

The US-Chinese trade war

China in the World Economy, 2021

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- When did China's current account surplus reach its peak?
- How were Chinese exports distinct from developing country exports in the 2000s?
- How did China stabilize its economy during the 2008 Financial crisis?
- > bank loans to SOE – mostly construction sector > **real estate bubble!**

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- Which economic sectors and technologies has China been trying to develop by its industrial policies?
- What is the name of the biggest currently effective program of industrial policy?
- What does it mean to say that Artificial Intelligence is a general-purpose technology?

- „...in the IDDS, the opportunity to move directly to the technological frontier and surpass other economies is no longer a wished-for feature of a few random sectors, but rather **a fundamental feature of the current global moment.**“

- „Increasingly, Chinese industrial policy is based on the idea that China has a **once-in-a-lifetime opportunity** to get in on the ground floor of a technological revolution and vault into the leading ranks of economic and technological powers.“

Today

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- International comparison – finally???

China's industrial policy programs

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- 2010 – SEI - „let's development these X sectors **AND become the global leader in them**“
- 2015 – MiC, IDDS - „let's development these X sectors AND become the global leader in them **AND implement these technologies in the entire economy**“

Industrial Guidance Funds

- Key **tool** of industrial policy
- The previous (MiC25 etc.) were programs laying out **goals**; this is about the **means**

Industrial Guidance Funds

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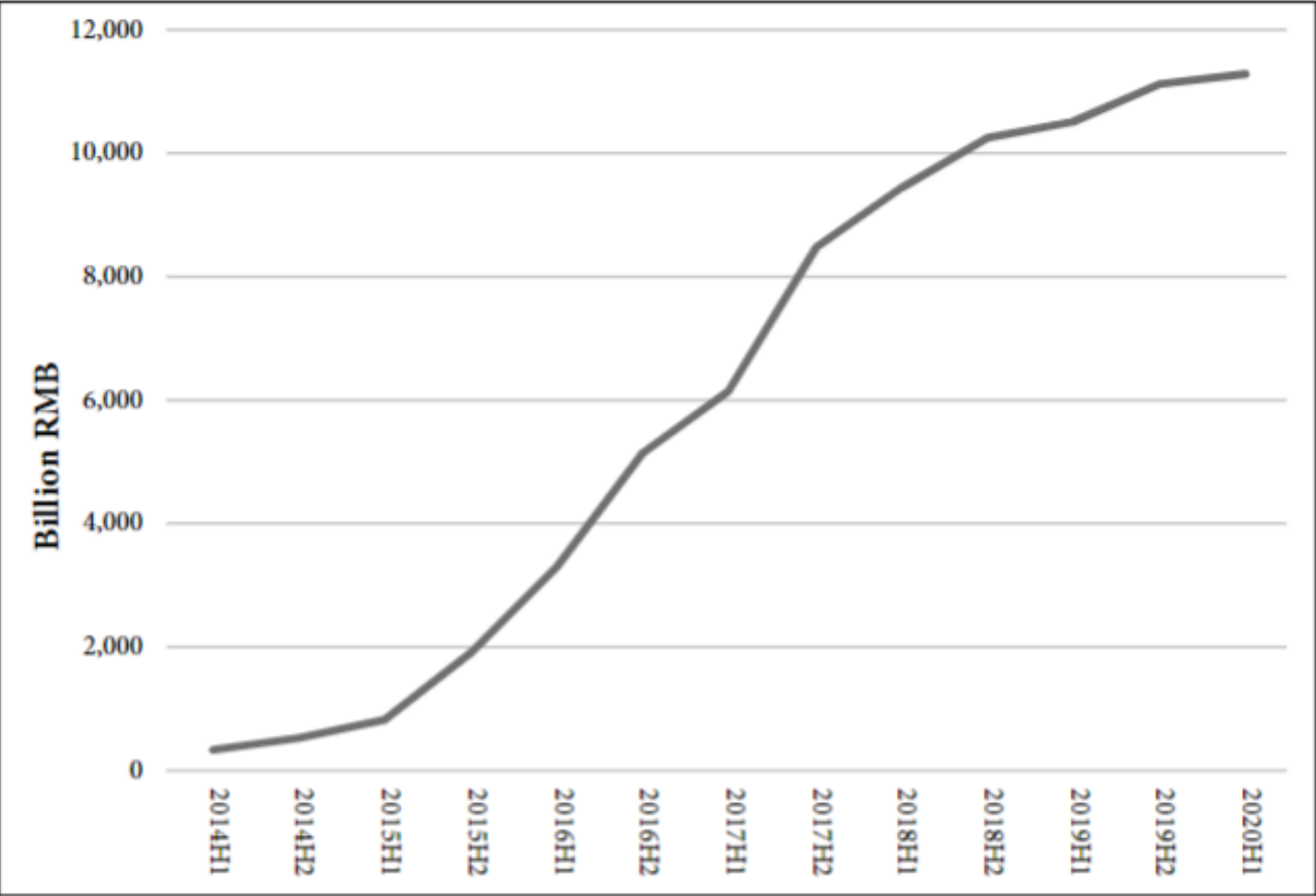
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- 2019 – total commitment **1,6 trillion USD – 11 % of Chinese GDP**

Figure 4.1: Government Industrial Guidance Funds: Cumulative Fund-Raising Scope



5.1 Sectorial Orientation of Industrial Guidance Funds

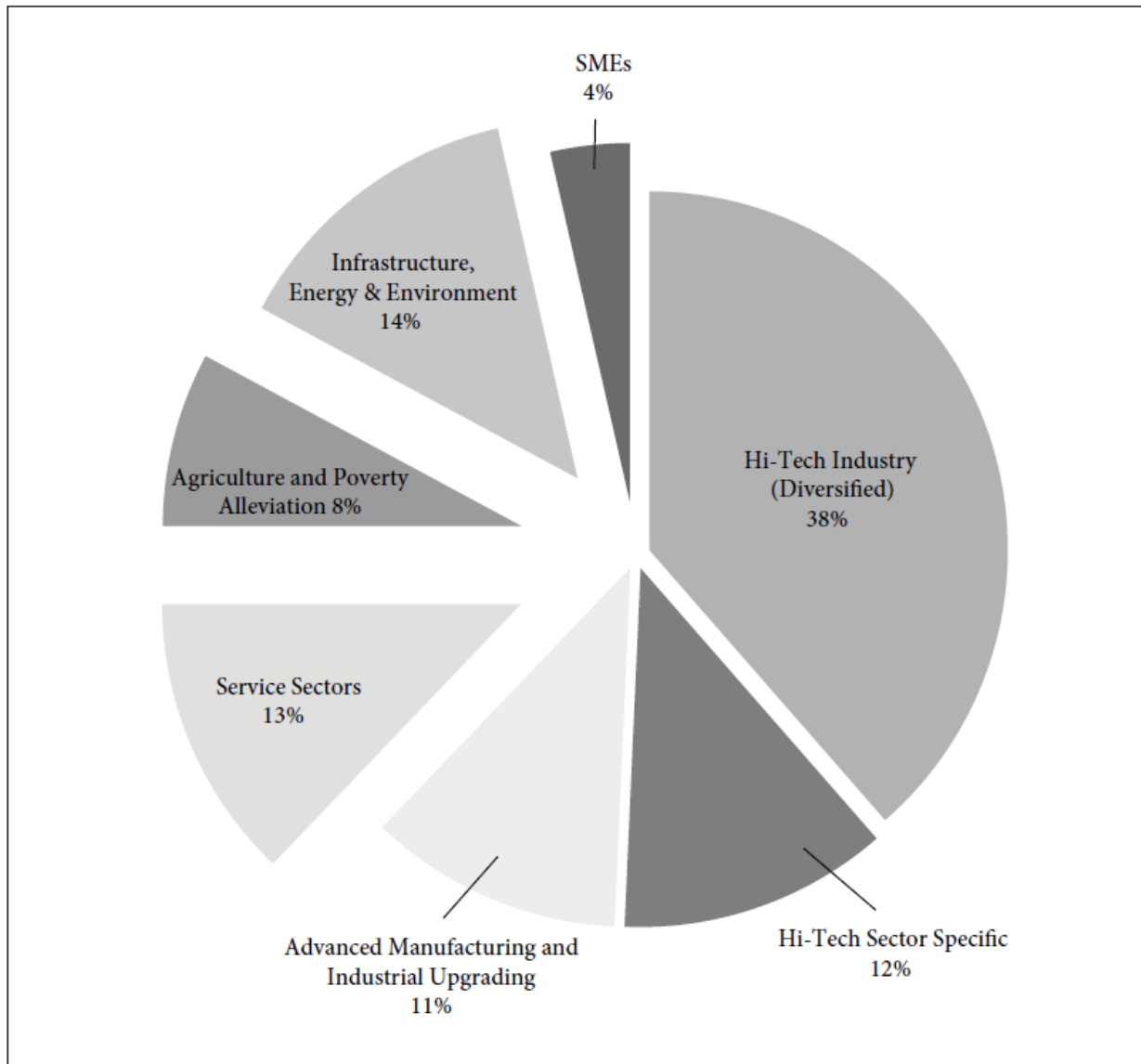


Table 5.1: Total Value of Industrial Guidance Funds (2020)

	Trillion RMB	Percent
National/Central	1.96	19%
Provincial	3.30	32%
Municipal	3.72	36%
County	1.34	13%
Total	10.32	100%

Sources: own elaboration compiled by the author from data supplied by Zero2IPO / Qingke Research Center (清科研究中心). Accessed at <https://www.pedata.cn/>. Some data may be behind paywalls.

