The Impact of the US-China Trade Dispute on the GCC

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Instant Insight

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What has happened in the U.S.-China trade dispute?

The trade dispute between the United States (U.S.) and China has escalated since March 2018. On March 22, 2018, U.S. President Donald Trump signed a memorandum directing the U.S. government’s response to the investigation on China’s economic activities, trade policies and practices related to technology transfer, intellectual property and innovation under section 301 of the U.S. Trade Act of 1974. Figure 1 illustrates the timeline and tariffs that both sides have imposed on each other’s imports. Back and forth negotiations between the two countries occurred alongside the bilateral escalation of trade tariffs for nearly two years before the first phase of a trade deal was signed on January 15, 2020.

In addition to China’s commitments to improve its intellectual property protection and technology transfer practices, it also agreed to increase its purchases of U.S. products and services by at least $200 billion more than in 2017 over the next two years. This includes $77.7 billion of manufactured goods, $32 billion of agricultural goods, $52.4 billion of energy commodities, and $37.9 billion of services.

Figure 1. U.S.-China trade dispute timeline.

<table>
<thead>
<tr>
<th>U.S. tariffs</th>
<th>Chinese tariffs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presidential Memorandum on section 301 investigation</td>
<td>Mar 2018</td>
</tr>
<tr>
<td>$34 billion at 25%</td>
<td>$34 billion at 25%</td>
</tr>
<tr>
<td>$16 billion at 25%</td>
<td>$16 billion at 25%</td>
</tr>
<tr>
<td>$200 billion at 10%</td>
<td>Sep 2018</td>
</tr>
<tr>
<td>$60 billion at 5%-10%</td>
<td>$200 billion from 10% to 25%</td>
</tr>
<tr>
<td>May 2019</td>
<td>Jun 2019</td>
</tr>
<tr>
<td>$60 billion at 5%-25%</td>
<td>$120 billion at 15%</td>
</tr>
<tr>
<td>Sep 2019</td>
<td>Subset of $75 billion at 5%-10%</td>
</tr>
<tr>
<td>$120 billion at 15%</td>
<td>Jan 2020: US-China phase one deal in effect</td>
</tr>
<tr>
<td>$120 billion at 15% cut in half</td>
<td>Subset of $75 billion cut in half</td>
</tr>
</tbody>
</table>

Source: KAPSARC.
What is behind the U.S.-China trade dispute?

The purported basis for the trade dispute is China's technology transfer and intellectual property practices. The U.S. administration has accused China of stealing U.S. technology, using foreign ownership restrictions, investment restrictions, and administrative review and licensing processes to force technology transfer (White House 2018). The Chinese government has accused the U.S. of distorting facts. It argues that technology transfer and licensing between Chinese and foreign enterprises is entirely voluntary and bound by contracts that follow international practices relating to the trade in commercial technology. China's technological progress has as its foundation large-scale government investment in basic sciences and innovation (State Council of China 2018).

The U.S.-China trade dispute represents a structural and systemic change in relations between the two countries. China's ambition for leadership in the international development arena may be viewed as a natural progression of its rising global influence. Yet the way U.S. government officials and opinion leaders have approached the Belt and Road Initiative (BRI) and Made in China 2025 has largely shown their concerns surrounding China's growing economic and political influence, and its influence in the field of national security.

Along with occasional optimism about the positive effects of the BRI, various U.S. assessments focus on concerns about its economic viability, financial sustainability, and environmental and social safeguards. The expansion of BRI projects in Eurasia and Africa over the last six years is increasingly perceived as a threat to U.S. interests. New international institutions or economic frameworks that China has established through the BRI, such as the Asian Infrastructure Investment Bank and the New Development Bank, threaten to challenge the U.S. stronghold on the global political and economic order.

There are two major schools of thought in U.S. strategic studies on how best to protect U.S. interests and counter the advantages that China is gaining through the BRI. The first is collective balancing. This approach accepts that China will continue to rise as an international power and that the corresponding balance of power will shift. It also posits that this shift can still be favorably maintained by leveraging the collective power of a coalition of like-minded states. The second is comprehensive pressure. This approach may include intensified military, diplomatic, and geo-economic initiatives meant to stymie China's bid for primacy in the Indo-Pacific and perhaps beyond (Brands and Cooper 2019). If the U.S. were to undertake either approach, or even a hybrid approach, it would directly compete and potentially counter or offset Chinese influence in the regions where BRI projects are focused, despite the risk that doing so would significantly escalate tensions.

The two countries have already started a direct confrontation on the future of internet-based technology development and the legitimacy of Chinese industrial policy – the Made in China 2025 plan. This plan was issued by the State Council of China in 2015, with the aim of moving the country up the manufacturing value chain by increasing innovation capacity in 10 industries. These industries include information technology, aerospace equipment, new synthetic materials, emerging biomedicine, advanced robotics and artificial intelligence, among others.

China is only imitating the best practices of other developed countries. For example, the industrial policies that the U.S. government has introduced, including its National Strategic Plan for Advanced Manufacturing
and its Strategy for American Innovation, formed part of the inspiration behind Made in China 2025. Chinese industrial policies are also similar to those of the U.S. government. They include adjusting and improving government investment to scale up input in manufacturing, increasing the government’s procurement of certain products, providing credit support to export companies to expand their global markets, and providing funding for innovation in manufacturing (State Council of China 2018).

