

# Research US-China

## Long-term tensions are here to stay no matter the election result

- We do not foresee a significant easing in US-China relations after the November mid-term elections, no matter the outcome.
- While we don't expect any disruptive measures to be taken by either side in the near term, the gradual decoupling and Cold War sentiment is set to continue with tech rivalry, self-sufficiency push and Taiwan tensions running high.

While the US-China trade war disappeared from news headlines following the Covid-19 pandemic, we have seen few signs of easing in the countries' bilateral relations. In fact, Biden's administration has taken an even more hawkish stance on China compared to what most expected. **The US administration's focus has shifted from mostly protecting the US companies' competitiveness to maintaining more strategic independence from any trading partners, and strengthening alliances with like-minded nations.** The pre-pandemic tariffs are still fully in place, and the recent speculation on some easing has been driven by the push to alleviate domestic inflation challenges, not easing foreign policy stance. Even the conditions of the phase one trade deal, which the counterparties agreed on just before the pandemic began, were never fulfilled.

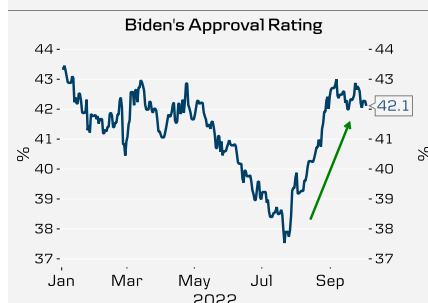
Before the pandemic, Trump's cabinet was filled with hawks known for their aggressive views not just in economic policies, but foreign policies as a whole. Robert Lighthizer, the previous US trade representative, supported the use of the tariffs already in the 1980s trade-war against Japan, and Peter Navarro, Trump's advisor on trade policies, became well-known for his aggressive views from his book 'Death by China' from 2011. In contrast, the current trade representative Katherine Tai has been much less vocal about her views, but she also sees that the tariffs provide US leverage against China, and **has emphasized the longer-term strategic competitiveness over short-term measures to curb inflation.**

**In addition to tariffs, the current administration has increasingly focused on supporting US self-sufficiency from China and restricting China's access to especially microchips.** The investment support of Chips & Science act from late July was followed by Biden's executive order to further limit US semiconductor exports to China last month. Another September executive order supported investments into biotechnology industries, also with the intention of limiting dependency on Chinese production. More broadly, the Inflation Reduction Act from late July provided a boost for investments into further diversifying US energy supply.

Recently, there has also been *increasing push* to boost monitoring of US investments into China concerning intellectual property rights of high-technology companies. Biden already limited Chinese companies' ability to invest into US technology in September, signaling that IP rights, which were a key issue already during the Trump-era trade war negotiations, remain high on the agenda also for the current administration.

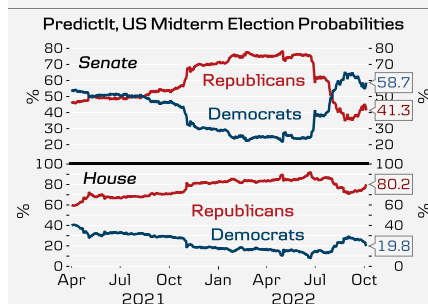
As we think the US economy is headed for a recession in 2023 on the back of the rapid tightening in global financial conditions, we see limited near-term risks for very hardline

### The late summer policy packages were a political victory for Biden



Source: FiveThirtyEight

### A lame-duck congress appears to be the most likely outcome of the midterm elections



Source: PredictIt

### Recent research on US-China rivalry and its implications

*Research China – The risk of a Taiwan war and what it implies – part 1, 11 August 2022*

*Research China – The risk of a Taiwan war and what it implies – part 2, 18 August 2022*

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policies towards China, which could potentially weaken the already fragile growth outlook. In addition, the most likely outcome of the upcoming midterm elections appears to be a divided ‘lame-duck’ congress, with Democratic party maintaining the control of the Senate, but Republican party flipping the control of the House. This would mean a low chance of major legislative changes over the next two years. In general, when it comes to supporting investments, US officials have appeared concerned around the developments seen in the UK (see *Bloomberg*), which likely signals that the room for further stimulus support could be limited regardless of the election results.

**We underline, that the past two years’ economic hardship combined with Democrat-controlled congress should have, ex-ante, resulted in the softest possible US foreign policy stance.** If republicans regain control in the congress, we see little chance of the current tough stance easing markedly over the coming years. While the approaching recession and high inflation will limit the most aggressive foreign policy measures over the next 1-2 years, US focus will remain firmly on strong long-term strategic relations with China.

