Letter n°101

China/United States, impossible divorce.

"What happens when your main rival is also your main trading partner?" Dominique Moïsi.

This is one of the questions posed by Dominique Moïsi in his recent book "The Geopolitics of Emotion," to which we will try to provide answers in this Letter 101.

In mid-November, in San Francisco, Biden and Xi sought to ease tensions; in Beijing, in recent days, Xi has sought to charm American leaders. Each of the two countries needs the other, but differences remain palpable:

- ***China needs external outlets***:

Achieving the goal of 5% growth, due to a lack of a dynamic domestic market, requires an increase in exports. Five reasons for this: between 1996 and 2015, the Chinese workforce grew by 100 million, but today it is decreasing. Additionally, investment as a percentage of GDP has consistently exceeded 40%, a level rarely reached elsewhere, but today overcapacity in many sectors, such as infrastructure and real estate, is abundant. Also, GDP growth used to exceed 10% per year, but today it is officially 5%, likely less, and job creation is insufficient to alleviate youth unemployment. The fourth reason is that provinces used to rely on land sales for real estate speculation; today, they are burdened with debt. Finally, the government has heavily invested in future technologies and, according to an Australian think tank, holds advanced positions in 53 out of 64 of them, but the Americans lead the race in the crucial sectors of AI and semiconductors.

- ***American companies, dependent on the Chinese market, remain deaf to government admonitions***:

On one hand, the US government estimated that 2 million jobs were lost in the country between 1999 and 2011 due to Chinese competition, and since 2016, both Trump and Biden have erected tariff barriers on Chinese products.

On the other hand, at the corporate level, the sentiment differs. The top 200 multinational firms generate 13% of their revenue from China. And behind this average, some companies are highly dependent. This is the case for Apple, which generates a quarter of its revenue in China. The same is also true of US retailer Dollar Tree with over 40% of its products purchased in China, far ahead of Walmart with 8%. The examples could be multiplied.

- ***Signs of tensions:***

Reflecting the tensions, the number of Chinese students in the United States decreased from 370,000 in 2019 to only 290,000 in 2022, and since 2019, the number of foreigners visiting China has dropped by over 60%.

As a consequence of the tensions, China's military budget in 2024 officially grew by 7% to $213 billion, a percentage higher than the country's economic growth, representing 2% of the GDP, but actual figures are likely 30% higher.

The rivalry with the United States is undeniably a cause. The determination displayed to reclaim Taiwan is one expression of it. The desire to expand control over the South China Sea at the expense of Vietnam, the Philippines, and Malaysia, which are close to the United States, is another example. In the South China Sea, since the Philippines granted the United States four new military bases, three of which are near Taiwan, conflicts are frequent. At the same time, there is an increase in joint American patrols with the Vietnamese.

To better understand the economic relations between the two countries, let us first analyse the American desire to rely less on China. Next, let us examine the advantages of the United States in their competition with China for global pre-eminence. Finally, let us study Chinese efforts to circumvent American sanctions and break free from dependence on the West.

American desire to reduce dependence on China:

Misleading figures:

The US trade deficit decreased in 2023 to $773 billion, thanks to a 1.2% increase in exports to $3.05 trillion and a 3.6% decrease in imports to $3.825 trillion.

Since 2017, the share of American imports from China has decreased by a third to 14%. American exports to China are not very high, but imports are.

In 2023, trade between China and the United States decreased by 11% to $665 billion after reaching a record of $760 billion in 2022. Thus, in 2023, the US trade deficit with China fell to $280 billion, its lowest level since 2010, compared to $382 billion in 2022 and far from the $420 billion in 2018.

Chinese statistics and American statistics diverge. According to the Chinese, exports to the United States increased by $30 billion in 2023, and according to the Americans, imports from China would have decreased by $100 billion. In fact, according to Adam Wolfe of Absolute Strategic Research, Americans underestimate their imports to reduce import taxes.

American measures to reduce dependence:

Half of American companies operating in China say they are in loss or break-even, and one-quarter have started or are planning to relocate out of China.

Chinese abuses, such as subsidies or other measures, are exploited by the United States to expand tariffs. Trump imposed tariffs up to 25% on $300 billion of Chinese exports, including steel and aluminium. Biden has maintained these measures and is working to restrict the possibility of exporting sensitive Western technologies to China.

China has filed a complaint with the WTO against IRA subsidies because companies like CATL, which controls 37% of the global battery market, cannot build factories in the United States and are forced to license their technology.

The Americans ignore these complaints. Trump, in violation of free trade rules, announced his intention, if re-elected, to impose a 10% tariff on all imports and even 60% for products from China, and Biden wants to triple steel tariffs. This would penalise both consumers of these products and the firms that purchase them.

- Regarding electric vehicles, the United States appears to be regressing. Sales of hybrid vehicles increased by 50% in January-February 2024 and exceed those of electric vehicles, which only saw a 13% increase. GM postponed the launch of three new electric vehicles. Ford suspended $12 billion in investments in electric vehicles, reduced its electric production line, and shifted personnel from electric to traditional vehicles.

