# U.S.-China Confrontation Runs Counter to Both Countries' Interests

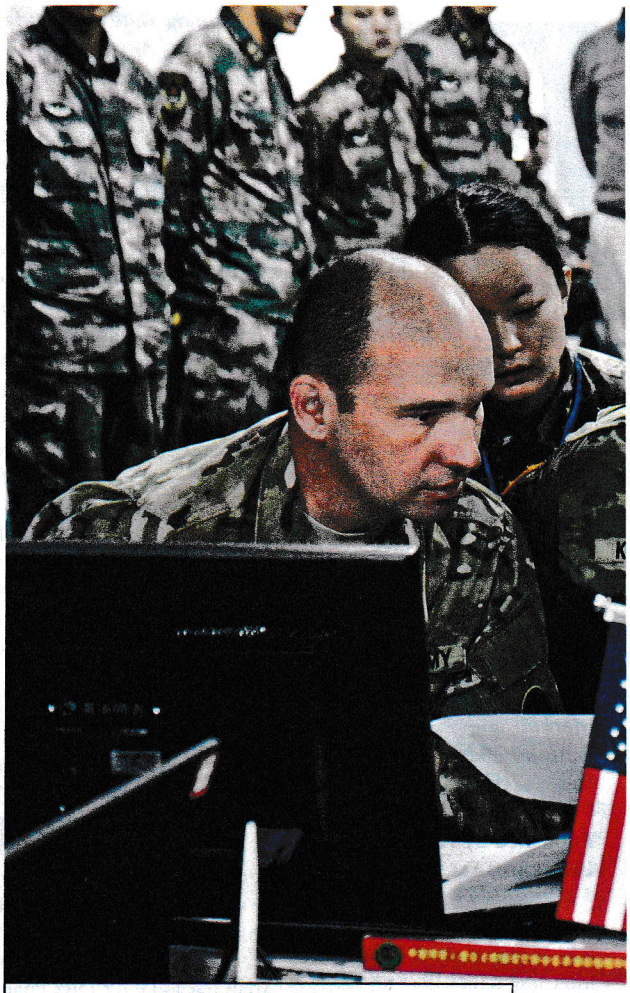
By **JOHN ROSS**

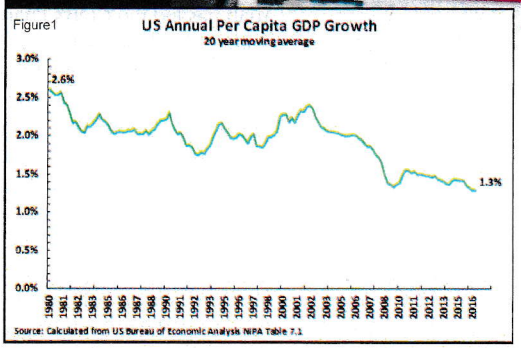
FEBRUARY 2017 marks the 45th anniversary of the first Sino-U.S. joint communiqué. Popularly known as the *Shanghai Communiqué*, it formed the foundation of the relations today between the two countries. The recent U.S. presidential campaign and its aftermath, featuring "China bashing" and even attempts to undermine these long established relations, make essential a clear analysis of why stable, friendly relations between China and the U.S. are in the fundamental interests of both countries and their peoples.

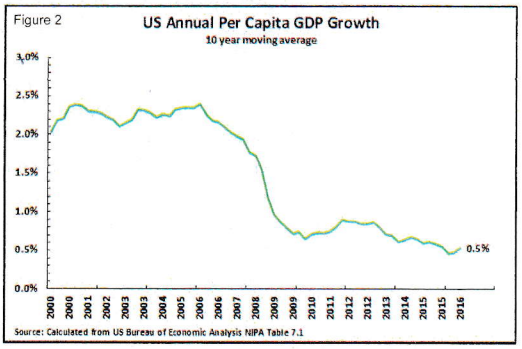
In particular, it must be understood that the 2016 U.S. presidential election culminated in the greatest destabilization of U.S. politics since the Great Depression. Such instability and dissatisfaction are undoubtedly rooted in an economic and social situation where U.S. household incomes are lower now than 15 years ago and a rise in U.S. economic inequality that has been afoot for three or more decades,

Yet both U.S. presidential candidates attempted during the campaign to divert the U.S. voting public's attention from these real problems in various ways, one of them "China bashing." Trump made false claims that China gains an unreasonably competitive edge through an artificially low exchange rate – an argument that even the U.S. Treasury has abandoned.

In fact, "China bashing" goes against the interests of both China and the people of the United States themselves. As the world's most important bilateral relationship, the dynamics between China and the U.S. affect the global situation as a whole.






Chinese and U.S. officers compare notes during a three-day joint humanitarian relief drill held in Kunming, Yunnan Province in November 2016.

## Income Trends

U.S. median household incomes in 2015 were still 2.4 percent below the level 16 years previously. And at the trough of the Great Recession, in 2012, they were 9.1 percent below their 1999 peak level. The U.S. population therefore suffered more than a decade and a half of significantly lowered incomes – something which could alone cause deep political discontent and anger in any country.

