A SYMPOSIUM OF VIEWS

Is the U.S.-China Economic Relationship About to Permanently Shrink?

Derek Scissors of the American Enterprise Institute makes the interesting case that after twenty-five years of enormous expansion, both the United States and China will soon reach the conclusion that the relationship involves two incompatible forces.

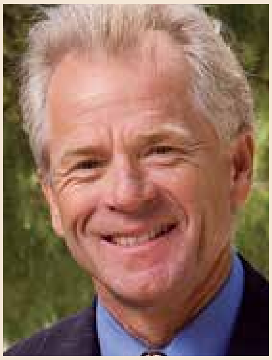
Indeed, Scissors argues that in the current trade dispute, both sides are close to the realization that whatever the deal, no agreement will last. The Trump Administration is a "difficult negotiating partner because it is divided on China goals." The Chinese were incorrectly led to believe that the U.S. trade hard-liners "would be pacified by a few headline deals."

Meanwhile, the Chinese currency since May has plummeted 8 percent against the dollar. The U.S. Foreign Investment Risk Review Modernization Act was just enacted. Since 2016, Chinese investment in the United States has plummeted.

Then there's Chinese President Xi Jinping who, Scissors argues, "has cultivated the image of another Mao rather than another Deng." Translation: A strong-man autocrat who is not a believer in liberalized markets.

Is Scissors correct that the U.S.-China relationship is about to permanently shrink? And if so, how will this change affect the global order, including currency relationships, relative levels of economic performance, and national security concerns?

Twenty distinguished global strategists consider the question, followed by a response from Derek Scissors.



The answer depends on China's willingness to embrace the market-oriented reforms that it promised when it joined the WTO. There can be no half measures here.

PETER NAVARRO
Deputy Assistant to the President and Director of Trade and Manufacturing Policy, The White House

Is the U.S.-China trade relationship "going to shrink," as the American Enterprise Institute's Derek Scissors argues? The answer depends on China's willingness to embrace the market-oriented reforms that it promised to undertake when it joined the World Trade Organization and fully commit more broadly to the principles—and practice—of free, fair, and reciprocal trade.

There can be no half measures here as the stakes are simply too high for America's future. President Donald J. Trump has made it clear he will no longer tolerate China's unfair trade practices, first and foremost its attempts to acquire America's technological crown jewels.

President Trump's 2017 National Security Strategy identified China for the first time as a strategic competitor, and the list of U.S. grievances in the technology space have been extensively documented in the landmark March 22, 2018, Section 301 investigation report published by the United States Trade Representative. Based on this and other public and government information, China's tactics to gain control of U.S. technology include forced transfer, state-directed and state-funded investment in cutting-edge U.S. tech companies, and the cyber-enabled and direct theft of intellectual property, trade secrets, and confidential business information.

In June 2018, the White House Office of Trade and Manufacturing Policy that I direct published a report entitled, "How China's Economic Aggression Threatens the Technologies and Intellectual Property of the United States and the World." This report assessed that China uses more than fifty unfair acts, policies, and practices that range from high tariff rates and non-tariff barriers to transshipment to evade United States antidumping duties. The bulk of these acts, policies, and practices are outside the norms of free and fair trade and disrupt not just the United States, but also the global economy.

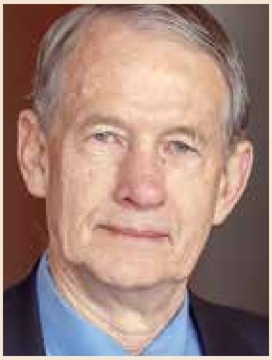
The picture that emerges from the USTR's and the OTMP's analyses is one of a Chinese model that, by construction, derives much of its economic growth at the expense of other nations. The key question, of course, is to what extent China will be willing to give up its unfair trade practices in any "deal" in exchange for continued access to U.S. markets. In OTMP's assessment, a core problem is that even if China ceases engaging in many of the ways that it extracts jobs, technology, and wealth from the United States, there are still many more tools of economic aggression our businesses, workers, farmers, ranchers, and entrepreneurs would have to contend with.

This need not be a stalemate, the pessimism of Scissors notwithstanding, if China take serious steps to address its unfair trade practices. However, the Chinese side continues to deny that it engages in practices such as cyber intrusions and forced technology transfer—despite abundant evidence to the contrary.

At the end of the day, the question is this: Will China be willing to join the ranks of nations that embrace fair and reciprocal trade and live up to the commitments it made to the United States and the rest of the world when it joined the WTO? Under President Trump's leadership, the United States is finally calling China to task, and other countries should do the same. Do not be fooled by China's claims that it is the biggest defender of the multilateral trading system.

The American public and business community fully understand the challenge facing America's long-term competitiveness. After decades of taking advantage of the United States, there is now widespread public understanding that America is being cheated. There is also broad bipartisan support, as well as increasing cooperation amongst U.S. allies such as Japan and Europe, for standing up to China's behavior, particularly on issues related to technological transfer and state-owned enterprise behavior.

President Trump will do what must be done to defend this country. China must address these fundamental market barriers if it wants to continue to expand its economic relationship with us.



My bet is that the United States will suffer as much as China from shrinking economic ties.

GARY CLYDE HUFBAUER
Nonresident Senior Fellow, Peterson Institute for International Economics

Derek Scissors, part-time advisor to the Trump Administration, is known for prolonged animosity to China. His prediction that the U.S.-China relationship will permanently shrink is partly wish-fulfillment and partly forecast that Trump will be re-elected in 2020. Scissors may prove right, and if so that will prove two things: that the White House can turn a major country from adversary into enemy with truculent tariffs and Cold War rhetoric, and that Trump has more staying power than his many scandals might suggest. Given this prospect, the real question is whether America will gain or lose from shrinking economic ties to China.

My bet is that the United States will suffer as much as China. Two-way trade, while orders of magnitude larger than my tribe of Treasury mavens foresaw in the 1970s, still falls well short of its potential magnitude given the economic size of the United States and China. Expanding trade delivers huge supply-side benefits to both parties, through the workings of comparative advantage, economies of scale, the narrowing of mark-up margins, and faster adoption of best practices by laggard firms. Weak U.S. productivity growth, well under 1 percent a year, suggests that the United States needs these tonics more than China. If Alibaba is foreclosed from the U.S. market, who will compete with Amazon?

Two-way direct investment is surprisingly modest and the recently enacted FIRRMA bill, alongside Chinese investment restrictions, will ensure it stays that way. Research by Theodore H. Moran and Lindsay Oldenski shows that Chinese firms operating in the United States pay better wages and conduct more investment and research and development than average American counterparts. As China rapidly evolves from technology imitator to technology innovator, the United States will forego spillover benefits that could flow from the local presence of top-flight Chinese firms. Only a supreme nationalist could believe that U.S. firms will remain best-in-class in every dimension of technology over the next two decades. Yes, in many, but not in all.

Skilled immigration could be another casualty of the Scissors vision. U.S. college applications show the wealth of Chinese talent. If economic ties shrink, student visas may well be tightened, just like H1-B visas, depriving the United States of highly promising scientists, engineers, and entrepreneurs.

Only Peter Navarro's acolytes will celebrate shrinking U.S.-China economic ties—if that's what the future holds. Other Americans should lament the multiple losses that could have become our economic gains.

There should be some bargaining equilibrium that is better for both countries than defecting.

JASON FURMAN
Professor of the Practice of Economic Policy, Harvard University's Kennedy School, Nonresident Senior Fellow, Peterson Institute for International Economics, and former Chairman, President's Council of Economic Advisers

The United States is clearly better off with an economic relationship with China than it would be without. Whatever problems the relationship has, losing access to an export market with 1.4 billion people would be a big loss for our economy and losing access to key intermediate inputs and final goods imports would be even worse. China is also better off with an economic relationship with the United States than it would be without, for much the same reason.

