

**Saturday July 14th**



## **The road to war: China's kryptonite - Part 2**

*As a general rule, the most successful man in life is the man who has the best information*

Many a comparison has been made between Donald Trump and Ronald Reagan, with the two presidents sharing a flare for the limelight (Trump as reality TV star and Reagan the former Hollywood actor), both seeking to strengthen the United States following a period of real and perceived global leadership weakness, and the two men using the military as a tool for regaining American power (the major difference between the two Presidents is that Reagan was profoundly pro-immigration and cared deeply about individual freedom, Trump not so much).

But Trump and Reagan have something else in common, and that is the shared belief that the United States faces an enemy it needs to take down a few pegs, and ideally, destroy. In Reagan's case it was the USSR; for Trump, it's China. As evidence of their shared purpose, consider Reagan's famous ["evil empire" speech of 1983](#), and Trump's recent [speech at the World Economic Forum](#) in Davos, where he took direct aim at China in his comments:

*"The US will no longer turn a blind eye to unfair economic practices including massive intellectual property theft, industrial subsidies and pervasive state-led economic planning. These and other predatory behaviours are distorting the global markets and harming businesses and workers not just in the US but around the globe."* US President Donald Trump, January 2018

*"Yes, let us pray for the salvation of all of those who live in that totalitarian darkness—pray they will discover the joy of knowing God. But until they do, let us be aware that while they preach the supremacy of the State, declare its omnipotence over individual man, and predict its eventual domination of all peoples on the earth, they are the focus of evil in the modern world .... So, in your discussions of the nuclear freeze proposals, I urge you to beware the temptation of pride—the temptation of blithely declaring yourselves above it all and label both sides equally at fault, to ignore the facts of history and the aggressive impulses of an **evil empire**, to simply call the arms race a giant misunderstanding and thereby remove yourself from the struggle between right and wrong and good and evil."* US President Ronald Reagan, March 1983

Trump of course has had it in for China ever since he stated his intention to run for President - railing against Beijing for unfairly keeping its currency low, allowing cheap Chinese exports to erode US market share, and causing the flight of US jobs to Chinese sweatshops that produce goods America used to make and selling them back at rock-bottom prices. The end result has been a climbing US-China trade deficit last measured (in 2017) at \$375 billion.

Reagan's enmity towards the USSR was on the other hand driven by ideology and straight real politik - not economics. The former California governor is often credited for collapsing the Soviet empire by causing an arms race the Russians were too weak to win. While that is debatable (many argue the Soviet Union's implosion was wholly internal), it is safe to say that Reagan lit the match that caused the USSR to explode. The more interesting question in today's context, is whether the Trump Administration has the ability to break China's back, just as Reagan did to the USSR. An attempt certainly seems to be on its way. This article is all about Reagan, Trump, and how the US could win a trade war against China. A clue: What's for dinner?

## **Reagan and Russia**

Thirty-five years ago the world was quite a different place, with the US and the Soviet Union locked in a seemingly interminable Cold War. It was a war the West

appeared to be losing, with Marxism on the march. In 1980 martial law was declared in Poland, the Soviets had invaded Afghanistan (where Osama bin Laden, a rich young Saudi, used his money and influence to back the mujaheddin), and the Russians were successfully projecting power abroad through the Marxist Sandinistas in Nicaragua and Communist governments in Angola and Mozambique.

The Soviet Army also aimed SS-20s, intermediate-range ballistic missiles armed with nuclear warheads, at European cities, without encountering resistance from Western governments or NATO, the organization designed to curb Soviet aggression. Into this climate of fear, in 1981 Ronald Reagan was elected the 40th President of the United States.

Straight away, Reagan showed he would play the Soviets differently than previous Presidents who tried to pursue a policy of detente which would supposedly merge Communism with democracy. Reagan reportedly told a visitor in 1977 that he had a simple solution to the problem: "We win, they lose." In 1982 during a speech to his alma mater he called for the end to the Soviet empire which was "faltering because rigid centralized control has destroyed incentives for innovation, efficiency, and individual achievement."

His strategy for beating the Russians was based on three national security directives:

1. Use covert groups to support anti-Soviet groups in Eastern Europe including Poland.
2. Disrupt the Russian economy by attacking its financial credit system, high technology and natural gas.
3. Replace co-existence with the Soviet Union by seeking every opportunity to change it and roll back its influence.

A key pillar in his military tactics was the Strategic Defense Initiative aka "Star Wars" - a network of anti-ballistic missiles that could effectively shoot down ICBMs and submarine-launched ballistic missiles, including the use of space-

based lasers. The idea was to replace the previous doctrine of "mutually assured destruction", which Reagan thought to be suicidal, with technology that would render nuclear weapons obsolete.

In 1985 the reformist Mikhail Gorbachev became chairman of the Soviet Politburo after the death of hardliner Yuri Andropov. Over the course of five summits between 1985 and 1988, Reagan convinced Gorbachev that the Soviet Union could not win an arms race so would therefore have to make peace with the West. In 1989 the Berlin Wall tumbled, beginning the cascade of falling dominoes that led to the implosion of the USSR.

