

U.S.-CHINA RELATIONS: MANAGEABLE DIFFERENCES OR MAJOR CRISIS?



DAVID G. BROWN

LI PENG

VICTOR D. CHA

MICHAEL McDEVITT

**CHU SULONG &
ZHOU LANJUN**

WILLIAM H. OVERHOLT

JOHN L. HOLDEN

SHAO YUQUN

JIA QINGGUO

YANG XIYU

October 2018

Contents

Introduction	1
<i>Donald S. Zagoria</i>	

Articles

An Uphill Battle: China's Efforts to Manage Uncertainties in U.S.-China Relations.....	3
<i>Jia Qingguo</i>	

The Growing U.S.-China Competition under the Trump Administration	10
<i>Chu Shulong & Zhou Lanjun</i>	

Myths and Misconceptions in U.S.-China Relations	19
<i>William H. Overholt</i>	

U.S.-China Economic Relations: Ballast in Stormy Seas, or Unsecured Cargo?	31
<i>John L. Holden</i>	

Whither Sino-U.S. Relations: Maritime Disputes in the East China and South China Seas?	41
<i>Michael McDevitt</i>	

Summit Diplomacy: Opening of a New Era or a New Cycle on the Korean Peninsula?	53
<i>Yang Xiyu</i>	

Diplomacy or Coercion?	62
<i>Victor Cha</i>	

The Taiwan Issue During the Trump Administration: Challenges and Opportunities for China and the United States	83
<i>Li Peng</i>	

A Fraught Cross-Strait Relationship	90
<i>David G. Brown</i>	

BRI and China-U.S. Relations: Perceptions, Prospects and Challenges	100
<i>Shao Yuqun</i>	

Myths and Misconceptions in U.S.-China Relations

*By William H. Overholt**

The relationship between the U.S. and China is under more stress today than it has been for any extended period since Chinese reform and Sino-American diplomatic recognition began in 1979. I say “extended period” because there have been moments of more severe crisis, such as when China was launching missiles in the vicinity of Taiwan in 1996 and President Clinton responded by sending aircraft carriers to the area. But the current period is distinctive in the degree to which there is bipartisan U.S. questioning of the rationality of the longstanding policy of engaging China, and there is similar questioning in China about the constructive intent and rationality of American policies toward China.

China’s severe human rights repression and its militarization of the South China Sea have inevitably stimulated Western anger, and its intellectual property abuses and restricted access to the service sector have mobilized foreign opposition, while President Trump’s trade war and apparent determination to disrupt China’s economic rise have similarly mobilized antagonism in China (and among virtually all American allies). Nothing can negate those inevitable reactions, but aside from these factors there is nonetheless a larger context of myths and overreactions that make the relationship gratuitously difficult to manage.

Myth: The Inevitability of Conflict between Rising and Established Powers

One strain in the “realist” political science literature argues that between incumbent and rising powers military conflict is inevitable (Mearsheimer) or highly likely (Allison), based on a presumed continuity of the pressures on such powers dating back to the Peloponnesian Wars. The pressures of the Thucydides Trap are implicitly alleged to be similar today to what they were for thousands of years before World War II.

In reality, the incentives for ambitious geopolitical powers have undergone a drastic change since World War II. For millennia, the way to become a big power was to grab some of your neighbor’s territory, tax his peasants, and sell off his golden temples, then repeat. In other words, if you wanted to become a big power, the key to success was territorial expansion by military means. That’s not the way it works anymore. Since World War II, the world has learned how to grow economies much faster and military expansion has become far more costly. This changes the structure of the geopolitical game.

Japan became a big power without much of a military. South Korea, once weak economically, politically and militarily compared with North Korea, cut back its military budget, focused on economic development, and is now more than forty times larger economically than North Korea. Likewise, in Indonesia, General Suharto abandoned his predecessor’s claims to most of Southeast

* Copyright William H. Overholt, 2018. This paper was written for the National Committee on American Foreign Policy. Much of the substance is derived from a larger project on Asian geopolitics that will be published in various forms later.

Asia, focused on economic development, and became the unquestioned leader of ASEAN. China also became an acknowledged big power before it started building up its military. A focus on superior economic growth is the contemporary route to geopolitical stature.

In the modern world, economics, which is not a zero-sum game, is the key to geopolitical success. In a world of primarily economic competition both sides can win, whereas in a world of primarily military competition a gain for one side is a loss for the other. It is important to scan any article or book about Sino-American issues to see whether it reflects an outmoded zero-sum mentality; as U.S. national strategy has given higher and higher priority to the military, and largely abandoned its successful Cold War economic strategy, the zero-sum mentality has become more and more prominent.