The mutual benefits from the economic relationship mean that there should be some bargaining equilibrium that is better for both countries than defecting. There is a strong case to be made that there is a bargaining equilibrium that would leave both countries better off than they are today. The United States wants China to hew more closely to international rules and norms on equal treatment of foreign investment, an end to forced technology transfer, stronger intellectual property rules, a reduction state subsidies, and the like. These may be exactly the steps China needs to take for its own domestic economic reasons.

Foreign companies are getting increasingly sick of uncertainty in China and are instead investing elsewhere—and when they invest in China they only bring and transfer the inferior technology. As China depends more on the accumulations of ideas instead of just raw capital, intellectual property rules will become increasingly important. Subsidies are increasing debt, especially for provincial governments, and distorting the economy toward the less efficient state-owned sector. In all of these cases, the U.S. demands may well be in China's economic interests—just as China's reformers used the cover of the World Trade Organization accession in 2000 to push for domestic reforms they would have wanted regardless.

Even if China has its own domestic reasons to agree to U.S. demands, however, it does not mean that it will definitely follow through. It may not realize the benefits of further reforms, they could be blocked by powerful interests, or just the appearance of giving in to a bullying United States could be too much.

The other possibility is that the U.S. demands are genuinely zero-sum and, as many Chinese policymakers believe, would only help the U.S. economy by forestalling China's continued rapid economic development. Even if this is true, there still should be a bargaining equilibrium that divides these wins and losses in a way that is superior to the even larger losses both countries would sustain from an extended economic war. But it would be much trickier to find this equilibrium.

In either case, it is important for both sides to come to a better understanding of their leverage. For China, that will require understanding that the problems it faces are not simply going to pass after President Trump's time in office is done but instead are widely shared in U.S. economic, business, and political circles—and by other countries as well.

For the United States, it will require understanding that its already finite leverage will only become more limited over time as the U.S. economy will represent a steadily smaller share of the global economy due to the substantially faster growth rates in economies that are still catching up, most notably China but other emerging markets as well.

I hope that a solution exists that would be better than the status quo *ex ante* for both. I am sure that a solution exists that would be better for both than the status quo *ex post* a major economic war. In either case, however, the challenge will be coming to an agreement around that solution.

Scissors' predictions can come true if U.S. policymakers want. The real issue is pessimistic U.S. ambition and goals.

JIM O'NEILL

Former Commercial Secretary to the Treasury, United Kingdom, and former Chairman, Asset Management, Goldman Sachs International

The very fact that this question is being asked suggests to me that there is something deeply troubling going on in the United States. In terms of the most simple answer, if the United States deliberately chooses to curtail its economic, trade, and investment relationship with China, then of course, it is quite likely that it will succeed.

But why would it do that? What is the likely benefit to the United States? Is the ego of senior policymakers and others so fragile that the very notion of another country having a larger U.S.-dollar nominal GDP than itself is seen as a threat? China (as well as India) has around four times more people than the United States, so unless China were to be in permanent weakness, it is quite likely a country of that size might become the largest economy in the world. But what is more concerning is some sort of presumption amongst some close to current U.S. policy that both this approach will help the United States, and along with it, the United States controls the global trade agenda. Both are highly questionable.

While China today is still only around 70 percent the size of the United States, in terms of relative change so far this decade, of all the increase in nominal global GDP, China is responsible for just over 49 percent of it. The United States is responsible for about one-third of it. Moreover, and what seems to be frequently lost by so many in the United States—except the boss of Apple—is that the Chinese consumer is increasingly driving most of their growth. On the same simple calculations, Chinese consumers have driven around one-fourth of the world's nominal GDP change this decade so far. Smart desirable international companies see this in their business, Apple being a particularly good example. Indeed more broadly, this is why China is now the third most important single export nation for the United States. For at least a decade, China has been more of a marginal driver of global trade than the United States. By the end of 2016, China—if you add total imports and exports—had already become

Germany's number-one trade partner. Germany exports more to China than to its neighbor, Italy. For at least ten years, China has been Japan's number-one export market, despite their history. And I would imagine, in coming years, more and more countries around the world will end up with China as their number-one export market.

Another angle for the United States to think about is the difference between American and Chinese consumers. It is currently fashionable to believe that the United States is once again driving the world economy. The U.S. economy is cyclically very strong, but much of this is primarily because of the one-off consequences of a big fiscal stimulus, especially benefiting U.S. companies.

Beyond this, the United States is stuck with an economy where the consumer is more than 70 percent of its own GDP. This problem is what got the United States into the mess it endured during 2007–2008 when its highly leveraged housing market finally turned around. For much of the preceding twenty years, the world was driven by the U.S. consumer, and international economic policy meetings would justifiably worry about an alternative source, with Germany and Japan usually regarded as possible, desired candidates. Due to their own aging, and lack of policy flexibility, we all know they never materialized to be that force. What is so odd about the timing of this Trump-led aggressive stance on China is that it comes when there is such clear evidence that the Chinese consumer is performing that role. As anyone who travels anywhere can tell, anecdotes of the aspiring Chinese consumer are everywhere, including among sellers of any modern telephone or other technology devices. If the United States had policymaking advisors that thought about their own twenty-year future, I reckon they would pretty quickly focus on the fact that to sustain anything close to 3 percent real GDP growth, maybe anything more than 2.5 percent, they will need investment spending and exports to be more important. And quite simply, without an important consumer elsewhere, it is tough to see this.

Maybe the bigger gripe is China's "Made in 2025" strategy. But while the United States could cite World Trade Organization rules as to why China shouldn't strategically subsidize domestic growth industries, it is a bit difficult for the United States to do this while so openly doubting most of the fashioned rules of international trade of the past thirty or more years, including the WTO. And in any case, as it relates to U.S. opportunities, Chinese success in achieving its long-term ambitions, including ranking the growth of its own consumer as the major priority in the past two five-year plans, should get more attention.

So I am not sure about Derek Scissors' predictions. They can become true if U.S. policymakers want them to, but surely the real issue that leading U.S. think tanks should be focusing on is why on earth would the United States have such pessimistic ambition and goals?

The only thing that can stop China becoming the world's largest economy is China's own government.

JOSEPH E. GAGNON

Senior Fellow, Peterson Institute for International Economics

It was inevitable that the rapid economic development of a country as large as China would cause major disruptions to the rest of the world. Whenever economic change creates winners and losers, it is the losers who grab the headlines. In the United States, China's rise has contributed to job losses, widening income inequality, and divisive politics, as many areas of the country feel left behind.

Going forward, China will not return to the large trade surpluses of ten years ago, nor should the rest of the world allow it to do so. They were the unintended result of an excessive focus on nominal exchange rate stability that led to massive currency manipulation. Issues related to intellectual property, including cyber theft, pirating, and forced technological transfer dominate the agenda. For its own sake, China should improve its behavior, and an agreement in this area ought to be possible.

State-owned enterprises pose a tougher problem. President Xi has made it clear that he wants to enhance the role of SOEs. My colleague Nick Lardy has shown that SOEs in China are getting favorable access to capital despite falling profitability. Private companies inside and outside of China face unfair competition from SOEs that do not have to face a market test for survival. The world needs to decide how to deal with this threat to the trading system. The Trans-Pacific Partnership made a start but much more needs to be done, including within the broader World Trade Organization.

