

Fall 2020, Issue 65, Tuesday September 1, 2020

Questions for Bob Davis and Lingling Wei, authors of *Superpower Showdown: How the Battle Between Trump and Xi Threatens a New Cold War* (Harper Business, June 2020)

At the beginning of the book you describe how in April of last year the Politburo Standing Committee discussed and then rejected a draft trade agreement with the U.S. that had been negotiated between Vice Premier Liu He and his American counterparts. It seems that those who opposed it most vehemently were Xi's closest allies. What could be their possible motives? What were the terms in the draft agreement that the top Chinese leaders found most objectionable or totally unacceptable? Was Xi kept well-informed of these talks as they progressed? What were the dilemmas Xi faced at that time? On balance, do you think he gained politically by rejecting the deal?

Lingling: President Xi Jinping has made himself the Chairman of Everything. At the outset of the talks, Xi established the principles for his chief negotiator, Liu He, and Xi was informed by Liu every step of the way. But despite all that power, he still had to seek the consensus of the Politburo Standing Committee before making any major decisions. That is what happened in April 2019, when Xi held a meeting with the six other members of the Politburo Standing Committee to decide whether or not to accept the deal as it had been thus far negotiated by both sides. Three of the Standing Committee members, also Xi's close allies, rejected the deal, mostly because it was too one-sided in the favor of the U.S. In particular, they disallowed the requirements that China should change specific laws by certain dates or face tariffs. If Xi were to sign off on the agreement as it stood at that time, it would have made him look weak and any number of his enemies could have tried to use it to bring him down. In the meantime, Xi also got a bit of cold feet about cutting a deal with the U.S. Due to the recovering Chinese economy, he felt time was on his side and he could afford to push back. In addition, as is often the case with the Chinese, nothing is finalized until everything is finalized. The entire leadership failed to anticipate how the rebuff would backfire in Washington.

You give an illuminating account of how the Chinese government lost its most valuable American allies – the U.S. business community. Were Chinese leaders aware that their policies and behavior were alienating this powerful and valuable constituency? Why didn't they do anything before the trade war to win back this group? Given the geopolitical hostility between the two countries, could the U.S. business community have made any difference even if it had tried?

Lingling: It took China's leaders too long to realize how much their policies and actions had alienated the U.S. business community, which traditionally had been their strongest lobby in Washington. The global financial crisis had led to a strong sense of hubris in Beijing. China's state-led model was prevailing over America's free-market system, and Beijing actually came to Washington's rescue in late 2008. Why change?

After Xi rose to power in 2012, he saw a greater need to beef up the state sector to strengthen party rule of the country. State firms were the key players in his plans to make China more independent of foreign technology and markets. As to foreign businesses, Beijing believed that a few could really afford to lose access to China's huge market and foreign businesses would always be there even as the government piled up demand after demand on the multinationals.

Bob: In many ways, the Trump administration could not have been more business-friendly. The President courted businessmen and wanted their respect. He appointed lobbyists to senior positions. (In October 2019, *ProPublica* counted 281 lobbyists who had been hired thus far.) Trump also cut tax rates for corporations and high-income earners. On trade, however, Trump listened to his own advice. People like Blackstone's Steve Schwarzman and casino-magnate Sheldon Adelson warned Trump that his trade policies could batter the market. That sometimes got the President to back off. But Trump was determined to use tariffs to try to force China to make concessions and to buy more U.S. goods and services. There was little business could do to convince him otherwise.

The kind of measures pushed hard by Robert Lighthizer may seem tough and even humiliating on the surface (especially his insistence on retaining the tariffs even after an agreement is reached), but could actually in the long run make the Chinese economy more efficient and turn China into an even more formidable geopolitical competitor. Were there fears in the U.S. administration that a "Yes" from Beijing would be worse than a "No"? How did the conflicting impulses within the administration complicate the trade negotiations?

Bob: During a Senate Finance hearing in March 2019, Sen. Sherrod Brown, an Ohio Democrat, asked Lighthizer this very question. If the U.S. succeeded in these trade talks and China made the changes that the U.S. sought, wouldn't that make China a more attractive place to invest? Sen. Brown asked. "You could end up creating more incentives for multinational corporations to close down their American factories," Brown said.

"Not at all," Lighthizer responded. "I hear what you're saying, but to me the real issue is that forced technology transfer is having a negative effect and that's really where we are losing jobs," Lighthizer said. That is the way the administration looked at China. If it could only get China to stop cheating – which was at the heart of the Lighthizer effort – U.S. companies would get a huge boost, and that would lead to more exports as well as to more foreign investment.

