

Financial Times (March 28, 2018).

How China can avoid a trade war with the US

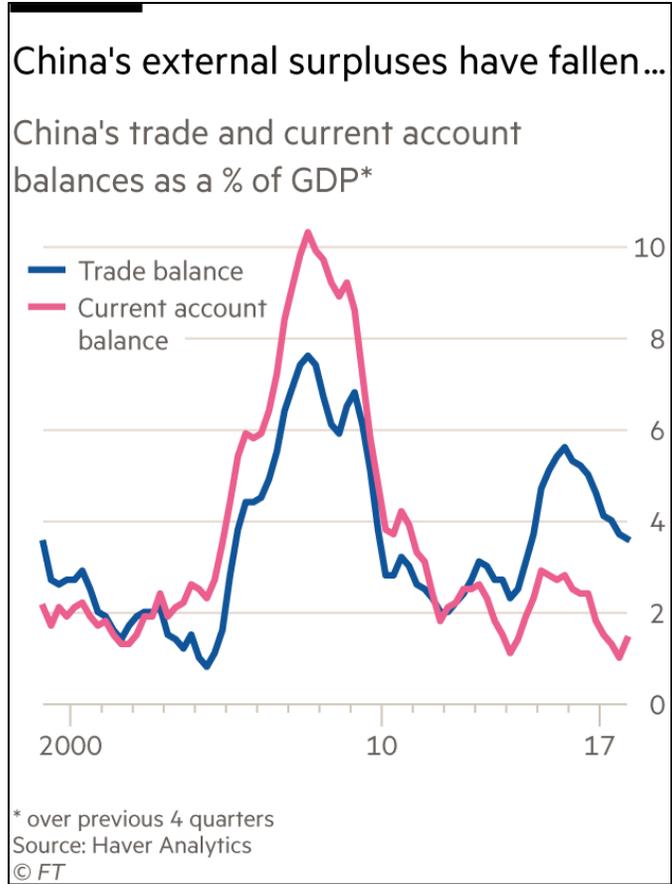
Beijing must recognise the shift in American perceptions and make some

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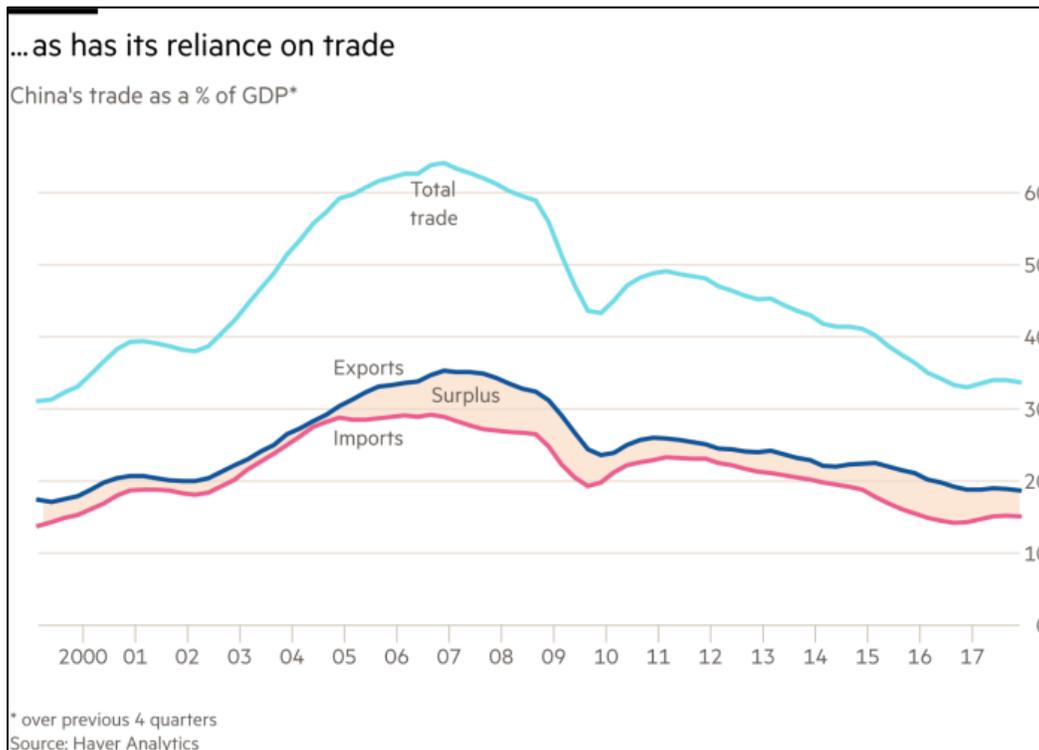


