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Mideast Security and Policy Studies No. 166

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ISSN 0793-1042
November 2019
Cover image: President Donald Trump at Seresnes American Cemetery outside Paris, Nov. 11, 2018, DOD photo by Navy Petty Officer 1st Class Dominique A. Pineiro

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EXECUTIVE SUMMARY

President Donald Trump's declared economic protectionism has taken the US's international relations with several foes and allies into uncharted territory. His open-ended trade wars with several nations have triggered criticism among conservatives and liberals alike in the US. He has justified his actions by arguing for a downturn of America's trade deficit, but the American people don't seem to be on board with his logic. A recent Harvard CAPS/Harris Poll survey shows 63% of registered voters believe tariffs imposed on Chinese products ultimately hurt the US more than China, while 74% said American consumers are shouldering most of the burden of those tariffs.

The political network funded in part by billionaire libertarian Charles Koch has contested Trump's approach toward China and is trying to shape an alternative strategy for 2020, the year of the US presidential election. One Koch senior official has acknowledged, "It doesn't penetrate with the people that are willing to go along with the argument that you have to punish China." There is now a pursuit of a "two steps back strategy," which will involve putting together a team of almost 100 business leaders to call on the Trump administration and lawmakers to end the trade war with China.

This paper examines the ramifications of President Trump's policy of economic sanctions and tariffs vis-à-vis several nations and international groupings. It also looks at China's counter-strategy and considers whether Middle Eastern countries like Saudi Arabia will be caught in the web of the current trade wars.

Dr. James M. Dorsey, a non-resident Senior Associate at the BESA Center, is a senior fellow at the S. Rajaratnam School of International Studies at Singapore's Nanyang Technological University and co-director of the University of Würzburg's Institute for Fan Culture.

Trump's approach

US President Donald J. Trump may not like armed conflict, but he sure loves economic warfare, whether it is to impose his political will on countries, protect sectors of the US economy, secure more preferential trade terms, or stop others from gaining technological advantage.

The list of countries subject to sanctions or import tariffs designed to force changes in either economic, military, or geopolitical policies is long, and it includes both US allies and rivals. Since Trump assumed the presidency in January 2017, he has sanctioned China, North Korea, Russia, Venezuela, Iran, the EU, Myanmar, Syria, and Cuba. In one of his first actions after entering the Oval Office, he pulled the US out of the Trans Pacific Partnership (TPP). He has also sought to undermine the World Trade Organization (WTO), a US-inspired pillar of global trade.

Trump's liberal use of sanctions amounts to more than a penchant for economic warfare in an effort to create trade terms more advantageous to the US. Economic warfare is the president's strategy to shape a new world order that is likely to be multipolar. Almost three years into his administration, it is proving to be a strategy with unintended consequences. Trump is not the only leader to discover that the employment of trade, commerce, and investment as not only an economic but also a political tool can be a double-edged sword.

Conspiring by default

Chinese president Xi Jinping is confronting mounting anti-Chinese sentiment in Eurasia and greater competition on China's border in the Russian Far East. Both he and Trump are being forced to respond to external shocks, like mounting tension between Saudi Arabia and Iran in the wake of recent brazen drone and missile attacks on the kingdom's oil installations. These attacks led to a temporary cut of Saudi oil production by half. They are likely to change trading patterns, particularly in energy, not only of China but also of multiple other Asian states, including Japan, South Korea, and India.