Table 5.2: Largest Industrial Guidance Funds (2020)

Fund Name	Level	Scale (Billion RMB)
Integrated Circuit Fund (both rounds)	National	338.70
Optical Valley Fund (Wuhan)	Municipal	250.00
Government-Enterprise Cooperation Fund	National	180.00
Central SOE Innovation Fund	National	150.00
Kunpeng Fund (Shenzhen)	Municipal	150.00
National SOE Adjustment Fund	National	130.00
Shanxi Taihang Fund	Provincial	105.00
Jiangxi Development and Upgrading Fund	Provincial	100.01
Beijing Investment Guidance Fund	Provincial	100.01

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- - by cheaper loans, access to public procurement contracts

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- A brimful of **goals and targets** – **but no plan of how to acquire them**
- > „**let the local Party leaders figure this out, we will reward the successful ones**“
- = combination of **central plans with local initiative** – typical for China since the Great Leap Forward

„Wish list approach“

- „The central government isn't issuing detailed marching orders to local officials for carrying out a master plan. Instead, it's giving them **hundreds of ideas for “gifts” that it would like to receive, and saying, “surprise me.”**“

Examples from Sheehan's article

- Are you in charge of transportation for the new megacity of Xiong'an? [Partner with Baidu's self-driving project](#), Apollo, to demonstrate autonomous vehicles in the city.
- Head of the Changping branch of Beijing's Public Security Bureau? Spend 2.75 million yuan (\$437,000) [procuring AI person-tracking software](#) for security cameras.
- President of a mid-tier engineering university in Shandong? [Open the province's first AI research center](#) focusing on medical and marine AI.
- Party chief of a Nanjing economic development zone? [Pour 8 billion yuan](#) (\$1.3 billion) into an AI-focused venture capital fund and dole out 5 million yuan (\$794,000) in R&D subsidies to each firm that sets up shop there.

„Wish list approach“

- “government-steered market economy”

The AI triad

- 1) **Collection of data** – sensors, cameras with facial recognition etc.
- 2) **Quick transfer of data** – next generation Internet
- 3) **Processing od data** – algorithms, **advanced hardware**

The AI triad

- China is **surprisingly weak in the creation of hardware**
- = mostly semiconductor chips

Chips

- **Basic unit – a transistor** – either allows electric current to pass through, or it does not

Chips

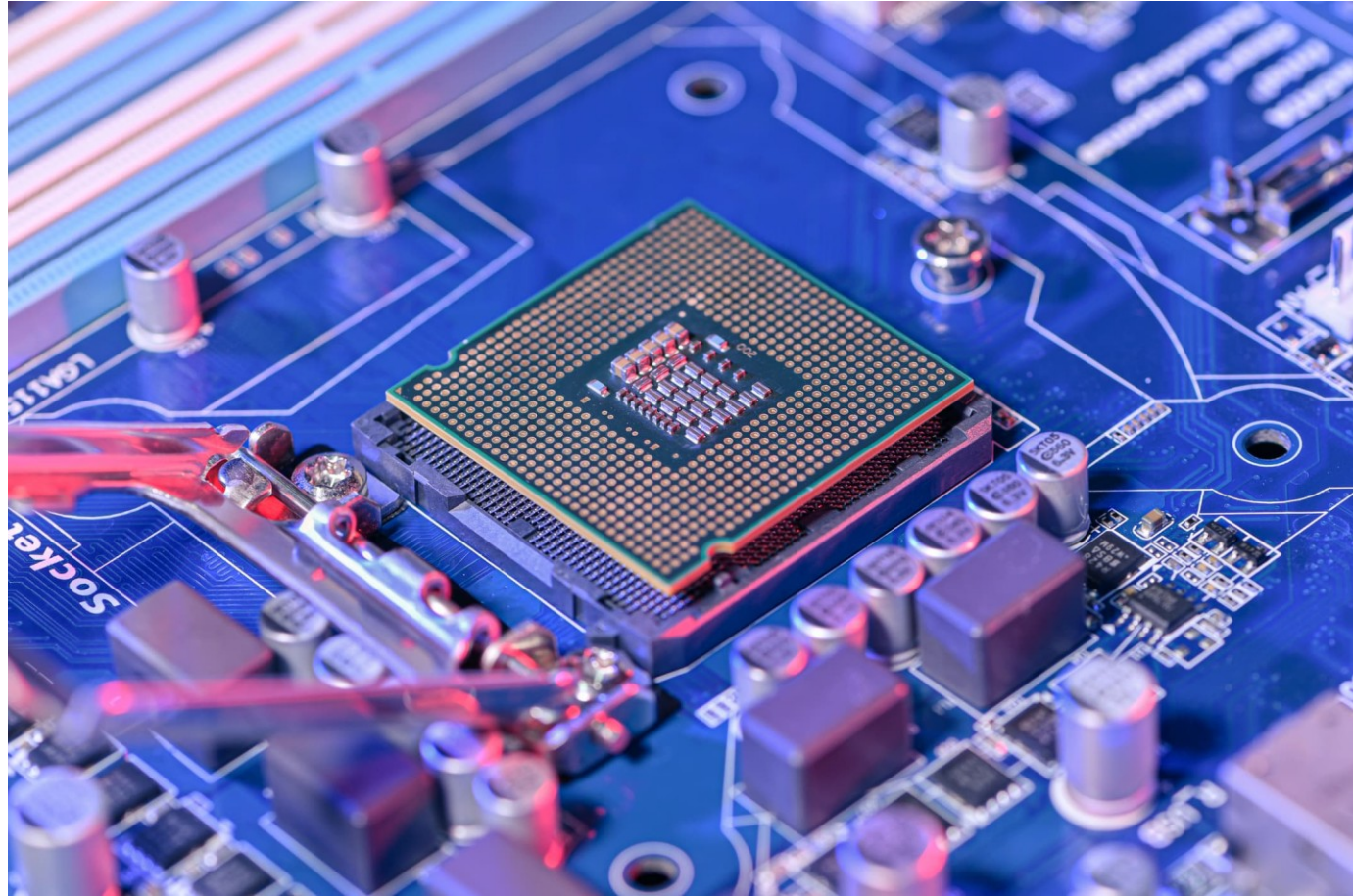
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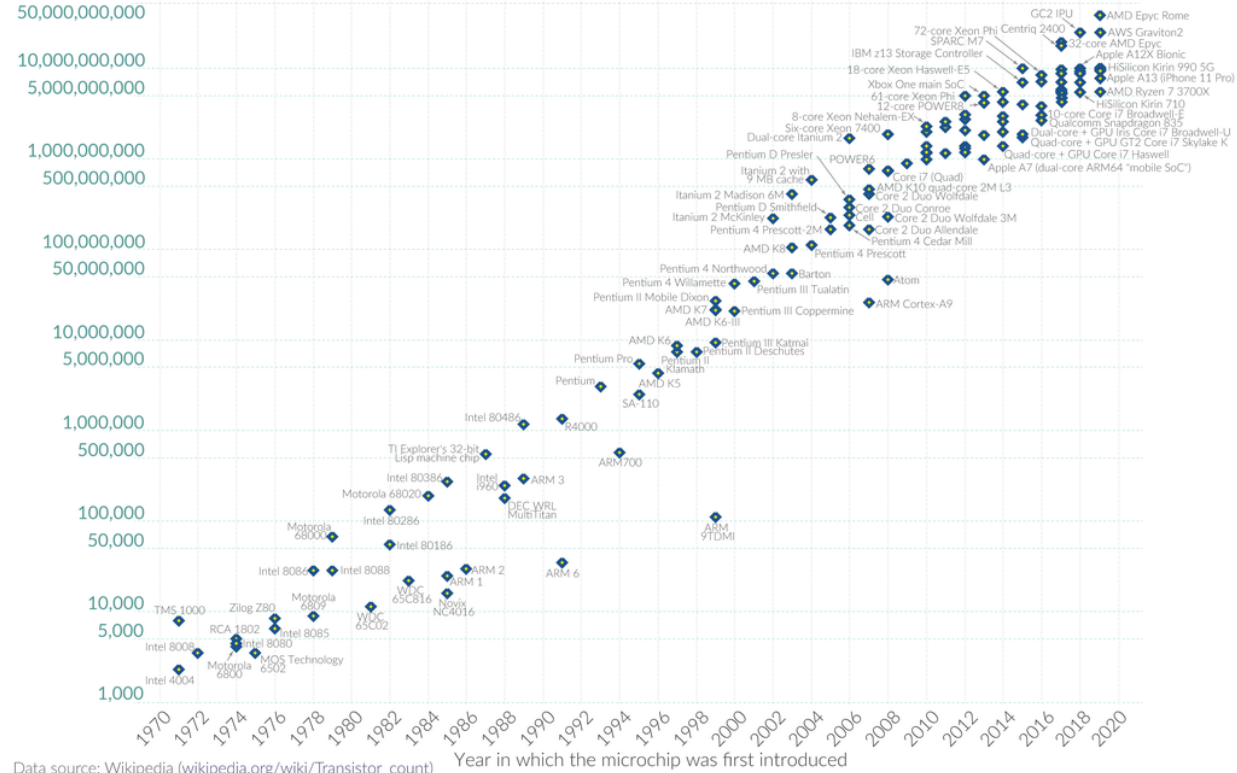
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Moore's Law: The number of transistors on microchips doubles every two years