The world has a right to set the terms on which China engages in trade. But it is folly to think that the United States, even with allies, can prevent China's rise. The only thing that can stop China becoming the world's largest economy is China's own government. Any attempt by the United States to impede China's rise will only generate ill will. Moreover, it would not be worthy of the example set by past decades of enlightened U.S. policy that encouraged economic development around the globe. We all benefit from a stable and prosperous world.

Besides confronting China, the United States needs to decide whether it wants to remain open and engaged with the world. The alternative path of tariffs and protection would ossify the U.S. economy and allow the rest of the world to eventually surpass it. Far better for the United States to compete in the world economy, keeping its firms at the forefront of efficiency. But we need to go beyond half-hearted trade adjustment assistance and institute broad training and jobs programs, along with partial wage insurance, to smooth the path back to productivity for workers who suffer from economic disruptions of any type.

Finally, the United States should recognize that it has the tools to correct its longstanding trade deficit without resort to harmful tariffs that have little effect on trade balances anyway. Two actions are needed: First, reverse the massive and ill-advised fiscal stimulus that is sucking in more imports. Second, adopt a balanced dollar policy that guides the exchange rate to a level consistent with balanced trade. Such a policy could be supported by stabilizing intervention in foreign exchange markets aimed at reducing imbalances. Or it could be supported by a modest tax on capital inflows.

The clash is not only over interests but values.

YUEN YUEN ANG

Associate Professor of Political Science, University of Michigan, and author,* How China Escaped the Poverty Trap *(Cornell University Press, 2016)

The idea that the United States and China are two fundamentally incompatible powers is not a fact, but a belief. To be precise, it is a dangerously self-perpetuating belief. This point is so important that it deserves to be repeated three times:

Beliefs make reality.

Beliefs make reality.

Beliefs make reality.

As American policymakers now believe that China is a "revisionist power" and fundamental threat, they respond by containing China, as we now see in the ongoing trade war. Such antagonistic actions confirm long-held beliefs among Chinese citizens that America is bent on undermining their country, leading to inflamed nationalist sentiments that inadvertently strengthen autocratic rule, further deepening fear among Americans. In other words, what we see unfolding is a self-reinforcing cycle of escalating tensions that began with a perception of incompatible interests.

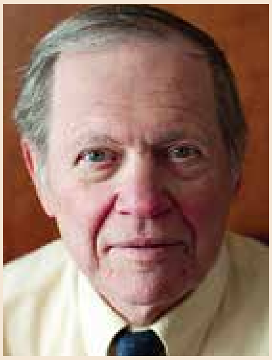
How did America arrive at such a perception in the first place? Is it possible for the United States and China to escape the so-called Thucydides Trap? If there is any hope for de-escalating current tensions, understanding the causes of misperceptions and correcting them is the first place to start.

Both the United States and China share responsibility for the current stand-off. On the American side, antagonism toward China arises from a convergence of international and domestic insecurity. On the global stage, America is unnerved by the decline of its status as the preeminent superpower; at home, it faces rising discontent from working-class Americans who failed to benefit from globalization and capitalism. In his campaign to "Make America Great Again," President Trump tapped into both sources of insecurity. China becomes a natural object of blame.

On the Chinese side, President Xi's "authoritarian revival" alarmed Western observers, who are now convinced that China not only will not liberalize as the economy grows but is becoming more autocratic than before. The abolition of term limits, crackdown on political freedoms, and revival of Maoist ideology have led the West to see China today as the antithesis of democracy. The clash is not only over interests but values.

This clash of values is exacerbated by an image of Chinese global ambition. China's grandiose Belt and Road Initiative and rapid outward investment in just the past few years, bolstered by an inflated sense of confidence in China's rise among some Chinese elites and capped with authoritarian revival at home, add up to a sharp image of China in the West as both autocratic and aggressive. Seen through this lens, every action in China, from industrial policy to promoting technology, appears threatening.

In fact, American and Chinese interests are far from incompatible. The two economies are inextricably interdependent. Politically, there is common ground in values, too. As I've argued in my essay in *Foreign Affairs,* the political foundation of China's economic dynamism since market opening is not simply autocracy, but "autocracy with democratic characteristics." China needs to understand, communicate, and most importantly, maintain the "democratic characteristics" in its political system, as they are crucial not only for the country's economic future, but for convincing America that China is not its arch nemesis.



What transpires will depend heavily on whether the two countries can collaborate in denuclearizing North Korea.

RICHARD N. COOPER
Maurits C. Boas Professor of International Economics, Harvard University

If President Trump follows through with his threats to increase tariffs on all or most goods from China, if China retaliates, and if he uses his new authority to restrict Chinese direct investment in the United States, there will certainly be a shrinkage of direct economic engagement between China and the United States. But will it be permanent? And will there be a shrinkage of indirect economic linkages, via third countries? And will national security relations "shrink," whatever that might mean? The answer to these three questions is most likely negative, unless the American public becomes much more isolationist than it is at present.

The higher tariffs will set back both China and the United States, but both will continue to grow over time, although China at lower rates than in the past, mainly for demographic and other reasons attenuating the reasons for high past growth. Europe and Japan (and Russia) are in relative decline, also for mainly demographic reasons, so China and the United States (and possibly India) will dominate national economies two decades from now. Their economic engagement will grow over that period of time, although less robustly than in the past two decades.

Capital is mobile enough internationally such that after a period of adjustment, both Chinese firms and U.S. firms will move to third countries, where labor is still cheap and education is rising, so indirect engagement (collaboration as well as competition) will occur in other parts of the world. The bilateral U.S.-China trade deficit may well fall, as Trump wishes, but it will shift to other low- and middle-income countries, such as Bangladesh and Mexico, determined as it is by a deficiency of U.S. national saving—including the growing federal budget deficit, about which Trump does not seem concerned—relative to investment in the United States.

China has to make many changes, including introducing full convertibility and a fair and impartial system for dispute settlement, before other countries will be willing to embrace the Chinese yuan as an international currency; the U.S. dollar will remain the dominant international currency for the next two decades. But its position will be eroded as others perceive U.S. abuse of this position in imposing sanctions on other countries, led by Russia, Iran, and now Europeans who are really ticked off by Trump's repudiation of the joint agreement on Iran's nuclear program.

In future, the two countries will be the two dominant military powers on their current trajectories. They will have to engage, albeit warily, to preserve peace in the world. What transpires in the next few years will depend heavily on whether they can collaborate in denuclearizing North Korea, a stated objective of both, and on whether as part of a successful deal American forces will be gradually withdrawn from South Korea. But even then they will have to be engaged elsewhere in the world, possibly collaboratively (as in peacekeeping) but even to avoid accidental conflict.

The U.S. relationship with the world is set to permanently shrink. China's relationship with the world will grow.

RICHARD JERRAM
Chief Economist, Bank of Singapore

The U.S. relationship with the world is set to permanently shrink—has already shrunk—and that with China is particularly exposed. President Trump's transactional approach—tolerated by Congress—has undermined faith in America's commitment to the postwar order and this will not be easily repaired. Whether the focus on China is due to perceived economic injustice, efforts to contain a rising superpower, or some more base prejudice is questionable, but the effect is the same. The bilateral relationship will bear the brunt as the United States turns inwards.

At the same time, China's relationship with the world will grow, reflecting its rising economic power and more confident leadership. This will be accelerated by America's withdrawal. Where this leaves Europe is unclear—too preoccupied by internal strains to fill the gap left by the United States, but wary of rising Chinese influence.

It seems unlikely that we will return to the "containment" policy of the Cold War era, simply because the United States no longer seems to be interested in providing leadership. This is evident across Asia. When the United States walked away from the Trans-Pacific Partnership, it confirmed earlier suspicions of fading commitment. We can also see it in Africa, where growing Chinese involvement, under the guise of its Belt and Road scheme, is being met with U.S. indifference.

