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# Reading the Tea Leaves on U.S.-China Economic Relations

The claim that the U.S.-China relationship will be the 21st century's most important has become a cliché repeated at policy gatherings in Washington and Beijing. It also happens to be the truth. For better or worse, the trajectory of that relationship will be established firmly before the next U.S. president takes the oath of office.

If one were to predict the nature of the bilateral relationship over the next few decades by extrapolating from trends during any six-year period between 1978 and 2006, expectations would be quite positive. Despite occasional frictions, the relationship bore fruit for people in both countries and the broader geopolitical and philosophical differences between the U.S. and Chinese governments were, to a large extent, quarantined from infecting mutually beneficial economic relations.

That appears to be no longer the case. Although the massive economic relationship – which reached a record half trillion dollars of trade and investment flows in 2012 – is still mutually beneficial, the future of U.S.-China relations based on developments over the most recent six years appears more problematic. Today, it seems, most bilateral economic frictions are magnified through the prism of those geopolitical and philosophical differences, making controversies seem larger and more intractable.

In general, policymakers had been mostly welcoming of China's growth until things started to change in the second half of the second term of the George W. Bush presidency. When Democrats regained control of Congress in January 2007, the emphasis of U.S. trade policy shifted from liberalization and accommodation to enforcement and prosecution. Skepticism over trade, its benefits, and the intentions of certain U.S. trade partners – China, in particular – animated the new congressional trade agenda.

The Great Recession and the election of Barack Obama accelerated reevaluation of the U.S.-China relationship, which was rapidly swept into the emerging narrative of "American decline." In 2009, as the United States was crawling out of recession at very low rates of growth, experiencing high unemployment, heavily indebted, and stricken by uncertainty about the future, opinion leaders observed China's continued near-double digit annual economic growth rates and asked two questions: Where did we go wrong? What did China get right? The answers that most resonated were that the United States had been too permissive of China's rise and that it was time for a tougher policy tack, and that the secrets of China's success were five-year plans and other elements of state-directed capitalism.

The confluence of media hyperventilation over China's inexorable rise to global preeminence and U.S. politicians' habits of scapegoating China for their own failures spawned a popular impression of China as an adversary in a zero sum game. In that game, exports are considered Team America's points, imports are Team China's points, and the trade account is the scoreboard.

Since the scoreboard showed a deficit, the United States was portrayed as losing at trade and it was losing because China perpetually cheats. Currency manipulation, subsidization of industry, dumping, intellectual property theft, discrimination against imports, forced technology transfer, indigenous innovation policies, raw material export restrictions, and other allegations of cheating came to define Chinese trade practices. Of course, some of the allegations had merit.

Buoying these claims was a report published by the American Chamber of Commerce in China – an organization of American multinational corporations that had for years counseled the U.S. government against taking provocative actions that might frustrate the economic relationship. The report identified questionable and possibly illegal Chinese policies intended to thrust China to preeminence in a variety of industries and documented how China's market reforms had been abandoned in 2002 and a subsequent re-embrace of state planning, support for state-owned enterprises, and official discrimination against imports and foreign companies operating in China had begun in 2003.

Meanwhile, on the home front, the U.S. government seemed to be taking a page right out of the same Chinese playbook it had so frequently criticized. That may come as a surprise to some, but those who follow trade policy closely may be aware that the United States has a rich history of skirting the rules of trade that it so often invokes to discipline China's (and other trade partners') actions. In fact, U.S. policies have been the subject of more World Trade Organization disputes (119) than have any other countries policies. (The EU is second with 73 and China is third with 30). No government is more likely to be out of compliance with a final WTO ruling – or for a longer period – than the U.S. government. In fact, to this day, the United States remains out of compliance on issues adjudicated several years (and sometimes more than a decade) ago.

U.S. subsidization of industry took off in earnest in 2009 under the American Recovery and Reinvestment Act and through other channels. Special deals for chosen companies, such as the infamous solar panel maker Solyndra, were cut as though they were state-owned enterprises. President Obama did not so much explain his rationale, but offered a rallying cry for the green industrial policy his administration was promoting to the tune of nearly $100 billion in 2010 when he said:

"Countries like China are moving even faster….I'm not going to settle for a situation where the United States comes in second place or third place or fourth place in what will be the most important economic engine of the future."