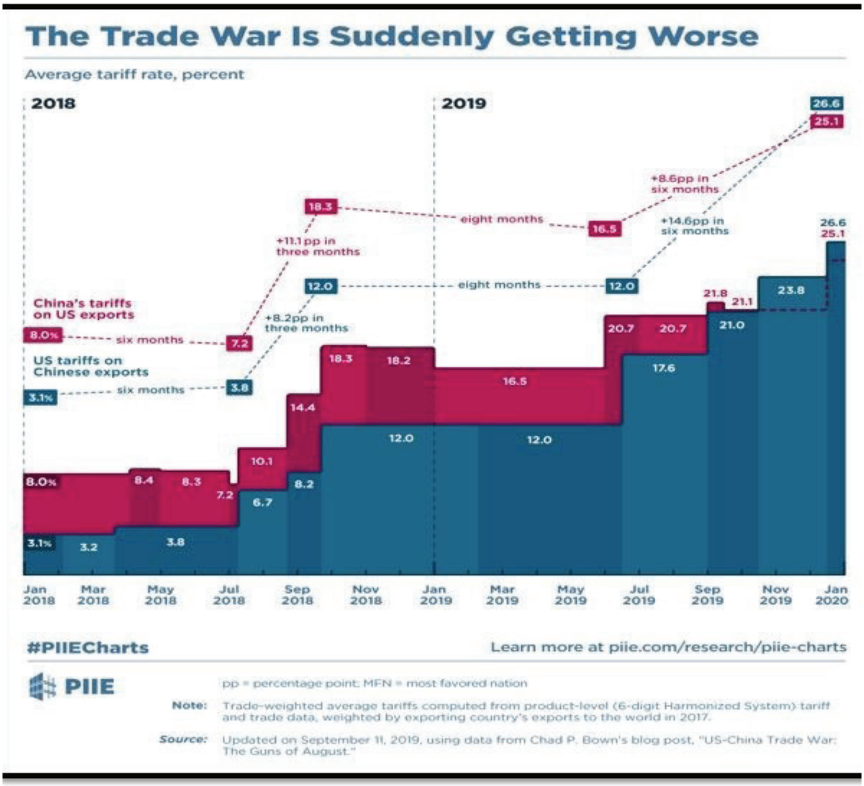
Trump's protectionist penchant for economic warfare, which breaks with 85 years of US trade and economic policy that was focused on free trade and open markets, has yet to produce a foreign policy success. China and Russia, determined to counter US power, particularly in Asia, have forged ever-closer ties. Iran and North Korea have demonstrated the resilience to endure harsh sanctions. Nicholas Maduro retains his grip on Venezuela while Europe is increasingly exasperated with America and discussing ways of improving relations with Russia to counter China.

Trump's renegotiation of the North American Free Trade Agreement (NAFTA), renamed the United States-Mexico-Canada Agreement (USMC), weakened protections for investors in Mexico as well as government commitment to allow foreign companies to bid for procurement contracts. While adding a review process to the agreement, this policy has created a sense of instability. Trump enhanced uncertainty by subsequently threatening to impose new tariffs on Mexico because he did not like the country's handling of Central Asian asylum seekers.

Former World Bank president, US trade representative, and deputy secretary of state Robert B. Zoellick predicts that Trump is likely to continuously wage economic warfare and keep trade partners off balance. "He will not change. Trade…is a core issue for the president's political base. He must keep it boiling," Zoellick said in a *Wall Street Journal* op-ed entitled "The Trade War's Winners Don't Include Us".

As a result, damage to US credibility and ability to regulate the international political and economic order may outlast Trump's sanctions and tariffs-driven policies. Countries like China and Russia are likely to expand trade relations with third countries and shift supply chains at the expense of preferential US access to markets. They may also defy US secondary sanctions that target third-country companies and entities that refuse to comply with, for example, sanctions against Iran, and initiate ways of undermining the global reserve function of the US dollar.

The Trade War Timeline



Source: PIIE

US losses are palatable. The TPP lowered trade barriers for member countries but not for the US. The EU has gained preferential access to Japan while China has retaliated with tariffs of 21.8% on US products and lowered them to 6.7% for others. The US Treasury has doled out billions of dollars to agricultural exporters who have lost significant market share in China that they will find difficult to recover.

US manufacturers are moving operations to third countries to evade the impact of the US-China trade war while foreign direct investment in the US is dropping. Chinese investment in the US has plummeted in the past two years. Meanwhile, India and the US are erecting barriers of their own that will negatively affect bilateral trade while negotiations with the EU are stalled.

Trump's trade wars have reduced the US' ability to establish rules and standards that govern key sectors like medical services, finance, intellectual-property rights, data access and security and enable the fight against corruption and promote transparency. "This president disdains rules; he acts as if governments control purchases like in old-style mercantilism," Zoellick said. "Trump thinks that trade policy is a tweet at 3 o'clock in the morning," added Democratic presidential candidate Bernie Sanders.

Bullying does the job

Trump's erratic approach toward policy-making and implementation, which entails a belief that bullying will do the job and vacillation between bluster and moderation, has projected him as an unreliable and impossible negotiator—a sharp contrast to his self-styled portrayal of himself as the master of the "Art of the Deal". At the risk of sparking the emergence of parallel economic worlds, one dominated by the US and the other by China, Trump assumes his trade war and efforts to block Chinese access to US technology will sabotage Xi's "Made in China 2025" program designed to make China commercially and industrially self-sufficient.