The conservative [Heritage Foundation](#) recalls the effect that Reagan's first mention of the Soviet Union as an "evil empire" - an exceedingly bold statement at the time - had on prisoners in Siberia, and Lech Walesa, leader of the Solidarity movement in Poland:

*The Soviet dissident Natan Sharansky was in an eight-by-ten foot cell in a Siberian prison in early 1983 when his Soviet jailers permitted him to read the latest issue of Pravda, the official Communist Party newspaper.*

*Splashed across the front page, Sharansky recalled, was a condemnation of Reagan for calling the Soviet Union an "evil empire." Tapping on the walls and talking through toilets, political prisoners spread the word of Reagan's "provocation." The dissidents were ecstatic. Finally, Sharansky wrote, the leader of the free world had spoken the truth--a truth that burned inside the heart of each and every one of us.*

*Lech Walesa, the founder of the Solidarity movement that brought down Communism in Poland and prepared the way for the end of Communism throughout Eastern and Central Europe, put his feelings about Reagan simply: "We in Poland...owe him our liberty."*

*So too do the many millions who lived behind the Iron Curtain and were caught up in one of the longest conflicts in history--the Cold War--which, because of*

*leaders like Ronald Reagan, ended in victory for the forces of freedom.*

Did Reagan break the back of the Soviet Union? The historical record is mixed. A 1994 [article in The Atlantic](#) says that contrary to the popular belief that increased US military spending forced the Russians to expend more on their military, thus breaking the Soviet economy, is false; Russian military spending throughout the 80s remained constant according to the CIA, and did not increase substantially until 1989. States the Atlantic:

*“Gorbachev’s determination to reform an economy crippled in part by defense spending urged by special interests, but far more by structural rigidities, fueled his persistent search for an accommodation with the West. That persistence, not SDI, ended the Cold War.”*

The left-leaning [Huffington Post](#) quotes author Jonathan Weiler, writing in a 2004 op-ed about Reagan’s effect on the Soviet Union’s collapse, that the SDI program at first was an impediment to arms control negotiations, but then when Gorbachev was told by his key scientific advisor that SDI would not work, he was less resistant to making a deal. “Once Gorbachev stopped worrying about SDI, significant arms reduction ensued,” states Weiler, noting that this paved the way for the 1987 INF treaty that eliminated Intermediate Nuclear Forces in Europe.

Others argue that the over-allocation of Russian resources towards its military, which represented 30 to 40% of GDP, without an economy the size of the United States or its technology, was a problem that dogged the Soviets since the 1970s.

In his book [Reagan at Rejkjavik](#), author Ken Adelman argues the doubling of US military expenditures under Reagan, from \$142 billion to \$286 billion, led the Soviets to believe they could not win an arms race. SDI was therefore the “straw that broke the Communist camel’s back”. A 2014 book review states:

*SDI was a complement to nuclear force reduction in Reagan’s plan to prevent a final confrontation with communism from triggering mass murder. Adelman argues, however, that it was more than that, “SDI became the straw that broke*

*the Communist camel's back." It "hit the USSR in its solar plexus" writes Adelman. "The Soviets lacked the technological infrastructure to compete in such a sophisticated realm. And, as Gorbachev admitted to the Politburo, the country was maxed out on defense spending." Reykjavik convinced Gorbachev that Reagan would never give up SDI, and that "SDI pushed Gorbachev to become more determined, even frantic, to reform his system." In short, the specter of SDI pushed the USSR into the abyss. The Reagan arms race drove events; not to war but to victory.*

## **The new enemy**

Today of course, Russia is a shadow of its former self, and despite recent interference in global affairs including nerve gas poisoning incidents in the UK, hacking of the US and other Western elections, and the annexation of Crimea, in the Ukraine, presents no real threat to the United States.

In terms of GDP per capita, Russia is a third world country, at \$8,200 versus the US at \$52,000. We have said that if the Western powers really wanted to finish off Russia, [all they would need to do is boycott its oil sales](#); 36% of Russia's federal budget comes from oil & gas revenues, and two-thirds of its exports. Russia could retaliate with force, but its conventional military is no match for the United States.

As far as China, recent maneuvers in the South China Sea demonstrate that [Beijing is willing to flex its muscles in a region it sees as strategically and economically important](#). Why the South China Sea? China is energy-starved and the areas off the coast of the Philippine province of Palawan are oil rich.

The United States has tried to counteract China's growing dominance – which includes building military bases on new, reclaimed islands constructed from tiny rock outcrops – but without much success.