However, there are echoes of the Cold War in growing resistance to Chinese acquisition of Western technology—in Europe as well as the United States—in recognition of the deeper rivalry that is emerging. The West belatedly seems to have woken up to the fact that China has no intention of becoming a liberal democracy as its economy develops. This could even unwind the "peace dividend" of the 1990s, when U.S. defense spending halved as a share of the economy, which is something the federal budget can ill afford after the huge fiscal giveaway at the start of the year.

There are no plausible substitutes, but we will increasingly need to question the role of the U.S. dollar as America disengages from the world. The search for alternatives will intensify and its dominance will naturally fade, even though this will be a very long-term project.

China could join, and the United States could re-join, the Trans-Pacific Partnership.

C. FRED BERGSTEN
Senior Fellow and Director Emeritus, Peterson Institute for International Economics

The rate of growth of U.S.-China trade and financial interaction will undoubtedly decline, as indeed it already has. The rapid burst of trade expansion as China boomed and integrated with the world economy was unsustainable and has already slowed considerably. Both countries have become increasingly cautious about further increases in their dependence on each other, for security as well as economic reasons. The cutback in the growth of investment flows, particularly of direct investment, has been even sharper as those concerns have accelerated in both the United States and China.

There may even be a reduction in the absolute level of economic interaction for some period. The current and proposed U.S. tariffs and Chinese countermeasures, if fully implemented, would clearly produce such a result. Trump wants to cut imports from China to reduce the bilateral imbalance. China, which is moving away from reliance on the market more broadly, wants to cut its dependence on the U.S. economy. These short-term shifts may lead to re-orientation of corporate investment strategies and supply chains that will have a lasting and reinforcing impact in a similar direction.

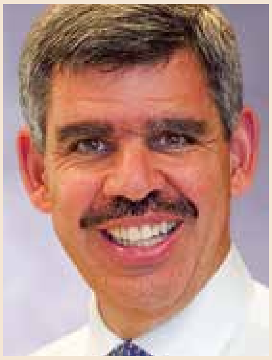
It is not clear that such developments would result in a reduction in the economic relationship between the United States and China, however. The management of the posited conflict will itself require extensive interaction between the authorities of the two countries, drawing on the extensive network of consultations and working groups that has built up over the past several years, if damaging trade and investment wars are to be averted.

Moreover, both countries will maintain a keen interest in the effective functioning of the global economy and will recognize that their cooperation is essential for it to prevail, whether on exchange rates or WTO reform. They will presumably want to avoid the further erosion of their relationship that could accelerate the onset of a new Cold War. The escalation of bilateral trade and investment conflict could thus paradoxically lead to an intensification of systemic cooperation between them.

The most constructive response to the current U.S.-China impasse would in fact be a renewed effort by the two countries, perhaps in broader regional and multilateral contexts, to seriously address the structural issues that lie at the heart of their confrontation. China could join the effort already initiated by the European Union, Japan, and the United States to reform the World Trade Organization, including to cover subsidies provided to state-owned enterprises and rejection of forced technology transfers.

China could join, and the United States could rejoin, the Trans-Pacific Partnership (now comprising the eleven other founding members) to work out new rules for intellectual property rights and foreign direct investment. The United States and China could pursue a bilateral trade or investment agreement first and then attempt to broaden its main features to their closest trading partners.

Whatever the technique, the goal would be to expand rather than narrow the relationship between the two economic superpowers—on which the world economy as a whole now relies so heavily—even if the actual level of economic interaction declines.



The U.S.-China economic relationship will change significantly.

MOHAMED A. EL-ERIAN
Chief Economic Advisor, Allianz; Contributing Editor,* Financial Times, *Columnist, Bloomberg Opinion, and Chair, President Obama's Global Development Council

Is the U.S.-China economic relationship about to permanently shrink? Not necessarily, but it will change significantly.

For years, the strategy of successive U.S. administrations had been to entice China to be a more responsible stakeholder in the international economy and the global trading system. To this end, it used many more carrots than sticks. All this changed with the election of President Donald Trump. His "America First" mantra has translated into a bigger emphasis on tariffs, overwhelming what had been a traditionally much more cooperative approach.

While sudden, this change has been long in the making.

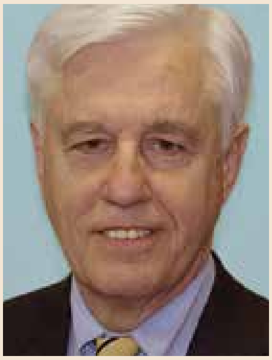
Amplified by China's impressive rise to join the very small club of systemically important global economic and trading powerhouses, there has been a steady buildup in the list of genuine grievances about China's proper adherence to the letter and spirit of the international rule-based system. This includes concerns pertaining to such issues as the theft of intellectual property, the proliferation of non-transparent bilateral payments agreements, and the terms accompanying the sizeable loans extended by Beijing to a growing set of developing countries.

Where we go from here is increasingly bimodal, and notably different from the status *ante.* What is certain is that, with a better trade tone developing between the United States and its western allies and a higher likelihood of a more coordinated approach towards China, the Chinese government and companies should brace themselves for greater pressure.

If readily accepted by the United States, timely trade concessions from China—particularly on intellectual property and joint ventures requirements—would lead to a still-free but fairer trade system. They could enhance the countries' role as twin engines of the global economy, open the way for beneficial international spillovers, reduce the risk of future financial instability, and provide a bigger window for the beautiful normalization of monetary policy in advanced countries. And they could even improve prospects for the much-needed reform of multilateral institutions and lower the risks associated with twin technology poles.

A continued tariff tit-for-tat, along with the expansion of threats and counter-threats, would increase the risk of a damaging global trade war and even its possible extension to finance given that China is a major holder of U.S. Treasuries. This would further fragment the international economic system, increase the risk of systemic financial instability, and, in the case of China, threaten the derailment of an internal economic consensus that is essential for avoiding the middle-income development trap.

How this increasingly bimodal distribution of possible outcomes develops depends in large part on the negotiating skills, agility, and open-mindedness of trade negotiators and high-level political interactions. It is in the interest of both countries, and of the global economy as a whole, to work together to address the imperfections of—and modernize—the global trading and institutional system.



Three constituencies in the United States have turned against building closer relations with China.

JEFFREY R. SHAFER
Former Undersecretary for International Affairs, U.S. Treasury

A stronger trade and investment relationship between the United States and China, built on fair market-oriented rules, would deliver tremendous benefits to both countries and the wider world. Gains from trade would be realized. Competition would bring out the best in both countries' business communities. Cross-border investment would rationalize supply chains and optimize the development and use of new technology. And agreement to strengthen and abide by rules regarding development credits would provide real benefits to recipients.

Benefits would transcend the economic. Close economic and financial engagement would restrain both countries from actions that threatened peace and security.

The two most powerful countries for a long time to come will be less confrontational and take fewer risks if the benefits from a strong economic relationship are at risk.

The U.S.-China relationship is at risk today. Attention has focused on the Trump Administration's trade and investment actions. If it were just Trump's policies, the Chinese side and those in the United States who support a strong economic relationship could hang on until a change in leadership. But other, more fundamental, developments are threatening the relationship.

Three constituencies in the United States have turned against building closer relations with China. Most important is the U.S. business community, which long supported increasing trade and investment with China. Frustration with market access, stolen or extorted intellectual property, investment restrictions, the China 2020 policy of protection, and the lack of follow-through on the reform pledge made at the third plenum of 2013 to allow the market to play a decisive role has depleted this support. Workers and the communities affected by declining industrial employment have become more active opponents of engagement with China. This opposition has become a powerful political force even though China trade is a less important factor in job loss than productivity, and the period of greatest dislocation is a decade behind us. And those in the United States who hoped for and saw for some time a rising trend of personal freedom in China associated with its taking its place in the global system have been disappointed by recent suppression of even mild dissenters.

