CURRENT HISTORY

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The Lose-Lose Trade War

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It was a high-stakes race on the high seas. Carrying 70,000 tons of American soybeans, the container ship *Peak Pegasus* sped to China, seeking to deliver its cargo before the trade war was due to formally begin on July 6, 2018. The vessel unfortunately arrived hours too late, and had to lie idle off the northeastern Chinese port of Dalian for two months. Docking, unloading, and clearing customs came at an extra $6 million cost in punitive import duties, paid by the Chinese buyer to the Chinese customs authorities.

This is just one snapshot in the lose-lose outcome of the ongoing trade war between China and the United States, which has shattered the once-popular liberal idea that economic interdependence would foster more harmonious relations between the two great powers. As they exchange tit-for-tat tariffs, vast numbers of importers, exporters, manufacturers—and, ultimately, consumers—bear the brunt of the fallout. American farmers are suffering their worst slump in decades, and some have been forced into bankruptcy. At the same time, Chinese consumers are paying more for pork and soybean products; inflation has been creeping up.

But this is about more than a battle of wills over a trade imbalance. The feud not only has precipitated an economic decoupling of the United States and China, but also has pushed the overall bilateral relationship to its lowest point in half a century. Unnerving as it is, this new norm was years in the making.

After the 2008 global financial crisis, and especially after Xi Jinping took power in 2012, China abandoned its modus operandi of lying low and biding its time—a strategy dictated by Deng Xiaoping in the 1980s—and became more assertive in its pursuit of power and influence abroad. Its clashes with the Obama administration on a range of issues—not least Taiwan, the East and South China Seas, and cybersecurity—provoked a fundamental rethinking among American scholars and practitioners of the engagement paradigm that had underpinned Washington's China policy since the Nixon era. A more adversarial US-China relationship was taking shape. The trade war might have begun in 2017 had President Donald Trump not decided he needed China's help to contain North Korea first.

Now, though, basking in the glow of a booming US economy, the Trump administration has resorted to draconian means to punish China. Chinese leaders have viewed some of the American demands as an assault on their nation's political system, sovereignty, and dignity—and resisted them ferociously.

A year after the trade war began, it has turned far worse than most expected and dampened the growth prospects of the global economy. Even if it is officially declared over soon, the geopolitical and strategic rivalry between Beijing and Washington will persist and may well intensify. Considering the size and power of these two giants, the downward spiral in their relations has far-reaching implications for the whole world.

A KOREAN HONEYMOON

Trump has been consistent in his economic nationalism. Railing against America's perennial trade deficit was a mainstay for him on the campaign trail. He found a perfect piñata in China. Alleging that the United States had been "raped by China," he promised to slap tariffs as high as 45 percent on Chinese goods.

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No sooner was he elected than Trump broke decades of precedent by taking a congratulatory call from the president of Taiwan, Tsai Ing-wen. But before he could convert his anti-China rhetoric into actual US policy, he was persuaded that the more pressing national security imperative was tackling North Korea's nuclear weapons program—and even asked for Tsai's assistance on that matter. That was a rookie mistake in diplomacy, since it has long been assumed that the road to Pyongyang goes through Beijing first. Upon realizing that Chinese cooperation would be indispensable to implementing his "maximum pressure" strategy against North Korea, Trump made a U-turn on Taiwan by reaffirming the longtime US "one China" policy, which avoids directly challenging Beijing's claim that Taiwan belongs to China.

Long exasperated with North Korea's provocations, which were destabilizing the region and complicating Beijing's relations with South Korea, Xi consented to and executed fresh rounds of United Nations Security Council sanctions targeting North Korea's exports and imports, most of which went through China. Trump had flattering words for his Chinese counterpart, calling Xi his "dear friend." Even as his administration was brandishing tariffs against other trade partners, Trump dangled the prospect of a favorable trade deal with Beijing if Xi could solve the "North Korean problem" for him.

TARIFF MAN

In November 2017, Trump paid his maiden visit to Beijing and was given a personal tour of the Forbidden City by Xi and his wife. American business leaders accompanying Trump garnered deals worth $250 billion, but many of them were in the form of memoranda of understanding rather than formal contracts—a prize that was symbolic at best.