How should China respond to Donald Trump's aggressive trade policy? The answer is: strategically. It needs to manage a rising tide of US hostility.

Of the events in Washington last week, the appointment of John Bolton as the US president's principal adviser on national security may well be more momentous than the announcement of a "section 301" trade action against China. Nevertheless, the plan to impose 25 per cent tariffs on \$60bn of (as yet, unspecified) Chinese exports to the US shows the aggression of Mr Trump's trade agenda. The proposed tariffs are just one of several actions aimed at China's technology-related policies. These include a case against China at the World Trade Organization and a plan to impose new restrictions on its investments in US technology companies.



The objectives of these US actions are unclear. Is it merely to halt alleged misbehaviour, such as forced transfers — or outright theft — of intellectual property? Or, as the labelling of China as a “strategic competitor” suggests, is it to halt China’s technological progress altogether — an aim that is unachievable and certainly non-negotiable. Mr Trump also emphasised the need for China to slash its US bilateral trade surplus by \$100bn. Indeed, his rhetoric implies that trade should balance with each partner. This aim is, once again, neither achievable nor negotiable.



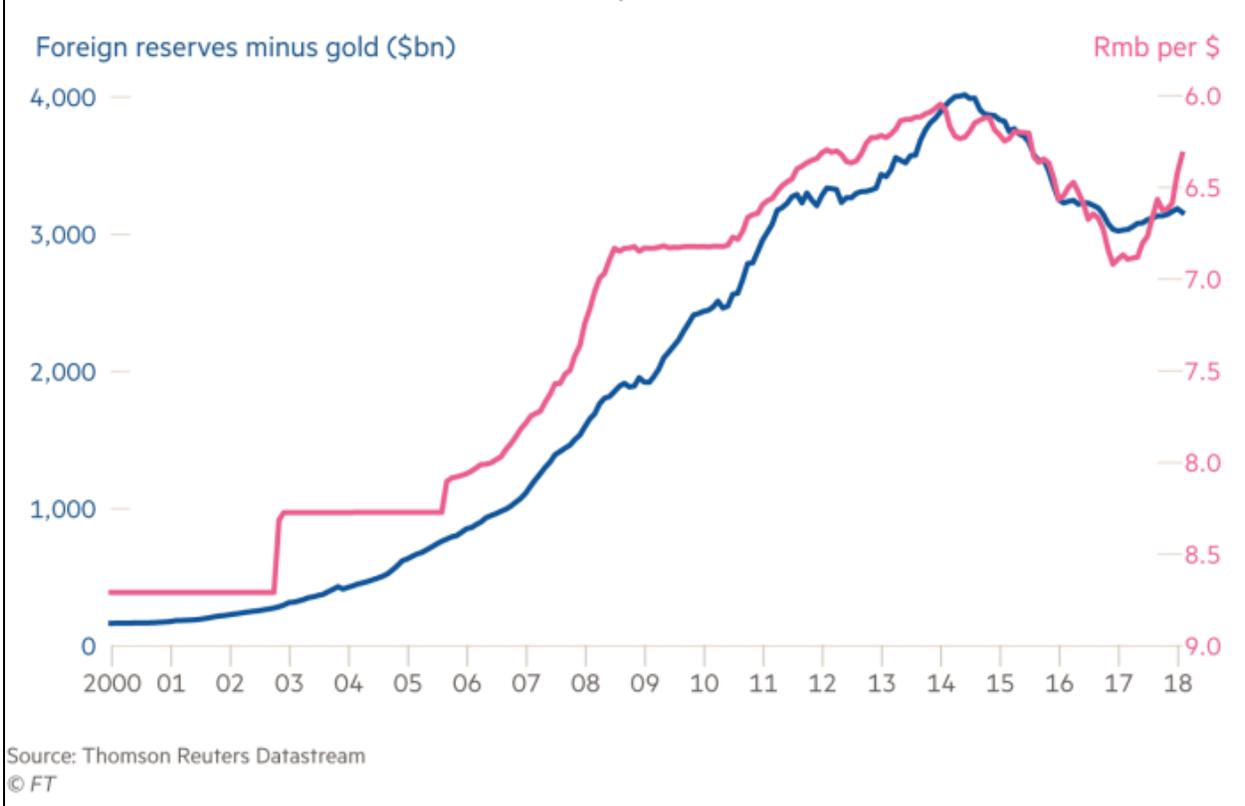
The optimistic view is that these are opening moves in a negotiation that will end in a deal. A more pessimistic perspective is that this is a stage in an endless process of fraught negotiations between the two superpowers far into the future. A still more pessimistic view is that trade discussions will break down in a cycle of retaliation, perhaps as part of broader hostilities.