Nonetheless, Graham Allison, in *Destined for War*, provides a valuable warning that rising powers and established powers can get into serious conflicts, even war.¹ Thinking in the old way can become a self-fulfilling prophecy, and some U.S. and Chinese policies run the risk of reinforcing self-fulfilling prophecies. Some of the U.S. military learned the lesson from the Cold War that the key to peace was absolute U.S. dominance, particularly in the seas. That was an accurate lesson for the Cold War era, but it is untenable in the more complicated world of today. Similarly, the U.S. Congress has attempted to preserve U.S. dominance of the World Bank and IMF by refusing to expand their capital and reform voting rights in proportion to the rise of other economies.

Such efforts to preserve obsolete structures are self-defeating; that they have been self-defeating is so obvious that it is amazing that we still need to point it out. The Bretton Woods institutions could have been adapted to the modern world; now, because of Congressional resistance to change, they will be overshadowed by much better capitalized Chinese counterparts. Such efforts to maintain our major institutions in obsolete forms also create gratuitous conflict of the kind Allison warns us about.

Myth: China Is Attempting to Destroy the Post-War Western Order

This is a partial myth. China is emphatically asserting its right to a global leadership role and it is establishing new institutions. But it is not trying to destroy the old institutions and indeed it is often more supportive of them than the Trump administration.

Older people can remember when China was really trying to destroy the Western system. Mao Zedong praised chaos and attempted to destroy all the major Western institutions. In the reform period China has joined those institutions, such as the World Bank, the IMF, the ADB and the WTO, and has generously contributed to them. It continues to support the fulcrum of the U.S.-led world trade order, namely the WTO dispute settlement mechanism. No country has ever accepted more onerous conditions for joining the WTO. The restructuring of Chinese industry required by those conditions was painful to the point of being heroic. In many cases, China accepted a sudden domestic restructuring of its industry that would be considered intolerable anywhere in the West. In the case of cars, for example, it accepted a degree of foreign dominance of the industry that our allies like Japan and South Korea would never even consider tolerating. There remain some areas where China has not completely met the WTO conditions, and Washington commentary focuses almost exclusively on those few concerns, but the basic story is one of drastic adjustment to the Western system. It demonstrates that negotiations can lead to highly workable relationships between quite different systems.

Of course, China has indeed sought adjustments of the established institutions and it has made the best use of the rules for its own growth. The requested adjustments mainly reflect the changed balance of the world economy, the so-called “rise of the rest,” and do not alter the purposes or critical procedures of the institutions. Beijing’s skillful use of the rules to obtain advantages for China’s more planned economy follow Japanese and South Korean precedents. U.S. allies planned their industrial rise and helped their companies achieve the desired goals. Skillful use of the rules is exactly what the U.S. does when it employs strained definitions of anti-dumping rules and national security exceptions to favor its own companies. Through all the stresses of the Sino-Western relationship, Chinese acceptance of the WTO dispute settlement system has been the key to the maintenance of the Bretton Woods order.

China has also begun creating important new institutions. One could indulge in unproductive contention about whether its founding of, for instance, the Asian Infrastructure Investment Bank (AIIB) was primarily a response to the refusal of the U.S. Congress to adequately increase the capital and reform the governance balance of the Bretton Woods institutions or, alternatively, whether it constitutes an attempt to create institutions with Chinese leadership. The core point about the AIIB is that it was carefully designed as a supplement to the World Bank and ADB with goals, procedures, and standards that are largely consistent with the older institutions. The CEO of the new bank, Jin Liqun, was even chosen in part because he is a veteran and admirer of both the World Bank and the Asian Development Bank. The Obama administration’s efforts to characterize the AIIB as a fundamental challenge to high standards was not credible to most of the world, including almost all U.S. allies, so the effort to oppose the AIIB was defeated. Washington isolated itself.

Washington is at risk of making the same error on a gigantic scale with China’s Belt and Road Initiative (BRI). The BRI is best understood as a constructive theft of the Bretton Woods intellectual property; its vision is hardly a transformational innovation. Like the World Bank/ADB-IMF-WTO system, BRI seeks to create development banks that will finance infrastructure, together with institutions that will promote common standards and resolve crises. Nothing could be less revolutionary than that. In fact, BRI is a more ambitious version of ideas that were developed by both the George W. Bush and the Obama administrations for Central Asia. To be sure, if the BRI vision is successful it will enhance China’s stature. That is only fair. At the same time, if BRI were to promote successful development in Central Asia, the Middle East and North Africa, it would be enormously beneficial to the U.S. As the examples of Indonesia, Bangladesh and Ethiopia show, wherever development occurs the threat of failed state terrorism drastically declines. Over a couple decades, successful development of these regions could save the U.S. trillions of dollars of military expenditures.