But the political consequences of the falling U.S. incomes trend were exacerbated by greater social inequality and a lower share by the overwhelming majority of the U.S. population in the nation's total income. The share of the bottom 80 percent of the U.S. population – the overwhelming majority – in total U.S. income fell from 56 percent in 1967 to 49 percent in 2015. Over the same period, the top 20 percent of the U.S. population's share in total U.S. income rose from 46 percent to 51 percent. In 2015, therefore, the top 20 percent of the U.S. population received a higher share of the total U.S. income than the bottom 80 percent.

This inequality has become more pronounced since Reagan's presidency in 1981. From 1980 to 2015, the bottom 20 percent of U.S. households' share in the total U.S. income fell from a low of 4.2 percent to 3.1 percent. Simultaneously, the share of the top 5 percent of U.S. households in total U.S. income underwent a sharp 5.6 percent rise from 16.5 percent to 22.1 percent. Meanwhile, the share of each household income group in the bottom 80 percent of the U.S. population in total U.S. income showed a sharp 7.1 percent decline from 55.9 percent to 48.8 percent.

Given these dramatic and growing income disparities since 1980, the rising political instability in the U.S. is no surprise.

The fundamental economic reasons behind these negative trends in U.S. incomes are equally clear. Figure 1 shows that, when taking a 20-year moving average to remove all effects of short-term business cycle fluctuations, between 1980 and 2016 the annual growth of U.S. per capita GDP fell by half – from 2.6 percent to 1.3 percent. That this slow economic growth was accompanied by a radical increase in social inequality explains the fall in U.S. median household incomes.

**The division of labor necessarily applies both internationally and domestically. Numerous factual studies have confirmed the positive correlation between economic openness and faster growth.**

Recently, this slowdown in the U.S. economy has worsened. As Figure 2 shows, under the impact of the international financial crisis the 10-year moving average of annual per capita GDP growth in the U.S. had fallen to 0.5 percent – close to stagnation – by the second quarter of 2016. Such miniscule per capita economic growth made impossible any significant increases in the living standards of the American people.

## A Win-win U.S.-China Economic Relationship

While, as analyzed below, foreign trade and investment are not main factors in the recent U.S. economic performance, the correlation of trade expansion and positive economic performance is nevertheless widely acknowledged – both theoretically and factually. Adam Smith said in the first sentence of the first chapter of his seminal work on modern economics *The Wealth of Nations*: "The greatest improvement in the productive powers of labor, and the greater part of the skill, dexterity, and judgment with which it is directed, or applied, seem to have been the effect of the division of labor." The division of labor necessarily applies both internationally and domestically. Numerous factual studies have confirmed the positive correlation between economic openness and faster growth.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**A tourism campaign is launched in eastern China's Suzhou City in October 2016 as part of the China-U.S. Tourism Year.**

This economic conclusion is also confirmed, in the negative sense, by the world's post-1929 relapse into the protectionism that presaged the Great Depression – the greatest economic crisis in modern world history. It was indeed this catastrophic experience that moved the U.S. after World War II to reverse its previous protectionist course and, for half a century, promote an open world trading order – one with great "win-win" benefits for both itself and other countries. Globalization brought great benefits to economies – not only to the U.S. but also to China in the wake of its reform and opening-up policy of 1978.

At the present stage of globalization the economic relations between China and the U.S. are critical. The U.S. and China are the world's first and second largest economies, accounting for 39 percent of the world economy at current exchange rates. They are hence the world's first and second largest trading nations.

In summary, China and the U.S. combined are sufficiently powerful to play a decisive role in the world economy and in world trade. Approaching the question of how to achieve optimum development of world trade and investment, therefore, necessitates discussions between the U.S. and China.

Furthermore, it is easy, from the point of view of economic fundamentals, to understand and build on the framework of mutually beneficial economic trading relations between China and the U.S. due to the two economies' different features.

China is the world's largest "upper middle income" economy, while the U.S. is the world's largest "high income" economy. Consequently, as regards medium technology items, China enjoys the combination of a comparable technological level but with much lower labor costs which the U.S. cannot match. Therefore, China has a decisive competitive advantage in medium and medium-high technology products. If, rather than importing these medium technology products from China, the U.S. were to manufacture them, the result would be substantially higher prices for U.S. consumers and producers, and consequently lower U.S. living standards and U.S. international competitiveness.

But, equally, the U.S. has competitive advantages over China as regards high technology. China's per capita GDP, which reflects the contrasting productivity of the two economies, is only 27 percent of that of the U.S. measured in PPPs – the most appropriate unit for long-term comparisons. Even with the best economic policies, therefore, it would take China several decades to equal the U.S.'s level of productivity. In other words, the U.S. will continue to enjoy a comparative advantage over China as regards high technology products for several decades to come.

The "win-win" outcome of economic relations between China and the U.S., therefore, is clarity and stability in both the short and long term. China will continue to be able to produce medium and medium-high technology goods more competitively than the U.S., which will meanwhile enjoy a competitive advantage in the field of high technology products.

The two economies' fundamental complementarity accounts for the dynamism of trade between China and the U.S. That the U.S. is China's single largest export market is well known. But since 1999, China's share of total U.S. exports has increased 5.3 percent, whereas that of the EU declined by 2.8 percent and Japan's