Moore's law describes the empirical regularity that the number of transistors on integrated circuits doubles approximately every two years. This advancement is important for other aspects of technological progress in computing – such as processing speed or the price of computers.

Our World
in Data

Transistor count



Data source: Wikipedia (wikipedia.org/wiki/Transistor_count)

OurWorldinData.org – Research and data to make progress against the world's largest problems.

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- Or focus on specific types of rudimentary, trailing edge chips – **Europe!**

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- Its national chip maker- **SMIC** – Semiconductor Manufacturing International Corporation
- **Quintessential national champion** on par with Huawei!
- Extremely high support - 50% of its revenue comes from state subsidies
- **But it is still far behind industry leaders and only has a small global market share**

Chips

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- Most of their production is even further from the frontier!

MOSFET scaling (process nodes)

10 μm – 1971

6 μm – 1974

3 μm – 1977

1.5 μm – 1981

1 μm – 1984

800 nm – 1987

600 nm – 1990

350 nm – 1993

250 nm – 1996

180 nm – 1999

130 nm – 2001

90 nm – 2003

65 nm – 2005

45 nm – 2007

32 nm – 2009

22 nm – 2012

14 nm – 2014

10 nm – 2016

7 nm – 2018

5 nm – 2020

Future

3 nm ~ 2022

2 nm ~ 2024

The semiconductor value chain

- **Perhaps the most sophisticated value chain in the world**

The semiconductor value chain

- **No country or company in the world is able to produce cutting edge chips on its own**

The semiconductor value chain

- Dominated by **USA + Taiwan, Korea, Japan**; Netherlands

The semiconductor value chain

- **EDA – software** (US firms)

The semiconductor value chain

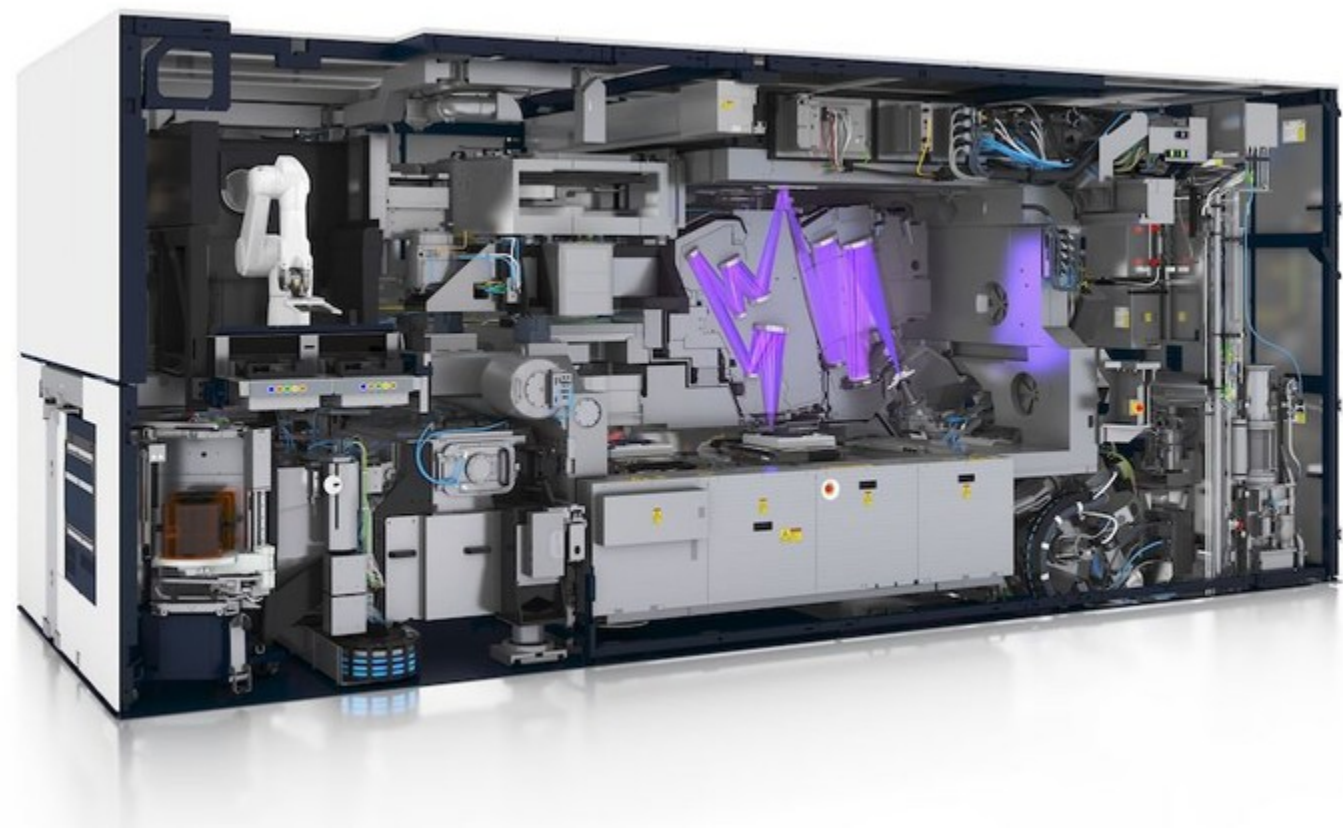
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- **Non-monetary inputs – need for engineers with experience**, which is extremely rare



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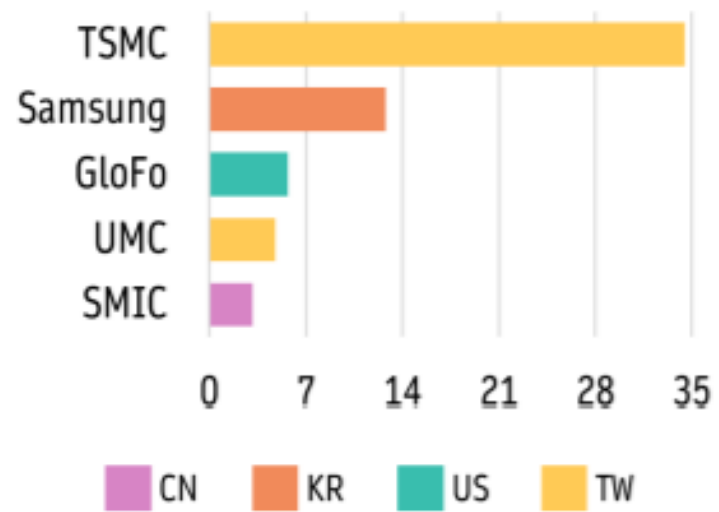
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The semiconductor value chain

- **Most important producer of chips in the world – TSMC – Taiwan**
Semiconductor Manufacturing Company
- - **50% of global production** or so, even stronger on the cutting edge

Largest Foundries 2019

[sales in US\$ billion]