Chinese unhappiness with the U.S. economic relationship has also grown. The United States has for some time engaged in hypocrisy—advocating for markets while putting up bars to investment and trade that go beyond any reasonable national security justification. The hypocrisy has intensified, and we now have a campaign of tariffs, undermining the decisive role of markets in the economy.

Both countries are now engaging in limiting visas for those who would engage in valuable exchanges.

Turning the tide will not be easy, but it is critically important. It must start with intense engagement of business people and thought leaders to generate public support for engagement. Some reengagement should be possible even before strong pro-engagement constituencies are rebuilt once a U.S. administration is in place that is willing at least to test the waters. For example, negotiations on a bilateral investment treaty would create a basis for addressing issues on both sides and making progress with the support of business in the two countries.

China and the United States will be economic rivals. It is critical for this rivalry to be played out in markets, not in government interventions. Only then will the benefits of engagement be realized.

One cannot understand the U.S.-China trade war without a geopolitical lens.

JENNIFER LIND
Associate Professor, Dartmouth College, and Associate Fellow, Chatham House

Observers typically rely on two lenses to understand the current U.S.-China trade war. One lens focuses on the specific menu of predatory Chinese practices—tariffs, barriers to foreign direct investment, forced technology transfer, intellectual property theft, and so on. This lens analyzes these practices and their effects on the U.S. economy; it assumes that the trade war will end when the two countries negotiate some sort of compromise, which will return bilateral relations to their previous uneasy but generally functional state.

People also view the trade war through the lens of domestic politics. This lens focuses on the populist wave that swept the United States and propelled Donald Trump into the presidency. According to this lens, Trump—and his misguided, zero-sum views about international economics—caused the trade war. Once the Trump Administration is a thing of the past, the trade war will end, and we can all "go back to the way it was."

These two lenses are both important, but incomplete. One cannot understand the U.S.-China trade war without a geopolitical lens. A predictable feature of international politics is that periods of great-power rise are tense and dangerous—indeed, historically, they have often led to wars. Tensions mount as a rising power grows into a system in which the powerful countries have written the rules; increasingly the rising state has the power to assert its interests, and to renegotiate those rules. And, understandably, the powerful countries try to defend the rules that they set up according to their preferences and interests.

Such is our world today. China has moved from a poor, weak, isolated country to one of the world's largest economies and manufacturing powerhouses. Formerly an economy that assembled products designed by others, China is steadily moving up the value chain and rising in the ranks of the world's most innovative countries.

As China grows more capable, Beijing is seeking greater authority in the forums that dictate the rules of the road in international politics and economics. It is also launching initiatives and institutions of its own (such as the Belt and Road Initiative, the Shanghai Cooperation Organization, the Asian Infrastructure Investment Bank, and others). In the security realm, China is more assertively advancing and defending territorial claims, and increasingly refusing to tolerate the U.S. military presence in East Asia.

The geopolitical lens reminds us that periods such as this—periods of great-power rise and relative decline—have always been tense, and often violent. The trade war is but one symptom of much larger forces at work. Namely, we are seeing a wholesale renegotiation of relations between China and the world, and particularly China and the United States: two great powers determined to advance their national interests. In not only the realm of trade, but across the many realms in which these two countries interact, this process will be fraught and dangerous. Assuming China's rise is not derailed by a major internal crisis, there is no going back to "the way things used to be."

China needs to acknowledge its status as a mature economy. The United States needs to take yes for an answer.

ROBERT A. MANNING
Senior Fellow, Brent Scowcroft Center on International Security, Atlantic Council

Derek Scissors correctly observes that the Trump Administration is "divided on goals." Witness the U.S. trade deficit with China actually rising in 2018 to record levels even as tariffs kick in. Trump tax cuts, record budget deficits, and a strong dollar suggest high trade deficits, making Trump's preoccupation more problematic, whatever sort of managed trade is needed to achieve it. Trump considers himself the ultimate dealmaker. But the logic of Trump trade policy is to pressure U.S. firms to bring manufacturing home, leaving China. Tariffs and rising labor costs have led some to do so. Some key advisors seek economic separation from China, others prefer a deal for reciprocal market access—if possible.

There is widespread agreement in the United States, the European Union, and Japan that core U.S. grievances against China, as detailed in the USTR Section 301 report, are really about technology-centered, state-driven industrial policies—China trying to own the future by hook or crook. Actions include stealing intellectual property, coerced technology transfer as a condition for foreign investment, predatory mercantilism, and digital protectionism (my favorite oxymoron is "internet sovereignty"). Beijing's "Made in China 2025" industrial policy seeking to dominate ten key technologies in itself might not be a problem. Indeed, it is modeled on Germany's "Industrie 4.0" plan. It is the massive subsidies and banning of foreign competition to create national champions that is over the top.

The current state of affairs reflects both a U.S.-China bilateral relationship and a global trade regime overtaken by the breakneck pace of China's growth—from $1 billion in GDP in 1999 to $11.2 trillion in 2016. This reality plus China's gaming the system whose rules and standards treated China more like a developing nation than the second-largest economy and largest global trading power exposed flaws in the global trade regime and cost millions of American jobs, catalyzing a backlash against globalization.

Avoiding a trajectory of economic separation will require China to acknowledge its status as a more mature economy and rethink its predatory mercantilism. For the United States, it means taking yes for an answer. What does that mean? For China, it would mean living up to its stated goal of having the market play "a decisive role" in the allocation of resources. That means halting coercive tech transfer practices and massive subsidies to create national champions, easing its digital protectionism (for example, restricting commercial data flows, no foreign ownership of clouds, no private VPNs, and so forth). At present, Xi Jinping's actual policies point in the other direction—more backing for state-owned enterprises, and more Chinese Communist Party control of everything, including boards of Chinese and foreign firms, and demanding Chinese Big Tech—Alibaba, Baidu, and Tencent—sell shares to the CCP, among other things. In short, a blurring between the private and state sectors.

For the United States, it would mean a common approach with the European Union, Japan, Australia, and other OECD nations to reform and modernize the World Trade Organization. Fixing the dispute settlement mechanism and toughening rules on state-owned enterprises and subsidies could provide leverage to rebalance U.S.-China economic ties based on reciprocity and transparency on trade and investment. Like U.S. Big Tech, China's version also wants access to global markets, and sees themselves increasingly cut out of Western markets, as investments are denied and leading Chinese firms like Huawei are banned from operations puts pressure on Xi. Trump would have to accept economics and live with a large trade deficit, albeit smaller, as China will buy perhaps $100 billion more in U.S. goods and services.

Such a scenario now appears a chimera. Tariff wars will get worse until a tipping point is reached. But the costs to the United States, China, and the global economic system of not eventually finding a *modus vivendi* will be astronomical.

The trade relationship is likely to shrink even as some financial relationships deepen.

CATHERINE L. MANN

Managing Director and Global Chief Economist, Citigroup

The current bout of trade and investment tensions likely will accelerate trends that were already in place. These trends will shrink the trade relationship but may deepen at least some financial relationships between the United States and China. Further strains may arise amid a deeper financial relationship and an attenuated trade relationship.

Trade integration likely will erode because both countries are large, relatively closed economies with rising services shares and differences in approaches to the digital economy. Although services are not "non-traded," they are more local, and there has been little progress in either plurilateral or multilateral negotiations on opening markets for tradeable services. There is no appetite in the current context to push for deeper or broader trade in services.

