



## **Key News**

- [A U.S. decision to impose special duties on Chinese tires](#) could open the door to a host of trade complaints against Chinese products, creating tensions as Western nations seek Beijing's support at the G20 meeting. (Reuters)
- [Euro zone industrial output fell in July](#) and employment dropped again in the second quarter. (Reuters)
- [U.K. banks are less than half way through](#) posting 240 billion pounds (\$398 billion) of losses on loans and securities, according to Moody's Investors Service Ltd. (Bloomberg)

## **Quotable**

"The conventional view is based on the notion that free trade is always a win-win proposition and that our trade with China fits the conditions of the traditional free-trade model. These include the assumptions that the markets are perfectly competitive, that exchange rates are not manipulated, that there are no economies of scale, that there is no cross-border investment or cross-border transfers of technology, and that there are no government subsidies or export requirements. If this were a true picture of our trade in tyres with China, then imposing tariffs would truly be harmfully protectionist and not be justified.

"But this is not even close to the reality of our trade with China, which far from embracing orthodox free trade has openly adopted a neo-mercantilist, export-led economic growth strategy. China keeps its renminbi undervalued against the dollar in order indirectly to subsidise its exports. Foreign direct investment in China is often induced by the use of special, targeted tax and financial incentives. Foreign companies investing in China are often required to export the bulk of their production as a condition of being allowed to enter the Chinese market. This is the case with Cooper Tires, which agreed to export 100 per cent of its production in return for being allowed to invest in a Chinese tyre factory. The tyre industry is characterised by enormous economies of scale and imperfectly competitive markets in which a few oligopolistic producers divide the market among themselves. It is Chinese industrial policies and not market forces that are currently determining the trade flows and the location of production and jobs to the detriment of the US tyre industry.

"Nor is the detriment only to the US industry. Orthodox unilateral free-traders argue that, even if the US tyre workers lose their jobs, the US economy will enjoy a net benefit from lower consumer prices. But this is true only if the shuttered US factories and laid-off workers quickly shift to some other equally productive and well-paid activity. If, as we know, they cannot, the entire economy will suffer a loss of productivity and wages.

“This kind of trade is not win-win. Rather it is a classic zero-sum game. It is well-known to game theorists that in such situations a tit-for-tat response is the optimal strategy. Unilateral acquiescence to the aggressive initiatives of another player (the orthodox unilateral free-trade response) is a sure way to lose.”

Clyde Prestowitz, [Financial Times editorial 9/10/09](#)

“The American press is Confucianizing itself. A key factor is that increasingly in the last twenty years, media professionals have been subjected to a litmus test on trade. Those who embrace laissez-faire ideology have seen their careers flourish. Those who don’t haven’t.”

“The litmus test is applied by various players with considerable power to influence a journalist’s career. Take, for instance, high-placed news sources in government, in business, in the think tanks, and on Wall Street. For top journalists, easy access to such sources have long been aggressively in Beijing’s camp. In the classic Confucian fashion know throughout East Asia, such sources seek to marginalize and indeed ostracize any reporter who tries to uphold the freedom of the press on China-related issues.”

“Even before reporters get the chance to talk to sources, they are already subjected to a litmus test by media proprietors...Proprietors who apply the litmus test include not only Rupert Murdoch’s News Corporation but General Electric (the ultimate owner of NBC) and Viacom. It is no coincidence that these companies have assiduously cultivated business links with China over the years.”

“...While not all corporate America’s socialization of media people is necessarily so Machiavellian, the fact is that literally trillions of dollar are at stake in the free-trade debate. The debate is of historic concern not only in China, and its corporate friends but also to all the Confucian nations—nations that, by no coincidence, have traditions going back millennia on the sort of politically motivated personnel management we have seen in the American in recent decades.”

Eamonn Fingleton, *In the Jaws of the Dragon*

### **FX Trading – Hats off to China—They have made their intentions clear.**

It may at times be a cozy symbiotic relationship that has been beneficial for the US; especially as it relates to the US consumer getting increasingly higher quality and very inexpensive goods from China—that does increase domestic purchasing power. But, our relationship with China is not free trade in the “usual” sense. Based on empirical evidence, i.e. read real world not theory, if we continue down this road the US economy will be completely hallowed out of advanced manufacturing—which is important.

Granted the US has the lead in technology, but when US multi-nationals willy-nilly share that technology with key competitors, what’s the competitive advantage?

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The most powerful interests in America will continue to try and convince us it is free trade and will invoke Adam Smith and David Ricardo blah, blah, blah...all in an effort to too keep the game going (there is likely a mix of true believers and those who know better but have the look of the Cat that swallowed the canary).

It won't take much, except facing up to the most powerful entrenched interests in the world to at least convert the US-Chinese relationship into at least pseudo free trade; that should be the objective.

So, a full-court press of Obama trade policy bashing will likely be filling the airwaves. No Obama fans are we. No Union fans are we. But it is just plain stupid to continue to call our trade relationship with China free.

China has proven again and again to be many steps ahead of its Western counterparts. It is in their interest to do so—so their actions cannot be faulted in the game of great powers. Those going into China to manufacture know the rules (most of them), China has clearly established the ground rules both explicitly; and implicitly by actions. They make no secret of the fact they want to receive technology transfer as quid pro quo, requiring domestic production for access, instead of just shipping in goods, as happens in a trade relationship almost every place else on the planet. Chinese policymakers make no secret of the fact they want foreigners to establish a domestic partner so that said technology can be replicated by a Chinese domestic firm and sold into the Chinese domestic market. Western manufacturers volitionally accept this situation. A situation they don't seem to accept anywhere else.

So we are not spinning China into the bad guy here. Hat's off for playing the West like a violin.

That said, any disruption to the China-US trade relationship could rock markets big time. But, given the power behind the status quo, the tire dispute will likely fade from memory as just another Western anti-trade action. And so it goes.

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