The semiconductor value chain

- China – no **EDA** or **SME**, few experienced engineers

The semiconductor value chain

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The semiconductor value chain

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- **> huge resources are being invested into redressing it**
- **> US pressure is concentrated in this area**

US – Chinese technological rivalry

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- **This embargo must include US allies** (Korea, Japan, Taiwan, Netherlands)

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- Biden's strategy - in line with this approach

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- **Exterritorial** – falls on foreign companies using US inputs or IP

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- > a **screening mechanism, which allows US authorities to stop the sale**
- If the owner still wants to sell, he must find a different buyer, if he can't one, the government will temporarily purchase it

- A tighter regime of export controls and investment screenings **is being created in the EU as well!**
- – **two new EU regulations in 2021!**

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- > de-industrialization, followed by **permanently decreased wages and employment**

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- > Donald Trump

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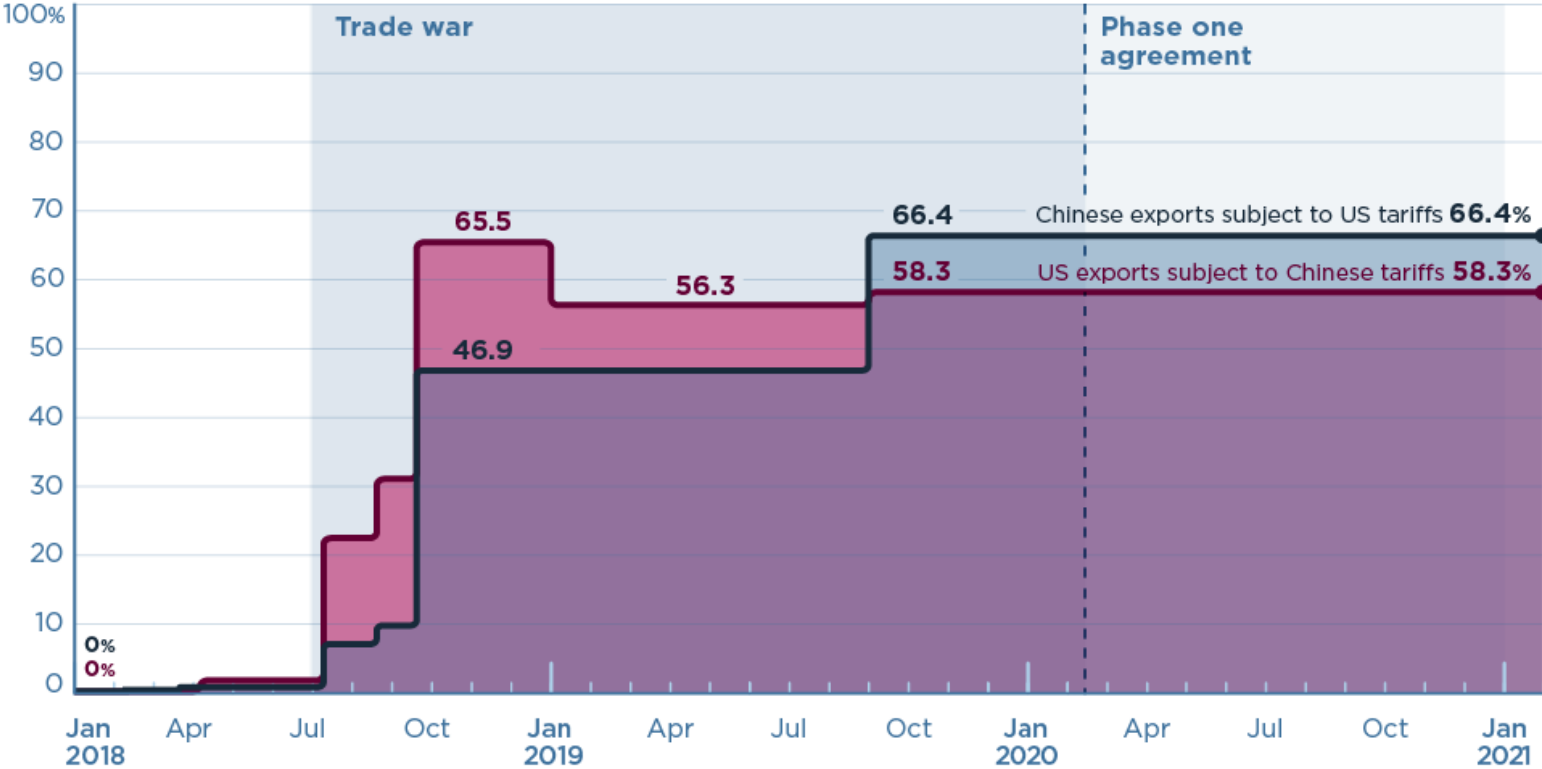
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- Chinese retaliation

b. Percent of US-China trade subject to tariffs



The US-China trade war

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- Popular in the US – Biden continues the same policy

- Mattoo and Staiger
- The tariffs serve as **leverage to force China to carry out reforms** that the US demands

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- = decoupling?

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- **Far less successful** – China remains paramount for large multinational companies
- - a giant market
- **Returns on investment** in China are higher than anywhere else in the world
- Sometimes – **feigned moves abroad** – products are completed in another country, so they avoid US tariffs etc.

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- This goes hand in hand with China's drive to decrease its dependence on exports – **promotion of domestic consumption**
- Trade war = another incentive to make China less dependent on exports

Threats to China's success story

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- **1) Backlash from industrialized countries**
- Even EU, CANZ, Japan etc. are starting to turn against China

Threats to China's success story

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Threats to China's success story

- 2) **An uncertain wager on digital technologies**
- Normally, industrial policy **is about catching-up**
- There are existing technologies to be copied – **it is faster to copy something than to develop it**
- Even if you decide for domestic innovations, **it is still clear that the technology is viable and can work**

Threats to China's success story

- **2) An uncertain wager on digital technologies**
- **As you get near the frontier, it is more and more hard to say which way to go**

