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What Will the U.S.-China Relationship Look Like in the Biden Era?

By [Oliver Reynolds](#) and [Arne Pohlman](#) January 07, 2021

Summary.

Barring an unforeseen political collapse or economic crisis, the author's projections show China continuing to narrow the U.S.' economic and technological advantage over the next five years. This is despite the potentially positive impact of a Biden presidency for the U.S. economy, with a less combative trade policy boding well for sentiment and investment.

The sight of [Hangzhou's railway station](#) packed to the rafters during China's Golden Week holidays in early October was a powerful symbol of the country's swift recovery from Covid-19. With mobility restrictions long lifted, more than 600 million Chinese crisscrossed the country to visit family and friends — providing an important boost to domestic consumption in the process.

The difference with the U.S. is stark: While in China, the virus has been virtually stamped out and economic activity continues to gain steam, many U.S. states are reintroducing social distancing restrictions as they grapple with surging caseloads. To some, this gives credence to China's goal of replacing the U.S. as the world's major economic power.

Our projections show China continuing to whittle away the U.S.' economic lead over the next five years. But this isn't a given: Structural problems persist in areas such as overcapacity in industry, [elevated debt levels](#), and [inequality](#). What's more, years of tensions with Trump have [hurt external competitiveness](#), while China's aggressive foreign policy is generating [increasing international pushback](#).

How the Biden administration handles the U.S. relationship with China will be not just crucial to Biden's presidency, but one of the defining themes of his time in office. The institutions [we polled](#) in mid-October expect some relaxation of trade tensions, with many anticipating that the U.S. will at least partially roll back tariffs and restrictions on Chinese tech firms. If this happens, it will be positive for the Chinese economy going forward. But Beijing won't be banking on any favors from Washington: The Communist Party is doubling down on efforts to fortify its domestic market and break free from the U.S. chokehold in crucial high-tech domains.

Indicative of China's economic outperformance is that Q3's [4.9% annual GDP growth](#) was met with mild disappointment — markets had expected a larger expansion. In contrast, G7 economies likely [contracted](#) sharply in the quarter — as did [South Korea](#), despite fairly successful virus containment efforts. Over 2020 as a whole, China is seen expanding 2.0% in our forecast, the only major economy to record growth. By comparison, we see the U.S. shrinking 4.0%, as stop-start social distancing restrictions restrain momentum. Some economists are [skeptical](#) of the accuracy of official Chinese national accounts figures, but a raft of other indicators paint a similar picture: [Merchandise exports](#) surged

in third quarter, retail sales are back in positive territory, and industrial production is booming.

While some of these gains may be temporary — China's share of world export markets will surely ebb as other countries overcome the virus — the underlying picture is still positive. This is enabling China to close the gap on the U.S. Our calculations suggest China's nominal GDP will rise to 71% of the U.S.'s this year, from 67% in 2019. By 2025, that figure will have risen to 82%.

Biden's Dilemma

In a survey of 67 international institutions we carried out recently, close to 80% of respondents saw Biden either partially or completely removing Trump's import tariffs. The economic incentives to do so are clear: Prices paid by U.S. consumers would fall, and in exchange, China would likely improve market access for American exports.

However, there was less consensus on the politically thornier issue of tech restrictions, such as those imposed on Huawei. While 61% of institutions saw a partial or total lifting of the restrictions, 39% expected the measures to remain in place. National security concerns combined with an increasingly hawkish attitude towards China in Congress and the American public at large could make softening the U.S. stance in this area unpalatable without significant concessions from Beijing on issues of corporate governance.

On balance, we can expect a rhetorically more civil U.S.-China relationship under Biden, including a willingness to engage on key international issues such as climate change, and less emphasis on punitive tariffs. However, the U.S. will maintain pressure over perceived intellectual property theft, and there will be no winding back the clock to the Obama era, as China is now seen as a direct competitor in the emerging technologies which will define the economy of the future. There are also protectionist tinges to some of Biden's proposals, such as his \$400 billion "Buy American" plan to promote public-sector demand for U.S. products, and plans to encourage firms to bring supply chains back to the U.S.

We found many of our survey participants agreed with the sentiment of this survey response from Dr. Louis W. Rose, director of research & analytics and cofounder of Rose Commodity Group: "U.S.-China diplomatic relations would likely 'appear' to improve," he said. "But the U.S. and China clash on far too many basic philosophies in governing for the nations to have a close relationship."