China is also losing patience with Taiwan, which it has claimed as its own ever since former Chinese President Chiang Kai-shek and his Kuomintang followers fled

to the island in 1949. Beijing under the leadership of increasingly authoritarian President Xi Jinping's (reappointed with no term limits) at the 19th Communist Party Congress said China must take control of Taiwan by 2050 at the latest, or as early as 2020. The US backs Taiwan militarily but a Chinese official said in February that it will not allow American warships to dock there. A forced reunification between China and Taiwan would almost certainly cause a war between China and the US; the Americans would never allow Taiwan, a key tentacle of US influence, to be overtaken by the Chinese.

Recently Chinese [overseas acquisitions of metal mines have switched from Africa to Latin America](#) - the backyard of the United States, where the Monroe Doctrine held sway for decades. Its quest for control of lithium in Chile is one way that [China is aiming to lock up resources for the new electrified economy](#).

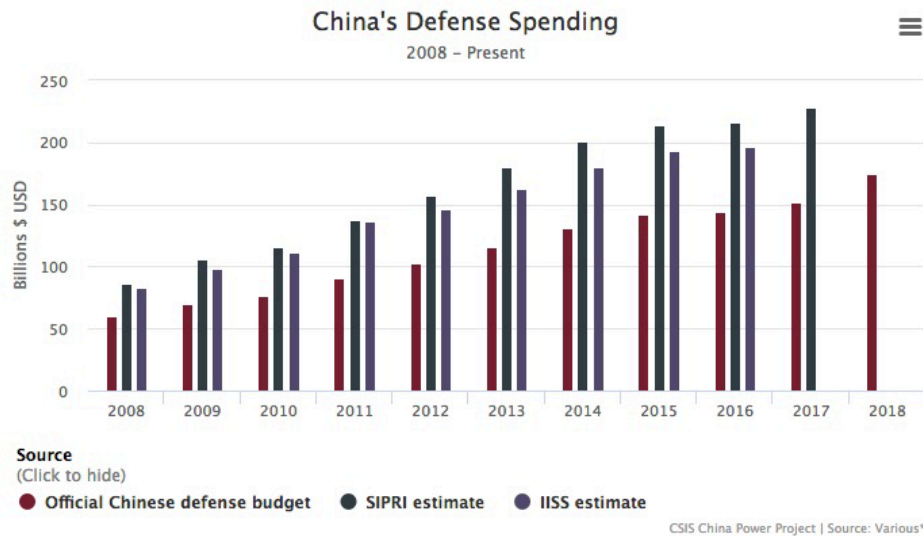
### **But nothing like the threat Russia was**

While many have mused at the idea of China challenging the US militarily, that isn't going to happen. To beat the United States, China would have to project its military power, and it's currently unable to do that. China has one aircraft carrier, the United States Military has 19. The United States maintains 800 military bases in over 70 countries. China just opened its first one, in Djibouti. The plans for China's J-31 jet and J-20 stealth fighter were obtained through espionage; the designs and electronic data were stolen from the US. The Chinese will never achieve military superiority by copying previous-generation military equipment that has not been tested or battle-hardened.

While the Chinese are apparently modernizing their military and [increased military spending by 8% this year](#), it's a drop in the bucket compared to what the US spends and the military equipment it has at its disposal. The increase puts the Chinese defense budget at \$173 billion - a quarter of the planned US defense budget next year of \$716 billion. China's military spending is 1.9% of GDP compared to 3.3% in the US.

Interestingly, [the Diplomat did a direct comparison between the military spending](#)

[of Russia and China](#), to see whether China faces the same vulnerability to its economy that Russia did during the Cold War. The article was written in 2013 so it's a bit dated, having not accounted for the military buildup that occurred since 2008. (see [chart below](#) - the black and grey bars are higher estimates from the Stockholm International Peace Institute (SIPRI) and the International Institute for Strategic Studies (IISS)).



The conclusion? There is no comparison:

*"Even during the past decade of rapid increases to defense spending, the official defense budget has held steady at roughly 1.3-1.5 percent of GDP—when calculated based on high-end foreign estimates of actual total defense spending during the same period the figure still falls between 2 and 3 percent of GDP."*

*For all the talk of new aircraft carriers, advanced missiles, and a blue-water navy, China's military modernization is nowhere near Soviet levels or anywhere near where it could harm its economy."*

Still, there is evidence that Chinese military prowess is increasing - enough to merit some concern on the US's behalf, particularly regarding the South China Sea and Taiwan. Jane's Defense Weekly reported at the end of June that China [launched two new destroyers in Dalian](#); on the same day the [Xinhua state news agency](#) quoted the Chinese President telling James Mattis, US Secretary of



Defense, that Beijing will not give up “any inch of territory” in the South China Sea.

“Our stance is steadfast and clear-cut when it comes to China’s sovereignty and territorial integrity... Any inch of territory passed down from ancestors cannot be lost while we want nothing from others.”

## **Preparing for war**

How has the Trump Administration responded to this newly aggressive China? As we have argued, [Trump is building the American economy - through protectionist measures that put America first](#) - in order to protect US industries including the steel industry it considers strategic for war-making.

