China might dance to trump’s tune – for a while

Henry Ergas 12:00AM February 1, 2019

Illustration: Eric Lobbecke.

As US and Chinese negotiators struggle to reach agreement before higher American tariffs on Chinese goods come into effect on March 2, it is increasingly clear that the Trump administration has two distinct, and potentially inconsistent, goals.

The first, which Donald Trump is focused on, is to vastly boost Chinese purchases of US goods, fulfilling the President’s promise to reduce the trade imbalance.

The second, which is the prime concern of American business and of the national security establishment, is to rein in China’s industrial policies.

Those policies aim to raise China’s technological capabilities through an array of instruments that go from coercing foreign firms into transferring technology to their Chinese counterparts, to tolerating (if not facilitating) the theft of intellectual property.

As one might expect, the Chinese authorities are far more willing to accede to the first of those demands than to the second.

Wasting public money so as to buy off conflict is deeply ingrained in their way of operating. If they must squander some of their still enormous reserves of US dollars on American goods, that seems a paltry price to pay for avoiding a trade war.

As for the goods themselves, China could re-export them at a deep discount, displacing more efficient producers.

And if that won't work, there is plenty of room for them to rot alongside the unused airports, empty housing projects and surplus manufacturing plants that litter China's landscape.

From an economic efficiency perspective, it is hard to say a kind word about forced sales of that type. But even putting their inefficiency aside, it is apparent they would make the US more, rather than less, dependent on China.

In effect, the lower the degree to which the Chinese actually need the goods (or the more readily they can obtain them from other sources at lower cost), the more credibly they can threaten to stop the purchases, inflicting pain that will only grow as American firms take hiring, borrowing and investment decisions that rely on those purchases continuing.

That possibility is hardly likely to prevent those purchases from figuring prominently in any agreement. But there is an obvious tension between them and the objective of containing China's growing power.

Some of the trade issues that objective raises are relatively straightforward.

There are, in particular, areas in which China's conduct seems plainly inconsistent with its international obligations, most notably in respect of intellectual property.

The administration of the intellectual property laws in China remains shambolic and marred by cronyism and corruption; so too are the courts that hear intellectual property cases. Given slack enforcement, the -unauthorised copying of patented or copyrighted material is widespread, as is the misappropriation of trademarks.

As well as damaging China's trading partners, there is mounting evidence that the ease with which intellectual property can be stolen undermines China's own efforts at industrial upgrading. More specifically, it has helped divert China's research and development capabilities from genuine innovation to thinly disguised imitation.

As a result, while China's stock of patents has grown in line with its rising number of scientists and engineers, fewer of those patents are technically significant than was the case for other fast-growing countries at similar levels of industrial development.

Remedying that would seem to be in China's own interest, rather than being merely a concession to the US. But that is less clearly the case for China's ambitious "Made in China 2025" plan, which is also in the Trump administration's sights.

As far as the Chinese are concerned, that plan merely follows similar efforts the East Asian "tigers" made during their rapid-growth phase. And their plan, they argue, is on a smaller scale and more market-oriented than its predecessors elsewhere.

Those claims are not unreasonable. It is, for instance, likely that Japan's

NEC received far greater public assistance as it moved towards the technological frontier than Huawei has. And it is a fact that the French - government intervened more directly and drastically to favour the emergence of Alcatel as a major force in global telecommunications than anything China's 2025 plan envisages.

Moreover, those interventions were mirrored, albeit much less successfully, in Britain and Italy, which also sought to transform their telecommunications equipment producers into export powerhouses.

Last but not least, in the US itself defence funding played a crucial role in the development and rapid commercialisation of telecommunications technologies that include fibre optics, digital switching and data transmission.

To that extent, compelling China to abandon its 2025 plan would prevent it adopting policies that other countries — rightly or wrongly — pursued as they sought to enhance their technological capabilities. As such, it would represent an unacceptable restriction on China's sovereignty.

But while those points have their merit, there are crucial differences between China's situation and those of the countries that adopted similar policies in the past. In part, that is a question of sheer size. Whatever Japan's industrial policies may have been 50 years ago, when Japan was a relatively insignificant player in international markets, they had much less impact on the world economy than China's now have, with - globalisation only accentuating the difference. The most salient difference, however, is political. Although France and Japan posed a commercial challenge to their trading partners, they were hardly a strategic threat.

In contrast, China is an authoritarian, one-party state in which every business decision is potentially subject to the Communist Party's direction.

To make matters worse, instead of receding, as was widely expected when China joined the World Trade Organisation in 2001, the party's control over the economy has increased dramatically. And there is every reason to fear that the Chinese leadership's aim, in strengthening the country's technological capabilities, is to bolster its capacity to project force domestically and overseas.

All that creates an unavoidable contradiction between China's regime, which makes economics an instrument of politics, and the world trading system, which is more sharply than in the past premised on their rules-based separation. Yes, China has mooted some concessions, such as rolling back the preferential treatment of government-owned businesses and easing restrictions on foreign subsidiaries, but they are limited, gradual and hard to enforce.

Faced with those difficulties, the Trump administration may well concentrate on extracting promises of billions of dollars in American exports, securing badly-needed "announceables" the President can boast about.

That would appease the immediate tensions, reducing the uncertainty weighing on the world economy, while leaving to another day the industry policy issues, which are as complex as they are combustible. The risk, however, is that as China's technological capabilities grow, and its bellicose nationalism with them, hosing down today's conflict may simply ensure "the fire next time".