Threats to China's success story

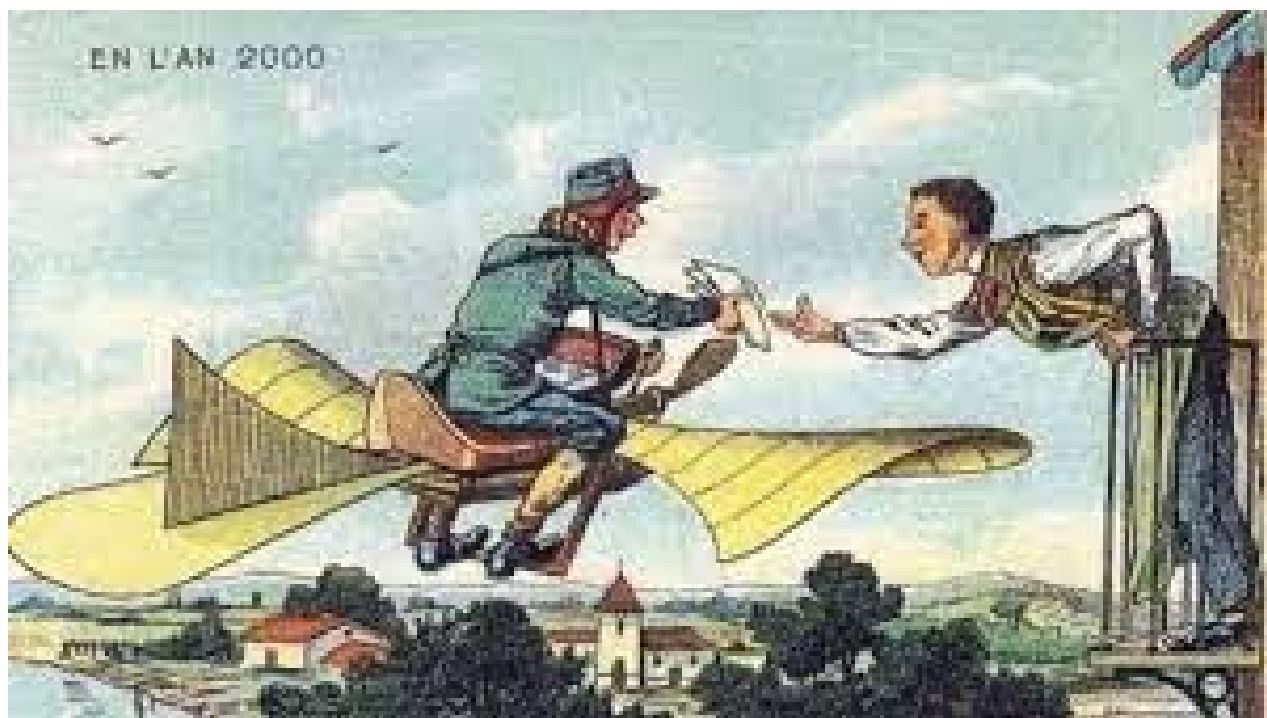
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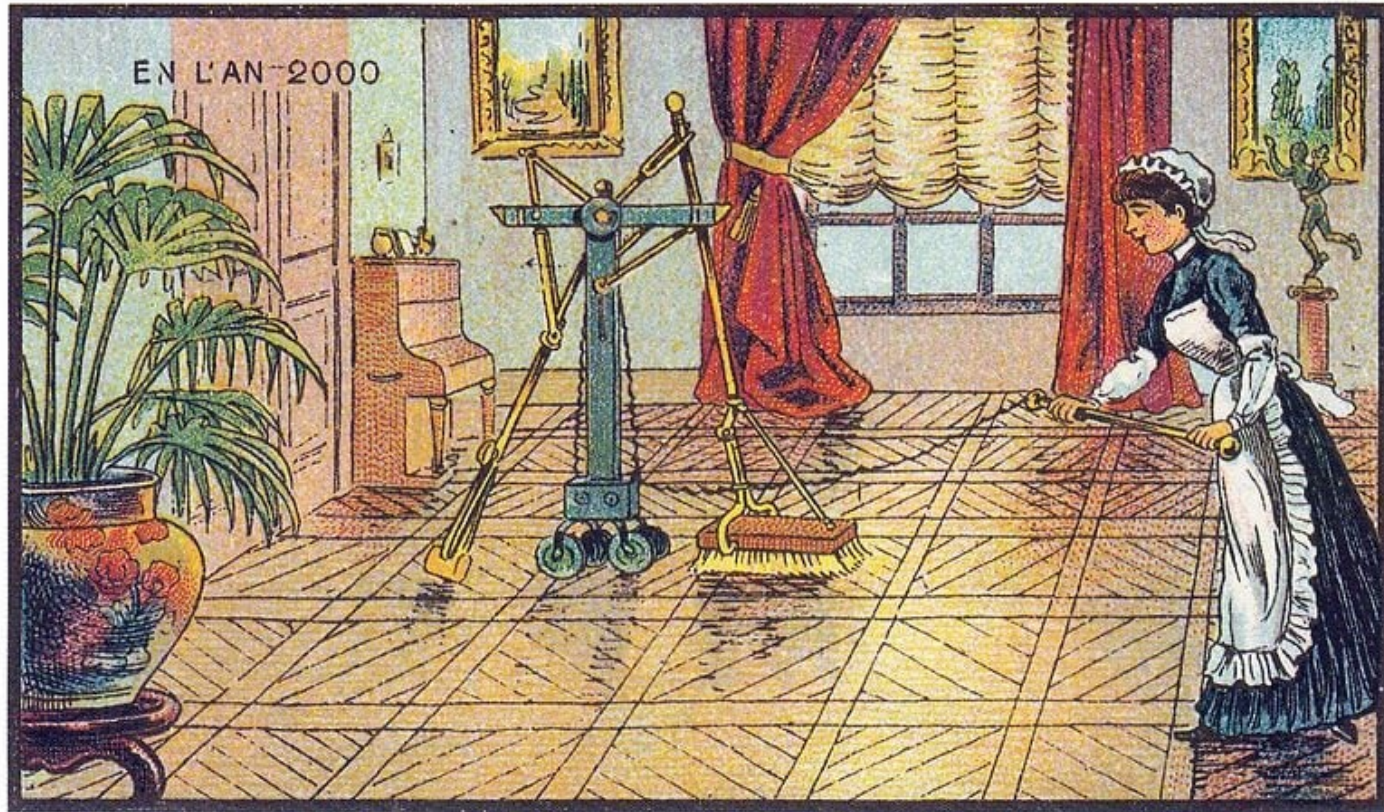
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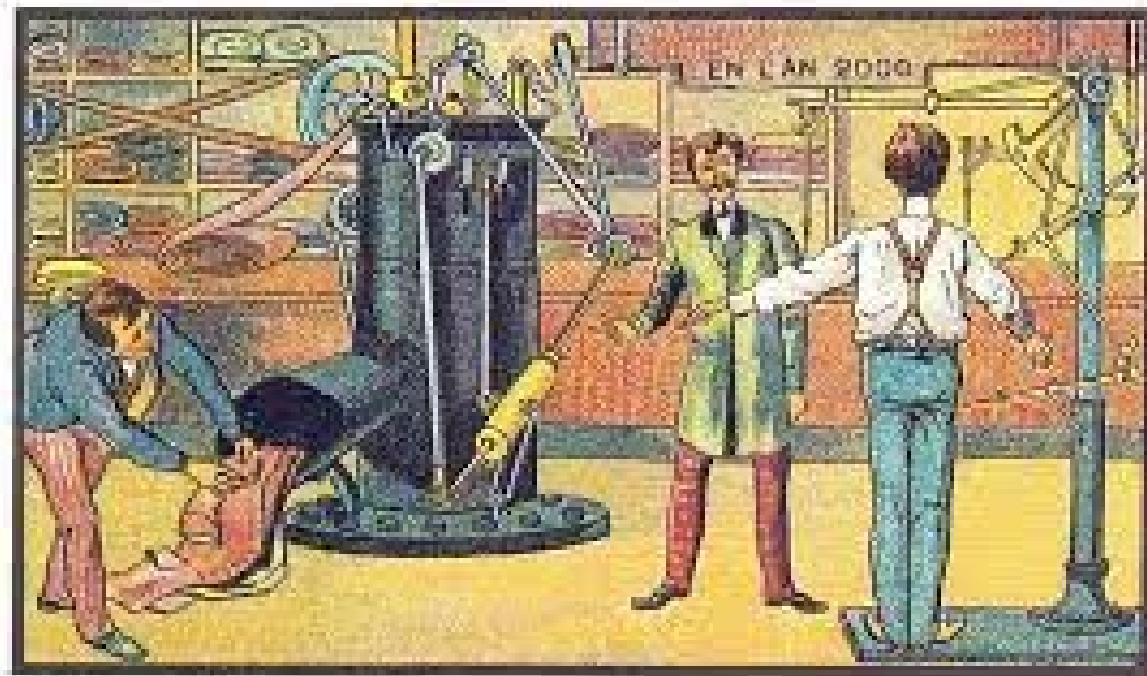
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- > What if the future doesn't work the way Beijing imagines?

