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The Internal Debates Driving the US-China Trade War

There are two opposing factions on each of two sides, and that is making a deal difficult.

By **Richard Boucher**

The China-U.S. trade war has become complicated because we've gone beyond the regular contortions of trade negotiations, threats, counter-threats, tariffs, and retaliation, into the realm of punishment and seeking strategic advantage. On the U.S. side, some elements in the Trump administration want to wall off China. On the Chinese side, some elements want to stand up to the United States and return to self-reliance and the ethos of the Long March. Neither can achieve what it wants, but these hardliners make life harder for those trying for a deal.

In Washington, there are two groups within the administration: trade deficit hawks and China-threat hawks. So far they've been in sync: As negotiators come up with new tactical moves, China hawks pile on in an attempt to isolate China. Each group operates on erroneous assumptions.

Trade deficit hawks mistakenly see the trade deficit as a measure of "winning" and "losing." In fact, in a modern economy, the trade deficit reflects how goods are manufactured in value chains and of the desire of foreigners to hold dollars. When the U.S. economy grows more quickly — as it has this year — the deficit rises. Be that as it may, the main goal of trade hawks is to increase U.S. exports to China, cut China's exports to the United States, and balance trade in the ledger. President Donald Trump, Trade Representative Robert Lighthizer, Treasury Secretary Steven Mnuchin, and others, many of them veterans of the same disputes with Japan in the 1980s, have been pushing for a deal much like the ones reached with Tokyo back then: A big buying mission; some sector openings, especially for automobiles; and promises to respect trade rules, such as intellectual property protection. This group, especially the president, wants to show they can negotiate a really big deal.

The trade group is egged on by a group of hawks — National Security Advisor John Bolton, presidential adviser Peter Navarro, and others — who characterize China's emergence as a challenge to U.S. hegemony in the world. They want to drive manufacturing out of China, cripple Chinese technology industries, and keep China from growing globally. This explains the overblown enforcement actions against ZTE and Huawei, their attempts to keep Huawei out of 5G in the United

States and Europe, limits on licensing of U.S. technology, and actions to keep Chinese firms from acquiring U.S. assets. This group would just as soon not have a deal; they'd rather build a wall around China. By increasing tariffs on products coming out of China, they hope to push producers to find other places to manufacture with low-wage workers, accelerating the movement out of China to places like Vietnam, Bangladesh, or Ethiopia already underway because Chinese wages have been rising. A corollary to the view is the mistaken belief that the United States can bottle China up again because the U.S. dominates the world economy — not so true anymore.

What about China? First, China is less vulnerable than in the past. In addition to the wage effect, China's planners have been trying to upgrade China's technical level, to work their way up the value chain. More of what China exports comes from inside China; the domestic content of China's exports sat below 60 percent in 2007 and has risen to over 80 percent since then. Already, Chinese owners and managers run the factories, rather than managers from Taiwan, Singapore, or the United States. Chinese companies also come up with innovations. Huawei has its own operating system, ready to roll out as early as this fall. The chips and SD disks they need will take longer, but they've already got a start.

China's fast growing internal market — the attraction to many foreign investors — has become an engine for growth, as exports have dropped to about 18 percent of GDP versus 36 percent at their peak in 2006. During the economic crisis, China shifted to markets in the developing countries of Asia, Africa, and Latin America, and now exports a smaller percentage to the United States and Europe. The overwhelming dominance of the U.S. market for China — although still large — has fallen.

Thus, a world divided between the China zone and the U.S. zone might be seen as an even deal in China, by supporting an acceleration in wage growth, export diversification, and technology value-added in their export sector. Within China there are also voices who argue that as Washington is trying to thwart China's modernization, China should no longer give in to U.S. demands. Hardliners on both sides use each other to prove their point.

China's White Paper on Economic and Trade Consultations with the United States showed both attitudes. The authors say repeatedly that "[c]ooperation is the only correct choice" based on"win-win" "dialogue and consultation" but they also threaten that China will fight if necessary. The paper goes to great lengths to argue that "China's technological innovation is based on self-reliance." Phrases like "China will never compromise on major principles concerning China's core interests" appear over and over, apparently to reject the U.S. push for privatization and for an open internet. Near the conclusion, the white paper returns to a tested theme: “The fundamental solution to economic and trade tensions is to grow stronger through reform and opening up” while also implying that China and the world are big enough for Chinese development even without the United States.

So, China wants a deal but doesn’t need one as badly as the Trump administration believes. Furthermore, President Xi Jinping is worried about getting “Kimmed” — left hanging at a high-level meeting like North Korea’s Kim Jong Un. Xi and the Chinese leadership also reject the Trump administration’s demand that the United States keep unilateral powers to enforce any promises on markets and intellectual property by imposing tariffs for which the Chinese cannot retaliate. Putting China in a position of permanent weakness is unacceptable to them for historical reasons.

The bottom line is this: Xi wants a deal. Trump wants to make a deal. There is a deal available. Neither country needs a deal as much as the other believes and are prone to adding on pressures in order to “win,” aided and abetted by hardliners. Both Trump and Xi head administrations torn uneasily between dealmakers and go-it-aloners. Getting through this conundrum will require leaders on both sides to silence their strategic hawks and push to a deal. The sooner they get on with it the better.

The Author

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