NOMURA
Connecting Markets East & West

Comments on “Economic Globalization in Transition: New Trends and Challenges” by Zhang Qi

Senior Fellow
C. H. KWAN

October 30, 2019

Nomura Institute of Capital Markets Research

Summary and Conclusions of the Paper

- Factors favoring globalization
  - A new round of technology innovation
  - In-depth changes in the global landscape centered on the rise of China
  - Increased global competition
  - Rising trade in services resulting from the integration of services with manufacturing
- Factors favoring de-globalization
  - A widening gap between the rich and the poor
  - Violation of international rules by unfair competition
  - Escalating trade conflicts as symbolized by the trade war between the U.S. and China
  - Growing policy uncertainty
  - New challenges in global economic governance
  - Growing emphasis on geopolitical over economic considerations in policy making
- Policy options
  - Improving bilateral economic relations
  - Promoting regional integration (for example, China's Belt and Road Initiative)
  - Advocating and building an open world economy under the principles of fairness, openness, cooperation and sharing

Globalization Versus De-globalization

NOMURA

The Globalization Trilemma - The stance of major economies -

	Hyper-globalization	National sovereignty	Democratic politics	Examples
Golden straitjactket	✓	✓	×	China
Gobal governance	✓	×	✓	EU, Japan
Bretton Woods compromise	×	✓	✓	U.S., U.K.

Source: Compiled by Nomura Institute of Capital Markets Research based on Rodrik, Dani, "Brexit and the Globalization Trilemma," Dani Rodrik's weblog, June 13, 2016, https://rodrik.typepad.com/dani_rodriks_weblog/2016/06/brexit-and-the-globalization-trilemma.html.

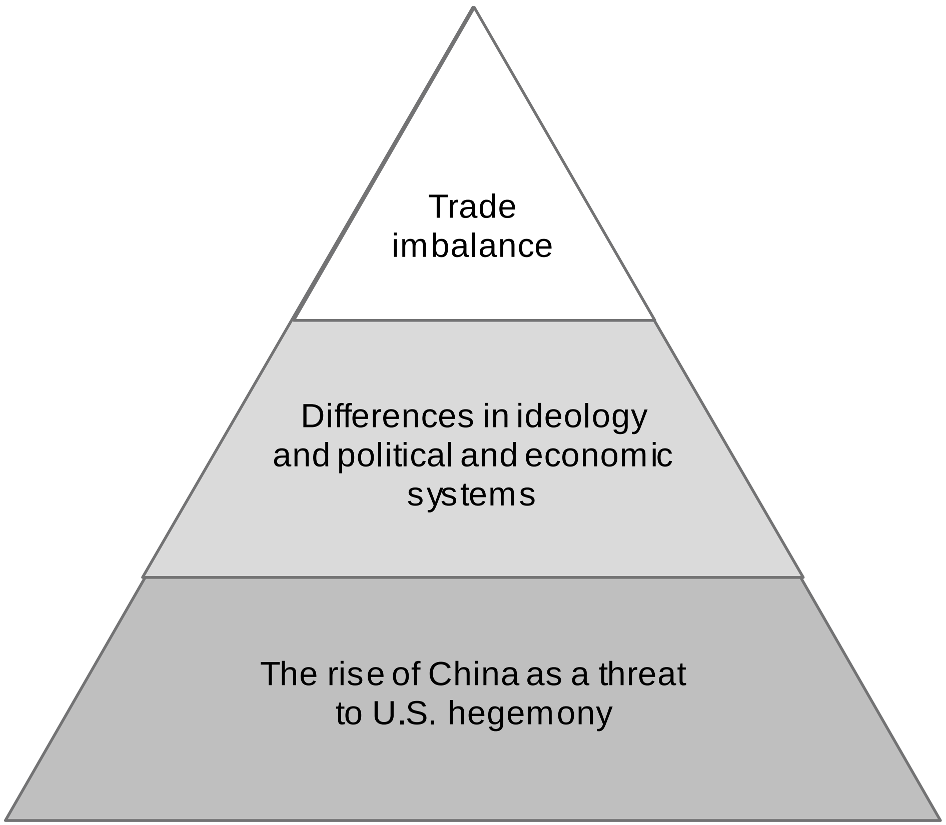
Can China Globalize While the Others Are De-globalizing?