Couple that with Trump's push for more purchases. (Trump had a completely mercantilist approach – he wanted more exports, figuring that would reduce the trade deficit.) Those were the two parts of the U.S. trade offensive: reduce Chinese pressure to hand over IP and also force China to buy more things from the U.S. The U.S. pushed and pushed. There wasn't any ambivalence on the U.S. side.

What were the lens through which Chinese leaders saw the trade war? Did they see it as a purely economic dispute, a roughly equal mixture of an economic dispute and a geopolitical conflict, or predominantly a geopolitical conflict disguised as a trade dispute? How did

their perspectives influence their response to the trade war? What was the strategy they finally settled on?

Lingling: Initially, the Chinese leadership thought Trump's trade offensive was purely about trade and it sought a quick end. That explains Liu He's first trip to Washington as Xi's point man on U.S.-China trade relations. During that trip in early 2018, Liu brought with him what the Chinese side viewed as an unprecedented offer – promises to fulfill existing commercial deals and to launch negotiations for a free trade agreement. That offer barely registered with the Americans.

As the back-and-forth negotiations dragged on, especially after the collapse of the talks in the spring of 2019 and the increased U.S. pressure on Huawei, China's leaders started to realize it was not just about trade. As Vice President Wang Qishan once told visiting American CEOs, trade is just one component of a broader fight between the U.S. and China that also includes national security and geopolitical and cultural issues. Wang also said China would not be pressured or bullied.

Wang's comments explain why Beijing has largely employed a "tit-for-tat" strategy. At the same time, it also sees the need to prevent the bilateral relationship from completely collapsing and to make concessions to protect core party interests. The Phase One trade agreement, for instance, was mainly used by Xi as leverage so that Washington would not push too hard on what the Chinese leadership describes as "red-line" issues, such as Taiwan and sanctions against Standing Committee members over Hong Kong or Xinjiang.

It seems that both sides are now actively engaged in reciprocal economic decoupling – the U.S. uses decoupling largely as an offensive tool to contain Chinese power while China responds with defensive decoupling to reduce its vulnerabilities. Although in theory decoupling sounds very appealing to the hardliners in both countries, what are their blind spots?

Bob: We define decoupling as a complete break in economic relations, similar to the very limited economic interchanges between the U.S. and the Soviet Union during the height of the Cold War. Although hawks on both sides may dream of this, we view it as a fantasy. Short of starting a war, U.S. companies are far too invested in China to ever break off completely.

Hawks in Washington need to be careful about what they call for. It is not clear what multinational companies would do if they were forced to choose between Washington and Beijing. Many U.S. companies have already set up overseas to avoid U.S. taxes and regulations. They want to keep investing in China, which is on its way to becoming the biggest market in the world, if it isn't already number one. Moreover, should the hawks succeed and force U.S. companies to scale back enormously, it would harm U.S. competitiveness. Research-and-development spending depends on scale and profitability. Blocking U.S. companies from operating in the Chinese market would undermine U.S. corporations and undermine their ability to innovate and compete. The U.S. has been fairly successful in cutting off Chinese investment into the U.S. That was small-scale anyway, so there was not that much of a loss. However, U.S.

companies and technology require massive investments. There has to be a way to encourage Chinese investment without compromising national security.

Lingling: China is actively promoting a policy that could lead the two economies to be more estranged down the road. The Chinese government is pouring resources into its research labs, universities, and companies to try to reduce China's dependence on American high-tech products, such as semiconductors and software. It is China's "Sputnik moment." But in all this hyped-up effort, the broader issue of how to address an increasingly inefficient system remains. China has already spent billions of dollars on its chip-development effort, but so far its chip designing still lags behind that of the U.S., Japan, South Korea, and Taiwan. This is because the state-driven model has led to a lot of wasteful projects and it has stifled real innovation. To really stand on its own feet, China will need to foster more competition by inviting more, not fewer, foreign businesses.

Overall, have President Donald Trump's objectives (whatever they are) been achieved through the trade war? How has the trade war advanced the larger American strategic objectives with respect to China? How has the Chinese response to the trade war served or undermined the country's fundamental interests?

Bob: The Trump administration never had a single unified goal. There were competing goals on the U.S. side. For Lighthizer and other economic aides, the goal was to get China to end pressure on U.S. companies to hand over technology and to eliminate many tariff and non-tariff barriers that hinder U.S. companies. The U.S. also wanted China to eliminate subsidies and make sure its state-owned enterprises operated as commercial, not political, entities. These are traditional goals of U.S. economic officials, though Lighthizer amped up the pressure far beyond what had come before.