- Regarding semiconductors, a plan was passed at Biden's initiative to help American companies regain market share, which was 40% 30 years ago but is only 10% today. Over the past two years, industry players, including foreign companies like Samsung and TSMC, have committed to investing nearly $250 billion in the sector. Among the latest examples, Intel will receive $8.5 billion in subsidies, plus $11.5 billion in loans and a 25% investment tax credit for setting up factories in four US states. TSMC will receive $6.6 billion in subsidies and $5.5 billion in public loans for setting up an advanced factory in Arizona. TSMC's total investment in Arizona will reach $65 billion.

  Furthermore, to avoid relying too much on Taiwan, the United States intends to establish new chip manufacturing plants in Southeast Asia, particularly in the Philippines.

- In the shipbuilding sector, Americans are concerned about their decline, with their global market share now limited to 1%, and the Chinese breakthrough benefiting from cheaper labour and abundant steel.

- In social networks, TikTok is suspected by Congress of threatening US security, espionage, and propaganda, knowing that one-third of adults under 30 regularly use it.

- In solar energy, despite tariffs, the United States has never imported as many cheap Chinese panels because, according to the IEA, Chinese production is three times the demand and prices dropped by 50% in 2023. Despite subsidies, American companies in the sector are abandoning some investment projects. This is the case for CubicPV, backed by Bill Gates, or Canadian Solar Panel. A year ago, the company had secured $100 million to build a $1.4 billion factory, but due to lack of competitiveness against the Chinese, the project is abandoned, and CubicPV prefers to specialise in a new technology.

The persistent allure of the American market:

The Chinese stock market has fallen by 30% since the beginning of 2021, while the American market has appreciated by 33%. Three reasons account for this: the appeal of the economy, the appeal of the stock market, and finally the $.

- ***The appeal and growth of the American economy persist***:

The United States, with a GDP of $27 trillion, maintains pre-eminence over China, at $18 trillion, Germany, and Japan, each at $4 trillion. Real GDP growth since 2019 has been 8.2%, compared notably with 1.8% for France, 1% for the UK, and 0.1% for Germany.

Unlike major industrialised countries, China, and India, the United States is a net exporter of oil and gas, which contributes to the growth of its GDP.

At Biden's initiative, the United States has launched massive plans to revitalise the semiconductor sector ($50 billion), accelerate energy transition (a $365 billion IRA plan), and renovate infrastructure through the Build Back Better Act.

The United States also remains the foremost military power, with a budget of $877 billion, surpassing that of all other countries combined.

The capitalisation of the American stock market in the MSCI World represents over 60% of global market capitalisation and has never been higher. In 1969, the S&P 500 index was at 92, today it is at 5010. Within the Nasdaq 100, over a third of companies have a market capitalisation exceeding $100 billion.

- ***The American market is attractive for global savings*:**

The United States, thanks to the dynamism of the tech sector and demographic growth, remains a magnet.

Emerging countries, despite their immense needs, paradoxically serve more as lenders than borrowers.

Rich countries with current account surpluses, such as the OPEC with a current account surplus close to 10% of GDP, China with a surplus close to 2% of GDP, Japan with a surplus exceeding 4% of GDP, Southeast Asia with a surplus close to 2% of GDP, and the EU with a currently low surplus, continue to be drawn to the American market, which is traditionally a net borrower. Japanese investors still hold the most Treasuries with $1.17 trillion, while the Chinese are reducing their holdings but still retain $775 billion, and the British have increased theirs to $700 billion.

In the United States, long-term capital inflows represent approximately 3% of GDP in value and exceed the current account deficit. The United States does not fear an annual budget deficit between 6 and 7% of GDP.

- ***The American appeal and the appeal of the $***:

While speeches from actors in the Global South emphasise the need for increased investment and South-South trade, reality does not always align with these aspirations.

"Dedollarisation" is a trendy term, but in 2023, 59% of international foreign exchange reserves were held in $, compared to 66% in 2015.

The $ remains at the core of the international monetary system and is used as a currency for settlement in 45% of international transactions, a percentage that has remained stable for the past 20 years.

The $ remains the primary currency chosen for issuing currency bonds, accounting for 47% of volumes, a weight that has been growing since 2010 when it was 32%.

Chinese efforts to circumvent:

China's strength lies in its industry, accounting for 38% of global production compared to 55% for the United States and its allies.

A few years ago, China received 10% of the world's FDI, with $87 billion in 2013. However, in 2022, it only received $18 billion, and in 2023, the net amount even turned negative, while investments increased in Vietnam, India, Bangladesh, and Mexico.

To circumvent sanctions, China is increasing relocations to Mexico, Indonesia, and Malaysia, and also resorting to "transshipment," changing the vessel carrying goods.

- ***Internationally***:

Americans are buying more from Mexico and Vietnam and less from China, but these countries trade more with China, and Chinese companies have invested heavily in them. For the first time in 2023, China was no longer the top supplier to the United States, with $472 billion, as Mexico took the lead with $475 billion; however, the US deficit with Mexico has worsened, from $95 billion in 2022 to $150 billion in 2023.

