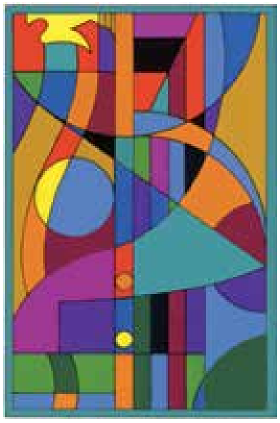

View from the Beltway

The Giant Is Now Awake

By Owen Ullmann

America is fully aware of China's ambitions. But now what?

During these times of bitter partisan polarization, Washington's political and policy communities are rallying around a rare consensus viewpoint about the biggest international threat confronting the United States: China.

From the far left to far right, politicians and experts see China rising as a global menace to U.S. economic and foreign policy interests. The days when the Clinton, Bush, and Obama Administrations dealt with China as a sometimes-cooperative competitor are gone. That approach has been replaced with Cold War-style assessments of China as a dangerous rival that is expanding its military reach and plotting to leapfrog the United States as the world's pre-eminent economic superpower within a generation.

Beyond sharing that concern, Washington hands are all over the place when it comes to finding effective strategies to deal with the expanding Asian power. Some are pushing for short-term deals that result in greater Chinese purchases of U.S. goods. Others are focused on broader agreements that aim to curb Chinese intellectual property theft, unfair trading practices—such as government-owned or subsidized enterprises, currency manipulation, and dumping—and investments in technology that threaten American national security.

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Several approaches advocate tough bilateral negotiations, while a number of experts are convinced that only multilateral talks pitting China against a broad American-led alliance can succeed. Then there are more radical proposals, such as a foreign investment tax aimed at devaluing the dollar to reduce America's chronic trade surplus with China and the rest of the world.

Yet there's scant evidence that China is interested in any deal that favors U.S. interests at its expense, a point President Donald Trump admitted on July 30, as his negotiators held inconclusive trade talks in Shanghai.

Trump has taken an erratic on-again, off-again tough-guy approach toward China: leveling tariffs and threatening more, but then postponing them; predicting a breakthrough in talks, then lowering expectations; lauding Chinese President Xi Jinping as a friend, then assailing China's trade practices.

"…[T]hey always change the deal in the end to their benefit," Trump tweeted. "They should probably wait out our Election to see if we get one of the Democrat stiffs like Sleepy Joe [Biden]. Then they could make a GREAT deal, like in past 30 years, and

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continue to ripoff the USA, even bigger and better than ever before."

"The problem with them waiting, however, is that if & when I win, the deal that they get will be much tougher than what we are negotiating now...or no deal at all. We have all the cards, our past leaders never got it!" Two days after that tweet, he announced 10 percent tariffs on $300 billion of Chinese goods effective September 1.

In fact, despite Trump's boast and new tariff threat, China is holding most of the cards. While Trump gets credit for taking a tough line, even from Democrats who revile him on most issues, he has failed to win any significant concessions from the Chinese. His controversial tariffs seem to be hurting U.S. farmers, businesses, and consumers more than China's economy, and they are largely opposed by Republicans as an ineffective impediment to free trade. (Democrats, who lean toward protectionism, are more supportive of the tariffs but are loath to praise Trump publicly for imposing them.)

China also has found ways to neutralize the tariffs, such as shipping goods to the United States through third countries and offsetting them by devaluing its currency. In early 2018, just as Trump started to impose tariffs, the renminbi exchange rate was about ¥6.3 to the U.S. dollar. By the fall, it fell to just shy of ¥7 to the dollar.

After Trump's August 1 tariff threat, the Chinese central bank let the renminbi slide past the symbolic ¥7-to-the-dollar mark for the first time since 2008. The Chinese government indicated it acted in response to the tariffs, prompting Trump to renew his complaint about China's currency manipulation. The U.S. Treasury Department followed up with the mostly symbolic move of declaring China a "currency manipulator," and China suspended purchases of U.S. agricultural products. As he often does, Trump blinked, postponing tariffs on popular holiday items, such as toys, until December—after the goods have been shipped to the United States.