Trends in the United States include the relatively lower share of consumer goods in the shopping basket of both millennials and retirees, which tends to shrink the bilateral trade relationship as a share of GDP. Trends in China include a moving on-shore of supply chains to increase domestic value-added, which likely will accentuate the decline in bilateral trade. Although the tertiary sector in China doubled over the last two decades as a share of GDP to around 50 percent, the services share of trade stalled.

With regard to digital trade, differences in attitudes towards the interrelationships among digital industries, government, and society were balkanizing cross-border information flows even before the recent tensions, and there was little prospect for agreement on these fundamental dimensions even before the current tensions arose.

Turning to financial relationships, some financial relationships are likely to shrink, but others may deepen. In terms of foreign direct investment, U.S. FDI into China already had started to sag as firms increasingly realized the difficulties of developing and then keeping markets in China. On the other hand, China's FDI investment in the United States was roaring ahead, until arrested by the current tensions.

FDI is not the only kind of financial investment. Integration via portfolio and debt finance show diverging trends that are driven by diversification motives. U.S. investment into China has increased with the Stock and Bond Connects, the inclusion of China in the MSCI index, and investors' desire to diversify their holdings to include exposure to China. On the other hand, China's outflow of capital has been increasingly constrained, limiting the direction of financial integration and diversification. For official finance, China's diversification motive may encourage an effort to reduce bilateral financial integration away from U.S. Treasury securities even as the inclusion of the RMB in the SDR basket could increase the desire for that currency.

The upshot of both trends and current policies are likely to shrink the trade relationship even as some financial relationships deepen between the United States and China. How that divergence between trade and finance plays out remains to be seen.

China seems determined to avoid its international responsibilities as a principal trading partner.

WILLIAM BROCK

Former United States Trade Representative and former U.S. Secretary of Labor

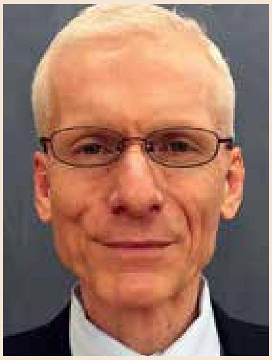
It may very well be that the total exchange of goods and services between United States and China will fall in the reasonably near term. I do not expect this to continue for an extended period of time, and certainly not on a permanent basis. Interestingly, while the economic value of a productive relationship is, or should be, compelling to most, political concerns in both countries appear to be surging. Those concerns have risen dramatically in this country, and for good reason.

In the years since China gained accession into the World Trade Organization, its commitments have not been kept. Worse, it is now clear that China seems determined to avoid its international responsibilities as a principal trading partner. State-owned enterprises continue to receive government support, whether they are capable of productively engaging in a competitive market environment or not. Unequal treatment of investment and intellectual property on the part of U.S. firms reflects the decision of China's business and political leaders to ignore equitable practices carefully developed and consistently refined by industrial nations over the course of many years. The list of these interventions and other negative actions is long and sad. The need for a global response is abundantly clear.

The U.S. government has demonstrated a willingness to take on this challenge. I might argue that the instrument chosen, significant tariffs without consultation, much less coordination with our fellow industrial nations and trading partners, is at best, risky, and at worst, dangerous. Pursued unilaterally, it will pose a threat to unity with those nations, which joined our efforts over these many years to construct a productive global trading system with equitable rules and an honorable dispute settlement mechanism.

There is scant evidence of such unity. Our failure to insist on remedial changes, and our failure to organize and lead a determined coalition, has left China with little incentive to behave constructively. Chinese abuses have created a problem that is real, and it is serious. Left unaddressed, it will represent a major threat to the most effective instrument of world growth in all recorded history, the global trading system which has created the opportunity for billions of individuals to escape the desperate extremes of poverty.

While the present mutually counterproductive governmental interventions will not soon go away, the extraordinary costs these interventions will impose on each country may quickly prove unsustainable. There is every prospect these imperatives will pull each nation's leaders to the bargaining table. Yes, they will be determined to advance their own nation's well-being, as they should. Even so, only the construction of a bilateral relationship with clear and enforceable rules and procedures within a global system of rules and procedures to resolve disputes will allow each country to advance its own interests and thereby advance their mutual interest. Will there be challenges and abuses? Of course. Even so, the long-term prospects for U.S.-China trade are positive. We have no choice. Nor does China.



Japanese concerns are repositioning to ride the technocratic tiger rather than fly over the cliff with the featherless eagle.

ANDREW DEWIT
Professor, School of Economic Policy Studies, Rikkyo University

The U.S.-China relationship will continue to shrink, though whether "permanently" is anyone's guess. And the confrontation is about industrial policy rather than the confused trade balance metrics cited by President Trump and his immediate circle.

Team Trump should read Cormac McCarthy's *No Country for Old Men* and ask, "If the rule you followed brought you to this [trade war], of what use was the rule?" Blustering will not make the Chinese abandon their "Made in China 2025" high-technology policy. China will almost certainly continue to use non-market mechanisms, including industrial spying and subsidies, to achieve that aim. After all, the Americans did much the same to the British, as Peter Andreas details in his *Smuggler Nation: How Illicit Trade Made America.* And Mariana Mazzucato's *The Entrepreneurial State* shows us that the Pentagon paid for much of the basic research that led to American leadership of the Internet and other advanced technologies. China's strategy is hardly novel, but the speed and scale of their success is.

So one can sympathize with America. The myriad implications of losing technological leadership are understandably unnerving for a polity that has been number one for over a century. And no one likes cheaters, especially a China whose ethos seems averse to a sustainable and liberal globalism.

America has plenty of options in addressing the China challenge. But tragically, it appears committed to the most futile and disruptive—indeed dangerous—course of action. It imposes escalating demands on the Chinese, demands whose rationales vary depending on which talking head pops up from the top ranks of the White House. And simultaneously, the administration alienates the Canadians, Europeans, Japanese, and other allies it needs to build a credible strategy. The liberal and globalized order is collapsing apace, as President Trump wantonly chops away at the norms, ties, and treaties that are its pillars.

America could be the biggest loser in this protracted struggle. Read "China: A Visit to the Epicenter." Henry McVey and Frances Lim make a compelling case that China can absorb the shock of this trade war through accelerating its technological development and regional supply chains. The Chinese have surely read Jeffrey Sachs' *A New Foreign Policy: Beyond American Exceptionalism,* particularly his assertion that American pressure on an emergent Japan in the 1970s and 1980s led to the latter's capitulation, and thus the lost decades.

Someone's going to shape most of the emerging global regime as well as the infrastructures of an urbanizing planet. Over the next couple of decades, new and vastly smarter cityscapes will comprise, in aggregate, an area the size of Spain and trillions of dollars in business. China's ambitious Belt and Road Initiative has its hiccups, but is backed by disciplined, strategic vision. At present, America lacks the patience and alliances to pose a potent challenge. One key indicator of this reality is seen in how Japanese shipping and other concerns are repositioning themselves to ride the technocratic tiger rather than fly over the cliff with the featherless eagle.

The Sino-American relationship has never been a marriage of convenience.

DIANA CHOYLEVA
Chief Economist, Enodo Economics, and co-author,* The American Phoenix and Why China and Europe Will Struggle After the Coming Slump *(2011)

The world economic and political order is undergoing a tectonic shift, as the rules of engagement between the existing superpower, the United States, and the aspiring superpower, China, are being rewritten. There has been a sweeping bipartisan change in American attitudes towards China while the Middle Kingdom under Xi Jinping has abandoned Deng Xiaoping's doctrine of "Hide your strength, bide your time."

