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CAPITAL ACCOUNT

An Economic Cold War Looms Between the U.S. and China

Some observers suspect that Washington's ultimate goal is to permanently disentangle America's economy from China's



China has shown no sign of caving to U.S. trade demands so far. Here, President Xi Jinping visits a farm Tuesday in northeastern China's Heilongjiang province. PHOTO: WANG YE/XINHUA/ASSOCIATED PRESS



By *Greg Ip*

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A decade ago, the growing mutual dependence of the U.S. and Chinese economies earned them the nickname “Chimerica.”

Now, as both dig in on their trade dispute, some see an economic cold war looming in which the U.S. and China seek to lead competing economic blocs. “Neither China nor America wants to be part of Chimerica anymore,” says Brad Setser, a China expert at the Council on Foreign Relations. “The Chinese don’t want the technological dependence, and the U.S. doesn’t want the persistent trade deficits.”

Officially, the U.S. is imposing tariffs on Chinese imports as a hard-nosed but hopefully temporary tactic to force China to treat U.S. companies and goods more fairly. Yet, Beijing has shown no sign of caving to U.S. demands that, in totality, entail a wholesale end of the industrial policy that has long guided Chinese economic development. Some suspect the U.S. goal isn’t a negotiated solution, but to disentangle the two economies permanently.

“The U.S. and China are in for a long and acrimonious confrontation,” Arthur Kroeber of Gavekal Dragonomics, a China-based research firm, wrote last week. This isn’t driven by President Trump alone, he wrote, but “by a powerful coalition of security and economic officials who believe the U.S. is entering an existential conflict with China for global economic, technological and geopolitical dominance.”

The situation has no precedent in post-war history. The U.S. had few economic ties to the Soviet Union, so their strategic rivalry seldom spilled over to trade. America’s trade disputes with Japan carried no security fallout because the two are military allies. By contrast, Washington worries that China’s use of cybertheft, trade barriers and forced technology transfer not only confer economic advantage but make it a more formidable geostrategic adversary.

Mr. Trump is mainly motivated by the U.S. trade deficit with China. Tariffs aren't likely to fix the imbalance: If a company shifts production from China to Vietnam to avoid U.S. tariffs, America's trade deficit with Vietnam will go up while its deficit with China goes down.

But China critics who don't share Mr. Trump's deficit obsession see a different benefit. Tariffs and other penalties, such as forthcoming restrictions on the export of key technologies, weaken China's appeal as a destination for foreign investment and start to unravel the supply chains that tie the U.S. to China. The longer tariffs remain in place, the more multinationals that want to sell to the U.S. will seek alternatives to China to source production. Taiwan and Thailand are already marketing themselves as alternatives.

Yet, moving a supply chain out of China is harder than it sounds. Mr. Kroeber notes in an interview that China doesn't offer just low labor costs, it also has well-developed infrastructure and logistics, skilled labor such as engineers, and access to China's own huge internal market. "That can't be matched somewhere else." Multinationals may need two supply chains: one with access to the U.S., and one with access to China. They would then have to decide whether their U.S.-centric or China-centric supply chain serves the rest of the world.

In the short run, China would clearly be the loser: It still depends heavily on the U.S. for intellectual property, know-how and investment, and as a market for exports.

Yet over time, China could overcome those disadvantages. It "has all the necessary prerequisites to make an Asian-based trading bloc work without the U.S.: a large domestic market, political support for open markets and manufacturing expertise," writes Larry Brainard of TS Lombard, an investment advisory. China already does more trade in manufactured and intermediate goods with the European Union than the U.S., and twice as much with the rest of Asia, he notes.

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Last year, Huawei Technologies Co. became the world's top supplier of telecommunications equipment, according to IHS Markit, despite being effectively barred from the U.S. over

concerns its equipment could be used by the Chinese government to spy on Americans. Chinese auto manufacturer Zhejiang Geely Holding Group, which owns Volvo Cars, last year bought a stake in Malaysia's struggling car maker Proton, which it hopes to make a platform for exports to southeast Asia and the Middle East.

China still lacks the U.S.'s most potent competitive advantages: deep, open and transparent markets overseen by trustworthy institutions and the rule of law, and a web of alliances underwritten by American military power. If forced to pick sides, the vast majority of companies and countries will pick the U.S.

That choice becomes a bit less one-sided if the U.S. becomes more isolationist. Shinzo Abe, Japan's prime minister, had seen the 12-nation Trans-Pacific Partnership as a counterweight to China's growing economic clout. With the U.S. abandoning that treaty, Mr. Abe is now hedging his bets, reaching out to Chinese President Xi Jinping for warmer economic relations.

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