In arguing for the implementation of import tariffs on steel and aluminum in March, the Commerce Department said that US dependence on steel imports puts the country in a position where it would be unable to meet demands for national defense and critical industries in a national emergency.

During the Korean War President Harry Truman seized the US steel industry to maintain production for the war effort, and during World War II, citizens were asked to donate their automobile bumpers to make scrap steel.

Like Reagan, Trump believes in peace through strength: *Si vis pacem, para bellum*. While Reagan’s evil empire was Russia, Trump’s is China. Towards this end, Trump has requested \$686 billion for defense in the coming fiscal year. This includes expanding the Navy from 280 to 355 ships, restoring funding for a Boeing fighter jet favored by the President, and boosting missile defense to counter threats from North Korea and Iran, [reports Fortune](#). The latter would increase about 25% from Obama’s Administration, to \$9.92 billion.

## **Tariffs: the first salvo**

On March 1 Donald Trump announced that his Administration would implement a

25% tariff on all steel imports and a 10% duty on aluminum.

Chinese steel companies, which produce half of the world's steel, have long been a target of US import duties, and the 25% tariff was clearly aimed at them. There are currently 169 antidumping and countervailing duty orders on steel, with 29 of them against China.

The trade spat escalated into \$150 billion worth of tariff threats from either side. At issue is not only the trade deficit with China last calculated at \$375 billion, but the theft of US intellectual property, which American companies must hand over as a condition of access to the 1.4 billion population Chinese market.

For several weeks the tariff threats were just that, but now the trade war is real. On July 6 the United States and China each imposed \$34 billion worth of tariffs on the other country's imports. That includes imports of US cars, soybeans and seafood. Economists say it could cut percentage points off China's economic growth. [The US and the EU have also imposed tariffs against one another.](#)

While media coverage in the West focuses on the effects of the tariffs on US consumers (ie. rising prices), a [video posted](#) the day before tariffs were imposed shows Chinese consumers in grocery stores complaining about more expensive American grocery items.

Beyond the price rises, though, there is something deeper going on in this economic war between China and the US. As the chart below shows, Chinese GDP is now nearly two-thirds that of the US, and it's making US policymakers nervous. [Bloomberg notes](#) US Defense Secretary James Mattis labeled China a "strategic competitor using predatory economics" when he unveiled the Pentagon's National Defense Strategy in January.



While the Trump Administration has been called mercantilist for introducing such stiff tariff penalties on its trading partners, China is acting the same. President Xi Jinping is trying to rejuvenate the nation (the Chinese version of MAGA) by doubling China's per capita GDP by 2021 and turning the country into a tech powerhouse including being a leader in artificial intelligence. China has matched US tariff threats at every stage of the escalation.

States Bloomberg:

*The aim is to produce global champions -- not just national ones -- and Xi's government is ready to use the commanding heights of its one-party state to steer subsidies and use preferential policies and ambitious local content rules favoring Chinese companies to get there.*

## Feeling the pain

As we mentioned in [The road to war, China vs US - Part 1](#), even before the tariffs kicked in last Friday, the threat of billions worth of levies on either side caused a major quake in the stock markets, with both the Dow and the S&P 500 plunging. The Chinese yuan hit a six-month low against the dollar and Chinese stocks lost so much value a bear market was declared.

The burning question, though: Can the US win a trade war with China? What weapons does each nation have at its disposal?

In the US corner, it has been claimed repeatedly that the size of the US economy versus China's (\$19 trillion versus \$12 trillion) will eventually beat China into submission.

On the other side are those who claim that Trump's tariffs will punish American companies and consumers more than the Chinese, considering that it's mostly a one-way trade of cheap imports from China. The US-China trade deficit is \$375 billion (the US buys \$375B more in goods and services than it exports to China).

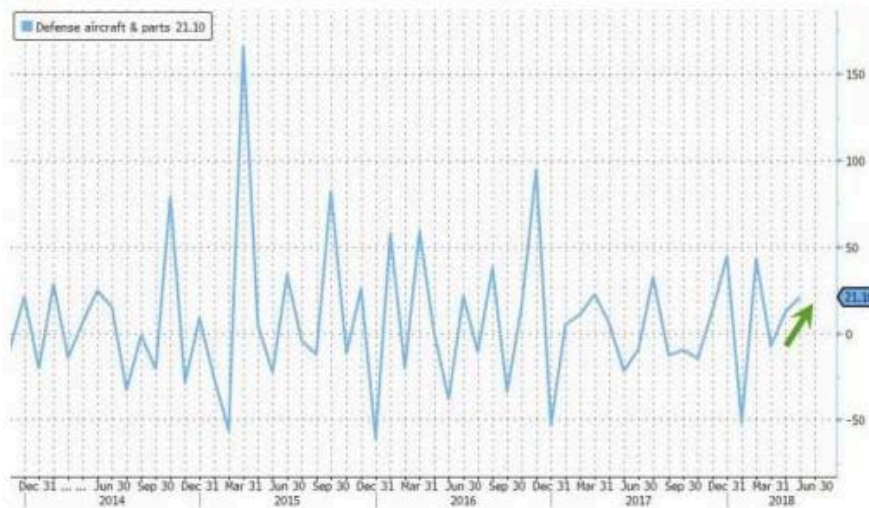
There is evidence of pain on either side even before the effects of \$34 billion worth of tariffs start trickling through both economies. (Trump [just threatened another \\$200 billion of tariffs](#))

