

INSIGHTS

The Middle Kingdom and the Parallel Universe



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In 2015, the Chinese Premier Li Keqiang introduced the “Made in China 2025” initiative (i.e. Fourth Industrial Revolution, Chinese Style) which is the new industrial policy to move China from the factory floor of the world to dominance in global high-tech manufacturing. This also means that China recognized the necessity to become independent from foreign technology suppliers. To actualize this audacious mandate, China would unleash government subsidies, leverage state-owned enterprises, and acquire intellectual property. The U.S., on the other hand, views the success of the initiative would rely on discriminatory treatment of foreign investment, forced technology transfers, intellectual property theft, and cyber espionage.

There are 5 main U.S. grievances and the Trump Administration is using tariffs[1] and other means to force changes now:

1. Huge trade deficit as a result of unfair trade practices
2. Theft of intellectual property
3. Forced technology transfer
4. Practicing “state capitalism” through state sponsored or subsidized enterprises
5. Currency manipulation

[1] <https://www.china-briefing.com/news/the-us-china-trade-war-a-timeline/>



To overcome these grievances would require China to change those laws and policies that produce unreasonable or discriminatory practices or actions that harm American intellectual property rights, innovation, or technology development. The U.S. is strong-arming China through the application of escalating tariffs to relinquish its economic model – Chinese industrial policy and the government subsidies – and significantly scale down Made in China 2025.

China will not commit to the demands of the U.S. to move from a command and control industrial policy to a market-oriented economy. The demands and the required actions to meet them would be an infringement on China's sovereignty and undercut the authority of the Chinese state and the power of the Communist Party.

The U.S. has also used other means to weaken China and to curtail its economic growth and influence globally. Huawei Technologies, for example, has become a target of the U.S. on national security grounds. More recently, eight Chinese technology companies have been blacklisted on human rights grounds. These companies are deemed to be in violation against Muslim minorities in the western province of Xinjiang.

China's ambition is clear, to be a global power, financially and militarily. It does not see itself replacing the U.S. but wants to have a respected seat at the world table. China wants to do business and understands that, in order to progress, it must conform to global standards of behavior in trade and diplomacy. On the trade front, China has demonstrated a willingness to make concessions and purchase American goods, such as commodities, corn, soybeans, sorghum, natural gas, oil, coal, chemicals, semiconductors, airplanes, etc. However, China has not demonstrated a willingness to make wholesale changes in domestic policy. Rather, it prefers to negotiate its way to a gradual but definitive road to openness and transparency by starting with banking, financial services, and currency. The fact that the Chinese currency has been a component of the currency basket is a recognition (and encouragement) of the changes China has and will need to make and the acknowledgement of the size, scope and reach of its economic power.

We expect this fundamental difference will fracture the world going forward as we permanently exit the U.S. centric unipolar world. As the U.S.'s influence shrinks (from America First policies, deglobalization efforts, disengaging from multi-lateral organizations that the U.S. founded and enforced, retreating from the leadership role that the U.S. has crafted and enjoyed with the combination of soft, hard and commercial power, looking at the world through the lens of scarcity rather than abundance, and other systemic and fundamental shifts of domestic and foreign policies) and allies are forced to find new allegiances, protection and cooperation, the unintended consequence is to speed up the independence and rise of China – exactly the direction in which the U.S. does not want to venture. A parallel universe of technology and influence will develop. This adds friction and inefficiency to global trade and innovation, and, in many ways, we are less productive and less able to optimize the allocation of capital and assets. Yes, there will likely be a phase 1, 2 and 3 of more trade pacts between the U.S. and China. But even if the U.S. is willing to back down from its demands or China is willing to concede on most of the central allegations, the mirror has cracked and a permanent seam is there between the two. The U.S. and China will not be reliable partners as trust has been broken.