China has resuscitated the U.S. postwar *vision* but in practice has serious problems promoting mutual development in these regions. China’s militarization of the South China Sea, its hard line toward India, and its use of economic warfare against Japan (rare earths), South Korea (Lotte, Hyundai, market access for Korean video games), the Philippines (bananas and other exports), as well as curtailing tourism to several countries for political purposes, makes many countries fearful of becoming dependent on Chinese-led institutions. Chinese policy in certain areas has become neo-colonial; there are parts of Myanmar where Chinese control is so great that even Myanmar’s ministers are forbidden to enter. Chinese state enterprises can be as ruthless as were European enterprises colonizing Africa. For instance, Sri Lanka’s Hambantota Port was a politically corrupt project with no chance of commercial success, and the Chinese company has exploited Hambantota’s inevitable economic failure to seize control for 99 years.

The BRI is a historic and inspiring vision. It is a vision copied from, and largely complementary to, the Bretton Woods vision, not an attempt to overthrow the Bretton Woods system. The U.S. will fail if it simply opposes that vision without a constructive economic policy of its own. TPP was a useful but utterly inadequate step. If Washington is going to have an effective strategy in Eurasia and North Africa, it is going to have to spend some money. It will get that money back, with huge dividends in saved military expenditures, but it has to start with an investment. Equally, China's BRI will fail if it is implemented in a neo-colonial or narrowly self-interested manner or if China's geopolitical assertiveness alienates the countries whose support is most needed for BRI's success. The constructive outcome would be for China to curtail its excesses and for the U.S. to mount a parallel effort or to negotiate a joint development program.

Recent years have seen a mutual retreat away from such a parallel, and mutually advantageous, convergence. Under Xi Jinping, China has engaged in systematic efforts to give its firms decisive non-market advantages at home and abroad. Under Trump, the U.S. has been moving to disengage from China in a misguided belief that U.S. firms are so weak and disadvantaged that they will be better off if the U.S. government forcibly limits their exposure to China. (This is the position of U.S. Trade Representative Robert Lighthizer.) As indicated by official statements of the U.S. Chamber of Commerce and the Business Roundtable, leading U.S. firms mostly reject that logic. The danger is evident in what is happening to the automobile industry. U.S. companies, especially General Motors, have been exceptionally successful in China in comparison with their Japanese counterparts, because they have proved better able to exploit China's greater openness to foreign car manufacturers. Rather than acknowledging China's superior openness, the Trump administration has focused on higher Chinese tariffs and imposed severe penalties. This gives an advantage to foreign companies, and Toyota, Nissan and Honda are making massive investments to seize advantages away from GM; they will probably succeed.

U.S. companies have legitimate complaints about Chinese policies. Theft of U.S. intellectual property, forced transfer of intellectual property, discriminatory treatment in areas like Chinese competition policy, and lack of access to the services sectors are important. The key is that, as with even more serious differences in the past, they are negotiable. Some are largely a matter of level of development; all the most successful developing economies, including the U.S. and Japan, rose in substantial part through theft of intellectual property. The U.S. needs to fight against it, because it is hugely consequential for many U.S. companies, but it also needs to do so in the understanding that, like environmental neglect, this is a developmental issue that tends to get resolved as successful countries acquire their own intellectual property and come to support a system that will protect it. China has been evolving fast in this respect. Fair access to the services sector is likewise a legitimate target for tough bargaining with China. When four Chinese banks are among the world's largest, this is not an infant industry for which high levels of protection can be justified. At the same time, the decibel level of U.S. characterizations of China needs to reflect the fact that China's banking system is almost twice as open to foreigners as Japan's. The ultimate refutation of the argument that China's system is radically incompatible with America's is straightforward: we have come to terms with, and greatly profited from, Japan's economy, which is far less open to U.S. trade, investment and finance than China's.

Myth: U.S. Has Wholly Welcomed China into the System

The wisest U.S. strategists have consistently said, if we treat China as an enemy then it will certainly become an enemy. There are many nuances, complexities and dilemmas in implementing such wisdom, but that view has driven U.S. policy since Richard Nixon. Therefore, they conclude, we should welcome it into the system but “hedge our bet” in case China goes rogue. Prior to President Trump, the U.S. did welcome China into the trading and investment system, albeit with rigorous conditions, for instance on WTO membership, that did not apply to other countries.