For Trump, the goal was to reduce the bilateral trade deficit. That is the metric by which he judges countries. When he said Germany is a bigger problem than China, he meant it. (That is because Germany has a big bilateral trade surplus with the U.S., but it cannot be pressured directly by tariffs because it is a member of the European Union. The EU, not its member-states, handles trade issues.)

How has it turned out? The Phase One deal has strong language about IP protection. But the U.S. failed to get China to commit to change specific laws and regulations on intellectual property, as it had hoped. There is also no commitment by China to eliminate subsidies – or even to detail them – or to do anything about the SOEs. Chinese economic policy is basically the same as it was before the trade war. China did commit to buy huge amounts of U.S. goods and services. Even before the coronavirus pandemic, those goals were unrealistic. But now they seem impossible to meet. Indeed, the only way Beijing can meet the targets is by ordering its SOEs to ramp up purchases. That would strengthen the role of SOEs, which is the opposite of what Washington wants.

Chinese retaliatory tariffs damaged U.S. companies and farmers. Trump used some of the tariff money to pay off farmers for their lost exports. But the farmers would have sold more to China and would have needed far fewer payments if there had been no trade war.

Overall, it is difficult to see big gains for the U.S.

Lingling: The trade war has hurt China in two major ways. First, it shook public confidence in China's growth prospects. As a prominent Chinese economist said, "China's opening up during the past four decades largely involved its opening to the U.S., along with the rest of the developed world. China should make necessary concessions to keep its growth momentum going."

The loss of any reform momentum in Beijing is the other major casualty of the trade war. Many market-oriented people in China had hoped Trump could help force changes to the country's economic system, as foreign pressure did in years past. That is certainly not the case under Xi Jinping. Trump's pressure tactics have instead helped Xi promote a more hawkish agenda that focuses on making the party the center of everything. These days, Liu He is again trying to get some of the reforms going, especially those involving allocations of credit and other resources and invigorating the private sector. But that will inevitably run up against the need to adhere to Xi's state-led plans.

Your book warns of a new cold war between the U.S. and China. It seems that there is remarkably little public debate or discussion in either country about the costs and dangers of an open-ended conflict between the world's two largest economies. Are we "sleepwalking" into such a conflict? How do Chinese leaders see this new cold war? Are there differing views within the U.S. establishment about waging a full-fledged geopolitical conflict with China? Do elites in each country believe they have already passed the point of no return?

Bob: From the U.S. side, the debate over a new cold war is just beginning – well after Trump should have laid out the case. The 2020 speeches by National Security Adviser O'Brien, Secretary of State Pompeo, Attorney General Barr, and FBI Director Wray all argue that China is the greatest challenge to the U.S. since the rise of fascism. O'Brien and Pompeo describe Xi Jinping as an heir to Stalin, meaning an ideological and military threat. (Interesting, that they do not say Xi is an heir to Mao, which is closer to the truth but far less of an insult. Administration officials wanted an insult.)

The debate will continue during the election season, though probably in cartoonish fashion as in most election-year debates. We'll see how deeply the two countries plunge into a cold war after the election. Biden might look to ease tensions by reaching out to China on issues such as Iran's nuclear ambitions and global warming. Trump might dial back the rhetoric if he thinks he has a chance for a deeper trade deal. Still, the long-term trend of disengagement is likely to continue no matter who is in the White House.

Lingling: It is past the point of no return for China. Xi's leadership now calls the battle with the U.S. a "protracted war" – that means the fight could well last into the next four years, regardless of who is in the White House. The leadership is adjusting its action plans accordingly. Most of the focus now is on building up China's domestic markets and companies and becoming less dependent on foreign firms and investments. Also, Xi's top-down governance style has made any

kind of meaningful debate less likely to occur in China today. That certainly gives rise to heightened risks of policy mistakes. But so far, the leaders seem to be restrained in their retaliation against U.S. attacks. That shows China still wants and is trying to avoid a full-blown shooting war.

About the authors

Bob Davis is a Pulitzer Prize–winning senior editor at the *Wall Street Journal*'s Washington, DC, bureau. He covers economic issues and continues to write about China, where he was posted from 2011 to 2014. Davis has served as the *Journal*'s bureau chief in Brussels, covering the European Union, and as the Latin America bureau chief. He lives in Washington, DC.

Lingling Wei is an award-winning senior China correspondent, who was based in the *Wall Street Journal*'s Beijing bureau from 2011 until China expelled *Journal* reporters in 2020. Hailing from a farm province in southeastern China, she came of age as a journalist in New York and then returned to China in early 2011 to report on changes in her homeland. She focuses on the intersection of Chinese politics and the economy.