

There are no winners or losers here. Economies will see some impact in the short term. However, one thing is for sure. Countries will take notice of this trade war and will change their economic policies to make themselves more open to trade and implement best trade practices. We will see this yin and yang play out over the next three or five years. The dust will eventually settle down but on a refined order of business.

May the best win, survive, and thrive!

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