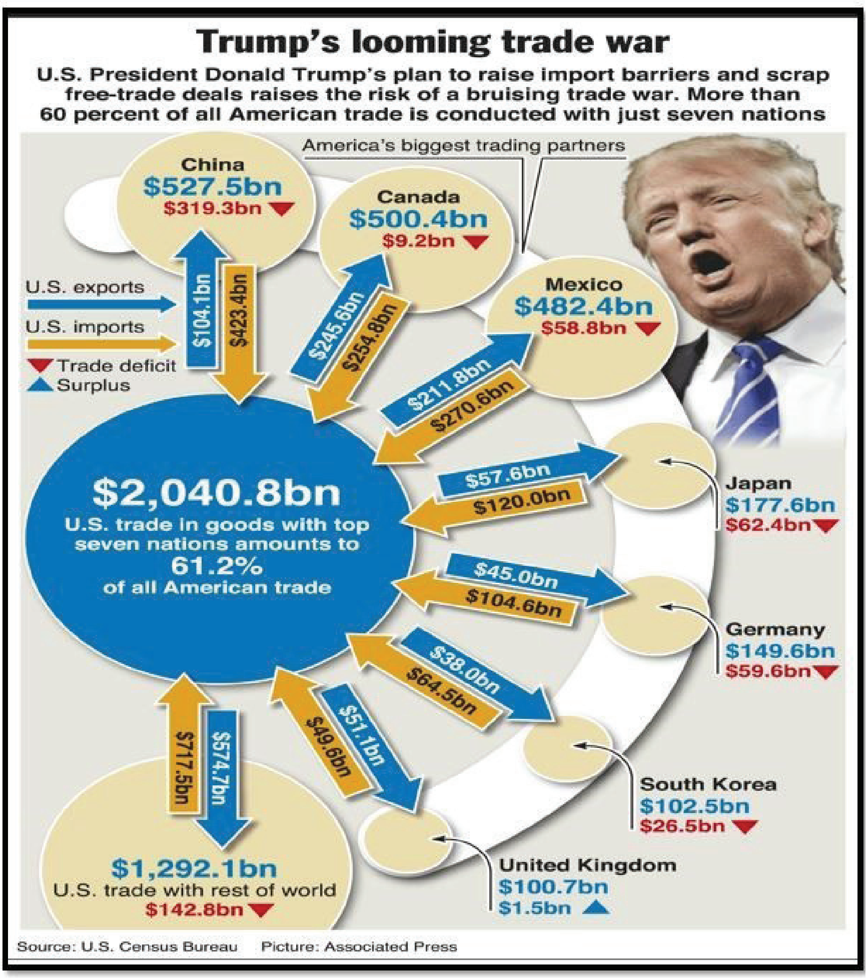
Trump further sees his trade war as a way of halting China's efforts to replace the US as the world's foremost, cutting-edge economy. Reporting on a recent visit by Xi to Henan Province, Communist Party newspaper *Global Times* reported the president had "urged the development of the real economy bolstered by manufacturing, with self-reliance as the basis of all endeavours."

Trump may be right in his identification of the threat China poses to US economic and geopolitical dominance. The problem is that his policy solution risks accelerating the process rather than reversing or even pausing it. Rather than stimulating research and development needed to ensure an American lead, Trump seems to believe that undermining China's abilities is the key. The threat of the demise of a global market and the rise of parallel markets appears to have reinforced Chinese determination to become as self-reliant as possible.

"A more competitive United States would be a stabilizing force," said Ely Ratnert, the executive vice president of the Center for a New

American Security and former deputy national security adviser to former VP Joe Biden, arguing that US strategy should involve both engagement and containment.