China has responded by becoming even more open to U.S. trade and investment than major allies. Foreign companies have bought many significant Chinese companies; this almost never happens in Japan. Drive in Beijing and Shanghai and you are immersed in a tide of Buicks and Volkswagens, which could never happen in Tokyo or Seoul. A recent statement by Deputy USTR Ambassador Dennis Shea that “China is in fact the most protectionist, mercantilist economy in the world,” displays a contempt for facts.²

In the military sphere, rather than welcoming or accepting China’s rise, the U.S. has treated China as an enemy. No amount of nuanced diplomatic language, sometimes including outright denials, can obscure this reality. The U.S. military plans against China as the primary enemy. Its budget reflects a priority to be prepared for a conventional war with China and a nuclear contingency. It backs Japanese determination to confine the Chinese military within “the first island chain” (Japan-Taiwan-Philippines-Indonesia). U.S. naval and air surveillance of China is so intense that it is appropriate only for use against an enemy. Surveillance, narrowly defined, is supplemented by what might be called provocative surveillance; hostile air and sea maneuvers are designed to trigger Chinese defenses so that the U.S. can read the response electronically and know how China would respond in the event of war.

This “system” of provocative surveillance was designed for use against the Soviet Union and was accepted by both sides because the U.S. and Soviet nuclear forces were on hair trigger and therefore both sides needed to know, at all times, exactly what the other was doing. After the collapse of the Soviet Union, this system was transferred for use against China even though there was no nuclear hair trigger and no mutual agreement. This deliberate provocation mobilizes all the Chinese fear and antagonism from a century of Western sea-borne invasions and utterly negates the wisdom that we should not treat China as an enemy. America’s wisest strategists, such as Chas Freeman and the late Zbigniew Brzezinski, have periodically spoken against this provocative practice, but they have been ignored. Chinese leaders therefore do not feel that they have been welcomed into the system. On the contrary, the Chinese reaction to this treatment is the mirror image of U.S. anger over Chinese behavior in the East China and South China Seas—but greatly magnified. The salience of this issue is rarely noted in Western media, so the interaction between Chinese fears and Chinese maritime behavior goes unremarked. The U.S. Navy justification is that what it is doing is legal; even professional China watchers usually cannot recall seeing a justification that it is wise.

U.S. partial welcoming of China into the Western economic system has been an enormously positive step, enabling the ascent of hundreds of millions of Chinese out of poverty, enhancing the welfare of Americans and the profits of U.S. companies, stimulating all the economies of Asia, enhancing growth in Africa and Latin America, saving Bangladesh from catastrophe, and much else. It has been a wise decision, comparable to facilitating the reconstruction of Japan and Western Europe after World War II. It has been beneficial not just in economics but also in national security. But it must not be mistaken for a broad acceptance of China into the international system.

Myth: The Standard of Success for U.S. Policy toward China Has Been or Should Be China's Transformation into a Western-Style Democracy

The primary justification for the U.S. opening to China has been that it would be conducive to peace, first in containing Soviet aggression and then in having a constructive relationship with an increasingly important power. This is the most appropriate standard for judging the relationship.

Secondly, the opening to China has been enormously beneficial to both economies and to the world economy. Moreover, because of Chinese economic demand, the economies of the poorest and most economically unstable countries, especially in Africa and Latin America, have grown and become more stable. It is an economic miracle that Bangladesh has become a viable economy and that Ethiopia has for a time been the world's fastest growing economy. These and many other successes result from Sino-American collaboration. There is an enormous U.S. national security dividend from such development, because otherwise radical movements, especially Islamic jihadism, would have spread much farther and faster.

Numerous commentators, including this one, have argued that the complexity of a modern economy creates social pluralism, which in turn would create pressures for social and political liberalization. Some have gone too far in arguing that such liberalization is inevitable. So far, China has moved very far indeed from democracy. However, the idea that pressures of social pluralism exist and have become very strong has certainly been proven valid.³ Of course, it is wrong to say that democracy, or even extensive liberalization, is inevitable. But it is true that China will pay a tremendous price in economic growth and political tension if, unlike South Korea and Taiwan at similar levels of development, it does not find a way to accommodate social pluralism.