For the time being, though, the Trump administration was stretched thin by vacancies in key positions and was busy negotiating revisions of the North American Free Trade Agreement and the US trade pact with South Korea. In an opening salvo in his trade wars, Trump imposed tariffs of 30 to 50 percent on foreign solar panels and washing machines in January 2018. Two months later came tariffs on imported steel and aluminum. But Chinese producers were largely unscathed due to a lack of exposure to the US market.

US-China negotiations to address the bilateral trade imbalance began in earnest in late February 2018. The two sides quickly staked out positions poles apart. Soon, as a negotiating tactic, each side began publicizing lists of goods to be targeted for tariffs. Once again, though, North Korea burst onto the scene when Trump announced his impromptu decision to meet with Kim Jong-un in Singapore. Xi reportedly was taken by surprise, like everyone else. When Kim showed up two weeks later in Beijing, however, it was Trump's turn to be blindsided. A second Xi–Kim meeting ensued six weeks later.

Trump began to bristle over North Korea's increasing demands for US concessions as a precondition for the Singapore summit. He accused Xi of double-dealing and called off his rendezvous with Kim. Only after entreaties by South Korean President Moon Jae-in did Trump agree to go through with the meeting. Trump left his inconclusive summit with Kim claiming that "there is no longer a nuclear threat" from North Korea.

Before going to Singapore, Trump had ordered—as a "personal favor" to Xi—the lifting of an export ban on ZTE, a state-owned Chinese telecommunications firm in Washington's crosshairs for violating the US embargo on Iran. But he was still dissatisfied that the trade talks had yielded no firm Chinese commitment except meager offers to buy up to $70 billion in energy, agricultural, and manufactured products.

On July 6, 2018, the trade war officially began as the Trump administration followed through with its threat to impose a 25-percent tariff on Chinese products valued at $34 billion and Beijing returned fire, dollar for dollar. As Trump continued to blame China for undermining his efforts to denuclearize North Korea, two more rounds of tariffs were implemented in August and September, bringing the total value of affected Chinese goods to $250 billion.

Over dinner in Buenos Aires on December 1, on the sidelines of a Group of 20 summit, Xi and Trump agreed to a truce. Both sides would refrain from increasing tariffs or imposing new ones, and they would aim for a formal agreement by March 1, 2019. As a goodwill gesture, China temporarily lowered tariffs on US car products and resumed purchases of American soybeans.

TAKEN BY SURPRISE

For all their defiance and counterpunches, Chinese leaders were caught off guard when Trump pulled the trigger on tariffs. Having played along on North Korea, they assumed that the seemingly good chemistry between Xi and Trump had more or less stabilized the relationship. Keen to prove to their domestic audience that China under the Communist Party would never cave in to a foreign power, they felt they had no choice but to match tough rhetoric with action in the face of Trump's ultimatums. It was a matter of self-defense, Chinese officials and analysts reiterated. Left unsaid was how they had erred in their assessment of Trump and the general tenor of the bilateral relationship.

China's political class had seen Trump as the lesser of two evils in the 2016 US presidential election. Beijing was wary of Hillary Clinton, a China hawk who spearheaded the Obama administration's "pivot to Asia," which was squarely aimed at counterbalancing Chinese expansionism. In Trump, Chinese officials and analysts found an atypical American politician who had no interest in lecturing them on democracy and human rights. His broadsides against the Obama-led, China-excluding Trans-Pacific Partnership trade pact—and against American allies, including Japan and South Korea—were music to their ears.

Despite Trump's anti-China tirades, the prevailing belief in Beijing was that a businessman who prided himself on mastery of the "art of the deal" must be pragmatic and realistic. Therefore he would not want to upset the applecart of broader US-China ties—arguably the most important and complicated bilateral relationship in the world today.

Anchoring that relationship, in the typical Chinese analysis, is the robust economic bond that has manifested itself in two-way trade and investment worth hundreds of billions of dollars every year. It supposedly bound the two countries of disparate cultures and political systems together in a manner that rendered divorce impossible for this "bickering couple," another analogy numerous Chinese officials were prone to using.

This economic interdependence gave many of them the false impression that China had achieved parity in power with the United States, which boosted their confidence. The belief that a unilateral disruption of this "win-win relationship" would amount to mutual destruction in economic terms gave Beijing excessive assurance that the vagaries of Washington's China policy would not swing too far.

