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The Trade War's Too Broad to Turn on Quick Fixes

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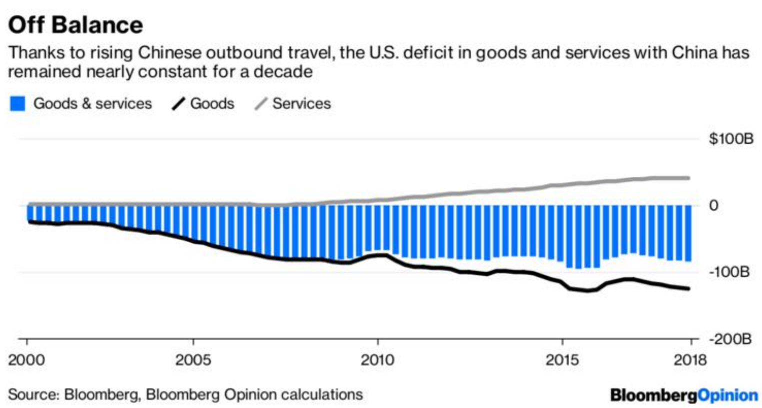
Count the straws in the wind, and it looks like the trade tensions between the U.S. and China could be moving closer to a resolution. Don't relax just yet, though.

Beijing will delay by a decade some of the targets in its Made in China 2025 program to move into high-technology industries, people familiar with the matter told Bloomberg News this week. The news comes on the heels of a Reuters report that PetroChina Ltd.'s parent China National Petroleum Corp. has suspended investment in Iran's South Pars gas project in the face of U.S. sanctions on Iran. To add the icing on the cake, China has suddenly ordered as much as 2 million metric tons of soybeans from the U.S., ending an unofficial ban that's been going on throughout the current crop year.

That all sounds positive – but it must be balanced against the fact that Iranian oil, Made in China 2025 and soybeans are just skirmishes in a much broader conflict. Small moves around the front lines won't change the underlying casus belli.

Let's imagine a deal between the two sides that goes beyond anyone's expectations. Made in China 2025's controversial import substitution targets – which fix planned levels of market share for domestic companies in key industries – aren't just deferred, but abolished altogether. That would see the program scaled down to something more like France's government high-tech industry programs, such as the 10 billion euro ($11.4 billion) Industrie du Futur plan or the 57 billion euro Programme d'Investissements d'Avenir, or even the German Industrie 4.0 plan on which it was originally based.



Meanwhile, technology transfer requirements are abolished along the lines that we've suggested and the list of penalties for intellectual-property theft announced last week successfully fills the enforcement gap in that area. Each country drops its punitive tariffs against the other, and China imports growing volumes of U.S. foodstuffs and consumer products. A weaker greenback and a recovery in Chinese outbound travel and education even help to narrow the bilateral deficit in goods and services.

Would that be sufficient to end the dispute between the two sides?

The question ultimately comes down to the war that's being fought. If it's a limited one intended to fix minor issues around China's international trading relations, the period of negotiations leading up to March 1 could be fruitful. Removing irritants around investments in Iran and purchases of soybeans (which in the latter case will still remain subject to 25 percent tariffs) seems a sensible way of clearing the way for a workable deal.

Bringing more cases through the usual World Trade Organization channels would also help, for all that this approach is now scoffed at: China's compliance with WTO rulings is "actually quite good,", according to an analysis last month by the Cato Institute, with no instances where it simply ignored rulings as has happened with both the U.S. and European Union.

That's clearly not the battle that's being pursued by U.S. Trade Representative Robert Lighthizer, though. What's needed instead are "fundamental changes to China's trade and investment regime, including the overarching industrial policies that have continued to dominate China's state-led economy," in the words of his January report to Congress on compliance with WTO rules.

It's hard to see how's there's much room for a deal on that front. As we've argued in the past, China's love of fostering state-owned national champions works to the detriment of its own economy, but it's not intrinsically an affront to a global trading system that doesn't consider a business to be receiving subsidies unless it's actually receiving subsidies.

Its industrial policy, meanwhile, has been one of the greatest economic success stories of the post-war era, and is fundamental to the legitimacy of the government. It's frustrating that China's integration with the global economy has seen its government grow less rather than more liberal, confounding the hopes of many at the time of its WTO accession. But trying to slow its economy with tariffs and embargoes is unlikely to reverse that trend or improve the welfare of its people. Quite the opposite.

U.S. and Chinese trade negotiators must decide what sort of victory they want out of the coming months. If this is about checking China's strategic rise, there are no grounds for compromise. Only a more limited deal like those with Mexico, Canada and South Korea can work. Small is beautiful.