

China pondering retaliation to recent US and WTO moves

Great Britain and France had the largest empires in the world, dominating the world economy in the 19th century thanks to their primary role in the inception of the Industrial Revolution. They were the superpowers of the recent past, whose rivalry has filled annals of history. The digital revolution has promoted the USA and China as the world's true superpowers. Like France and Britain, the US and China have also been indulging in an all out economic war and while diplomacy has masked rivalries, the events of the past few months have revealed many fractures in their bilateral relationship. Very different positions on the Syrian civil war, Russia, Ukraine, Iran, expansion in the South China Sea and the Pacific and the dispute over the now Japanese controlled Senkaku Islands have generated diplomatic tensions. Recent revelations of intense Chinese industrial espionage in the United States have lit the fuse to an already explosive scenario. China has become a crucial player in the world of high technology and electronics, despite its reputation as a country with a pronounced tradition of industrial counterfeiting.

Telecommunications equipment manufacturer Huawei is competing with Ericsson, Nokia and Motorola for first place in the sector. Foxconn is the leading manufacturer of high-tech devices including such iconic brands as Apple. Even in the software department, Chinese based search engine Baidu is putting up a valiant fight against Google. The Chengdu technology park will be the world's largest with over a million square meters at its disposal. The United States has, so far, had few shots to fire to re-establish pre-eminence. The US considers Huawei as a threat to security because of its ties to the Chinese Communist Party according to China's

Minister Chinese Commerce. The House's Intelligence Committee has claimed that Beijing could be using Huawei, the second largest manufacturer of routers and telecommunications equipment, for espionage purposes to the extent that Chinese investment activity in the United States is suspected as being a "potential Trojan horse".

Rare earths may be at the heart of the US-Chinese economic war; without them there would not be flat screen TV's, hard drives, smart-phones, hybrid engines, wind turbines and solar panels – not to mention missile guidance systems and laser cannons. These minerals are strategic and China still controls 95% of their production and sale while owning less than a third of the world's known reserves. Having managed to secure a virtual monopoly on rare earths – thanks in no small way to shortsighted policies in the West – China has exploited the opportunity to impose export quotas, undermining the needs of Western industries. China's trading partners have accused China, through the World Trade Organization (WTO) of trying to raise prices and force foreign companies in the sector to relocate to China to secure access to rare earths. Meanwhile, amid suspicion of espionage, in 2012 China filed more patents than the United States. Surely, many of these were trivial and filed in response to Chinese government 'quota fill' requests; however, the UN's World Intellectual Property Organization (WIPO) has conducted a study, demonstrating that the level of Chinese patents is improving and a fast growing number are up to world class.

A week ago, the US-Chinese 'conflict' achieved a new peak as the U.S. Justice Department accused several Chinese hackers suspected of industrial espionage. The five suspects belonged to the military and were spying in the metal and solar energy industry and a union. In turn, Germany's investigative journal 'Der Spiegel' claimed that last March U.S. spies had managed to infiltrate China's IT company Huawei. Doubtless, China will not take the accusations lightly, given the tense geopolitical

timing of their revelation. China has a number of economic artillery options in its arsenal from establishing tougher standards for American made products to throwing bureaucratic spanners such as unscheduled inspections. China could also find cyber-espionage accusations of its own against the West and it can certainly make it put up a strong challenge against the WTO ruling demanding it drop unfair quotas and restrictions to exports of rare earths.

This being a period of 'reflection' in China, as the country is trying to confront the environmental damage caused by years of haphazard industrial growth, China's retaliation will be guarded and delivered to strike maximum effect when it feels it is in a stronger position. For the time being, the US and the WTO are 'winning'. On May 22, the WTO ruled that China may not enforce punitive tariffs on cars (having engine displacement of 2.5 liters or more). China had been charging 21.5% duty on these largely General Motors (GM), Ford and Chrysler cars namely such models as the Jeep Grand Cherokee, Cadillac Escalade and Buick Enclave. China had justified the punitive tariffs claiming that U.S. carmakers are backed by Washington and, as such, have been able to sell their cars at low prices in the People's Republic. Overall, the United States exported in the year vehicles in the amount of \$ 8.6 billion in the People's Republic. The Obama administration continues, for some time now, has aggressively pursued efforts against trade barriers and industrial espionage, holding China responsible. China and the EU have their own fair share of trade issues and conflicts. In 2013, the EU had imposed punitive tariffs on Chinese solar panels while China then examined European wine imports and was considering its part to raise tariffs on large displacement European cars. Because the two sides agreed on a minimum price for solar cells, however, the conflict was resolved at that time.

Following the decision of the WTO, it is very likely that China will raise tariffs on exports. The current system of

export quotas was “invisible” in recent years because the actual export volumes were below quota. In 2013, the prices of these minerals were low, affecting the Chinese producers. At Baotou in the Inner Mongolia Autonomous Region, where 34 major producers are based, industry revenues reached Yuan 1.81 billion (290 million U.S. dollars) last year, down 25.3%. Profits meanwhile fell 4.7 % to Yuan 210 million, while exports plunged 47.2% to Yuan 31 million. Chinese authorities may deal with the WTO by imposing higher taxes on producers of rare earths on the basis of the value of minerals, rather than the volume, as is the case now. This change will result in higher production and, of course, export prices. But China’s revenge will be brewing in a slow process, designed to hurt much deeper.