A dangerously underappreciated aspect of this all-encompassing geopolitical confrontation is the critical role played by China's integration into the world trading system after it joined the World Trade Organization in 2001. This was a factor contributing to the global financial crisis, discrediting the Washington Consensus doctrine of liberal economics, and undermining the West's confidence in the superiority of the free market.

The crisis was not the result of failing free markets, and "greedy bankers"—the popular scapegoat—played only a tangential part. Rather, it was a consequence of the clash between two distinctly different economic systems within a global trade and financial framework largely set to serve liberal markets.

China was welcomed into the WTO on the premise that its model would converge with the Western template, and it duly made great strides in modernizing its economy. But its progress was an odd construct: it was predicated on grabbing export market share and opening some parts of its economy to market forces, while keeping the cost of borrowing and energy under strict control, pegging its currency to the dollar, and not allowing the free movement of capital.

Bolting China's semi-command economy onto America's free markets resulted in a huge build-up of debt in America that ushered in the financial crisis. But U.S. profligacy was not the proximate cause of the meltdown. The culprit was China's serious deficiency in domestic consumer demand, which led it to accumulate vast savings that it had to export. The upshot was that China was willing to throw money at the United States at next to no cost. For the United States, this was an offer that it would have been too rude to refuse.

This thesis is far from commonplace, yet the economic rationale behind it could not be more clear-cut. It is based on the well-known national accounting identity that saving must ultimately equal investment. If the fundamental driver was America's desire to borrow and spend, this had to be matched by extra saving, which, in turn, needed to be induced by higher interest rates globally. But if China's excessive desire to save was the driving force, what was needed was lower real interest rates in order to induce the extra investment. We all know what happened to inflation-adjusted rates around the world, so the direction of causation is clear.

It is extremely important for both the United States and China to understand this dynamic. Beijing has genuinely, but prematurely, concluded that its top-down semi-command economic model is superior. For its part, America has spent too long since the crisis beating itself up: there was very little its policymakers could have done under the current global economic and financial framework to prevent the catastrophic build-up of domestic debt.

The Sino-American relationship has never been a marriage of convenience. Niall Ferguson and Moritz Schularick could not have been more wrong in 2007 when they argued that "so long as both sides discern the benefits of their remarkable economic marriage of convenience, Chimerica—and the global asset boom it has created—will remain a reality and no mere chimera." The chimera all along has been the idea that there could be a symbiotic relationship between the world's largest market economy and its largest command economy. Unless the two systems had fused together, there is no way the rules of engagement could have stayed the same.

The stakes are high: Further economic decoupling would slow growth in both countries and increase the likelihood of heightened security competition destabilizing Asia.

ATMAN TRIVEDI
Managing Director, Hills and Company, and Adjunct Fellow, Pacific Forum

The United States and China are steadily moving down a path of economic estrangement. That road most likely leads to a gray area between the economic division of the Cold War and the high degree of bilateral connectivity characterizing the last decade. Reversing this deteriorating relationship depends on a newfound Chinese willingness to revisit their fundamental economic approach, as well as the quality and competence of leadership in Washington and Beijing.

Near-term economic ties are fraying as both governments use the wrong tools to achieve growth and prosperity. China's state-directed industrial strategy, forced technology transfer and investment rules, systemic IP practices, and joint venture requirements are threatening the competitiveness of U.S. companies.

The Trump Administration is correct in its diagnosis of the problems with China, but the liberal use of tariffs is no substitute for a strategy. The ongoing trade war is unlikely to force significant and lasting changes to the country's approach. Even if China's economic vulnerabilities are not overstated, Beijing's own political imperatives make a humiliating climbdown unlikely.

Less public than the trade war, yet also consequential, is the loss of bilateral investment flows. From the first half of 2017 to the first half of this year, Chinese investment in the United States plummeted over 90 percent—and these figures don't reflect the recent law passed by Congress (with China top of mind) to tighten scrutiny of foreign investment in critical, defense-related technologies. At the same time, U.S. investment in China is encountering new regulatory attention that sometimes results in preferential treatment of domestic businesses.

Whether or not the discord is short-lived hinges on a number of factors. At least in theory, the United States and China share economic interests in achieving prosperity through trade, reducing inequality, and improving quality of life for the middle class.

But the Chinese government's role in driving the economy and the scale of its activities produces an unfair advantage. These trends appear to be headed in the wrong direction: growing Chinese Communist Party intervention in business, increasing government investment in state-run firms, and a reduced state appetite for open markets.

Beijing should understand that Washington's tolerance for the economic status quo is diminished in both political parties. A few tweetable deals that increase U.S. exports won't address concerns. This flinty attitude took shape towards the end of the Obama Administration and reflects a growing consensus that talks have not yielded enough change.

Without demonstrable progress, hardening views on China within the administration, Congress, and the establishment make a costly, long-term economic separation more likely. The American business community traditionally has provided ballast with China during rocky moments. But it has expressed growing disappointment with Beijing's policies that limit their opportunities.

Both countries see each other's trade policies as part of a comprehensive effort to achieve commercial and military hegemony. This mutual mistrust also produces an environment in which finding common ground on economic issues becomes more complicated, requiring wise and adroit leadership. Can Xi lead less like Mao and more like Deng? And can Trump (or his successor) and Congress learn from past mistakes and rebuild domestic support for a different approach with China?

Perhaps after each inflicts some more unnecessary pain on the other, one proposal that might find common ground is working to build a stronger, reformed World Trade Organization. Economist Yukon Huang has outlined how rules curtailing nonmarket assistance to state-run companies and removing restrictions on foreign participation in joint ventures could alter China's behavior. In September, the European Commission tabled a proposal for revamping the WTO. If the White House can continue to mend trading ties with Europe and other traditional allies, it may still be able to rally them behind a more robust WTO better equipped to deal with China's state-driven economy. That, of course, will require the administration to abandon counterproductive efforts to undermine that institution and weaken its rules.

The stakes are high: Further economic decoupling would slow growth in both countries, contribute to a global economic downturn as supply chains shift, inflict collateral damage on allies, and increase the likelihood of heightened security competition destabilizing Asia. Given the risks, let's hope the mounting costs of trade and investment barriers lead cooler heads to prevail.

Scissors paints an unnecessarily dark, even dystopian, view of the future.

CRAIG ALLEN

President, U.S.-China Business Council, former U.S. Ambassador to Brunei Darussalam, and former Deputy Assistant Secretary for China, International Trade Administration, U.S. Department of Commerce

Derek Scissors of the American Enterprise Institute is an astute observer of the U.S.-China bilateral relationship. But he paints an unnecessarily dark, even dystopian, view of the future.

While there are hardline voices in both Washington and Beijing calling for a "decoupling" of the bilateral relationship, these represent extreme views that overlook history, the dynamism of the current bilateral relationship, and America's strategic role in the world.

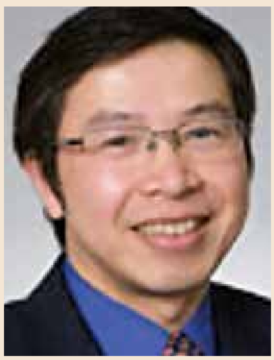
America has benefited from trade and investment in China since our founding. English tax on Chinese tea was the proximate cause of the Revolutionary War in 1776. Americans first settled both California and Hawaii, in part, as a platform to expand U.S. exports to China. Bilateral trade, immigration, and investment with China have been a permanent part of the American experience since the very first days of America's founding.

Currently, U.S.-China bilateral trade and investment employ some 2.6 million Americans. In the city of Shanghai alone, there are more than four thousand American-registered foreign-invested enterprises. American exports to China have grown almost every year so that China has become our second-largest export market after Canada. In addition, American companies produce American-branded products in China in the amount of almost $500 billion. USCBC members operating in China are generally both profitable and optimistic about the China market.