Any trade deal will be just a temporary cease-fire in a long-lasting economic war.

Yet the Chinese view was not entirely baseless. The last time the United States had tried to leverage access to the American market as a way of punishing China, in 1994, President Bill Clinton had to walk back his threat to link China's privileged trading status with its human rights record after the pro-China business community turned against him. Trump surely would face a similar boomerang effect should he carry out his threat to impose punitive tariffs. Beijing's retaliation would cause targeted pain for Trump's electoral underbelly, the Midwestern swing states that were pivotal in his improbable 2016 victory but dependent on the Chinese market for their agricultural exports.

So entrenched was the belief that self-interest would deter Trump from putting into practice what he preached that China's political elites failed to fully grasp his unpredictability, a trait he himself touted as a key ingredient of his business successes. Nor did many Chinese observers realize that the thriving US economy had further emboldened Trump.

It is doubtful that many Chinese officials and analysts ever seriously contemplated the outbreak of a trade war, let alone prepared for it. Some continued to publicly play down the possibility, even after Trump had already used tariffs against traditional US allies.

The trade war came at an inopportune time for China—just as its economy was going through a rough patch, weighed down by mounting public debt, an overheating real estate market, stock market volatility, and the collapse of numerous online lending schemes. Signs of stress from the trade fight soon appeared almost everywhere: stocks slumped and the renminbi depreciated, inching close to the symbolic level of 7 to the dollar. As business confidence declined, consumer spending began to show signs of flatlining just when it was sorely needed to boost the economy.

The government cranked up its censorship machine to tamp down talk of an economic slowdown on social media. However, that could not stop the spreading news of a bad hiring season for fresh college graduates and large numbers of layoffs by previously high-flying Internet companies. In intellectual circles, murmurings of dissent and unease, and questioning of the authorities' handling of the economy and US relations, could also be heard in coded language. Even Deng Xiaoping's eldest son reportedly expressed dismay at the jettisoning of his father's foreign policy strategy of keeping a low profile, as well as the broader direction the country was taking.

THE HARD BARGAIN

The restart of negotiations in December 2018 was a welcome reprieve. To appease Trump, the apparent solution for Beijing was to buy more American products. But the reality was far more complicated. Whereas mainstream US economists, trade experts, and business leaders dismissed Trump's fixations on the trade deficit and China's currency manipulation as misplaced or outdated, they were nonetheless united in their frustration over Chinese trade practices and economic policies. The list of complaints spanned restricted market access for foreign firms, state-sponsored industrial espionage, intellectual-property theft, forced technology transfers, and government subsidies for Chinese companies.

The Made in China 2025 plan, a strategic blueprint that the Chinese government unveiled in 2015, called for achieving global leadership in 10 industries, such as information technology and robotics. It fueled fears over China's ambitions. Once the trade war was in full swing, the bigger question became whether Trump should settle for a deal that would narrow the nearly $400 billion annual US trade deficit with China, or push for more: long-term structural changes in China's economic system.

Chinese leaders were caught off guard when Trump pulled the trigger on tariffs.

Determined not to reach a deal only to see China stonewalling or backtracking later, the Trump administration was dead set on an enforcement mechanism. Beijing resisted a US demand for a provision that would allow Trump to impose unilateral tariffs if he deemed Chinese actions in violation of the deal. After Treasury Secretary Steven Mnuchin announced that Washington was prepared to accept an enforcement scheme that "works in both directions," speculation was rife that a final deal was in the offing.

But then, on May 5, came bombshell tweets from Trump accusing Beijing of reneging on prior concessions, and threatening to ramp up tariffs on Chinese goods. A visit to Washington by Vice Premier Liu He, Xi's right-hand man for economic policy, failed to break any new ground. On May 10, Trump raised punitive duties from 10 percent to 25 percent for $200 billion worth of Chinese goods. China responded with tariff hikes on $60 billion worth of American goods, mostly agricultural products and other raw materials.