Trump's Looming Trade War



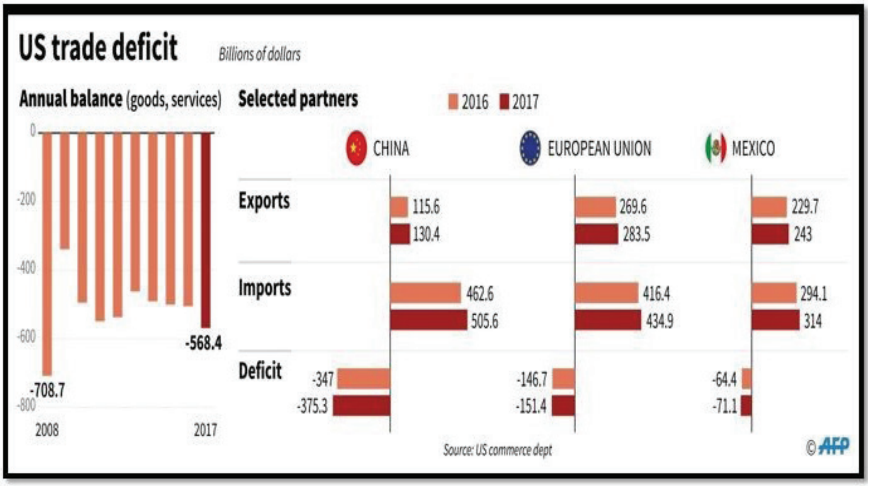
Source: AP

Xi responded quite differently to US sanctions on telecommunications equipment and systems maker ZTE Corporation, which threatened to bring the company down, and Huawei, another major Chinese telecom equipment manufacturer. That difference suggests that Xi has factored the emergence of parallel worlds into his thinking. Last year, he phoned Trump to plead with him to lift a crippling seven-year ban on the acquisition of US components by ZTE. The ban, imposed in response to allegation of ZTE's busting of sanctions against Iran and North Korea, effectively sounded the death knell for ZTE, which has a workforce of 75,000. Trump agreed to lift the ban in exchange for ZTE's agreeing to pay a $1.3 billion fine, undertake sweeping management changes, and hire American compliance executives to monitor the company from inside.

No such deal was available to Huawei—but nor would Xi be willing to accept another deal that could be perceived as reminiscent of China's historical humiliations at the hands of Western powers. Huawei has responded defiantly to US sanctions, the detention in Canada at the behest of the US of its CFO Meng Wanzhou, daughter of the company's founder, Ren Zhengfei, on charges of financial fraud, sanctions violations, and obstruction of justice; and a global campaign to prevent companies from acquiring Huawei's 5G technology. The US asserts that Huawei has close ties to China's military and security forces. In line with what has been termed the decoupling of the US and Chinese economies, Huawei introduced Harmony, its own operating system to rival Android.

In September 2019, the Trump administration took a further step toward decoupling with proposed new rules that would allow the US to exert greater control over foreign investment by broadening the government's authority to block technology and real estate transactions. The rules would give the Committee on Foreign Investment in the United States (CFIUS) greater power to stop foreign investment in areas the US deems protected, a move that primarily aims to bar China from access to sensitive American technology and other valuable assets. Beyond technology, the rules would red flag investment in infrastructure, such as telecommunications, utilities, and energy, as well as companies that collect sensitive personal data related to finance and health, particularly of individuals and/or federal employees involved in national security. Real estate acquisitions would be vetted on proximity to military installations, airports and ports.

