Beyond Tariffs: Rebalancing the US-China Deficit through Strategic Capital Integration

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Motivation: US-China Imbalance & Divided Approaches in the US

- Despite the 2018 Trade War and "Liberation Day" tariffs, the bilateral deficit remains structurally high
- The underlying capacity gap remains:
  - * **US:** Excess demand and capacity constraint (Expenditure > Production)
  - * **China:** Overcapacity (Production > Expenditure)

The current policy divide in the US:

1. The *Populist* approach

(Priority: Labor interests / common people)

- **Tool:** Broad unilateral tariffs against China and global imports.

2. The *Globalist* approach

(Priority: MNE profit / global capital)

- **Tool:** Pressuring China to boost consumption with a coalition (e.g., WTO); diversification of supply chains.

Limitations of Existing Policies

- **Key issue:** Current policies are contractionary (controlling capacity). They attempt to rebalance by suppressing trade or raising costs in a fragile, liquidity-constrained global economy
- Tariffs lead to inflation and diversion to other exporters (e.g., Vietnam, Mexico), without adding US industrial capacity
- Forced Chinese consumption leads to more expensive exports to US
- Rebuilding supply chains from scratch (“friend-shoring”) incurs massive fixed investment costs. Productivity is lowered due to loss of agglomeration economies

- **Proposition:** The most economically efficient way to shrink the trade deficit is to transform **Chinese surplus** into **US production** via FDI
- **The US Imbalance (Deficit):** $Y_{US} = C_{US} + I_{US} + G_{US} + \underbrace{NX_{US}}_{-}$
- **The China Imbalance (Surplus):** $Y_{CN} = C_{CN} + I_{CN} + G_{CN} + \underbrace{NX_{CN}}_{+}$
- If China invests NX_{CN} in the form of FDI in US, US will have more capital. Y_{US} will increase relative to $C_{US} + I_{US} + G_{US}$, then NX_{US} will shrink over time
- **The Mechanism:**
  * **Status Quo:** China produces goods $\rightarrow$ Ships to US (Deficit).
  * **Rebalancing:** China builds factory in US $\rightarrow$ Sells locally (No Deficit)

Why Increasing Capital Flow is Superior to Blocking Trade Flow

- **Macro stability: Expansionary & liquidity enhancing**
  - Unlike tariffs or forced consumption increase in China, FDI injects liquidity
- **Debt sustainability: Equity over debt**
  - **Status Quo:** The US finances its deficit by selling treasuries (debt)
  - **Proposal:** FDI finances the deficit via equity (ownership)
- **Geopolitical stability**
  - Assets in the US serve as a geopolitical buffer. China is less likely to disrupt a US economy where it holds significant illiquid fixed assets
- **National security:** US has better control over a Chinese factory in Michigan than in China/US geopolitical rivals
- **Local job and fiscal revenue generation**

Past Lessons: From Japanese Automakers to TikTok

- **Success:** Japanese auto manufacturers (Toyota/Honda) built factories in the US South during the 1980s trade tensions
  - Created local jobs
  - Gained political protection from US Senators in "Red States"
  - Market expansion mitigated the weak demand in Japan and Yen appreciation
- **Uncertainty:** TikTok is still stuck in US–China geopolitics
  - A US law says TikTok must be sold to a non-Chinese owner (or shut down in the US)
  - A US-controlled structure is negotiated. Enforcement has been extended (Dec 2025)
  - The biggest problems: who really controls TikTok (especially its recommendation algorithm) and whether China will approve any deal
- **Why it matters:** The TikTok case will likely become a model for how future US–China investment deals are handled

Implementation Difficulties: New Legislations Targeting Bilateral Capital Flows

- Examples of restrictions affecting Chinese investment in US
  - **FIRRMA (2018):** Expanded Congress review authority, widening scrutiny of deals in sensitive sectors and certain non-controlling investments
  - **IEEPA-based executive actions (2020):** Attempts to restrict TikTok/WeChat via emergency authorities (frequently challenged in court)
  - **Secure Equipment Act (2021):** Restricted authorization of communications equipment on US networks
  - **State-level examples:**
    - **Florida (2023):** Limits on property purchases by some foreign nationals in designated areas (e.g., near military bases/critical infrastructure)
    - **Montana (2023):** Statewide TikTok ban (later blocked by a federal court ruling)

Implementation Difficulties: New Legislations Targeting Bilateral Capital Flows

- Examples of restrictions affecting US investment in China
  - **Broadened sanctions list (SDN, CMIC):** Banned US investment in listed companies (e.g., DJI)
  - **Holding Foreign Companies Accountable Act (2020):** Forced Chinese firms to delist from US stock exchanges if they failed US audit inspection
  - **Uyghur Forced Labor Prevention Act (2021):** Heightened compliance burden for US investment in manufacturing sector in China (e.g., solar polysilicon)
  - **Outbound investment controls over tech (EO 14105, 2025):** Banned US PE/VC investment in China's advanced technologies
  - **State-level examples:**
    - States like Indiana, Florida, Missouri, and Texas have passed laws or directives requiring state pension funds to divest from Chinese assets

Implementation Difficulties: Policy Uncertainty Discourages Investment

- **Public speeches by US officials increase perceived risk for Chinese investors**
  - *"Chinese-made smart cars may be collecting data every minute" on "millions" in the US.* — Commerce Secretary Gina Raimondo (2024)
  - *"Chinese garlic is a national security risk."* — Senator Rick Scott (R–FL, 2023)
- **State links raise scrutiny:** Many major Chinese firms have some state ownership/ties, making them easy targets in geopolitical tensions
- **Long horizons vs short politics:** Chinese capital often targets long-term goals (market share, supply-chain ecosystems). These plans are vulnerable to shifts in US administrations and rules.
  - **Populist policies:** emphasis on jobs, labor interests, and domestic winners
  - **Globalist policies:** emphasis on multinational profits, cross-border capital, and international coordination

Conclusion: Rebalancing requires Recoupling, not Decoupling

- Tariffs disrupted supply chains and weakened the global economy
- **Tariffs did not address the core of the imbalance problem:** capacity constraints in the West vs overcapacity in China
- **In principle, US openness to Chinese industrial capital could raise efficiency,** but in practice it is limited by legislative restrictions and administrative uncertainty
- **Policy Recommendations:**
  - **Begin with *greenfield*:** Manufacturing projects in non-strategic sectors
  - **Clarify the review rules:** Replace vague “National Security” threats with clear lists of “Go/No-Go” sectors to reduce uncertainty
  - **The EU model:** The US should observe Europe's approach (e.g., BYD in Hungary) to manage risk while accepting capital.