Host Country (China) / Rest of the World	Pro-globalization	Anti-globalization
Pro-globalization	Globalization	De-globalization
Anti-globalization	De-globalization	De-globalization

Source: Compiled by Nomura Institute of Capital Markets Research.

Why Has the U.S. Launched a Trade War Against China?

Three Major Factors



Source: Compiled by Nomura Institute of Capital Markets Research.

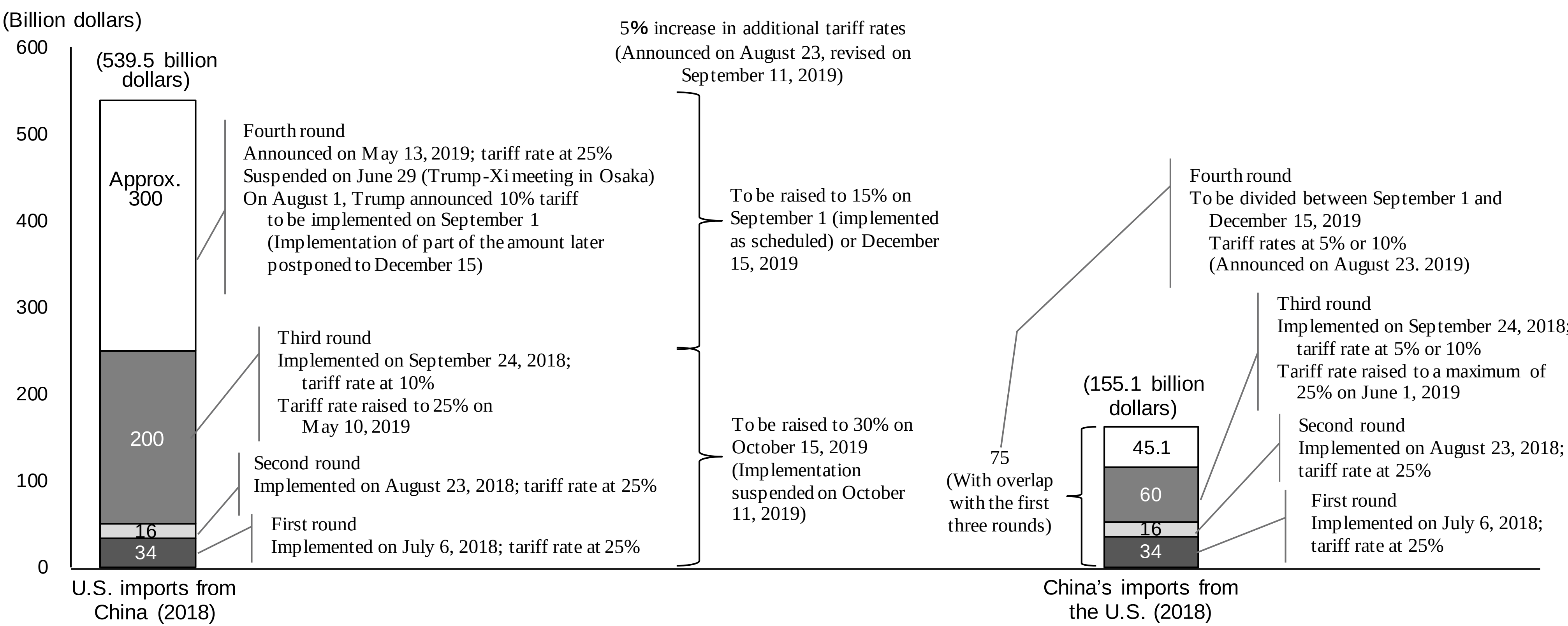
From Engagement to Decoupling

- As China has emerged as a major economic power while maintaining different political and economic systems from the West, the United States' policy toward China has shifted from "engagement" to "decoupling".
- Under the engagement policy, the U.S. supported economic development in China, hoping that its political system would change as a result (peaceful evolution).
- Under the decoupling policy, the U.S. aims to cut its links with China by restricting the flows of trade and investment, as well as technology and people between the two countries. Curbing technology transfer to China has become an important policy to deter the rise of China.