Keep the Home Fires Burning

A potential rollback of tariffs and tech restrictions would boost China's growth in the years ahead. However, even in this scenario the legacy of the Trump era could linger: Many firms may continue to diversify their supply chains away from the Asian giant, chipping away at China's export dominance. The Covid-19 pandemic could potentially accelerate this process, by bringing into focus the importance of supply chain diversification. In any case, Biden will not alter Beijing's view that China must strengthen domestic activity and reduce economic pressure points in core technologies, such as semiconductors.

This philosophy is encapsulated by the new buzzword in Chinese state media: dual circulation. First mentioned by Xi Jinping in May, the term — referring to the reorientation of the economy towards internal consumption without closing off from the outside world — has in reality been government policy for years, albeit now with renewed intent. The 14th five-year plan, released on October 29, has dual circulation at its heart. The logic is sound: The capital-intensive model that has powered China to the economic forefront in recent decades is running its course. Total factor productivity growth is slowing. And China's economy is lopsided, with private consumption representing a mere 40% of GDP, far lower than over 60% in developed nations such as the U.S.

Iris Pang, Greater China economist at ING, argues there are early signs the strategy is working: "The central government has promoted cross-provincial travel within Mainland China during the summer holidays. This has successfully supported service sectors, especially in scenic areas and resorts. ... The government has taken note of this successful measure and is promoting even more internal tourism. Given China's big geographical area, we expect more local governments to propose such tourism measures to the central government."

Looking further ahead, our forecasts suggest the government is likely to have some success: We expect Chinese private consumption growth to average around 6% out to 2025, significantly faster than overall GDP growth. Nominal wages are seen growing over 9% next year, and over 7% in 2022.

That said, China's approach is not without risks, as analysts at Nomura highlight: "Although Beijing has clarified several times that DCS [dual circulation] is not a euphemism for turning inward, we are concerned that risks of turning inward may become elevated. Suppressing funding for the property sector could backfire, while massive government subsidies and investment in chipmaking could invite rent-seeking by the private sector, SOEs and local governments, leading to inefficient investment and bad loans."

Moreover, profound reforms will be required to truly unlock the potential of the country's swelling middle class and ensure sustainable future growth. Reducing the elevated saving rate through strengthening the social safety net and altering the Hukou system — which discriminates between urban and rural citizens in access to public services — will be key. Streamlining stodgy state-owned enterprises, which currently enjoy much easier access to financing than private firms, is another crucial step.

Overcapacity and debt levels are other concerns, argues Louis Kuijs, of Oxford Economics: "The government has made progress with cutting excess capacity in coal mining and steel. But more capacity reduction is needed, including extending the reform efforts to other industries such as cement, glass, electrolytic aluminum, and shipping. ... Non-financial corporate debt rose rapidly in the 2010s and stood at 159.3% of GDP in H1 2020. While we still think that the risk of a systemic financial crisis remains low, a renewed pick-up in credit growth could eventually lead to more pronounced financial stress and raise the risks of defaults and market turmoil going forward."

Room for Two?

Nonetheless, barring an unforeseen political collapse or economic crisis, our projections show China continuing to narrow the U.S.' economic and technological advantage over the next five years. This is despite the potentially positive impact of a Biden presidency for the U.S. economy, with a less combative trade policy boding well for sentiment and investment.

Following decades of hegemony, the ability of the U.S. to tolerate and collaborate with a similarly sized economic power will be a crucial factor to watch in coming years, as will be the ability of China's unique political and economic system to transition towards a more durable economic model, which would ensure the Asian giant continues to close the gap to the U.S. in the longer term.

"How China can achieve sustainable, balanced and high-quality growth in coming years and enter the high-income group from the upper middle-income group currently is the key long-term question for policymakers in China," comment [analysts at Goldman Sachs](#). "Although the Chinese government has been calling for a transition in the development model for a number of years, we think the next five years will be particularly important, both politically and economically."

China's leadership is conscious of the challenges it faces: The 14th five-year plan outlined in late October focuses on boosting the quality of growth and stimulating domestic consumption in the face of a more adverse external environment, while the surprise pledge to be carbon-neutral by 2060 likely has one eye on burnishing dented international credentials.

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