Contradictory accounts of what had derailed the negotiations emerged. Public comments by Liu suggested that there were three main fault lines: Chinese demands that tariffs be lifted once a deal was in force, the appropriate volume of Chinese purchases of American goods to narrow the deficit, and US demands that China codify concessions in law. Perceptions and misperceptions about each other's strengths and weaknesses also played a role. Whereas Trump repeatedly boasted that Beijing was desperate because its economy was suffering, his pressure on the Federal Reserve to lower interest rates was seen by the Chinese as a sign of his eagerness to cut a deal that could boost the US economy as well as his reelection chances. Xi appeared emboldened by such perceptions to reject sweeping US demands as infringing on Chinese sovereignty.

Beyond the clash over trade, the two sides have been waging a parallel struggle over high-tech supremacy. Thanks to investment, innovation, and government protection over the years, China is fast gaining an edge in some critical industries of the future, such as artificial intelligence, self-driving automobiles, and fifth-generation (5G) mobile communications technology. This prospect of Chinese global domination in technology has prompted Washington to deploy all the powers at its disposal to limit China's reach in the United States and abroad. The administration and Congress have toughened laws and rules aimed at restricting Chinese investment and acquisitions of high-tech companies. Individual Chinese companies and businesspeople were targeted.

Right in the bull's-eye is Huawei, the world's largest telecommunications equipment maker and a leader in 5G technology. The company has been blocked from the US market for years, but American officials have grown more strident in their warnings that Huawei products could contain "back doors" designed to let Chinese intelligence agents snoop on communications or bring down networks altogether. While no concrete evidence has been presented for such claims to date, Edward Snowden's 2013 leaks of US National Security Agency secrets revealed that it had hacked into Huawei's servers.

In December 2018, at the behest of Washington, Canadian authorities arrested Huawei's chief financial officer (and daughter of its founder), Meng Wanzhou. Along with the company, she was indicted in January by the US Justice Department for allegedly stealing trade secrets and evading US sanctions on Iran. In the wake of the breakdown in trade talks in May, the US government effectively declared all-out war on Huawei by cutting off its access to American software and components.

In a meeting with Xi at the G20 summit in Osaka, Japan, in late June, Trump promised to ease some of the restrictions on Huawei, and the two agreed to a second truce. Negotiations between top Chinese and US officials restarted a month later, but yielded little. The truce soon gave way to renewed escalation of the trade war.

Complaining that China had not purchased US farm goods in the quantity it had promised, on August 1 Trump announced that he would slap tariffs on an additional $300 billion in Chinese goods. If this order is executed in September as scheduled, almost all Chinese imports would then be subject to Trump's tariffs. China immediately retaliated by suspending all purchases of US agricultural products. Days later, its central bank allowed the yuan to depreciate below 7 per dollar, the lowest level in 11 years, prompting the US Treasury Department to label China a "currency manipulator."

Acute Insecurity

It is now apparent that any trade deal struck between Beijing and Washington in the near future will be just a temporary cease-fire in a long-lasting economic war—a conflict that stems from the US strategic recalibration on China. The old American approach, commonly known as engagement, sought to guide China's rise and integration into the global economic and security systems in a peaceful and gradual manner. This process, which notably included China's entry into the World Trade Organization in 2001, was predicated on the West, and especially the United States, playing a "mentoring" role to China (and ensuring it changed to their liking).

But as it turned out, China's ascent fueled an acute sense of insecurity in the United States, not least because China, under Xi, has increasingly flexed its muscles in its regional vicinity and in global forums. Beijing has plowed ahead with the massive Belt and Road Initiative (BRI), Xi's signature foreign-policy project, designed to promote Chinese infrastructure development and investments around the world. Whereas many scholars contend that the BRI is economic in nature and chaotic in execution, American officials have characterized it as a geostrategic challenge to the US-led liberal international order. In retrospect, even before Trump's election, the writing was on the wall that a recasting of America's China strategy would be necessary.

Under Trump, suspicion, fear, and resentment have hardened into outright hostility. Such sentiments were laid bare by Secretary of State Mike Pompeo's claim in May 2019 that China poses "a new kind of challenge, an authoritarian regime that's integrated economically into the West." Pompeo made the remark in London while lobbying European countries to boycott Huawei.

US policy makers are more prone than ever to see any Chinese activity through the prism of national security, even at the expense of other interests. Politicians on both the left and the right have warned against the purchase of seemingly innocuous rail cars made in China. In March, the Committee on Foreign Investment in the United States ordered the Chinese owner of Grindr, a popular gay dating app, to divest—out of concern that Chinese authorities might gain access to its user data and blackmail its American users, especially military and intelligence personnel.