The US Trade Deficit



Source: European Data News

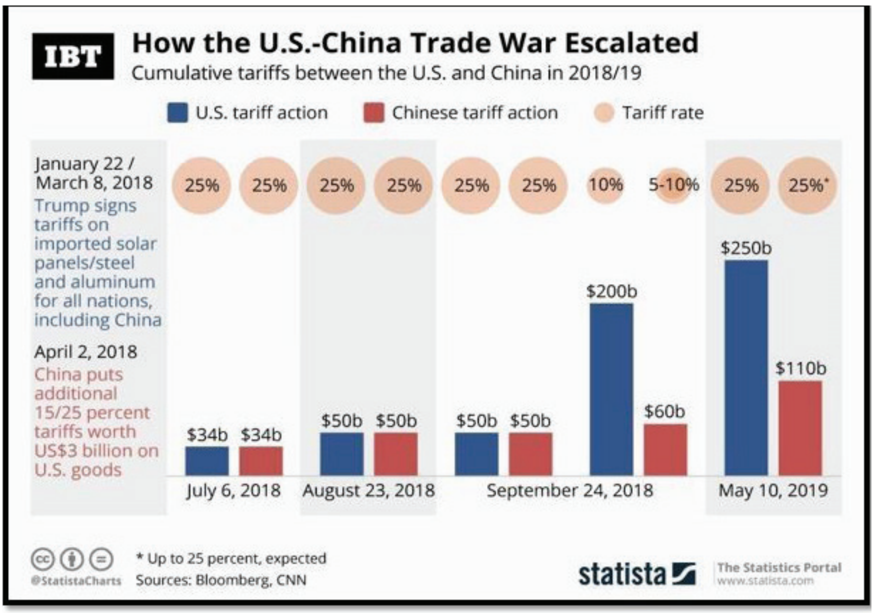
Chinese trade policy backfires

If Trump has demonstrated his inclination to wage economic wars, his Chinese counterpart, Xi, sees trade and foreign investment as a means of not only securing economic growth by imposing increasingly controversial commercial terms but also achieving China's geopolitical goals and promoting its concept of an invasive surveillance state. With countries like Pakistan, Malaysia, Myanmar, and Nepal questioning projects that fail to respond to local needs and fail to contribute to economic growth because they rely on Chinese labor and materials, China has conceded that it may have to make adjustments to a policy that by default rather than design could end up contributing to decoupling.

"It is normal and understandable that development focus can change at different stages in different countries, especially with changes in government. So China can also make some strategic adjustments when cooperating with these countries, but it is definitely not a reconsideration of the B&R (Belt and Road) initiative," Wang Jun, deputy director of the Department of Information at the China Center for International Economic Exchanges told the *Global Times*.

Jun spoke as Chinese FM Wang Yi was confronted on a visit to Islamabad with a Pakistani demand that China refocus its $45 billion plus investment in the China Pakistan Economic Corridor (CPEC), the single largest country infrastructure investment related to the Belt and Road initiative, to emphasize manufacturing and poverty reduction projects. The Pakistani demand amounted to a rejection of China's approach, which appeared to position Pakistan as a raw materials supplier for China, an export market for Chinese products and labor, and an experimental ground for the export of the surveillance state China is rolling out, particularly in its troubled northwestern province of Xinjiang.

How the US-China Trade War Escalated



Source: The Statistics Portal (STATISTA)

Elsewhere in Asia, other countries are putting their money where their mouth is. Chinese commercial terms prompted Nepal, like Pakistan, to withdraw from a Chinese-funded dam project. Furthermore, protests against the forced resettlement of eight Nepali villages persuaded CWE

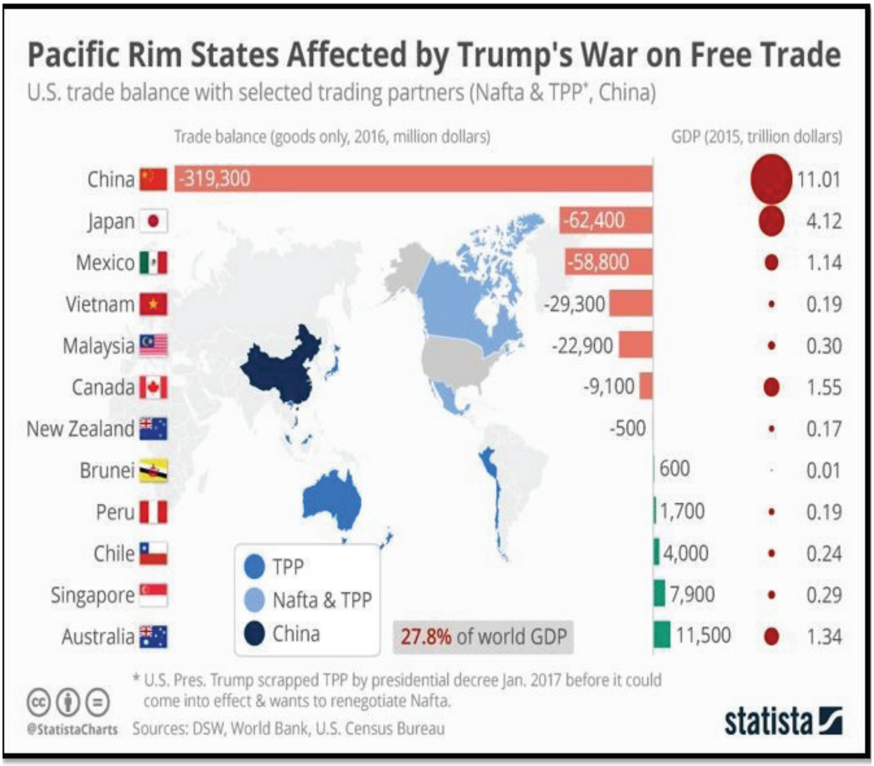
Investment Corporation, a subsidiary of China Three Gorges, to cancel a 750MW hydropower project.

