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Weaponised Dependency

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The kindest take on the recently concluded US-China summit in Beijing was that the relationship has 'improved' from antagonism to direct engagement. That the meeting ended without acrimony was the achievement.

The US has clearly recalibrated its approach towards China, as confronting it has not helped. Reasons are likely a mix of a realisation that the Chinese have become too strong to intimidate, and that culturally they do not respond well to threats. China played the good host, and President Xi signalled a conflict was not unavoidable, saying "achieving the great rejuvenation of the Chinese nation and making America great again can go hand in hand."

They allowed Secretary of State Marco Rubio, who had been sanctioned in 2020 for his remarks against China, appropriate access to events and President Xi, by changing the Chinese name of his spelling.

But economic and geopolitical observers globally, who had their radars up to catch signals of either side shifting stances on a host of major issues, were left counting the number of hours the two leaders spent together, shifts in body language, the sites visited, the food served and the music played.

For the rest of the world, and India, it is important that the two largest powers in the world today do not exchange blows, but also that they do not get too close in an explicit G2 formulation, dividing the world into geographical and sectoral spheres of dominance.

After an escalation in the trade war and the military action in Venezuela, Cuba, and Iran - all moves in the Grand War between the US and China - perhaps an 'expensive sight-seeing tour of Beijing' as some have called it, was necessary.

But one cannot but lament the complete lack of progress on major issues plaguing the global economy. Chinese mercantilism continues to do more damage to global trade than Trump tariffs: goods exports grew 14% year-on-year in April, with auto exports up 74%. 9 million cars exported in the last 12 months mean one-in-six cars sold outside China was Chinese. In March and April this shifted towards one-in-five, and one-in-four if one excludes the US, where a tariff wall effectively blocks Chinese cars.

Despite promises to boost domestic consumption (which in our view is not easy), and pronouncements against 'involution' (excessive competition that is wiping out industrial profits in China), investments in industrial capacity continue. While most commentators - including, sadly, many in the US government - focus on the nominal dollar-renminbi exchange-rate, given very low inflation in China, the real-effective-exchange-rate (REER), the true measure of a currency's impact on trade competitiveness, continues to fall. It is down by nearly a fifth in three years.

On the other hand, significant barriers remain on foreign firms accessing China's market in a range of sectors, especially in services.

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The rest of the world thus must work out their own solutions to counter their worsening trade balances against China. A collective approach would be more efficient, but with the World Trade Organization and other multilateral forums now nearly defunct, this is unlikely. Which means that Chinese exports will continue to distort global trade and raise justifiable political opposition to free trade in economies on the receiving side.

Even for the US, the pledge to create a 'Board of Trade' for non-sensitive goods, an investment council to enable Chinese investments in non-sensitive and non-strategic sectors (akin to India amending Press Note 3), and 'potential' Chinese purchases of aircraft and beef, do little to further its strategic objectives. These objectives have been enunciated by the current US administration itself: revive US manufacturing and reduce income and wealth inequality (desirably by creating more blue-collar jobs).

A necessary condition to meet these objectives is a weaker dollar, which would also address other imbalances like a worryingly negative net international investment position (NIIP: the gap between what the US as a country owns in global assets and what foreigners own in the US), and an unsustainable government debt to GDP ratio.

The last two times the US found itself in such a predicament - in 1971 when Nixon broke the dollar's peg to gold, and 1985 with the Plaza accord when the G5 agreed to devalue the dollar to address severe global imbalances - it forced the dollar to weaken against the Yen and the Deutsche Mark, currencies of its two major manufacturing competitors. This time, it needs the dollar to weaken against the Chinese Renminbi. This is not even on the agenda yet.

Weaponisation of trade dependencies, which both parties are guilty of (rare earths on one side, advanced chip technologies on the other), while tempting tactically as we settle into new geopolitical realities, is a matter of grave concern for the world. As is the growing balkanisation of the technology sector, including AI regulation, as countries being forced to choose sides slowing down innovation, and one-upmanship on AI potentially exposing the world to significant risks.

We saw no progress on these issues. Even on the closed Strait of Hormuz, a weaponised dependency that US and China are involved in, affects them both and is the most pressing current issue for the rest of the world, nothing material was made explicit other than agreeing it must be reopened.

These developments reinforce the view that India's will be a 'resisted rise' (as against the 'assisted rise', for example, of post-world-war Japan, Germany, then South Korea and Taiwan, and finally China). Doubling down on reforms that improve our global competitiveness, and reducing bottlenecks that throttle the domestic economy, including our own sources of demand, should be our priority.

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