A major concern for the U.S. is that the financial assistance that the Chinese government may provide to Chinese firms, through state-directed investment and preferential access to credit, will create an uneven playing field for foreign enterprises. Another concern is that the local content goals of Made in China 2025 will likely hurt U.S. high-technology suppliers. Furthermore, the U.S. is deeply concerned about the security and competitiveness of Chinese communications technology. If China establishes sole dominance over 5G, it will be able to dominate the opportunities arising from a range of emerging technologies that will be dependent on and interwoven into 5G networks. The power the U.S. has today to use economic sanctions would pale by comparison to the unprecedented leverage China could have through 5G technology (Barr 2020).

How does the trade dispute impact the GCC?

Relations between the U.S. and China have deteriorated significantly since the start of the trade dispute. The phase one trade deal agreed in January did not halt the escalation of the dispute. The extended confrontation will weigh on the global economy, and a prolonged crisis will add challenges to the already complicated economic and political situation of the Gulf Cooperation Council (GCC) countries. An immediate direct impact can already be observed on energy trade and investment flows.

- The impact on energy trade

In the phase one deal, China committed to increase its energy imports from the U.S. by $18.5 billion in 2020 and $33.9 billion in 2021. As Figure 2 shows, if China fulfills its promise, it will result in nearly a fivefold growth in the value of U.S. energy exports to China by 2021 compared with 2017. The significant oil price drop during the Covid-19 pandemic will add more physical delivery of crude oil, liquefied petroleum gas (LPG), and liquefied natural gas (LNG) if the portfolio of China’s energy imports from the U.S. is the same as in 2017.

China’s economy is moving into a slow-growth period, a long-term trend determined by China’s late stage of industrialization. The Covid-19 pandemic and the U.S.-China trade dispute will further constrain China’s economic growth in 2020-2021. Energy demand in China is projected to decline by more than 4% in 2020, a reversal of its average annual demand growth of nearly 3% between 2010 and 2019 (IEA 2020). It will be hard for China to increase its total energy imports over the next two years against such a backdrop. One possible option would be for China to reduce its energy imports from other countries to accommodate the agreement with the U.S. It would have to mainly reduce its imports of crude oil, LPG and LNG products from countries other than the U.S., despite the crude transportation cost from the U.S. being almost three times that of the GCC average.
China’s reduced imports from non-U.S. suppliers are unlikely to majorly impact GCC crude suppliers. Only large integrated refinery and petrochemical sites have the flexibility needed to manage shifts in feedstock and product yields. Most independent refineries in China can only use crudes from the GCC, which are typically heavy and sour. At the strategic level, the long-term development of economic interdependence and cultural exchange has established a comprehensive partnership between China and the GCC. A sustainable relationship with the GCC around energy provision also serves China’s long-term interests.

- **Impact on investment**

China has become an increasingly important stakeholder in GCC countries’ economic diversification programs. Bilateral trade between China and the GCC countries tripled to around $170 billion between 2005 and 2019. Foreign direct investment (FDI) flows from China to the GCC rose sharply from only $52 million in 2005 to $1.3 billion in 2018. Since the implementation of the BRI, Chinese investment in the GCC has focused on the construction sector and the operation of industrial parks, such as Jazan Industrial City in Saudi Arabia, Khalifa Industrial Zone in Abu Dhabi, and Duqm Industrial Park in Oman. These investments complement China’s domestic development and help to facilitate trade and FDI flows to the GCC. Chinese enterprises are also involved in the petrochemical industry, renewables and telecommunications.

However, the U.S. remains the largest investor in the GCC, and is the top target of GCC foreign investment, though GCC investment flows into China are growing. By the end of 2019, the stock of U.S. FDI in the GCC
was over $28 billion, and the stock of GCC FDI in the U.S. was over $12 billion. The Framework Agreement for Trade, Economic, Investment and Technical Cooperation between the U.S. and the GCC, signed in 2012, significantly strengthened business relations between both sides, especially in new technology and emerging industries. For example, the U.S. company PayFort announced an initiative to increase online transactions and revenue for small and medium-sized enterprises in the Middle East; Oracle has chosen Saudi Arabia to host its regional cloud data center, and Hewlett-Packard is planning to provide the information technology knowledge and skills for labor market capacity building. In 2020, the U.S. company Air Products signed an agreement with ACWA Power and Neom to develop a $5 billion green hydrogen-based ammonia production facility powered by renewable energy in northwest Saudi Arabia.

**Figure 3.** FDI flows between the GCC and China and the GCC and U.S.

Escalated geopolitical tensions between the U.S. and China will discourage bilateral investment and supply chain reliance. This might redirect some of the foreign economic activity of both the U.S. and China toward their strategic partners in the GCC and elsewhere. However, this may also lead to intensified competition between the U.S. and China in the GCC. To deal with challenges arising from the U.S.-China dispute, on May 14, 2020, the Chinese Communist Party’s Politburo, the highest decision-making body in China, announced its dual circulation strategy. Under this new strategy, China will prioritize the growth of its domestic market through deepening political economy reforms. It will also remain open to foreign investors and will strengthen its connection with international markets rather than decoupling from the outside world. If this works well, any negative impact from the U.S.-China trade dispute on China’s BRI investment and industrial cooperation projects in GCC countries would be alleviated to some extent.
The way forward

The U.S. has been a strategic ally to the GCC for decades, and China has become an increasingly important stakeholder in the region on trade, investment and industrial cooperation. Both China and the U.S. also rely on the GCC countries to balance the energy market. The economic transition programs the GCC countries are currently undergoing may create thriving markets for Chinese and U.S. products. The U.S.-China rivalry will inevitably damage global economic growth. The GCC should work to balance its partnership with both countries and try to bridge the growing divide through a collaboration framework for its members’ collective interests.

References