Much like the Chinese government, President Obama was throwing the weight of the U.S. government behind the companies and industries that he believed mattered most to the future. And he was asserting his belief that the United States and China are economic rivals in a zero-sum game.

By 2011, the Obama administration was advising U.S. telecom carriers that if they had aspirations to partake of the lucrative U.S. government procurement market, they should not purchase routers or other equipment from Chinese companies, Huawei and ZTE, citing them as cyber security threats to the United States. In 2012, the House Intelligence Committee produced a report reaching similar findings and advising all U.S. companies against doing business with those companies.

Whether Huawei and ZTE present unique security risks or there is an effort in Washington to sabotage emerging Chinese economic rivals is unclear. What is clear is that the public version of the Committee's report contained no evidence to support its allegations or recommendations, just as the administration's admonitions in 2011 were based on classified analyses never released to the public.

What is also clear is that, in 2012, Chinese participation in U.S. green energy projects was scuttled by the Obama administration on several occasions, despite the president's avowed commitment to wean the U.S. economy of off fossil fuels and promote renewable energy consumption. In addition to U.S. imposition of antidumping and countervailing duties on Chinese-made solar panels and wind towers, the U.S. Committee on Foreign Investment in the United States recommended that President Obama block a Chinese purchase of a U.S. wind farm in Oregon, which he did, reaffirming his view of China as an economic rival.

Although an official decision has not yet been made, whispers in Washington are growing louder that the Obama administration is considering reneging on the United States' obligation to begin treating China as a market economy for the purposes of calculating duties under the U.S. antidumping regime by no later than December 11, 2016. That would be a breach of exceptional consequence.

When China acceded to the WTO in 2001, it agreed to allow standing WTO members to apply what amounts to a punitive antidumping calculation methodology – known as the non-market economy (NME) methodology – to Chinese companies for a period not to exceed 15 years. The methodology is arbitrary, capricious, utterly unrepresentative of economic reality, and it creates a cloud of uncertainty that essentially deters U.S. importers from purchasing Chinese products that could potentially be targeted by U.S. industries. It is also a stigma that the Chinese government is anxious to put in the past. Reneging on that commitment would be perceived by Beijing as the worst kind of affront.

In 2012, the administration reported progress toward completion of a trade agreement between the United States and 10 other Asia-Pacific nations, which conspicuously excludes China. The Trans-Pacific Partnership was first embraced in the United States by the State Department as a potential tool of foreign policy, and not by the U.S. Trade

Representative as a possible trade initiative. Negotiations have been evolving as the United States has been rather loudly announcing and executing a foreign policy “pivot to Asia,” all in the midst of intensifying acrimony between China and several neighboring countries over conflicting territorial claims on islands in the South and East China Seas. These developments have raised suspicions that the United States may be pulling back on its policy of engagement with China, as it commits more resources to a policy of containment.

That makes the future of U.S.-China economic relations especially murky. A future in which both countries are fully committed to engagement looks very different from one where containment of China has become a more prominent policy objective.

A recent report to Congress from the Office of the U.S. Trade Representative implies an ultimatum to the new Chinese leadership: recommit to the kinds of market reforms undertaken in the past and significantly curtail the state’s role in the economy or the United States will focus on thwarting China’s economic advances. Lending credibility to that threat is the fact that over the course of the next few years, the Obama administration will be the gatekeeper watching over billions of dollars of possible Chinese direct investment in the United States. The administration will unveil a national cyber security policy that could be crafted to the disadvantage of Chinese companies. It will decide one way or the other on antidumping policy toward China. And, it will presumably conclude trade agreements with several Asia-Pacific nations not named China, which may or may not be crafted to accommodate China’s eventual accession.

Of course, one must wonder whether the United States will curtail its own burgeoning state-ism if China were to reform. After all, China’s interventions have served as rationalizations for the Obama administration’s generous subsidies and industrial policies.

The shape and tenor of evolving U.S. policies will profoundly affect the bilateral relationship, but the future will not be decided exclusively in Washington. There is plenty that the new Beijing government can do to assuage growing fears in Washington that China is no longer committed to market reform. But a nagging question is whether that reform would assuage growing fears that China is an economic adversary whose continued growth threatens U.S. interests.