Chinese groups are seeking ways to bypass barriers erected by Western countries to sell their surplus in electric vehicles, batteries, solar panels, wind power, steel, metallurgy, shipbuilding, and white goods such as washing machines.

In fact, many Chinese producers have set up operations in Mexico to circumvent US sanctions, selling electric cars from Mexico and benefiting from a limited tax of 2.5%. China invested $2.5 billion in Mexico in 2022. BYD, the global leader in electric vehicles in 2023 with a net profit of $4.1 billion, plans to assemble 150,000 electric vehicles in Mexico, to be compared with its global production of 3 million vehicles, of which 243,000 were exported. To appease the Americans, Mexicans had to impose taxes of up to 80% on certain steel imports from China.

Similarly, the deficit with Vietnam has doubled in recent years to reach $104 billion.

In other words, the ties between Americans and Chinese are less strained than expected.

China is increasingly exporting components to countries like India or Vietnam, which then re-export to the United States. These intermediary countries are pleased to add some value and create jobs in the process.

For example, in semiconductors, Chinese companies like Fengshi, eager to avoid sanctions, have set up operations in Malaysia. Since the implementation of sanctions decided by Trump, the number of factories in the sector, supplying components, has increased from 16 to 55, according to the FT.

- ***On the domestic market***:

The ambition is to reduce China's dependence on the Western world in sensitive technologies, raw materials, and food. It doesn't matter if the quality is inferior, independence is paramount.

For the manufacturing of computer hardware, there is a substitution of Chinese producers, such as Tongfang, for traditional companies like IBM, Cisco, and Dell. Dell has seen its market share halved to 8% in five years, and others have also experienced a decrease in their revenue. HP, a manufacturer of servers and storage devices, generated 14% of its revenue in China in 2018 but only 4% in 2023.

The trend is similar for software as Microsoft, Oracle, Adobe, and Salesforce are gradually being replaced in the Chinese market by Alibaba and Huawei. Orders have been issued to replace all foreign software in government agencies and state-owned enterprises with Chinese software by 2027.

In semiconductors, China is investing heavily to reduce its dependence. According to estimates from the US Department of Commerce, there have been $150 billion in subsidies over the past decade. China relies on its two main groups, SMIC, a partially state-owned company, and Huawei, and the catch-up is swift.

In telecommunications, Huawei seems to be overcoming US sanctions with a 9% revenue growth in 2023 to $97 billion, still 20% lower than 2020 but far from disappearing. Since the beginning of the year, Huawei's sales in the Chinese market have increased by over 60% at the expense of Apple, which has seen a decrease of nearly 25%.

China is closing its doors to foreigners. In 2023, the number of residence permits granted to foreigners, 710,000, was 15% lower than in 2019. On one hand, the country is no longer as appealing, and on the other hand, it is more restrictive.

Conclusion:

- ***A quest for national independence in the United States, as in China***:

The United States does not want to face what it considers unfair competition and continues a policy of "containment" of China by tightening military ties with partners in the Pacific region, including Japan, the Philippines, Australia, India, and Taiwan...

In the United States, noteworthy currently is the TikTok affair, but also, in opposition to its Japanese ally, Biden's blocking of the purchase of US Steel, the third-largest American steel producer, by Nippon Steel, a $14.9 billion deal. This blockage occurred despite Nippon Steel's commitment not to relocate American plants.

In China, multinational companies, both American (such as Apple and Qualcomm) and non-American (such as Samsung and Kering), have reported a decrease in revenue in 2023 or early 2024.

- ***Limited cooperation***:

The United States only agrees to cooperate with the Chinese on major transnational issues such as dealing with the debt of emerging countries and environmental policies.

- ***International trade slowed:***

Deglobalisation primarily affects the exchange of goods and services, particularly between the United States and China. While there was a decrease in global goods exports in 2023, the decline in trade between China and the United States was more pronounced.

For consumers or businesses buying components, subsidies for relocations, the public debt arising from these aids, and import taxes are the seeds of inflation.

- ***An American analytical mistake*:**

The American trade deficit is indeed the result of unfair Chinese subsidy practices, but it is also the consequence of American excesses and shortcomings.

Excessive budget deficit, trade deficit, reflections of a credit-based growth, shortcomings in past research spending that have allowed the Chinese to conquer dominant market shares in several future industries.

Overall, it is estimated that the Chinese content of products consumed in the United States has not decreased.

- ***China, hit but not sunk***:

We do not see China gaining the upper hand over the United States, but it would be a mistake to believe that the economic struggle will curb China's political emergence; Napoleon, it is remembered, had imposed a continental blockade on England, but there was no English collapse.

China preserves many assets, notably rare earths, of which it sometimes produces 80% of the global total, and as early as ***1992, Deng Xiao Ping*** declared ***"The Middle East has oil, China has rare earths".***

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