In April, FBI director Christopher Wray openly championed "a whole-of-society approach" toward China. A number of Confucius Institutes, Chinese government-sponsored centers for culture and language training, have been closed on university and college campuses. Several researchers of Chinese origin have lost their jobs due to their links to China, and a much larger number of Chinese students and scholars have been denied US visas or had their existing ones voided. Such trends not only have aroused suspicions of racial profiling and stereotyping, but also risk impeding normal people-to-people exchanges of a cultural and commercial nature.

In April, the State Department's director of policy planning, Kiron Skinner, cited the fact that China is "not Caucasian" to help explain the US-China competition, seeming to invoke the controversial "clash of civilizations" thesis of the late political scientist Samuel P. Huntington. Xi, speaking at the Conference on Dialogue of Asian Civilizations, denounced the argument as "stupid" and "disastrous." Meanwhile, China's propaganda apparatus has launched a blitz aimed at domestic as well as international audiences, vowing not to back down in the face of American pressure.

Spiraling confrontation

Back in October 2018, a speech by Vice President Mike Pence accusing China of (among other things) interfering in the American political process stirred many pundits into talk of an unfolding cold war between the world's two greatest powers. The Trump administration subsequently indicated that it had extended the zone of confrontation with China to regions as far afield as Africa, the Arctic, and Latin America.

Still, the sites of more immediate concern are the South China Sea, where US warships routinely sail through disputed waters in a challenge to Chinese territorial claims, and Taiwan. Despite Trump's earlier promise to stick to the "One China" principle, his administration has ignored Beijing's angry protests and warnings while steadily elevating diplomatic and military ties with the pro-independence government of the Democratic Progressive Party in Taiwan.

China's political class has been jolted by the intensification of American hostility. Even though Xi personally dismissed the possibility of a "Thucydides trap," a situation where tensions between a rising power and an established one spiral out of control and lead to war (as they did between Athens and Sparta in ancient Greece), they are now at least one step closer to it. By no means had Beijing planned for this to happen. Xi told Trump in their first meeting that "there are one thousand reasons to strengthen the Sino-American relationship, and not even one to damage it."

Having turned China's one-party rule into one-man rule, however, Xi faces the unenviable choice of either giving in to American demands or challenging the United States head-on. He has called on the nation to revive its revolutionary spirit to prevail in what looks to be a protracted period of confrontation with the United States. State media have lashed out at those at home who call for a compromise.

As the Chinese economy braces for a severe downturn, the government has redoubled efforts to shore up employment and introduced new stimulus packages. However, the shift of supply chains out of China is accelerating as the trade war drags on. Beijing's attempt to create its own blacklist and its veiled threat to cut off rare-earth exports to the United States in response to the Huawei ban will force more foreign investors to rethink their China strategies.

Nor is further squeezing China necessarily in American interests. Already farmers' losses are piling up after China stopped purchasing pork, soybeans, and other agricultural products. The Trump administration pledged to provide $15 billion in farm aid, but that will be barely enough. And since punitive tariffs now also cover consumer goods from China, American consumers will have to pay more, even though Trump has misleadingly claimed that China will foot the bill.

Washington's ultimatums have put many countries in the awkward position of tiptoeing between the United States and China. The US campaign against Huawei is a prime example of how superpower competition poses dangers for smaller countries. While Meng Wanzhou fights her extradition to the United States in a Canadian court, three Canadians have been detained in China, with one sentenced to death for drug smuggling.

The concurrent rise of anti-Americanism in China is bound to stiffen Beijing's resolve. That would be unfortunate, because for every irreconcilable difference between the United States and China, there is another area for bilateral cooperation, be it climate change, financial stability, or regional security.

Washington and Beijing need to find a modus vivendi for the range of issues that have put their relations to the test, including North Korea. Most urgently, Trump and Xi must figure out how to put the trade war behind them, now that the resulting market uncertainties have dampened global economic growth. The imperative of managing a competitive coexistence will test the wisdom and judgment of the leaders of both countries as they search for a mutually acceptable resolution to the ongoing economic dispute—and to the future crises that will inevitably arise in this complicated dance of giants. ■