The Chinese economy remains quite robust, despite the movements of its stock markets. In the first half of 2018, China's economic growth exceeded 6.8 percent. Job growth is strong. Investment is strong. The Chinese government of course faces many economic problems, such as growing debt. However, we should not underestimate China's macroeconomic management capabilities. The Chinese government has many tools at its disposal to ensure continued macroeconomic stability and economic growth.

Moreover, the consequences of an effective decoupling of the U.S.-China relationship are dire. Are American companies to forego the benefits of participating in the world's most rapidly growing emerging market? Can the United States really re-shore global supply chains when we have a 3.8 percent unemployment rate—among the lowest in the last twenty years? Can our alliance structures in Asia—and indeed the entire global economic architecture—withstand a sustained U.S.-China separation? If so, will anyone win?

The U.S.-China relationship is certainly under stress. The Trump Administration has rightly called out China for its failure to implement WTO obligations and its sustained aggressive techno-nationalism. These are serious problems. But they should be considered as multilateral problems that are best addressed by multilateral engagement with diplomatic allies. We do not need to decouple. We need to work with our allies to engage China so that China fully lives up to its WTO obligations and works with us to upgrade the WTO. In that way, everyone can continue to enjoy the obvious benefits of global supply chains, collaborative problem-solving, and regional stability.



If the trade war is not resolved or contained, it could spiral into financial, intelligence, military, and political areas.

HONGYI LAI

Associate Professor, School of Politics and International Relations, University of Nottingham

With President Trump's imposition of tariffs on $200 billion worth of China's imports in September 2018, U.S.-China relations have entered a new period of uncertainty. Although it is difficult to predict how long this period will last and whether this is the start of a prolonged economic cold war, populist leadership on both sides seems to reduce the likelihood for a satisfactory resolution of the disputes.

Trump sees "fair trade" as a key to his pledge to make America great again. He tries to repay his loyal supporters by materializing his presidential campaign promise of getting tough on China and rectifying what he perceives as China's failure to protect U.S. intellectual property rights, open up its markets, and end excessive subsidies to state firms. China's President Xi Jinping, on the other hand, would likely associate resistance to foreign intrusion with his dream of Chinese national revival and see defending China's "legitimate economic rights" as key to his political legitimacy. He would like to demonstrate to the Chinese public that he is strong enough to stand against the American bullies who willfully use their predominance in global market shares, the financial system, and top layers of the value chains to pressure trade partners into submission. At a deeper level, while Trump sees the end of Chinese government aid to firms—especially state firms—to foster technological innovation as essential to a trade deal, Xi sees this as a sinister attempt to choke off China's drive toward sustainable growth. Many analysts believe that China could weather this trade war despite heavy losses through the state's tight monitoring of media, social media, and protests, and through portraying Trump as the whimsical perpetrator of this economic crisis. Top leaders' power consolidation, vision, and skills, as I argued in my 2010 book, have thus driven U.S. and Chinese foreign policy.

If the trade war is not resolved or contained, it could spiral into financial, intelligence, military, and political areas. Even if the U.S.-China trade dispute is resolved in a way less disruptive than a tariffs war, an overwhelming American negative reaction caused by their perception of China's unfair trade practice and unfree state capitalism, life-time autocrats, and assertive diplomacy much increases the chance of perpetual confrontation with China.

Trade war has already inflicted economic pains on the middle-class citizens who hold the listed stocks, as well as exporting firms in China. While the U.S. economy seems strong, dynamic, and robust at the moment, a protracted war will create side effects not only in China, but also in the United States. In the longer run it could raise prices for consumer goods and imported production inputs, dampen investment and consumption, disrupt supply chains, and may encourage divestment in order to avoid tariffs. Decelerated growth and decreasing demand for imports in these two largest economies could reduce the growth of economies exporting to them. Trade partners of the United States might also feel that the U.S. failure to resort to multilateral or reform initiatives undermines rule-based procedures in the global economic system. ◆

Scissors Responds

U.S.-China disengagement will likely continue and expand.

DEREK SCISSORS
Resident Scholar, American Enterprise Institute

I do not speak for any part of the U.S. government. My views on China started to shift sixteen years ago, when pro-market economic reform first ebbed. This is the single most important reason for the partial separation of the American and Chinese economies: Beijing has long abandoned the pro-market path and shows no true interest in returning to it.

There are other factors, of course, including President Trump recently leading a protectionist tilt in the United States. It would be foolish to predict a permanent or necessarily all-encompassing disengagement stemming from such factors. But disengagement will be multi-dimensional and protracted, and indeed has already begun.

Those anticipating Chinese reforms to permit more commercial competition and strengthen private property rights have been wrong for at least a decade. There have been policy changes that can be termed reforms, but they have sought to limit competition with state-owned enterprises and repeatedly failed to enhance private property rights. The much-hyped Communist Party Third Plenary meetings in late 2013 have proven empty, as some discerned at the time.

China's frequently predatory trade behavior follows easily from its domestic policy. If state-owned enterprises must be sheltered from competition, genuinely open trade cannot be tolerated. If domestic private property rights are limited, why would foreign intellectual property be protected? Claims that the Sino-American relationship can thrive are based on false beliefs that China is reforming consonant with being a better partner, or hopes that it will do so. The time to re-expand bilateral economic relations is only when such hopes are realized.

Politics argue strongly for separation, whatever one's preferences. In the United States, Trump's razor-thin electoral margin in 2016 may have stemmed from sharp criticism of open trade. The signing of the United States-Mexico-Canada Agreement leaves the PRC as by far his top target. For their part, Democrats have criticized Trump for being too lenient with China and have a protectionist constituency in labor unions. On the other side of the Pacific, General Secretary Xi's intention to remain in power indefinitely leaves no reason to expect better policy in 2022.

Disengagement has been and will be uneven. It is well-known by now that Chinese direct investment in the United States has plummeted, and fresh investment by American companies in China is comparatively small. However, American portfolio investors could become more exposed to the PRC through their international holdings, whether they are aware of this or not.

Related, Sino-U.S. technology cooperation is shrinking and will continue to shrink. In this, the much-discussed changes in U.S. investment review made in the last National Defense Authorization Act were secondary to a tighter export control regime in the same document. The Trump Administration is further tightening export controls through executive action.

Moreover, it's likely that Chinese researchers and students will be barred from additional advanced technology research projects on American university campuses. This is a reasonable step, but extending bans to Chinese students beyond technology is not reasonable. Gary Hufbauer's association of me with attacks on people-to-people movement in his comment is inaccurate. Two-way people movement should be preserved as much as possible, which makes China's tighter visa issuance and restrictions on foreign non-government organizations especially harmful.

Goods and services trade, despite the gnashing of teeth, does not yet show disengagement. Volume grew in 2017 and the first half of 2018. The 10 percent U.S. tariffs on $200 billion worth of goods are minor and the scheduled jump to 25 percent on the first day of 2019 as well as tariffs Trump promised on remaining imports from China both remain in doubt. Trade volume as a share of U.S. GDP was 3.7 percent in 2017, versus 1.2 percent in 2001. If it merely holds the present level, disengagement will remain limited.

This, however, is just phase one. Trade expansion has brought trade deficit expansion. Given candidate Trump's extremely strong language during 2016, the bilateral deficit is an enormous target for Democrats in 2020. Barring surprising changes from the PRC, trade and two-way people movement will be under more fire eighteen months from now than they are today. Ideally, the United States and China would tackle internal problems such as debt accumulations, then reconsider economic relations. More likely, the separation process will stagger forward. ◆