

Cougar Global Viewpoints

The war front with China

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China is the world’s second largest military spender after the United States,¹ but any war with China will be fought on several fronts. Already, economic skirmishes are underway. In 2021, China quietly dropped its goal of increasing the service sector’s share of gross domestic product (GDP). The economy continues to struggle from the property cycle bursting and a shrinking population. The pivot back to manufacturing could serve both defensive and offensive Chinese priorities with the potential to hollow out some U.S. industries.

From a defensive standpoint, the Wall Street Journal reported a leaked directive from Chinese policy makers running a “Delete America” campaign.² The overarching focus is on removing reliance on foreign companies from their IT systems. This is in line with the push toward self-sufficiency in addition to any security concerns. The West’s high-profile export restrictions on microchips likely cemented the perceived imperative of this initiative. State-sponsored entities are dramatically increasing the use of homegrown technology, allowing for increasing budgets and markets for local hardware and software makers. U.S. tech companies are increasingly losing out.

The media poured a lot of attention on the case of Chinese-manufactured cranes at U.S. ports with potential cyber surveillance or sabotage vulnerabilities. China dismissed many of the accusations as paranoia. However, to paraphrase a famous line, just because you are paranoid, doesn’t mean that someone isn’t watching you. In fact, as mentioned above, China itself is looking to limit the access and use of U.S. technology in its economy likely for the same reasons.

Meanwhile, Chinese companies are exploiting U.S. Customs’ de minimis exceptions to avoid tariffs. Some large firms attempting to gain market share are willing to lose money doing so. Therefore, China’s exports were not far from a 10-year high last month in volume terms. However, thanks to deflation and currency weakness, in value terms they are below where they closed in 2021.

At a March hearing on consumer products from China, Adam Wolfe, Emerging Markets Economist at Absolute Strategy Research, told the U.S.-China Economic and Security Review Commission how China’s sheer size presents problems.³ Merely holding its manufacturing sector’s share of GDP steady has “felt like a deluge to the rest of the world,” he said. Wolfe convincingly suggests U.S. imports from China may have been understated by \$100 billion or more each year since 2020 due to tariff avoidance behavior. He also points to a study that shows the movement of final assembly of products out of China into places like Mexico has not significantly altered the value attributed to China in the process. The main outcome of these moves has been simply to lengthen supply chains. One of the biggest risks is that even with government subsidies, U.S. electric vehicle and battery, green energy,

and semiconductor companies may find it difficult to be profitable if China's excess capacity weighs on global prices. Even the European Commission has opened several anti-subsidy probes since last October on electric vehicles, solar panels, and wind turbines.

Beyond direct business competition, additional social risks may emanate in part from China. In April, the U.S. Senate passed a bill with wide support to ban TikTok unless its Chinese owner divests itself of the social media video app. U.S. lawmakers says its broad and popular use allows an adversary undue influence over the psyche of millions of Americans. Already, China is complicit in the rising drug-

related deaths in the United States. According to the U.S. House Select Committee on the Chinese Communist Party, the party provides tax rebates to producers of precursor chemicals to the illicit drug fentanyl.⁴

In conclusion, U.S.-Chinese tensions are running high across several dimensions. All the policy support in China for manufacturing is quickly leading to overcapacity in many industries. Therefore, valid concern is growing in Western capitals, particularly in green technology sectors. Thankfully with immense economic strains domestically, China's enormous military budget will be defrayed somewhat on maintaining stability at home.

1 "Global military spending surges amid war, rising tensions and insecurity," Stockholm International Peace Research Institute news release, April 22, 2024. Available at: <https://www.sipri.org/media/press-release/2024/global-military-spending-surges-amid-war-rising-tensions-and-insecurity#:~:text=China%2C%20the%20world's%20second%20largest,the%20Asia%20and%20Oceania%20region>.

2 "China Intensifies Push to 'Delete America' From Its Technology," Wall Street Journal, March 7, 2024. Available at: <https://www.wsj.com/world/china/china-technology-software-delete-america-2b8ea89f> (Subscription required.)

3 Hearing on "Consumer Products from China: Safety, Regulations, and Supply Chains," U.S.-China Economic and Security Review Commission, March 1, 2024. Available at: <https://www.uscc.gov/hearings/consumer-products-china-safety-regulations-and-supply-chains>

4 "Select Committee Unveils Findings into CCP's Role in American Fentanyl Epidemic," U.S. House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party, April 16, 2024. Available at: <https://selectcommitteeontheccp.house.gov/media/press-releases/select-committee-unveils-findings-ccps-role-american-fentanyl-epidemic-report#:~:text=The%20Select%20Committee's%20investigation%20has,synthetic%20narcotics%20through%20tax%20rebates>.

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