Imposition of Punitive and Retaliatory Tariffs by the United States and China

NOMURA

- The latest round of U.S.-China trade friction was triggered by the U.S. decision on March 22, 2018 to impose sanctions on China under Section 301 of the Trade Act of 1974. As symbolized by the tit-for-tat tariff hikes implemented by the two countries, the trade friction has developed into a trade war.



Source: Compiled by Nomura Institute of Capital Markets Research based on trade statistics published by the U.S. Commerce Department and the General Administration of Customs of China, and various reference materials.

Decoupling Measures Contained in the National Defense Authorization Act (NDAA) for Fiscal Year 2019

NOMURA

- The Foreign Investment Risk Review Modernization Act (FIRRMA) of 2018 strengthens the authority of CFIUS.
  - The scope of transactions under CFIUS review has been broadened to include non-passive (but non-controlling) investments in U.S. businesses owning critical technology, critical infrastructure or the personal data of U.S. citizens.
  - Consequently, it will become more difficult for Chinese companies and investment funds to acquire or invest in U.S. companies, particularly in the high-tech sector.
- The Export Control Reform Act of 2018 (ECRA) authorizes the Department of Commerce to establish appropriate controls on the export, re-export, or transfer (in country) of emerging and foundational technologies essential to the national security of the United States.
- Restrictions are imposed on government use of products manufactured by a number of China-based technology firms, including telecommunications equipment makers Huawei and ZTE, and a number of video surveillance manufacturers such as Hytera Communications Corporation, Hangzhou Hikvision Digital Technology Company, and Dahua Technology Company.

The Ban on Huawei

- In its attempt to cut its links with China’s high tech sector, the U.S. has taken a particularly tough stance toward Huawei, the world's largest supplier of telecommunications networks and the leader in 5G technology.
- Huawei's chief financial officer Meng Wanzhou was arrested in Vancouver, Canada on 1 December 2018 at the United States' behest, for conduct relating to U.S. trade sanctions against Iran.
- On 15 May 2019, the U.S. Commerce Department added Huawei and 68 affiliates to its Entity List, which comprises individuals and entities subject to specific license requirements for the export, re-export and/or in-country transfer of specified items.
  - This move in effect bans Huawei from buying parts and components from U.S. companies without U.S. government approval.
- On the same day, President Trump signed an executive order barring U.S. companies from using telecommunications equipment made by firms posing a national security risk, paving the way for a ban on doing business with Huawei.