US tariffs look to torpedo China world leadership hopes. China counts on restrained riposte to draw sting from US trade clash.

The steady rise of an America First world. Which it turns out to be also depends on China. It must recognise the shift in US perceptions, of which Mr Trump's election is a symptom. Moreover, on trade, the Democrats are far more protectionist than the Republicans.

What are the forces driving this shift? China's rise has made the US fear the loss of its primacy. China's communist autocracy is ideologically at odds with US democracy. What economists call "the China shock" has been real and significant, although trade with China has not been the main reason for the adverse changes experienced by US industrial workers. The US has also failed to provide the safety net or active support needed by affected workers and communities.

The renminbi rises and reserves finally fall

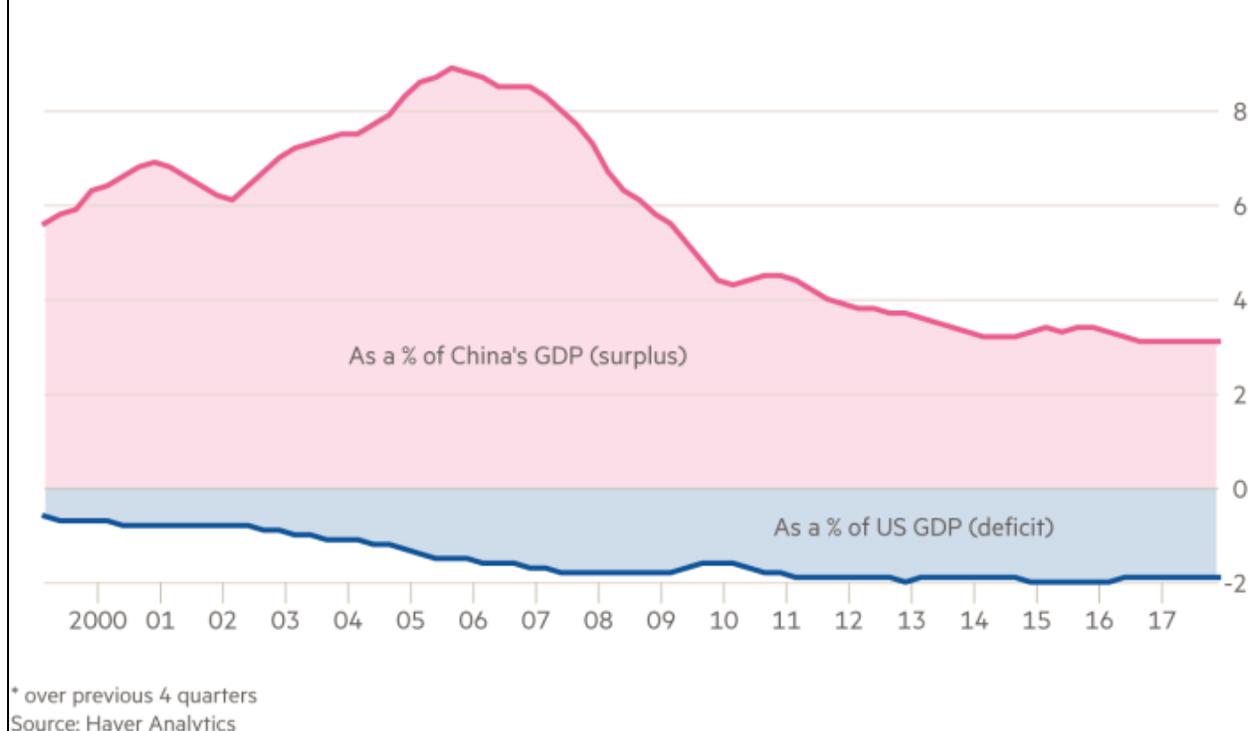


Furthermore, the deal reached when China joined the WTO in 2001 is no longer acceptable. As Mr Trump states, the US wants strict “reciprocity”. Finally, many business people argue that China is “cheating”, in pursuit of its industrial objectives.

Experience shows that the complaints will never end. A decade or so ago, complaints were about China’s current account surpluses, undervalued exchange rate and huge accumulations of reserves. All these have now been transformed: the current account surplus itself has fallen to just 1.4 per cent of gross domestic product. Now complaints have shifted towards bilateral imbalances, forced transfers of technology, excess capacity and China’s foreign direct investment. China is successful, big and different. Complaints change, but not the complaining.

