

Yun Sun | Oct 31, 2019

ISSUE BRIEF

Managing the Fallout of the US-China Trade War

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Topline

Since the beginning of the tariff war in mid- 2018, the escalation of the trade tension is widely expected to continue into the 2020 presidential election season. While President Trump's team may still believe that a trade deal is well within reach in the near future, that perception is not at all shared by the Chinese government. The U.S. and China have entered a war of attrition. The U.S. policy makers need to prepare for a long game in the trade tension and the eventual de-coupling of the two economies, regardless of whether that was the original intention.

The Problem

As the trade war escalates to where it is today, the two negotiation teams have exhaustively discussed the issues of divergence. The 90% of the deal that had been reached by May 2019 represented what the two sides could realistically agree on and the rest 10% most likely will remain unresolved despite more efforts. Quantitatively they might appear minor, yet qualitatively they represent the most difficult disagreements that neither side is at the liberty to make a compromise.

Essential Context

Important Issues Remain Outstanding

On the most immediate issue of lifting the tariffs imposed since the beginning of the trade war, U.S. believes that the pressure must be kept in place for the Chinese to follow through their commitment while the Chinese believe the lack of immediate tariff withdrawal offers them no incentive to have a deal. On the most essential issue of Chinese economic structural reform, the U.S. sees it as the central piece to remove China's unfair economic advantages and trade practice, while the Chinese see it as undermining the economic foundation to the Chinese Communist Party's one-party rule and its legitimacy. On the most controversial issue of the enforcement mechanism of the negotiated result, the

U.S. sees it as indispensable to the trade deal while the Chinese see it as American law and compliance enforcement power on the Chinese territory that will make the U.S. both the umpire and the player in the game. On the most fundamental issue of Chinese legislation to set the agreed content in stone, the U.S., following its legalist tradition, sees it as the necessary guarantee to the implementation of the trade deal while the Chinese see it as a matter of national pride and political impracticality, both due to the Chinese legislator's reputation as the "rubber stamp" and the lack of the rule of law in China.

Further Compromise Would Undermine Xi Jinping's Political Power

The Chinese are stuck with certain positions for political reasons. Each of these issues will lead to broad public outcry and challenges to the Chinese top leader Xi Jinping on his political wisdom, credibility, and therefore, his legitimacy within the Chinese Communist Party. While the government might be able to mobilize the state propaganda machines to manipulate or silence public opinions, what Xi cannot suppress is the discontent and challenges launched by dissenting and grieved factions from within the Party. Any leader of China agreeing to the essential terms the Trump team had posted will be labeled a traitor compromising China's national interests and the Party's political legitimacy. The deal as Washington wanted was politically impossible to begin with.

The War of Attrition Will Encourage Businesses to Decouple US-China Economic Ties

With the irreconcilable bottom lines entangled in the crossfire, the real possibility of a trade deal that the Trump Administration envisioned has rapidly declined, if not completely disappeared. What Beijing can agree to, it has. All that is left- the critical 10%, will remain unmovable. The U.S. might have severely misjudged China's position at the Osaka G20 Summit. For the Chinese, the line is drawn.

That brings us to the war of attrition where escalation of tariffs hurt both economies and the additional measures on technology sanctions, currency manipulation designation as well as the impediment of investment drive the two countries further away from each other. Increasingly, the "de-coupling" of the U.S. and Chinese economies looks inevitable. While the complete severance of the two economies is impractical, the tariff war and the uncertainty associated with the future policies have promoted actors on both sides to change the direction and composition of their supply chains. As examples, American companies fearful of U.S. tariffs are looking to relocate their production lines; Chinese agricultural importers are shifting their import mechanisms to target soy beans from Brazil. Once the supply chain is altered, the changes set in motion are likely to be long-term, if not permanent.

Policy Recommendations

Maintain the pressure on structural reform. While the de-coupling will be a much longer process, the Chinese are much more likely to approach the economic restructuring and trade reform in their own pace and according to their own priorities. Many of the American demands are in line with Beijing's long-term vision. (Others are not.) And one positive effect of the trade war has been the Chinese government's justification to pursue certain reforms against the interest groups' pushback.

Develop realistic assessment on the de-coupling and its effect. The de-coupling will free U.S. from certain vulnerabilities in dealing with China, especially in the era of intensifying great power competition. But the prospect of critically weakening China or even toppling the Chinese government is not at all guaranteed. China will develop its alternative partners of trade, accesses to technologies and supply chains much less subject to future American disruption. Contrary to the belief that any growth rate under 6% will create internal instability in China, the Chinese Communist Party still enjoys a large margin in terms of public tolerance.

State a clear end goal with a balanced approach. The de-coupling is dangerous in that if the two countries shed all ties and common interests, what's left will be the raw and pure conflicting

interests and diverging agendas. If we indeed let the bilateral relations spiral downwards without any brake, a new cold war may not just be people's wild imagination. The American policy-makers must develop more accurate understanding of the origin of China's behaviors and more nuanced and balanced approach to shape them instead of one single maximalist and coercive strategy. The Chinese often wonder whether on China the U.S. is after extortion (a deal) or suppression (a duel). A clear statement of American goals paired with a realistic and balanced way forward will be the most prudent.

Additional Resources

Recalibration and Adaptation: China's Relations with her Key Neighbors during the Trump Era by Yun Sun in China Leadership Monitor, Fall 2019 Issue 61. <https://www.stimson.org/content/recalibration-and-adaptation-china>

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