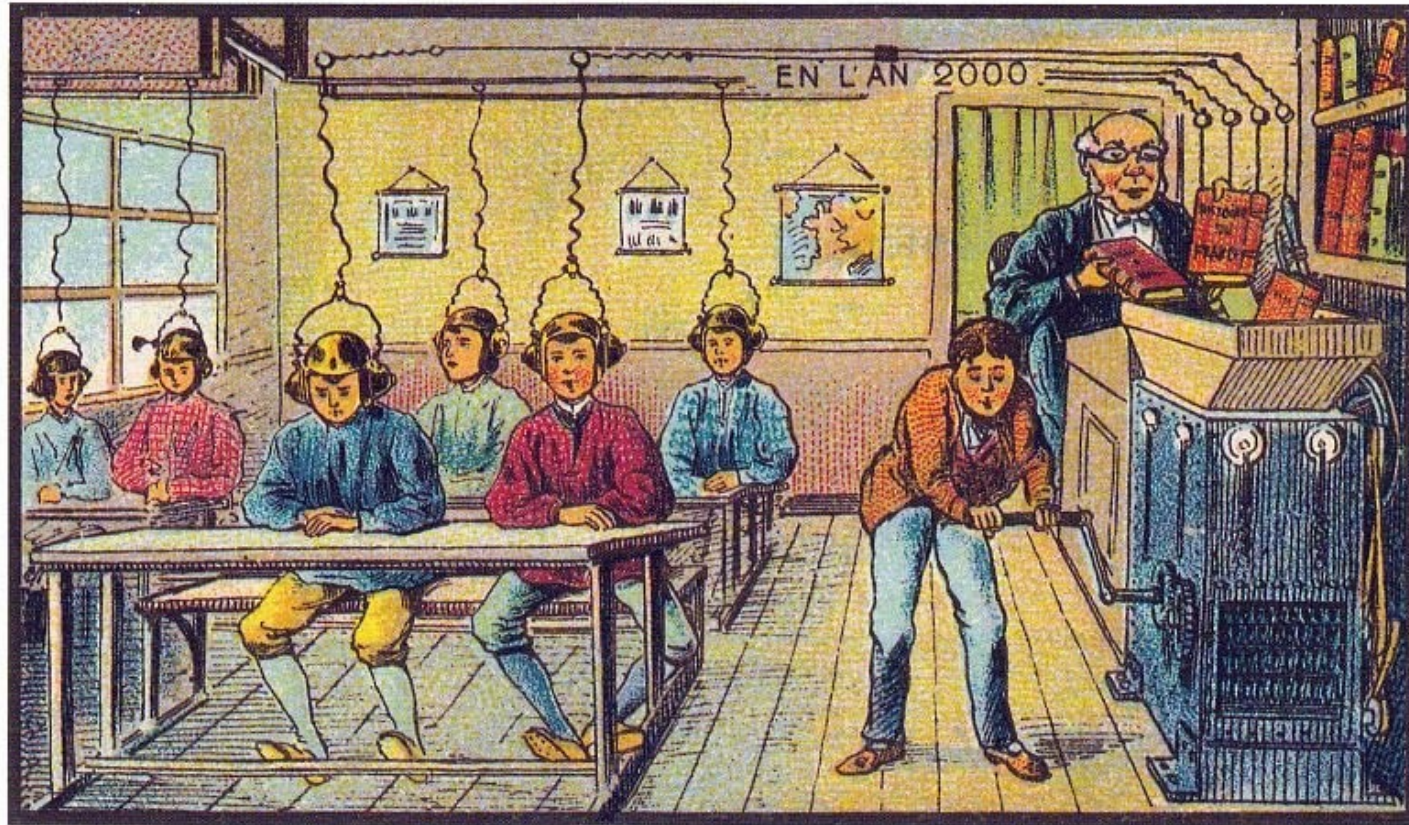




Electric Scrubbing



A Tailor of the Latest Fashion



At School

- „The future will be just like the present, only more so“

Threats to China's success story

- **2) An uncertain wager on digital technologies**
- Huge resources might be wasted creating unproductive industries
- At the expense of the actually promising sectors

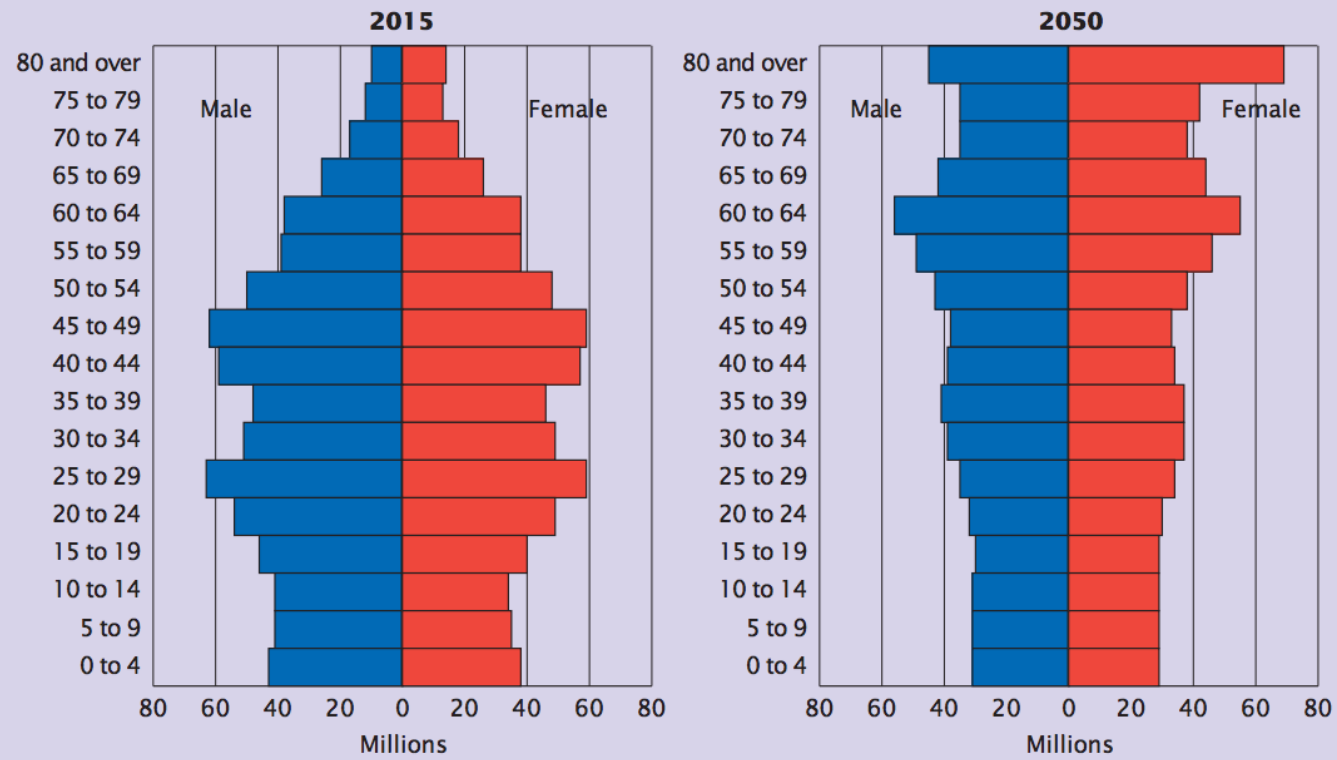
Threats to China's success story

- **2) An uncertain wager on digital technologies**
- Huge resources might be wasted creating unproductive industries
- At the expense of the actually promising sectors
- **Bursting of a bubble x permanent support for an entrenched interest**

Threats to China's success story

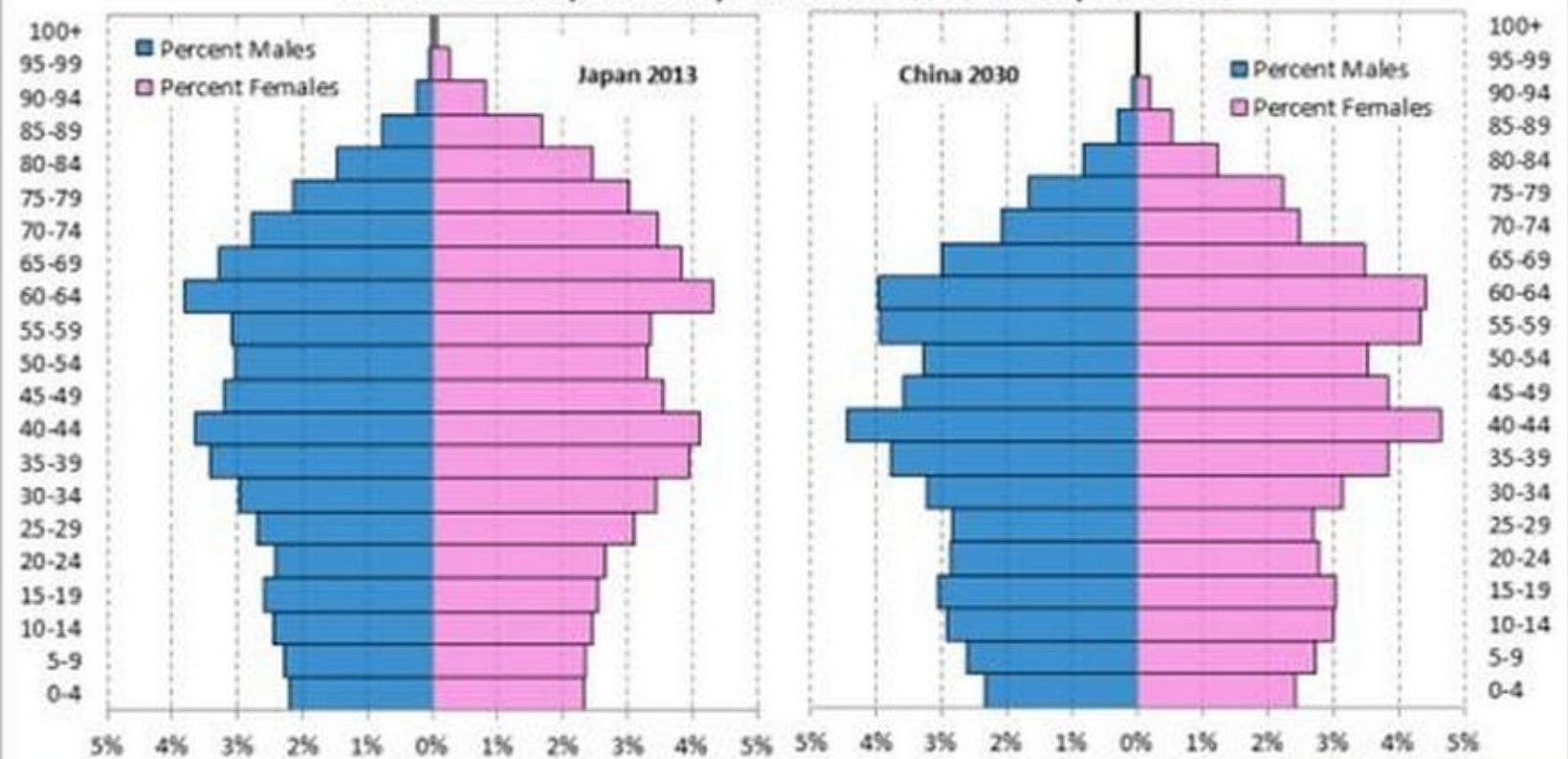
- **3) Ageing population**

Figure 3-2.
Population by Age and Sex for China: 2015 and 2050



Source: U.S. Census Bureau, 2013; International Data Base.