The repressive Xi Jinping administration is a fearful effort to control those pressures, which were building up to a degree that frightened an old guard leadership generation and convinced it that the country had to be radically centralized or face gradual disintegration. It decided to accommodate the pressures of economic complexity by moving to "market allocations of resources," with a vast array of often painful policy reforms entailed by that overall decision. But the leadership also decided to fight the pressures of social and political liberalization. Because the pressures are so strong, the Xi administration is caught in a cycle of increasing—and increasingly counterproductive—repression. Moreover, the politics of reaction includes many measures that contradict the economic reforms, like strengthening Party committees in every enterprise.⁴ This could ultimately imperil China's economic vitality.

It has become common among Washington elites to believe that the current repressive Chinese administration has finally defeated the forces of social pluralism. In this telling, Xi Jinping has created a new, permanent system where he is president for life, political repression will continue and increase without triggering serious problems, and the economy will continue to grow vigorously. But anyone familiar with the discontents of China's entrepreneurial class—with the

contradictions between the requirements of rapid growth and reform as well as the desires of almost every upper and middle class Chinese family to get their money and their children out of China—knows that this type of “end of Chinese history” theory, however popular it is in *Foreign Affairs* and *The National Interest* and in Pentagon budgeting, will be proved wrong faster than Fukuyama’s Western version of the end of history. China may get worse, or it may get better, but it cannot stay the same. And most Chinese, including in the leadership, understand that.

If the U.S. wants to facilitate a more liberal China, it will mute the ideological war. What the Congressional China commissions and *Radio Free Asia* and the National Endowment for Democracy have accomplished is to make opposition to “bourgeois liberalization” an issue that can summon great reserves of Chinese nationalistic fervor to avoid the defeat of their nation by a Western ideological enemy. Pressure and attacks do not help. Extolling the virtues of democracy and freedom, without hostile propaganda and post-1989 sanctions, can help. Condemning bad human rights abuses sets a valuable standard without making a foreign country feel that we are imposing our system on them. Setting a shining example of beneficial social and economic management helps. Sober analysis of the undeniable realities of social complexity helps.

One of the favorite U.S. myths about modern Asia is that the great transitions from authoritarianism to democracy in South Korea and Taiwan, which began as socialist economies and Leninist polities, resulted from U.S. pressure. This theory of valuable pressure is then explicitly or implicitly transferred to China. In reality, when they were most dependent on the U.S. in the 1960s and early 1970s, Taiwan and South Korea were at their most authoritarian. As someone who was involved with the South Korean transition and had a front row seat at the Taiwan transition, I can testify that the motivation for change was domestic social pressures. It did help that the U.S., a democracy, was a supportive ally. In China, the abstract idea of democracy garners universal support, but there is intense debate over what that means for China. It hurts terribly that the U.S., the leading example of Western-style democracy, has postured itself so that any substantial Chinese move in the direction of U.S. style democracy would be perceived by a large proportion of nationalistic Chinese as defeat by an enemy.

Advocates of some version of the end of Chinese history theory see an implacable, institutionalized personal dictatorship that can control Chinese society and provide rapid economic growth for the indefinite future. The reality is a leadership generation frightened by social changes so powerful that all the resources of the state have to be mobilized for repression. The leaders sit on the lid of the boiling kettle and they are very worried about being blown off. Chinese elites are pervaded by minority voices that insist on the need for rule of law and for a robust way to connect the Party and government to popular sentiment. Supporters of the Xi administration typically argue that the current situation demands tough measures on the way to a more mature economy and polity. Vanishingly few Chinese see the current economy and polity as the ultimate Chinese system. Washington has more true believers in the end of Chinese history theory than Beijing does.

U.S. democracy promotion has become ideologically blinded. The U.S. message is that India is a better society than China, because India holds elections. If you give Chinese people a choice of keeping their education, their health, their housing, their women’s rights, and their longevity, and additionally having U.S. freedoms and U.S.-style elections, most would choose that option. But that is not the choice the Chinese people see. China and India started from about the same place economically and socially. You would have to spend a very long time in China to find someone who would give up their dignified lives for the degradation that the majority of Indians suffer in return for holding elections. The number of Chinese families that own homes is about twice the number of Indian families that have access to a toilet. The difference between Chinese society and Indian society is not about a little bit of money, not the difference between a Buick and a Chevrolet.

It is knowing that your wife will survive childbirth, that your child will survive infancy, that your family will not suffer from malnutrition, that you will not die from tuberculosis or diarrhea, that your women will have education and modern social rights. If the U.S. message to China is that it is evil until it becomes like India, then U.S. policy will fail, not just with China but also with many other countries. India's social failures cannot be separated from its governance system. If the U.S. criterion for success of its policy toward China is that China should have become like India, then U.S. policy was doomed from the beginning.