### China focus on self-reliance and non-Western relations

**The change in US policy towards China since 2016 from engagement to confrontation has led to a clear change in Chinese policy in many areas.** China now sees the US strategy as being one of containment and encirclement (security wise) and that the US will continue to take measures to hold China back. While China aims to manage the relationship with the US to the extent possible, the Chinese leaders have little hope that current US path is going to change. A tough-on-China policy is one of the only thing the Democrats and Republicans agree on and that is unlikely to change. China’s relationship with the EU is also getting increasingly strained following the recent years confrontations over covid, human rights issues around Hong Kong and Xinjiang and rising EU support to Taiwan. China’s working assumption is now that the challenges with the West are set to continue.

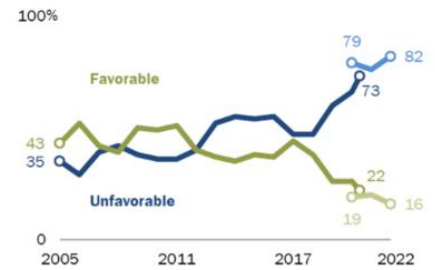
What does this mean for Chinese policy? **The most clear consequence is China’s rising focus on self-reliance.** The US tech war on China made it clear for Chinese leaders, that it will face increasing restrictions on US exported core technologies such as micro chips and if China is to determine its own faith, it will need to become more independent on key technologies and any other area, that is critical for China’s development. The self-reliance focus has also extended to food security and energy security. The policy does not mean China is closing for investments in China. On the contrary. It is in China’s interest to make the West *more* dependent on China by having lots of investments in China.

**China also puts more weight on building stronger relations with non-Western countries** to reduce reliance on the West as well as increase the counterweight to Western pressures. China’s value proposition to these countries is very much economic without strings attached and reflected in new trade agreements such as RCEP in Asia and the Belt and Road Initiative, which provides Chinese investments in infrastructure and people-to-people exchanges in around 150 countries across Asia, The Middle East, Africa and Latin America. China also works on being part of the CPTPP trade deal, which is the original TPP that Trump pulled the US out of and which was meant to counter China.

**Finally, China aims to push back more towards the confrontations from the West.** The most clear example recently is around the Taiwan issue, when China responded to US speaker of the House Nancy Pelosi’s visit to Taiwan. It has also put sanctions on certain European politicians and opinion leaders in response to EU sanctions related to Xinjiang.

### Americans opinion on China has deteriorated sharply

% of Americans who have a(n) \_\_\_ view of China



Note: In spring 2020, the Center ran concurrent phone (dark blue and dark green in chart) and online panel (light blue and light green in chart) surveys in the U.S. In summer 2020 and prior to 2020, U.S. surveys were conducted over the phone. Source: Spring 2022 Global Attitudes Survey, Q5b. “Negative Views of China Tied to Critical Views of its Policies on Human Rights”

Source: Pew Research Center

### China’s dual circulation and self-reliance

China’s new development philosophy and dual circulation was explained a paper in the CCP “Seeking Truth” magazine in 2021, which among other things highlighted the need for self-reliance. Especially one key quote underlines the motivation for self-reliance:

“If we can, by dint of our own efforts, ensure unimpeded domestic flow to effectively shield ourselves from harm, we will have the vigor and vitality to not only survive but thrive amid volatile international situations, **making it impossible for anyone to keep us down or to back us into a corner.**”

We must speed up our efforts to create a new development dynamic, so that **no matter the challenges or difficulties we encounter, whether anticipated or not, we will be better able to survive, compete, and maintain sustainable development.** This way, we can ensure the course of national rejuvenation is never delayed or interrupted.”

Source: Understanding the New Development Stage, Applying the New Development Philosophy, and Creating a New Development Dynamic, July 2021

**It is also interesting what China has chosen *not* to do.** While China has a very strong weapon in the close to monopoly of rare earth minerals used in high-tech products such as mobile phones, EV's, LED-TV screens and missiles, it has refrained from retaliating on US tech restrictions by for example putting export restrictions on rare earth minerals. The calculation is likely to be that the US holds the strongest cards in an all out economic war and that it would hold back China even more in its rise to economic super power. Hence, it plays the long game and wait to build strength over the coming decades. We believe, China will continue this strategy and refrain from weaponizing rare earth minerals.

### **Tensions to continue but no near-term disruptive measures**

The tensions between US and China are likely to remain high in the years to come. In the US the negative view on China is bi-partisan and shared in the population. And to some extent Democrats and Republicans compete on who is the toughest on China. On the Chinese side, it is also unlikely that it will give in to US demands for changes. China believes its' system is more effective in solving problems and meeting challenges and it comes from a collectivist origin that goes thousands of years back, which China is increasingly proud of. It sees the capitalist model of the US as failing in solving key problems in society.

While we don't expect the Biden administration to take any disruptive measures, such as a new trade war, the path of gradual decoupling measures such as rising tech restrictions on China and self-sufficiency measures in new sectors (such as biotech) is set to continue. Human rights related sanctions may also increase. China will work on decoupling by seeking more self-reliance and invest heavily in tech and increasing energy and food security. Tensions are also likely to stay elevated around Taiwan where a new status quo with a very high level of tension is the new normal.

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