Dependence on its bilateral surplus with the US has fallen

US-China bilateral trade balance (using US trade data)
as a % of GDP*

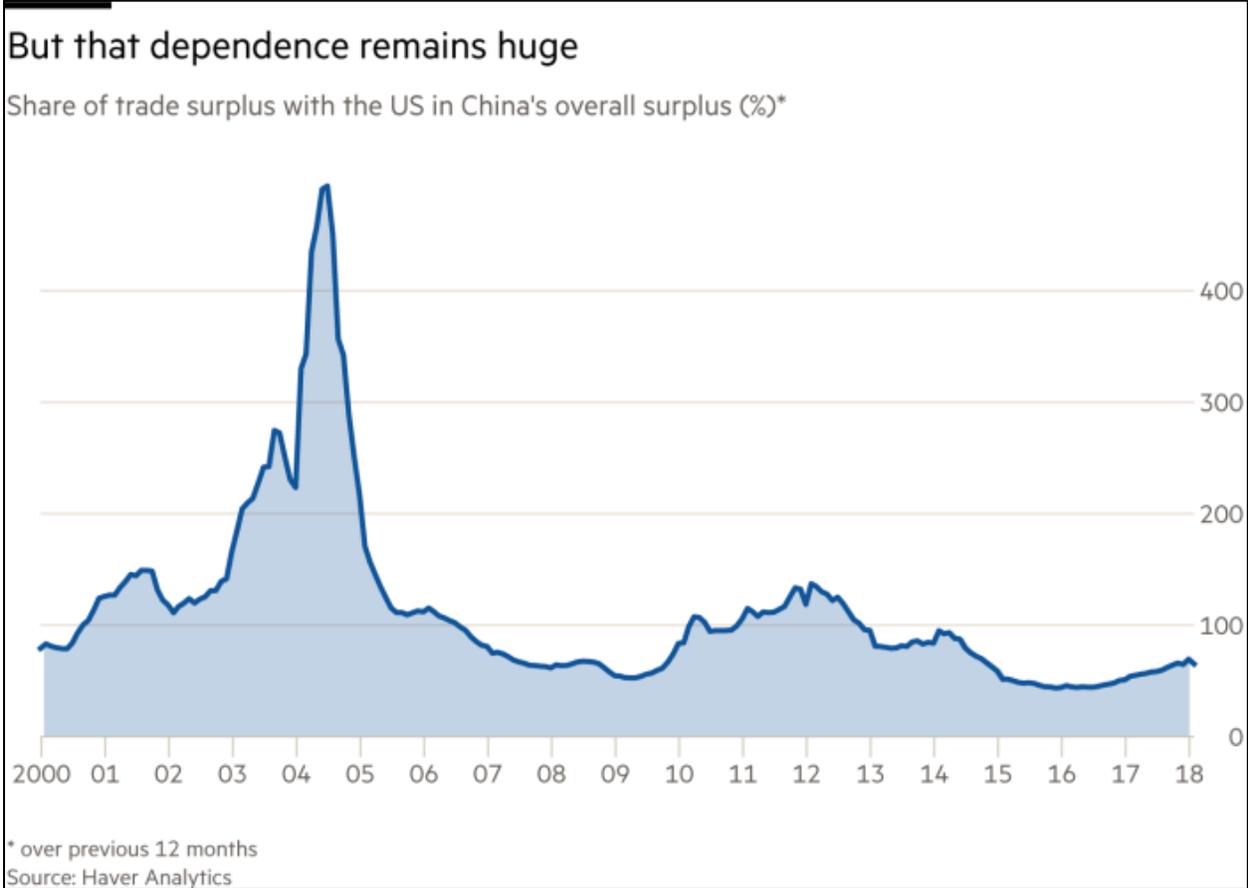


How might China manage these frictions, exacerbated by the character of Mr Trump, yet rooted in deep anxieties? **First, retaliate with targeted, precise and limited countermeasures. Like all bullies, Mr Trump respects strength.** Indeed, he respects China's Xi Jinping.

Second, defuse legitimate complaints or ones whose redress is in China's interests. Liberalising the Chinese economy is in China's own interests, as the astonishing results of 40 years of "reform and opening up" demonstrate. China can and should accelerate its own domestic and external liberalisation. Among the widely shared complaints of foreign businesses, is over pressure **to transfer know-how as part of doing business in China. Such "performance requirements" are contrary to WTO rules.** China needs to act decisively on this.

Third, make some concessions. China could import liquefied natural gas from the US. This would reduce the bilateral surplus, while merely reallocating gas supplies across the world.

But doing the same thing for commodities in which China is the world's dominant market would be far more problematic, since it would hurt other suppliers. Mr Trump may well want China to discriminate against Australian foodstuffs or European aircraft. That way lies the end of the liberal global trading system.



Fourth, multilateralise these discussions. The issue of surpluses in standard products like steel cannot be dealt with at a purely unilateral or bilateral level. As a rising global power, China could play a central role in trade liberalisation, thereby strengthening the system and increasing the world's stake in the health of the Chinese economy. Operating at such a global level brings another potential benefit: it is hard for great powers to negotiate bilaterally, since they tend to view concessions to each other as humiliating. In the global context, however, a concession can be seen as a benefit to everybody. Finally, by operating under the rubric of the WTO, China puts Europeans in a difficult position.

Europeans share US anxieties over China's policies on intellectual property, but they also believe in the rules. If China took the high road, Europeans might feel compelled to support it.

We are in a new era of strategic competition. The question is whether this will be managed or lead to a breakdown in relations. Mr Trump's trade policy is a highly destabilising part of this story. China should take the longer view of it, for its own sake and that of the world.