

September 20, 2018

Meeting Highlights: Scott Kennedy of CSIS

On September 14, Scott Kennedy, Deputy Director of the Freeman Chair in China Studies and Director of the Project on Chinese Business and Political economy at CSIS, shared insightful thoughts on the US policies towards China and discussed potential risks from the latest developments in US-China relations. The event was off the record.

Key Takeaways

The grand bargain worked for a long time and provided many mutual benefits, but it is no longer working. The direction of US-China relations will largely depend on both countries' leadership.

The world order has broken down as US-China trade relations are now in stalemate, and it will be unlikely to be rebuilt in the short term. The chances for escalation and spiraling out of control are high.

There is still economic and political space for the US and China to continue to be closely tied to each other under the current world order. Businesses should especially speak out, even if their views are unpopular with either government, in order to prevent a full divorce.

Background

At the very beginning, it was a “grand bargain” that helped normalize US-China relations. In the wake of World War II, the US, together with other western countries, established a “liberal world order” so that an international system—based on rule of law and respect for national sovereignty as well as human rights—could prevent a global war from happening again. International institutions, such as the United Nations and the World Trade Organization (WTO), were built to guard this world order.

China was invited to join this liberal order under the condition that China must open up its economy and reduce government intervention. China took the offer and appeared intent to honor the rules for many years. Although this “liberal world order” also came with US military presence in Asia, China saw it as an opportunity to focus on developing its economy without needing to worry about regional security. At the time, some in the US thought by letting China become part of the world order, China will eventually embrace democracy, while most thought it would at least have a “calming effect” on China's policies.

Highlights

The grand bargain worked for a long time and provided many mutual benefits, but it might not be working anymore. The year of 2018 marks the 40th anniversary of China's opening-up and yet, China has not become a market economy. Under Xi's leadership, stability has become a top priority instead. This means that the full liberalization of the Chinese economy will still take years to come. China's political and economic systems are also unlikely to change, in contrast with the US wishful thinking from decades prior. Moreover, China is no longer content with the US military power in the region and is poising itself as the guardian of Asia while seeking to delegitimize US presence in the region. That said, China is still interested in a multilateral system, but one in which China can set its own rules to protect and strengthen an authoritarian China.

The direction of US-China relations is largely dependent on the leadership. China is taking a different path away from the US expectations under Xi's leadership, while the US has also lost faith in this grand bargain. Trump expedited the wake-up call, crystallizing and view that China might never become a true member of the "liberal world order." Additionally, Trump views multilateralism as "lose-lose" and is attempting to shift the US towards a model of bilateral agreements (see the recent NAFTA trade talks). This is also true for the US military support of its Asian supporters—Trump feels the US has not been properly compensated for the expensive military presence in the region. Therefore, the kinds of decisions made by both American and Chinese leadership are shaping the future of US-China relations.

The world order has broken down as US-China trade relations are now in stalemate, and it will be unlikely to be rebuilt in the short term. Chances for resolution or cessation of hostilities between the US and China are small. This is because neither the US or China is well-positioned to be ready for a resolution. For the US, pro-negotiation officials (Steven Mnuchin/Wilbur Ross/Gary Cohn) have zero influence over Trump. The new debate in Washington is between those that want to see structural reforms in China and those that want to completely divorce from China. For China, its strategy is to find the cheapest price to pay to make the trade tensions go away. China doesn't want to change its system. For them, the "how" is the system. So, when the US says, "we don't mind you becoming a tech superpower, what we do mind is how you go about achieving this," they see this as a direct threat to their system. The "how" is key for them. Moreover, China seems to be waiting for a game-changing event to happen and ease the situation (e.g., mid-terms, Russia investigation and the US stock crash). But these are all bad bets. As a result, China will likely only offer minor adjustments to provide market access in limited areas and will not compromise per the US terms.

The chances for escalation and spiraling out of control are high. There are several signs: one, criticisms of China's control and crackdown of major religious groups and ethnic minorities in Xinjiang have been high in DC. While Trump may not personally care about these issues, they are the hot buttons that he can push to stir up his political base and gain support. Second, China is squeezing Taiwan by pushing the remaining countries to switch their diplomatic recognition from Taiwan to the PRC. The further Taiwan gets squeezed, the further China pushes the US to lean beyond the "red line" of what China can tolerate vis-à-vis US support of Taiwan. Third, many US companies are looking into a "Plan B" to shift their business model away from China if needed. If a deal is not reached around the G20, we may see signs of the "divorce" being set in motion.

Any hope? Yes.

- ◆ There remains economic and political space for the US and China to continue to be closely tied to each other under the current world order. But this will require tough actions and discipline to push things forward.
- ◆ Activism is required for many to maintain belief that there is still hope for the normalization of US-China relations again. Businesses must go public with their concerns, even if they are unpopular with either government. Divorce will happen if companies do not stand up.
- ◆ China has announced plans to reform on many occasions and should “just do it.” China doesn’t need to concede to or negotiate with the US to make these changes. The groundwork has been laid. However, it appears that. China is not changing because it does not want to and prefers to make the current authoritarian political system and semi-liberal economy more efficient than to open up.

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