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OFFICIAL WHITE HOUSE PHOTO BY SHEALAH CRAIGHEAD

Donald Trump *has taken an erratic on-again, off-again tough-guy approach toward China: leveling tariffs and threatening more, but then postponing them; predicting a breakthrough in talks, then lowering expectations; lauding Chinese President Xi Jinping as a friend, then assailing China's trade practices.*

Xi Jinping: *China is holding most of the cards. Trump has failed to win any significant concessions from the Chinese. China also has found ways to neutralize the tariffs, such as shipping goods to the United States through third countries and offsetting them by devaluing its currency.*

The trade tiff ratcheted up on August 23, when Trump threatened new steep tariffs in response to China's vow to raise tariffs on U.S. imports. And in a tweet laughable for its dictatorial tone but unenforceable command, Trump tweeted: "Our great American companies are hereby ordered to immediately start looking for an alternative to China, including bringing your companies HOME."

The result of this trade tit-for-tat in the United States: A volatile stock market, retrenched business investment, more pain for farmers, higher prices for consumers, and growing odds of a major economic slowdown—or even a recession. The message from China: We can give as good as we get on trade and won't be intimidated by Trump's bullying tactics. Indeed, Trump turned more conciliatory in subsequent days and the two governments agreed to resume trade talks in October.

Trump imposed real pain on China when it barred U.S. companies from doing businesses with telecommunications giant Huawei, citing questions about whether its equipment could pose national security concerns. But then he relented after meeting with Xi at the G20 summit in Osaka in late June, saying the Chinese leader agreed to an unspecified increase in Chinese purchases of U.S. agricultural products—a promise now very much in doubt in the wake of the latest trade spat.

The economic cycle also seems to favor China: Its economy may soon bottom out and the government has plenty of tools to stimulate faster growth, while the U.S. economy continues to slow amid weaker global demand and little prospect of fiscal stimulus in the face of

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burgeoning budget deficits. Despite the Federal Reserve's quarter-point cut in interest rates on July 31 and the prospect of more cuts this year, it's hard to see the dollar weakening much to reduce the U.S. trade deficit with China when other major economies are weaker.

In another sign that China can wean itself off the U.S. market, Chinese foreign direct investment in the United States plummeted from a record $46 billion in 2016 to just $5 billion in 2018, the Rhodium Group reported. By contrast, American FDI in China last year dropped only slightly to $13 billion from $14 billion in 2017, the economic research firm said.

Finally, China's totalitarian political system works in its favor. It can take a tough negotiating stance and stick with it, while U.S. democracy produces a variety of interests pulling in different directions. "The Chinese think their system benefits them tremendously," observes a senior U.S. government official who has dealt with the Beijing government. "They have a very tight leadership team that has worked together for decades. The political decision at the top sticks. And we have a very robust system of checks and balances."

Xi, who has consolidated power and imposed tighter state controls than any time since the rule of Mao Zedong, has made clear he has no intention of curbing subsidies for state-owned entities or backtracking from the Communist Party's ambitious Made in China 2025 plan to become the world's leader in electric vehicles, telecommunications, robotics, and artificial intelligence.

Xi's recent reaffirmation of China's goals was one of the worst strategic blunders since the Communist Party came to power in 1949 because it provoked a backlash in the United States, contends Rob Atkinson, president of the Information Technology and Innovation Foundation. "And that's what China did. And the giant is now awake," he de-

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clared at a Brookings Institution panel discussion July 18 on U.S.-China trade. "You can not like the giant, but the giant is awake and it's not going back to sleep—meaning the United States is seriously concerned about what China's strategy is."

Concern, however, does not translate into an effective strategy to confront the threat. Bonnie S. Glaser, director of the China Power Project at the Center for Strategic & International Studies, is pessimistic about a new trade deal being reached in the wake of failed talks during the spring, when the two sides appeared close to a breakthrough agreement.