China's 2030 Population Pyramid Looks A Lot Like Japan's Now



Source: U.S. Census, Bloomberg

BloombergBriefs.com

Threats to China's success story

- **3) Ageing population**
- > need for far greater spending on **pensions, healthcare spending**

Threats to China's success story

- **3) Ageing population**
- > need for far greater spending on **pensions, healthcare spending**
- China currently only has a tiny welfare state
- Because „it promotes laziness“

Poll

- Is China right-wing or left-wing?

Poll



Noah Smith  
@Noahpinion



Is China's current regime a leftist one, or a rightist one?



5,727 votes · Final results

7:48 PM · Sep 5, 2021 · Twitter for Android

Threats to China's success story

- **4) A real-estate bubble**

Threats to China's success story

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Threats to China's success story

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- Also infrastructure

Threats to China's success story

- **4) A real-estate bubble**
- **Huge build up of real estate since 1990**
- Also infrastructure
- **Financed by state banks, built by SOEs**

Threats to China's success story

- **4) A real-estate bubble**
- **During every crisis > financial injection > even more build up**

Threats to China's success story

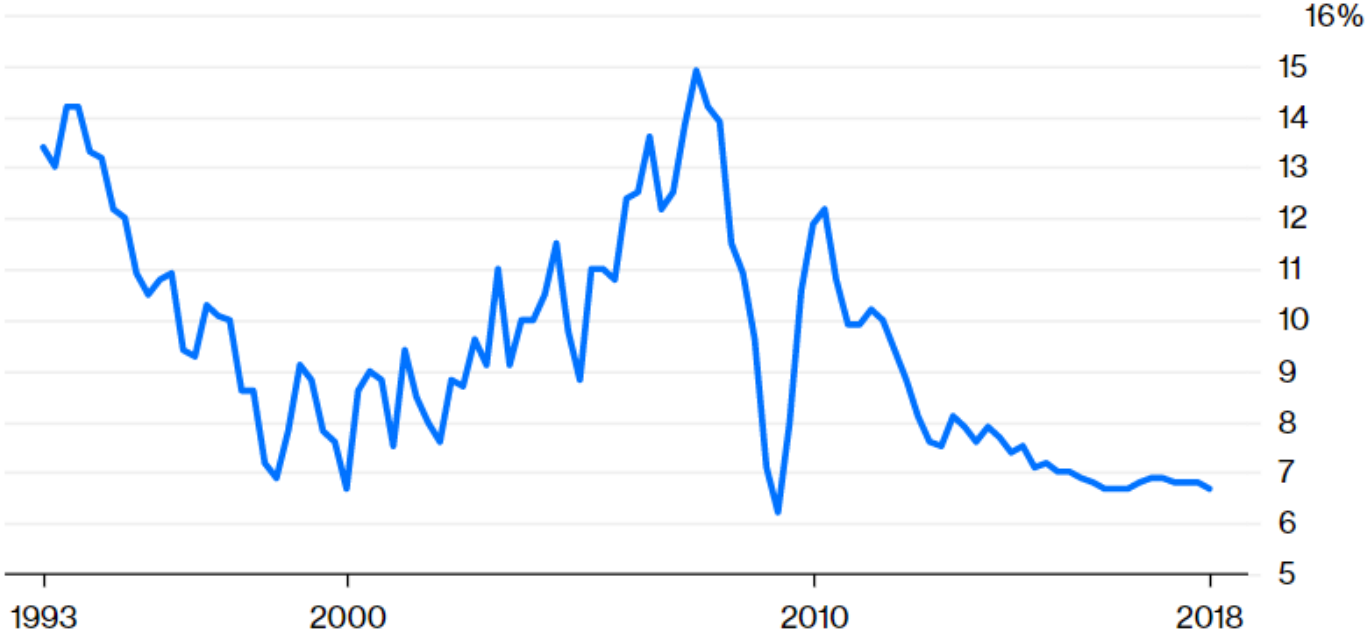
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Threats to China's success story

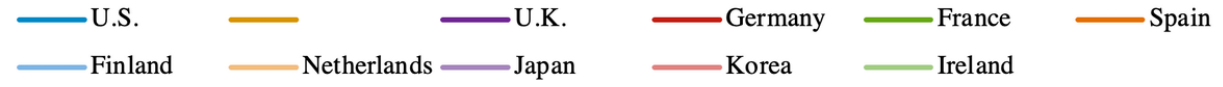
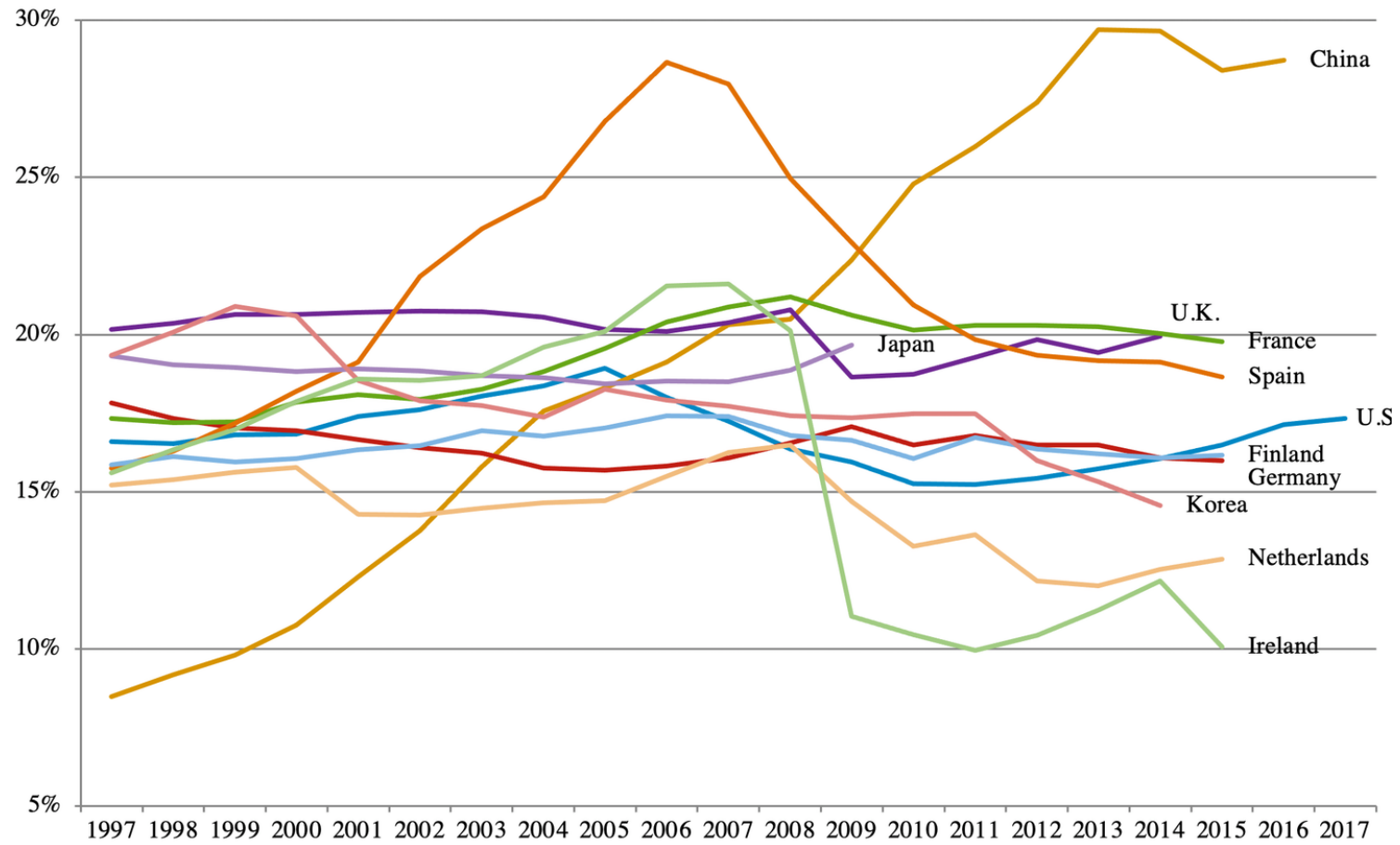
- **4) A real-estate bubble**
- **During every crisis > financial injection > even more build up**
- „Keynesianism with Chinese characteristics“ was based around real-estate
- **> near miraculous ability to escape recessions**