In the United States:

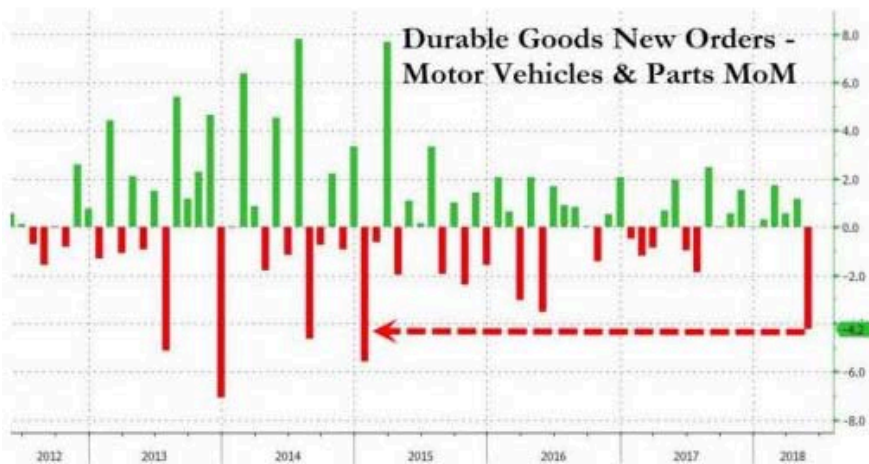
- Stock markets have been hurt, although they have recovered this week heading into earnings season. Mining stocks are particularly down, due to the threat of waning demand for metals from top commodities consumer China once tariffs bite. Copper for example is down 16% from a June high.
- Orders for US durable goods (those that last up to 3 years) were down in May and June. Steel and aluminum is more expensive due to tariffs implemented in March.
- US factory orders were slightly up in May, but would be down if defense orders are taken out of the equation, states ZeroHedge. Manufacturers are complaining about the higher cost of steel. Defense aircraft and parts were up 21% in May but new orders for automakers were at their lowest since January 2015.

### Which economy is booming America?

Defense Aircraft & Parts were up 21.1% MoM...



But automaker new orders plunged most since Jan 2015...



War is a racket, indeed.

- The US dollar is climbing, making American exports more expensive.
- Farmers are upset that the threat of Chinese countervailing duties on US agricultural products have already cut prices. [Among the most important exports to be affected are pork, cheese, wheat and soybeans.](#) China stopped buying US wheat last March, unwilling to accept the threat of rising prices.

For China, the effects are being felt in:

- A low yuan, which is the Chinese government's defense against the

trade war - keeping goods competitive. The yuan is dropping to levels not seen since last August. This is good for exporters but bad for importers of US products.

- In June China' manufacturing PMI fell to 51.5, versus 51.9 in May, indicating a slowdown in the economy.
- A sub-index of new export orders fell to 49.8 from 51.2, signaling weakening demand from other countries.
- Chinese companies are concerned about slumping sales due to higher prices of US products.

[AFP notes](#) that China could impose other weapons of trade war if it doesn't like the effects of the tariffs. These include boycotts on specific brands or stores (in 2017 South Korean retailer Lotte shut 75% of its shops in China due to a consumer boycott because Lotte had provided land to deploy an American anti-missile defense shield that China opposes); delaying US imports through ramped-up inspections; limiting the number of tourists and students that go abroad; scaling back its purchase of US Treasury bills; depreciating the yuan; and lifting sanctions on North Korea.

But according to an [op-ed in The Daily Beast](#), China's economic power against the US is overstated and it actually has more to lose than the United States. Gordon Chang writes that China will lose a trade war against the US for four reasons. First, because China is more dependent on the American market than previously. In 2016 just 68% of China's merchandise trade surplus related to US sales; in 2017, it was 88%. Countries with trade surpluses generally get hurt more in trade wars.