If the U.S. backs off from its ideological pressures, there is a chance it will be happily surprised by the direction of the next generation of Chinese leaders, backed by the Chinese people.

Myth: Chinese Industrial Policy Poses a Unique and Overwhelming Challenge to the U.S. Economy

It has become popular in Washington to view the Chinese system as so uniquely successful that it threatens the U.S. economy. China's Made in China 2025 program in particular is viewed in important quarters as life-threatening. In reality it is neither particularly unique nor overwhelmingly formidable.

China's industrial policies emulate what South Korea and Japan did in earlier decades, and they will increasingly have many of the same problems. China's state-owned enterprises, which carry most of the leaders' hopes of industrial dominance, are currently unable to earn their cost of capital. The consolidation of formerly separate companies into national champions often forces successful companies to absorb less competitive firms. As Chinese policy antagonizes foreign investors, new foreign direct investment will be less than it would have been, limiting what has been a powerful driver of growth and technological advancement. Some of the favoritism and subsidies will work, and the U.S. will need to take appropriate countermeasures against any major domestic damage, but as in Japan China's successes will be expensive and there will be expensive failures. As an example, the billions upon billions China is pouring into subsidies for the semiconductor industry are not yielding proportionate success in competition with the U.S.

China's programs are by no means identical to either Japan or South Korea. As Barry Naughton has pointed out, Chinese companies are more open to outsourcing than their Japanese counterparts and that should enhance their relative efficiency. On the other hand, they are burdened by a bigger bureaucracy and by political interference (Party secretaries inside the company and outside, who can affect corporate policies and, for state enterprises, appoint the corporate leaders). Ultimately the structural issues are the same: restricted competition reducing innovation, bureaucrats missing potential breakthrough developments, gigantic conglomerates affecting national policy and distorting the market, subsidized finance creating waste and financial risk.

Fears in the U.S. of a seeming juggernaut of Chinese industrial policy reprise the paranoia of the 1980s about Japan taking over the world. Those who do not remember history are apparently condemned to repeat it—at higher decibel levels and with less nuanced policy responses.

China will be a formidable competitor in both economics and geopolitics. But the characteristics that Washington seems to fear most are the characteristics likely to limit the Chinese challenge. It is ironic that U.S. politicians who promote more and more extreme versions of the market economy at home, as the key to domestic efficiency and growth, tend to express the greatest fears of being overwhelmed by the presumed superiority of a highly managed foreign economy.

Moreover, the panic about dealing with a different system is ironic in light of the proven ability of the U.S. to negotiate satisfactory arrangements with more centrally managed economies, including both its principal Asian allies and China.

If the U.S. manages its market economy in a way that helps its workers cope with technological change, it can maintain leadership in technology and standards of living. If the U.S. supports policies and institutions that the world sees as constructive, the U.S. will continue to be acknowledged as the leader by much of the world. If the U.S. loses leadership, it will be because it retreated from open economic engagement and competition; because it allowed its national strategy to degenerate into just a military strategy; because it destroyed the WTO dispute settlement mechanism that has been the fulcrum of international development in a disputatious world; because it rejected the international consensus on environmental amelioration and climate change; and above all because it failed to take care of its workers, finding it more convenient to blame China for their problems than to undertake the politically arduous task of helping workers cope with technological and organizational change.

China today is one of the great successes of human history. In the BRI, it projects an inspiring international vision with which the U.S. no longer chooses to compete. If it fails to become a global leader, it will be because it clung too long to economic and political management structures that cannot cope with the complexity of a modern economy; because it gradually cut itself off from foreign competition and investment; because it came to be seen by its neighbors as oppressive; because its domestic political repression became repugnant to much of the world; and because its people became so fearful of arbitrary and conflicting leadership that they engaged in massive efforts to move their wealth and their children abroad. These risks are very real for China today.

What Is to Be Done?

Historically, the U.S. has dealt with the Asian miracle economies, which share common developmental characteristics, with pragmatic toughness. It has engaged in continuous negotiation to create workable relationships between quite different economic structures. When unfair subsidies, managed currencies, intellectual property theft or targeted industrial policies threatened important U.S. interests, it defined U.S. goals clearly, took sufficiently tough actions to defend American interests, and negotiated mutually profitable deals. This pragmatic, focused, and evolutionary approach produced mutual prosperity and a kind of noisy, conflictual amity.