Other U.S. Offensive Actions against China's High-Tech Industry

NOMURA

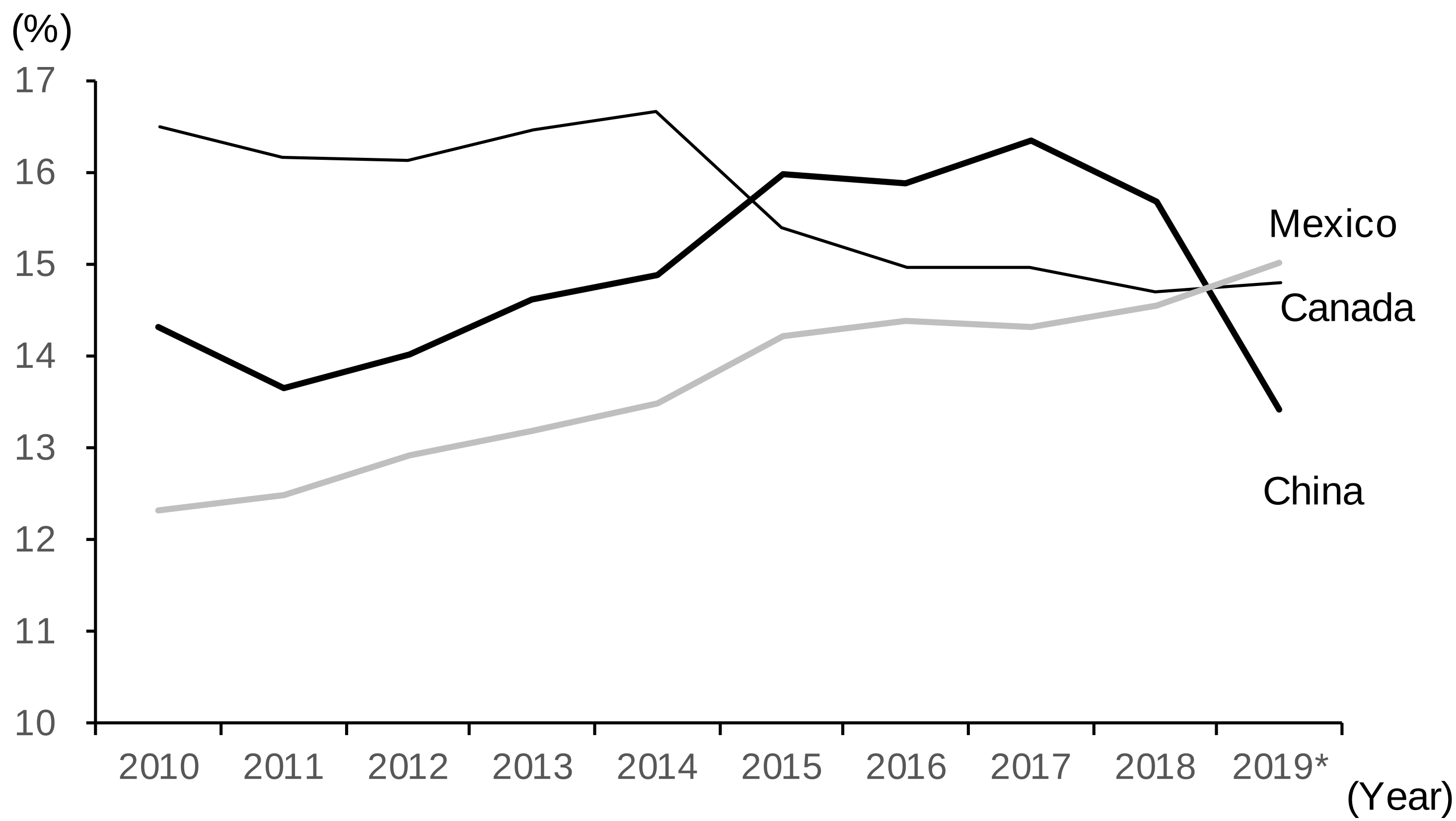
- In addition to Huawei, more and more Chinese companies in high-tech sectors have been added to the Entity List that bars them from buying U.S. parts and components without U.S. government approval.
  - Most of the Chinese entities found on this list are involved in high-tech areas such as electronics, aviation, semiconductors, engineering, and materials used for hi-tech components, including China's leading supercomputer maker Sugon.
- The U.S. government is seeking the cooperation of its allies to ban Huawei and other Chinese high-tech companies.
  - So far it has gained support from Japan, Australia and New Zealand.
  - Japan effectively banned Huawei and other Chinese companies from public procurement involving 5G technology in December 2018, amid heightening pressure from the U.S.
  - Japan also announced in May 2019 that 20 sectors in information and communications industries will be added to a list of businesses for which foreign ownership of Japanese firms is restricted, effective 1 August 2019.
- In U.S. policy circles, suspicion of China is starting to resemble a new "Red Scare"
  - Universities in the U.S. are heightening scrutiny of research proposals from China and, in some cases, restricting collaboration.
  - Visas for Chinese graduate students studying topics such as robotics or advanced manufacturing have been shortened to one year from five.

The Trade War may Hurt China by Reducing its Potential Growth Rate

NOMURA

- While in the short term, the U.S.-China trade war is dampening the Chinese economy, mainly through a decline in demand, over the medium to long term, it could depress China's potential economic growth rate through supply-side factors.
  - The U.S. government's move to strengthen restrictions on acquisitions of U.S. high-tech companies by Chinese companies has made it more and more difficult for China to acquire technology from the U.S. through this route.
- For China, which is catching up with the industrial countries from behind, importing technology from abroad has been one major factor contributing to its high economic growth. If the trade war with the United States means that China can no longer rely on this latecomer advantage to raise productivity, its potential growth rate, which has already been falling on the back of aging population and the drying up of rural surplus labor, may decline further.