In July, Malaysia restarted the China-linked East Coast Rail Link project after forcing China to agree to downsizing construction costs by a third. The rail project, led by China Communications Construction Co. and Malaysia Rail Link Sdn., was canceled in 2018 by PM Mahathir Mohamad after he balked at the $16 billion cost. The rail scheme was one of several projects, including a natural gas pipeline, suspended or cancelled by Mahathir after taking office in May 2018. Similarly, Myanmar forced China to scale back its Kyaukphyu deep-sea port project from $7.5 billion to $1.3 billion.

Even China's approach toward trade with Russia, its closest ally, has sparked anti-Chinese sentiment and raised questions of whether the current state of affairs is sustainable. Chinese investment in Russia is a fraction of China's investment in other regions like sub-Saharan Africa or South America and less than China's expanding stake in countries like Nigeria and Brazil. A Chinese-Russian agreement on economic cooperation in Siberia, Russia's far east, and China's northeast for a period of nine years ending in 2018 has fallen far short of expectations.

The agreement identified 91 joint investment projects of which only 11 materialized. Similarly, energy failed to live up to its billing. CEFC China Energy's plan to acquire a 14% stake in Russia's largest, and majority state-owned, oil company, Rosneft, never happened. Neither did an agreed $25 billion investment in Russia's Power of Siberia gas pipeline. The pipeline's export of 38 billion cubic meters of natural gas is but one source for China, which in 2017 imported more than 90 billion cubic meters from Australia, Qatar, and Turkmenistan.

Pacific Rim States Affected by Trump's War on Free Trade



Source: STATISTA

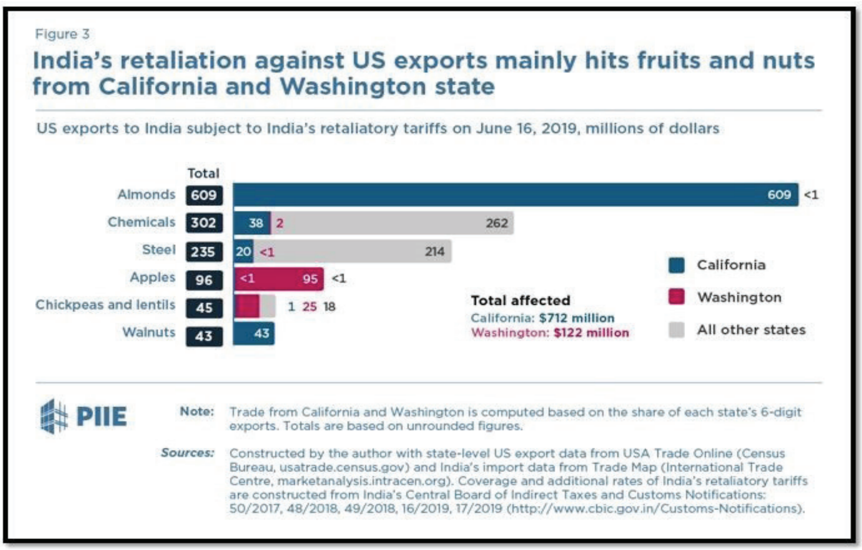
Russia scholar Leo Aron charged that the lopsided nature of Chinese-Russian economic relations fits the definition of Karl Marx and Vladimir Lenin of colonial trade, in which one country becomes a raw material appendage of another. "China is Russia's second-largest trading partner (after the EU) and Russia's largest individual partner in both exports and imports. For China, the Russian market is at best second-rate. Russia ranks tenth in Chinese exports and does not make it into the top ten in either imports or total trade," Aron said. He noted that three-quarters of Russia's exports to China were raw materials as opposed to consumer goods, electronics, and machinery, which accounted for the bulk of Chinese sales to Russia.

More ominously, China—starting in Central Asia, a crucial region that borders on its strategic province of Xinjiang—is making deployment of its intrusive surveillance systems a precondition for investment. In some cases Beijing appears willing to supply infrastructure at no cost as part of a Smart City project developed by Huawei for initial roll-out in former Soviet states. Huawei says the system, which involves installing thousands of security cameras equipped with artificial intelligence and facial recognition technology in public places, has been exported to 160 cities worldwide.