Second, the size of the American economy versus China's, as noted above, means the US can dictate terms. And third, while many like to think of China as "the Walmart" of the Western world, in fact this is no longer the case. The lowest-cost producers are now countries like Bangladesh, El Salvador and Nicaragua. Finally, the American economy, writes Chang, is more stable than China's, which is verging on a debt crisis - with a debt to GDP ratio of between 350 and 400%. China is scared of capital flight, which happened in 2015-16 (to the tune of \$2.6

trillion). Many think that China can hurt the US by selling Treasuries (China is the largest holder of T-bills) but Chang argues it's been selling them since 2014 to prop up the yuan and that hasn't had any impact on the US's ability to finance its deficits. In the end, the US will win:

*China's [Ambassador to the US] Cui can threaten selling greenbacks in response to Trump's tariffs ... but his government either has to dump dollars or clamp down even harder on money flows. Clamping down can only work in the short term, so dollar sales will eventually occur, whatever Trump does or does not do on trade...*

*In short, Trump holds the high cards when it comes to China, and, unlike his predecessors, he knows it.*

## **China's kryptonite**

The world was shocked when Chinese tanks rolled into Tiananmen Square and soldiers fired live ammunition, killing hundreds of students protesting against the government and pushing for greater democratic reforms. But a deeper reading of Chinese history shows that China has consistently been led by authoritarian rule, albeit with frequent challenges to its control. In practically every dynasty there have been revolts, rebellions and uprisings. During the Qing dynasty, which lasted almost 300 years from 1644 to 1912, there were no fewer than nine uprisings, including the Boxer Rebellion of 1900 when 230 foreigners and thousands of Chinese Christians were killed.

The Chinese government fears popularized discontent where it could lose control of the 1.4 billion population, spread over a vast territory and including numerous ethnic minorities whose religions and cultural beliefs have not meshed with the majority Han culture and government in Beijing (Eg. Tibetans, Uyghur Muslims). Even the presence of a seemingly benign spiritual sect known as Falun Gong, which attracted tens of millions of supporters, was enough for the Chinese government to [ban the group in 1999 after organized protests by the group for being criticized by the government as dangerous "feudal superstition."](#)

This is the reason that China cracks down on dissidents - much to the West's dismay and lack of understanding. Consider this: While protests against Trump in early 2017 drew upwards of 100,000 participants, the number of students and other protesters in Tiananmen Square in 1989 was estimated at a million. That is a very large number of people to suppress.

The Chinese Communist Party is well aware that a trade war with the United States could have very negative repercussions on its economy not to mention President Xi's plan to "Make China Great Again" through his consolidation of power at three levels: the nation, the party and himself. [In the words of Project Syndicate:](#)

*Xi is determined to defy the trend-line of Western history, to see off Francis Fukuyama's "end of history" culminating in the general triumph of liberal democratic capitalism, and preserve a Leninist state for the long term.*

*This approach – known as "[Xi Jinping Thought](#)" – now suffuses China's foreign policy framework.*

The greatest threat to Beijing's plan to secure its place in the world comes from within, through its own people. How could this happen? The most direct path to a confrontation between the people and the Communist Party leadership is through measures that could dial back China's progress towards a growing middle class whose wealth and strength is catching up with the United States. We are talking here about **food security**.

Between 1959 and 1961 China's system of food production completely broke down and led to [The Great Chinese Famine](#). Tens of millions of people are estimated to have starved to death from a combination of then Chairman Mao's failed agricultural policies and a drought. Coinciding with The Great Leap Forward, Mao banned private farms, forcing the collectivization of agriculture, and borrowed planting techniques from the Soviets such as close planting and deep plowing. But planting close together made species compete with each other, dragging down yields, while in shallow, rocky soil, deep plowing buried fertile topsoil and stunted seedling growth. By 1960, grain production fell 70% to its



level two years earlier. Crop production decreased from 200 million tons in 1958 to 143.5 million tons in 1960.

The Chinese government must have watched with trepidation the events of the Arab Spring, which was triggered by bread riots. When grain prices spiked in 2007-08, the price of bread in Egypt rose 37%. But the Egyptian government did nothing to make more bread available to the masses (bread means "life" in Egyptian), and food price inflation spiked to 18.9% before the fall of President Mubarak, [The Guardian reminds us](#).

How secure is China's food supply now and what could the effects of Chinese tariffs on US agricultural imports mean for it? The modernization of China has had a dramatic effect on the percentage of under-nourished Chinese. According to the Food and Agriculture Organization, this number dropped from 23% in 1990 to 9% in 2015. [The China Power Project](#), a report from the Center for International and Strategic Studies, makes the correlation between lower under-nourishment rates and per capita income which has skyrocketed 2,000% in the same period.

### **Climbing the Protein Ladder**

But while China is striving for food production self-sufficiency, it is vulnerable in grain. Over the last 40 years grain consumption has doubled but all of its production is consumed domestically. Compare that to the US, which produces around 1.5 times as much grain and rice as it consumes, Brazil, which produces twice as much wheat as it consumes, and Australia, where the the ratio is 3:1.

There has been a dramatic rise in meat consumption in China as incomes rise and people move out of the countryside and into cities. Rural populations eat a mostly grain-based diet. According to the China Power Project, consumption of meat has gone from 7 million tons in 1975 to 75 million tons in 2016. China is now the largest consumer of meat in the world - a key reason for the rise in meat prices over the years.