Top Trading Partners of the United States
- Share of Total U.S. Exports and Imports

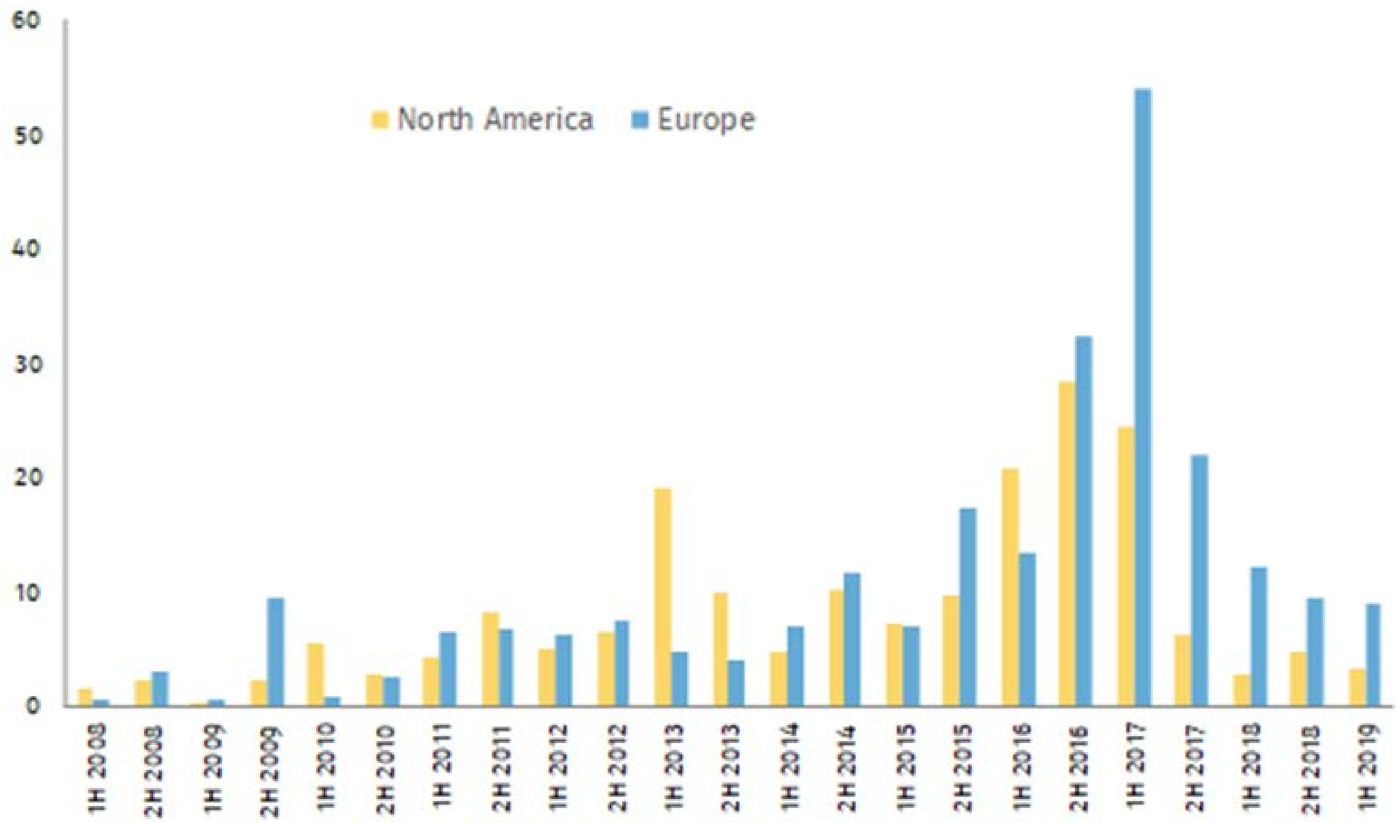


Note: *The first 8 months only for 2019.
Source: Compiled by Nomura Institute of Capital Markets Research based on U.S. Census Bureau statistics.

Foreign Direct Investment by China in North America and Europe Falling

NOMURA

(Billion dollars)



Source: "Chinese FDI in Europe and North America: 1H 2019 Update," Roduium Group, July11, 2019.

A World Divided into Two Major Blocs?

- The United States' efforts to decouple itself as well as its allies from China may lead to the disintegration of the global economy into two major economic blocs centered on the U.S. and China.

- With flows of capital, goods, technology, people, and information between them tightly regulated, multinationals could no longer optimize the allocation of resources by investing globally, and supply chains would have to be reshaped to adapt to this new environment.