This technocratic approach was typically supported by the political center, while being opposed by the left and right of the political spectrum on grounds of human rights abuses and lack of democracy for the left and unfair currency, subsidy, trading or investment rules, or a desire to support Taiwan, for the right. To enhance support from the right, Reagan campaigned on a platform of restoring diplomatic relations with Taiwan, and to enhance support from the left Bill Clinton campaigned on a platform of ending China's principal trading privileges, but in office all previous presidents reverted to the pragmatic, technocratic approach that has brought the world unprecedented prosperity and big power peace. With the center having disappeared in the Congress, and with a president from one of the extremes, U.S. support for pragmatic negotiation has declined, and support for treating China as an apocalyptic economic and national security challenge has increased.

This is all about domestic politics, not about objective analysis of China and the scale of our differences with China. Treating it as a system so alien that we cannot negotiate with it, as such an overwhelming threat that we just have to try to keep it down, is not just factually wrong. It endangers peace and prosperity.

The Trump administration has provided an ideal template of how not to negotiate. It created a maximum sense of confrontation. It focused on nonsensical demands that China reduce the trade deficit. (The U.S. trade deficit is domestically determined, the difference between what we save and what we spend, and it is drastically increased by the huge government deficits created by Trump tax policy. China's overall trade surplus is modest.) When Chinese officials asked what Trump's policy goals were, the administration had no coherent answer, so the Chinese had no idea how to negotiate.

President George W. Bush provides a useful illustration of how to deal successfully with China. At the beginning of his first administration, a U.S. spy plane and a Chinese fighter jet collided. The Chinese pilot died and the U.S. plane went down on China's Hainan Island. The situation was delicate for both sides. President Bush started with peremptory demands that China immediately return the pilots and the plane. The Chinese did not respond positively to that kind of foreign command. But then President Bush discovered that, if he negotiated calmly, the Chinese would respond professionally and would keep their word. The two sides successfully resolved a potentially explosive problem. The Bush administration went on to handle both national security and economic issues in that manner. Treasury Secretary Hank Paulson followed a model of tough but constructive negotiations and the Bush administration went on to deal successfully with a whole range of difficult economic and security issues.

Both the Obama administration and the Trump administration have lacked the top-level China expertise—like Hank Paulson's—that previous U.S. administrations took for granted. The U.S. should always have Cabinet-level China expertise. Before negotiating with the Chinese, it should resolve its internal differences about goals, then consult with allies, then present China with a very specific list of demands. No policy can be successful without a coherent policy process.

U.S. economic policy needs to focus on the real issues, most notably intellectual property theft, forced transfer of technology, and access to the Chinese services economy. These are negotiable issues. In fact, the Chinese government was planning major liberalizations and improvements in these areas in the face of determined domestic opposition, but the diffuse Trump confrontation elicited a nationalist popular backlash in China and made it more difficult for Xi to do what he had been planning to do anyway. Negotiation, of course, does not mean being soft. The U.S. can and should sanction Chinese companies that steal intellectual property, limit Chinese takeovers of U.S. companies with sensitive technology, retaliate against Chinese companies that force transfer of technology in return for access, and insist on measured reciprocity in the services sector.

On national security issues, the U.S. should implement the position that it upholds rhetorically: we stand for the rule of law and for peacefully negotiated solutions. That means *inter alia* holding Japan to the same standards we apply to China. In the South China Sea, the U.S. should be much more evenhanded in the way it describes the conflicts. It should push China hard to conclude a Code of Conduct that all parties support in principle but China has been slow to finish. If the Philippines request it, the U.S. should draw a red line prohibiting the militarization of Scarborough Shoal. The U.S. formally claimed the Shoal for the Philippines in the 1930s, so China cannot assert that it made the first claim. China promised at one point to withdraw from the Shoal, then reneged on its promise. This is an appropriate place to take a stand.

More broadly, the deal in the South China Sea must be that China has to negotiate in good faith with some of the other claimants and must not further militarize the islands/rocks. If China wants to be seen as a good neighbor negotiating in good faith, it must start resolving some of the maritime disputes. The right place to start is its dispute with South Korea, a relatively minor problem that has not become emotional on either side.

The U.S. will continue to defend its allies and to reassure them. At the same time the U.S. needs to stop treating every enhancement of China's capabilities as a threat. It needs to treat China fairly in disputes with Japan—no more hypocrisy about promoting the rule of law in the region but not applying it to Japan. It needs to acknowledge China as a fellow power in space and negotiate rules of engagement in good faith.