No Recession Here

China real quarterly annualized gross domestic product growth



Source: Bloomberg



Threats to China's success story

- **4) A real-estate bubble**
- 2008 – the biggest injection of them all > **overproduction, redundant capacity**

Threats to China's success story

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Threats to China's success story

- **4) A real-estate bubble**
- 2008 – the biggest injection of them all > **overproduction, redundant capacity**
- Also – since finance is controlled by the party-state, **real estate is the one asset into which households can invest**
- Empty suburbs of investment flats



Threats to China's success story

- **4) A real-estate bubble**
- **The Xi leadership – lets switch resources to manufacturing!**

Threats to China's success story

- **4) A real-estate bubble**
- But:
- What if the manufacturing strategy fails?

Threats to China's success story

- **4) A real-estate bubble**
- But:
- What if the manufacturing strategy fails?
- If the move is permanent and the construction industry becomes obsolete, **how will China react to a future crisis?**

Threats to China's success story

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- Local governments get income from selling land > **will they have to switch to higher taxes?**

Threats to China's success story

- **4) A real-estate bubble**
- But:
- What if the manufacturing strategy fails?
- If the move is permanent and the construction industry becomes obsolete, **how will China react to a future crisis?**
- Local governments get income from selling land > **will they have to switch to higher taxes?**
- **What about the middle class and their savings?**

- Do we still have time?

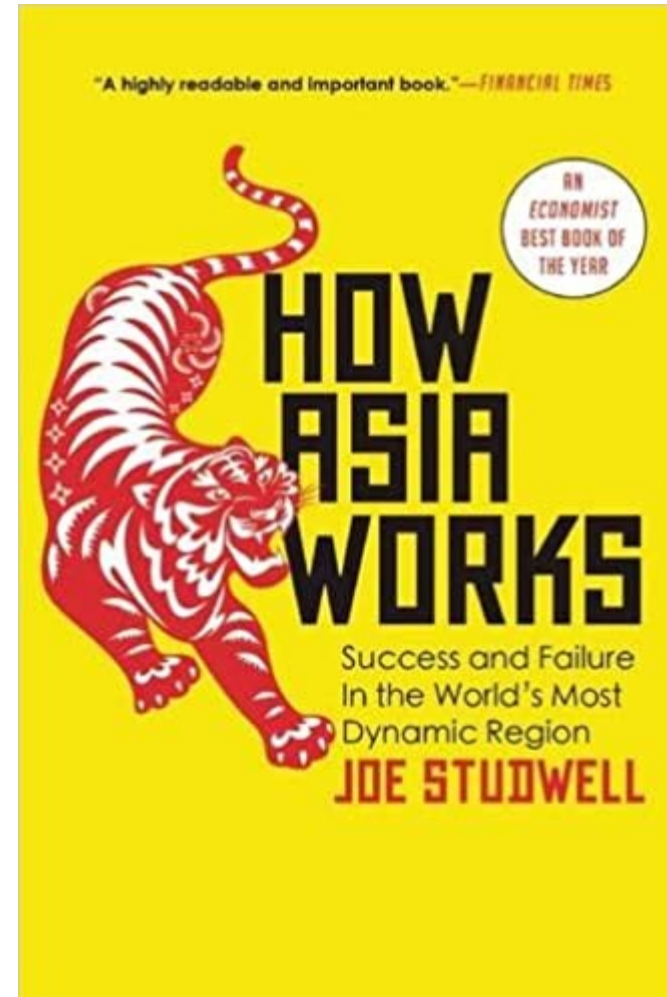
- Do we still have time?
- Probably not...

Next time

- **China in the World Trade Organization**

Asian developmental state

- „How Asia works“ – Joe Studwell



Asian developmental state

- „How Asia works“ – Joe Studwell
- 1) Land reform
- 2) Industrial policy > promotion of exports
- 3) State owned banks – also promotion of industry

Asian developmental state

- New firms are not going to succeed on their own, **they need protection and help from the state (x free trade)**

Asian developmental state

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- But they must be tested so that they don't become complacent > „**export discipline**“ – they must be able to sell products abroad

Asian developmental state

- New firms are not going to succeed on their own, **they need protection and help from the state (x free trade)**
- But they must be tested so that they don't become complacent > „**export discipline**“ – they must be able to sell products abroad
- Why abroad? Success in the closed domestic market doesn't prove anything

Asian developmental state

- **Undervalued currency** – helps with export

Asian developmental state

- China – **somewhat similar, but even more statist**
- Most large enterprises continued to be state-owned (to this day)

Asian developmental state

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- **No liberalization after successful growth**

Asian developmental state

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- Most large enterprises continued to be state-owned (to this day)
- **No liberalization after successful growth**
- **J, K, T attempted to catch up, not to become the undisputed leader**
(x China's ambitions for next generation Internet, AI....)

Asian developmental state

- J, K, T – **developmental state as a necessary evil**, a precursor to **capitalism** which isn't possible yet
- = more or less in line with Western theorists of protectionism – Alexander Hamilton, Friedrich List

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Asian developmental state

- J, K, T – **developmental state as a necessary evil**, a precursor to **capitalism** which isn't possible yet
- = more or less in line with Western theorists of protectionism – Alexander Hamilton, Friedrich List
- CH – **developmental state as a necessary evil**, a precursor to **socialism** which isn't possible yet
- = **China does not yet possess the capacity for planning and redistribution necessary to achieve socialism, so it has to accept markets**

Asian developmental state

- CCP – China's advantage continues to be the ability to mobilize resources

ISI

- **Import-substituting industrialization (ISI)**
- **Not so important for us**, but often discussed in IPE
- Latin America, circa 1945-1980

ISI

- **Protectionism, state-owned banks and large enterprises – similar to Asia**

ISI

- **But – no promotion of export! – closed economies**

ISI

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ISI

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- **> trade deficits > financed by debt**
- **Overvalued currencies – to pay back the debt – but exacerbated the trade deficits**
- **Also – no sweeping land-reform = surviving inequality, „old elite“**
- **1980s – bankruptcies, transition to free trade (IMF, WB)**

ISI

- **Economists – identification of ISI with protectionism and Asia with free markets**
- **= misinterpretation**

Shock therapy/Neoliberalism

- Eastern Europe after 1989
- = **full transition towards free market capitalism**
- = **privatization of enterprises, market prices, free trade**

Shock therapy/Neoliberalism

- Main idea – the Communist regimes have collapsed > **there is no power capable of overseeing central planning**

Shock therapy/Neoliberalism

- Main idea – the Communist regimes have collapsed > **there is no power capable of overseeing central planning**
- > we must move quickly towards markets, **otherwise the managers of the SOE's will plunder the assets**
- = the need to dissolve public ownership relatively quickly, before it's completely hollowed out

Shock therapy/Neoliberalism

- **Derided and discredited today** – collapse of Russia, Ukraine etc, poverty, rise of oligarchs

Shock therapy/Neoliberalism

- **Derided and discredited today** – collapse of Russia, Ukraine etc, poverty, rise of oligarchs
- But – **Baltic countries, Poland, Czechia, Slovakia, Slovenia, Hungary...**
- > often reasonably successful!

Shock therapy/Neoliberalism

- China – We don't want shock therapy, because:
 - 1) **we still basically believe that socialism will win in the end**
 - 2) **doing so would drastically curtail the Party's power**

Shock therapy/Neoliberalism

- China – We don't want shock therapy, because:
 - 1) **we still basically believe that socialism will win in the end**
 - 2) **doing so would drastically curtail the Party's power**
- Eastern Europe – We don't want Chinese-style mixed economy because:
 - 1) **we no longer believe in socialism**
 - 2) **doing so would mean keeping the security apparatus to oversee the SOEs**