Liu Jiaxing, head of Huawei's representative office in Uzbekistan, disclosed China's insistence on adopting its surveillance approach in an interview with an Uzbek news outlet. "Investors will only go where the situation is stable. In view of this, the implementation of the Safe City project is very important for Uzbekistan as it will help the country develop its investment potential," Liu said.

With no transparent regulation and oversight to ensure Central Asians' privacy rights, China is likely to have access to data collected by Smart City technology. Kyrgyzstan's interior minister said data, once collected, would be handed at no cost to the government by Chinese National Electronics Import and Export Corporation (CEIEC), a company believed to be tied to the Chinese military. Its technology is deployed in Xinjiang, China's surveillance system laboratory.

India's Retaliation Against US Exports



Source: PIIE

A joker in the game

The Middle East may not be at the core of the trade wars and policies that appear to be reshaping world trade. However, harsh US sanctions on Iran and opposition to them by China, Russia, and Europe have enabled Saudi Arabia and Iran to put their stamp on them. Devastating attacks in September on two Saudi oil facilities, which were claimed by Iranian-backed Houthi rebels in Yemen and blamed on Iran by the US and less directly by Saudi Arabia, have prompted the kingdom's major Asian customers to look at diversifying their supplies, which could force them to upgrade their ability to refine heavier grades of crude. "The key is to gradually get rid of heavy reliance on Middle Eastern oil. There is a consistent risk to oil supply from Middle East countries. China has been diversifying its oil suppliers," said Zhu Guangming, an analyst with consultancy Sublime China Information.

China's diversification options are Russia, the US, and Iran. Russia may be China's safest bet as long as the US imposes sanctions on Iran, while the US is tricky given the trade war. Trading patterns in the immediate aftermath of the attacks in Saudi Araba of Unipec, the trading arm of Chinese oil giant Sinopec, highlight China's dilemma. Unipec was rushing in early September to sell US oil it had acquired as China imposed a 5% tariff on imports of American oil. Two weeks later, it was chartering ships to import US light crude to compensate for Saudi shortfalls.

A careful reading of Saudi and US responses to the attacks reveals subtle differences between the two governments. They mask several emerging fundamental issues that could have far-reaching consequences for the Gulf's security architecture and energy export focus. US Secretary of State Mike Pompeo and President Trump explicitly pointed the finger at Iran as being directly responsible. Saudi Arabia stopped short of blaming the Islamic Republic, saying its preliminary findings showed only that Iranian weapons had been used in the attack. Iran has denied any involvement.

Saudi Arabia's initial reluctance to unambiguously blame Iran may have a lot to do with Trump's America First-driven response to the attacks, which appeared to contradict the Carter Doctrine proclaimed in 1980 by

President Jimmy Carter. The doctrine, a cornerstone of the Saudi-US relationship, stated that the US would use military force, if necessary, to defend its national interests in the Gulf.

Trump's apparent weakening of the American commitment to the defense of the kingdom encapsulated in the doctrine risks fundamentally altering the relationship, already troubled by Saudi conduct in the more than four-year-long war in Yemen and last year's killing of journalist Jamal Khashoggi in the Saudi consulate in Istanbul.

Signaling a break with the Carter doctrine, Trump was quick to point out that the attacks were in Saudi Arabia, not the US, and suggested it was for the Saudis to respond. "I haven't promised the Saudis that. We have to sit down with the Saudis and work something out. That was an attack on Saudi Arabia, and that was not an attack on us. But we would certainly help them," Trump said, without identifying what kind of support the US would be willing to provide.

Despite blustering that the US was "locked and loaded," Trump insisted that "we have a lot of options but I'm not looking at options right now." He further called into question the nature of the US-Saudi defense relationship by declaring, "If we decide to do something, they'll be very much involved, and that includes payment. And they understand that fully."

Conclusion

The structure of global trade is—by design or default—in flux, with potentially far-reaching consequences for international relations as well as political systems in various countries. The escalating trade war between the US and China risks a breakdown in global trade as the world's two largest economies contemplate encouraging the emergence of trading environments to dominate. Add to that the impact of President Trump's penchant for economic sanctions, which, in the case of Iran, have sparked escalating tensions between Saudi Arabia and the US that could reshape security perspectives in the Gulf and lead to alternative flows of energy to Asia's largest importers. The possible decoupling of the Chinese and US economies would make it easier for China to politically align some beneficiaries of China's Belt and Road initiative by imposing its concept of a 21st-century Orwellian surveillance state on them.

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