The change of diet among newly prosperous, urban populations in developing countries is the most important factor stoking the rise in global food demand. A

rising income means more money in the household budget. The new middle class consumers forgo plant based calories in favor of adding more protein from meat and dairy products to their diets. It takes up to 8 kilograms of grain to produce one pound of beef - less for pork, chicken, milk or eggs - between 2kg and 6kg. As meat consumption soars, more grain is needed to feed more livestock.

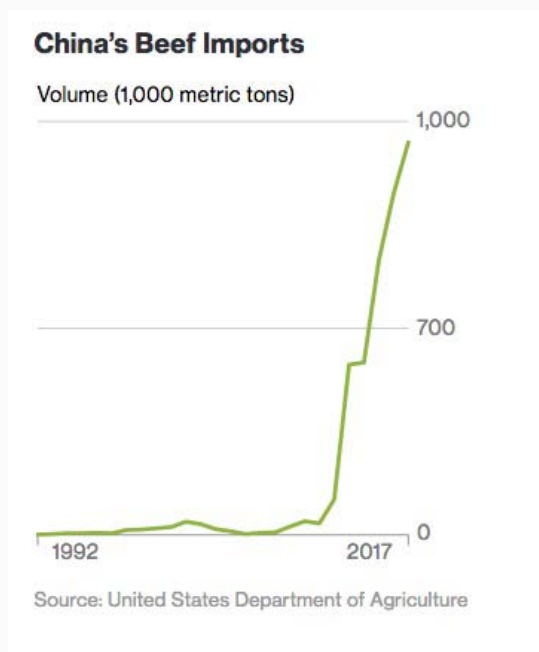
In 1995, the Chinese ate an average of 25kg of meat per person, by 2007, the Chinese were consuming 53kg of meat per person.

Enlarging and diversifying the meat supply is a first step for every developing country.

The Protein Ladder:

5. Grain fed beef
4. Grass fed beef
3. Milk, other dairy products
2. Pork
1. Chicken and eggs

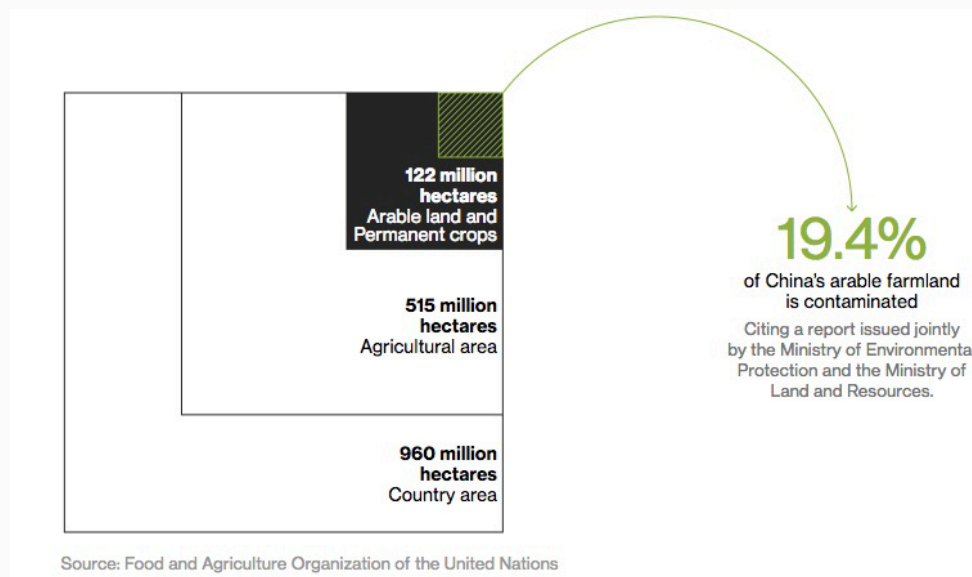
Rice, beans and bread



In response to this exploding demand the Chinese government has tried to intensify agricultural production, by paying out billions in agricultural subsidies and in particular supporting imports of productive animal breeds.