Vested interests in China felt threatened by looming curbs on state-owned enterprises, and prospects for cracking down on intellectual property theft or limiting technology transfers are dimmer because China seems less eager to strike a deal now, according to Glaser.

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"A good agreement may be unachievable," she said. "Trump may have drawn a lesson from North Korea—no deal is not so bad for his political base. The Chinese see weakness in the U.S. economy, and its propaganda machine is in overdrive stoking nationalism and encouraging very anti-American sentiment that suggests the government sees the trade war going on a long time."

Glaser believes continued use of tariffs will harm both economies and prompt Beijing to make it more difficult for American companies to operate in China by imposing new bureaucratic rules and blocking U.S. citizens from getting visas.

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"We have seen a relationship that is predominantly cooperative under President Obama move to a relationship that is predominantly competitive with mutual suspicion," she added. "The Chinese are convinced the United States is trying to weaken the Communist Party, is behind the Hong Kong protests, and is fostering dissent in China. It is not a relationship poised to improve anytime soon. One might even ask how much more it can deteriorate."

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"Realigning the dollar is the single best tool we have to address our very large and persistent trade deficit," he said, noting that China's currency is undervalued by at least 30 percent. "Capital flows are driving exchange rates. We need a new mechanism to control massive movements of capital" into the United States, which he said totaled an estimated $55 trillion in 2017 and $44 trillion in 2018.

Scott advocates imposing a market access charge—a sales tax equal to 25–50 basis points on every dollar invested. Another idea to bring down the value of the dollar, he said, is to impose a withholding tax on profits earned on investments that are not taxed. That would be less objectionable to policymakers than direct currency intervention, he added.

"Many U.S. trading partners have a huge surplus in trade," Scott observed. "The populism in the United States and Britain is a backlash against these huge deficits that have devastated manufacturing workers and cities. You get a pitchfork rebellion. That is the problem we should be dealing with. We need to address globalization, or the pitchfork rebellion will spread."

Trump's approach to China won't work, he predicted, because "it suffers from an abundance of arrogance and ignorance. We think we can impose on them our political system. They have developed their own way of doing things. They won't knuckle under to us just because we impose some tariffs. It is incredibly arrogant and stupid to force them to act like a Westernized economy."

Whatever the merits of Scott's dollar proposal, there is no political will in Washington to implement such a radical move or to take other overt steps to devalue the dollar. And tariffs are clearly a negotiating tool, not an end game.

At this juncture, the United States has little leverage to wring significant concessions from Beijing, despite Trump's hollow boasts. American negotiators would have had more of an advantage through the favorable trading terms of the Trans-Pacific Partnership, which excluded China, but Trump withdrew from the twelve-nation accord—probably for no reason other than that it had been negotiated by the Obama administration.

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Perhaps what the United States needs to count on now is destiny. In the 1980s, Americans were convinced that Japan would overtake us as the world's top economic power, and we feared the growing military might of the Soviet Union would eclipse us. In each case, history produced a very different outcome.

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The continued rise of China is not inevitable. Its economy, though seemingly well managed for now, is not impervious to a collapse caused by a real estate bubble, other massive debts, an unstable shadow banking system, or other unseen problem corroding the system. Because of a lack of transparency, we don't know the extent of any lurking dangers.

Politically, the ever-tightening grip the Communist Party imposes could be a sign of lasting power—or one of greater insecurity. Clearly, the massive pro-democracy protests in Hong Kong and flickering hopes for independence in Taiwan are reminders that challenges to Communist rule persist, even if containable at the present time.

Former Federal Reserve Chairman Alan Greenspan observed decades ago that a system allowing greater economic freedom while stifling the human urge for political freedom and personal liberty is not sustainable in the long run. He may prove to be correct. We just don't know how long it will take to find out. ◆