- The negative impact on global trade and investment, as well as on economic growth, may far exceed that of the withdrawal of the United Kingdom from the European Union.

The Kindleberger Trap

- Charles Kindleberger, an intellectual architect of the Marshall Plan, argued that the disastrous decade of the 1930s was a result of the United States‘ failure to provide international public goods after it had replaced Britain as the leading power (*The World in Depression* 1929-1939, University of California Press, 1973).
- Under Trump's Presidency, in addition to launching a trade war against China, the U.S has withdrawn from the Trans-Pacific Partnership (TPP), the Paris Agreement on Climate Change, the International Criminal Court, UNESCO and the Intermediate-Range Nuclear Forces (INF) Treaty. Donald Trump has also fueled the rising trend of protectionism in global trade and made the immigration laws more stringent.
- There remains doubt as to whether China is capable of replacing the United States as the key provider of international public goods needed to support a stable global system and to reverse the trend toward de-globalization.
- The current situation of the world shares some similarity with the1930s, and is raising the risk of the world economy falling into the “Kindleberger Trap.”

Questions Related to the Policy Options Discussed in the Paper

NOMURA

- At the bilateral level
  - What are the prospects for trade negotiation between China and the United States?
  - What are the remaining issues that need to be addressed?

- At the regional level
  - What are the prospects for the Belt and Road Initiative?
  - Is it going to be a success like the Marshall Plan, or would China suffer “imperial overstretch”?

- At the global level
  - Is China ready to replace the U.S. as the major supplier of international public goods?
  - What specific roles would China play in improving global economic governance?

KWAN Chi Hung （C. H. Kwan）
Senior Fellow, Nomura Institute of Capital Markets Research

Education	1979: Bachelor of Social Science (Economics), Chinese University of Hong Kong 1986: Finished Doctor Program in Economics, University of Tokyo (Ph. D. in Economics, 1996)
Employment History	1986-1987: Economist, Hongkong and Shanghai Banking Corporation 1987-2001: Senior Economist, Nomura Research Institute (September 1999 – June 2000: Visiting Fellow, Center for Northeast Asian Policy Studies, The Brookings Institution) 2001-2004 Senior Fellow, Research Institute of Economy, Trade and Industry 2004- Senior Fellow, Nomura Institute of Capital Markets Research
Books in English	*Economic Interdependence in the Asia-Pacific Region: Towards a Yen Bloc*, London: Routledge, 1994 *Yen Bloc - Toward Economic Integration in Asia*, Washington: Brookings Institution Press, 2001.
Books in Japanese	*The New Normal of the Chinese Economy*, Nikkei Publishing Inc. 2015. *China Facing Two Traps*, Nikkei Publishing Inc., 2013. *China as Number 1*, Toyo-keizai Shimposha, 2009. *Economists Who Changed China*, Toyo-keizai Shimposha, 2007. *Japan-China Relations - A Win-win Game*, Toyo-keizai Shimposha, 2005. *China's Economic Reform - The Last Lap*, Nihon-keizai Shimbunsha, 2005. *Dilemma Facing the Chinese Economy*, Chikuma Shobo, 2005.
Japanese Government Committee Memberships	1996 - 97: Economic Council (Advisory Council to the Prime Minister) 1997 - 99 and 2003 -2010 : Foreign Exchange Committee (MOF) 2004 - 05: Working Group on Globalization, Council on Economic and Fiscal Policy (Cabinet Office)
Homepage	“China in Transition” (since January 2002) http://www.rieti.go.jp/en/china/index.html

- Established in April 2004 as a wholly-owned subsidiary of Nomura Holdings, Inc. and the only institution of its kind, the Nomura Institute of Capital Markets Research (NICMR) is dedicated to research on capital markets as well as the financial system, especially how the two are regulated, organized, and perform. Its mission is to encourage the sound growth of Japan's financial and capital markets through unbiased research and policy recommendation.
- The information and opinions in this document are for general information use only and are not intended as an offer or solicitation with respect to purchase or sales of any financial instruments or as personalized investment advice. Although this publication is compiled based upon information that NICMR considers reliable, NICMR dose not guarantee its accuracy or completeness, nor does NICMR assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice.
- If this publication has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. The sender therefore does not accept liability for any errors or omissions in the contents of this publication, which may arise as a result of electronic transmission.