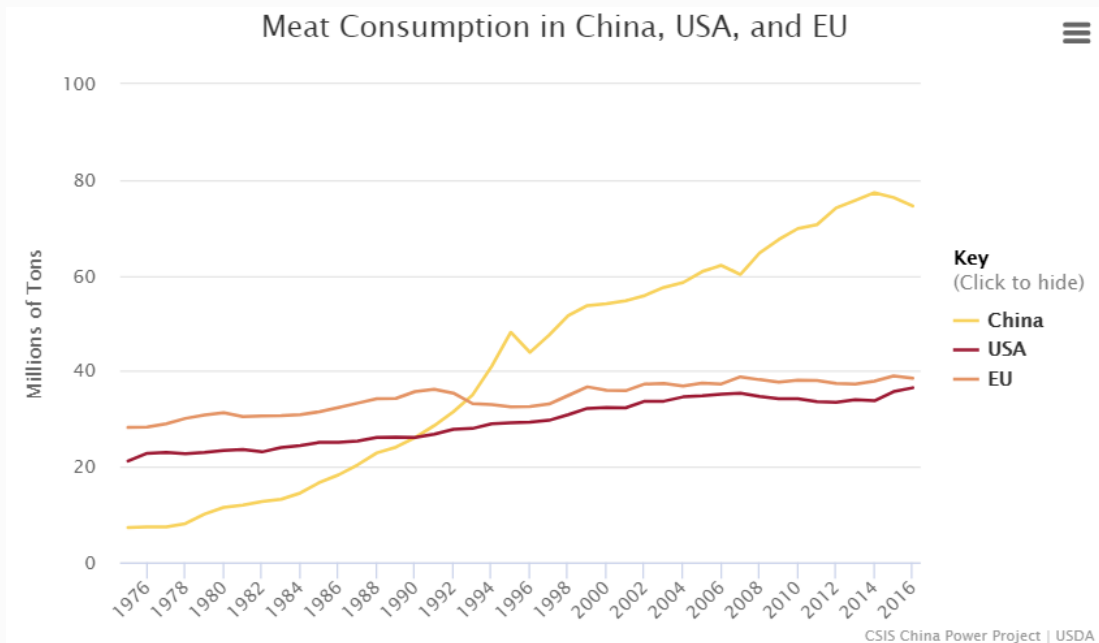
However mistakes like having farmers grow on unsuitable land and subsidizing food that would be cheaper to import has led to unsustainable farming practices. Only 0.19% of acres per capita are arable. According to The Economist Intelligence Unit the country was ranked 17th out of 25 for sustainable agriculture. Germany was number one.

Add to this the environmental damage inflicted on the land due to pollution. [Up to 13 million tons of crops have been tainted with heavy metals and almost a sixth of China's land base contains contaminated soil due to toxic runoff.](#) The Global Food Security Index ranked China 40th out of 113 countries in terms of food quality and safety. Nearly 60% of China's underground water is unsafe for drinking without treatment. Highly publicized scandals like melamine-laced milk and cadmium-laden rice have eroded trust in China's food supply.



This has led to an increased push on agricultural imports, and here is where the tariffs could hit China the hardest. In the decade between 2005 and 2015 China's food imports increased 50-fold, from \$6 million to \$300 million. It is the world's largest vegetable importer, with soybeans constituting nearly two-thirds of the total.

China is by far the largest buyer of US soybeans - in large part for China's expanding livestock operations where soybeans are used as animal feed. [According to Bloomberg](#), beef sales to China have risen 19,000% in the past decade and imports of soybeans have grown so fast that Beijing dropped them from its self-sufficiency list in 2014.



Increased prices of soybeans imports due to Chinese countervailing duties are sure to concern China's soybean buyers. The higher costs will be passed on to beef producers, meaning beef in grocery stores and restaurants will cost more. But the meat genie has been let out of the bottle and the Chinese are not going back to a diet of rice and cabbage without a fight. This should make Beijing nervous.

The answer could be, just buy cheaper soybeans from Brazil, which exports slightly more of the bean to China than the US, but a recent article addressing this question says it isn't going to happen, for two reasons. First, the seasons are different. In the US, soybeans are harvested and exported in the fall, whereas in Brazil, the harvest is in the spring. This means after September, buyers must shift from Brazil to the US. As important, Brazil doesn't produce enough soybeans to supply the Chinese market. [South China Morning Post reports](#) that China's 97 million tonnes soybean imports in 2017 almost accounted for the entire US and

Brazil harvests which each produced 119 million tonnes. But Brazilian and American producers must save enough soybeans for their domestic markets, which in Brazil amounts to 43MT.

In short, China needs both Brazilian and American soybeans.

## **Conclusion**

The road to war between the US and China is well on its way to being paved. Between economic threats and bluffs being called in the form of \$34 billion in tit for tat tariffs, plus Chinese military expansion/aggression in the South China Sea, the prediction of Steve Bannon that war between China and the US is inevitable may regrettably be coming to fruition.

President Donald Trump's predecessors saw the rise of China as a good thing. Allowing the country to join the WTO was seen as normalizing trade relations with Beijing and "letting it into the club." But China has greater ambitions than status-quo trade. It wants to become the most powerful nation on Earth, and has proven it is willing to bend or break the rules to do so. Trump is the first President to recognize that China is a threat, not a partner, and needs to be dealt with accordingly. Like President Reagan before him, Trump is not interested in accommodation, and sees confrontation with the world's second largest economy as the way to best counter the threat. Will he succeed? It's too early to tell, but we have pointed out some of the weak spots in China's underbelly - its kryptonite if you will. On the top of the list is food security. A shortage of or substantially higher prices for meat - highly symbolic of middle class success in China - could be the thin edge of the wedge that leads to an undercurrent of discontent that Beijing cannot afford to grow stronger. Concessions would then be more easily to wrest from its leadership. I've got the repercussions of the trade war on China's food security on my radar screen. Do you? If not, perhaps you should.

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