These are not the most important issues, however. The important issue is that China has a national strategy—BRI—combining economic, military and diplomatic means, while the U.S., which once had the most successful national strategy in world history, now just has a failing military strategy. The U.S. needs to revive the economic and diplomatic components of its strategy. It must have a competitor or complement to the BRI, or it is not even a serious player in the geopolitical great game. When China goes to Africa with a grand economic strategy and the U.S. goes to Africa with scattered groups of Special Forces officers, however brilliant those officers are, China wins.

For its part, China has the right vision but needs to make it coherent internally and also consistent with its other policies. The BRI will not work if much of it means unleashing ruthless state enterprises to do corrupt deals for unworkable projects in Sri Lanka or colonizing parts of Myanmar. It will not work if other aspects of Chinese policy antagonize most of the littoral neighbors, as it has. It might be hampered by Islamic countries' reactions to ruthless suppression of Muslim practices in Xinjiang. China has some very fundamental choices to make.

On the economic issues, China needs to make rapid progress in the areas of legitimate U.S. and EU complaints. Stopping IP theft, ceasing forced technology transfer, refraining from excessive subsidies, and opening the services sectors are not only concessions to Western powers. They are required by China's own reform and opening policies. For 15 years China has moved too slowly, for its own good and for relations with other major countries, in reform and opening; it must now make up for lost time. While doing that, it should ignore silly Trump administration demands about the trade balance, retaliate against an unjustified trade war, and insist that Washington negotiate coherently about specific issues. China should consolidate its new role as a leader on environment and climate change issues, and it should build on its intention to promote multilateral trade and investment agreements.

The U.S. problem is not so much that it is being pushed out by China; rather it has abdicated much of the role it had established with its grand post-World War II strategy. China's strength is its grand vision; its weakness is a consistent failure in the new century to make the choices required by that strategy.



WILLIAM H. OVERHOLT has been Senior Research Fellow at Harvard University since 2008, except for two years as President of Fung Global Institute in Hong Kong. From 2002-2008 he held the Asia Policy Distinguished Research Chair at RAND's California headquarters and was Director of RAND's Center for Asia Pacific Policy.

During his time at RAND he held concurrent appointments as Distinguished Visiting Professor at Yonsei University in South Korea and Visiting Professor at Shanghai Jiaotong University.

During 21 previous years in investment banking, he served as Head of Strategy and Economics at Nomura's regional headquarters in Hong Kong from 1998 to 2001, and as Managing Director and Head of Research at Bank Boston's regional headquarters in Singapore. At Bankers Trust, he ran a country risk team in New York from 1980 to 1984, then was regional strategist and Asia research head based in Hong Kong from 1985 to 1998.

At Hudson Institute 1971 to 1979, Dr. Overholt directed planning studies for the U.S. Department of Defense, Department of State, National Security Council, National Aeronautics and Space Administration, and Council on International Economic Policy. As Director of Hudson Research Services, he did strategic planning for corporations.

Dr. Overholt is the author of eight books, including *China's Crisis of Success* (2018); *Renminbi Rising* (2016); and *Asia, America and the Transformation of Geopolitics* (Cambridge University Press and RAND, 2007). The others are: *The Rise of China* (W.W. Norton, 1993), which won the Mainichi News/Asian Affairs Research Center Special Book Prize; *Political Risk* (Euromoney, 1982); and (with William Ascher) *Strategic Planning and Forecasting* (John Wiley, 1983). He is principal co-author of: *Asia's Nuclear Future* (Westview Press, 1976) and *The Future of Brazil* (Westview Press, 1978). With Zbigniew Brzezinski, he founded the semi-annual *Global Assessment* in 1976 and edited it until 1988.

Dr. Overholt received his B.A. (magna, 1968) from Harvard and his Master of Philosophy (1970) and Ph.D. (1972) from Yale.

¹ Allison, Graham. *Destined for War: Can America and China Escape Thucydides's Trap?* New York, NY: Houghton Mifflin Harcourt Publishing Company, 2017. Print.

² U.S. Mission Geneva. *Ambassador Shea: China's Trade-Disruptive Economic Model and Implications for the WTO*. 26 July 2018. Web. 2 October 2018. <<https://geneva.usmission.gov/2018/07/27/55299/>>

³ My recent book, *China's Crisis of Success*, provides the details: Overholt, William H. *China's Crisis of Success*. Cambridge, MA: Cambridge University Press, 2018. Print.

⁴ For a systemic analysis of these measures, see *China's Crisis of Success*.