



A New Global Rivalry

U.S.-China Relations Ahead



October 2019

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The Evolving U.S.-China Relationship

Executive Summary

U.S.-China Trade Tensions

- The U.S. trade deficit with China accounts for more than 65% of the total U.S. trade deficit in goods, though China is an important destination for many U.S. exports of goods and services
- The seeds of current U.S.-China trade tensions were planted when tariffs were levied on Chinese solar panels, steel, and aluminum, but the key driver is the Section 301 case launched in 2018
- Under that case, the U.S. has levied tariffs on virtually all Chinese imports, while China has retaliated with tariffs on \$135 billion in U.S. products
- The U.S. and China have held over a dozen rounds of trade negotiations aimed at reaching a deal, but a recent tentative agreement amounts to little more than a truce
- Negotiators have made little progress on key U.S. concerns about structural issues, such as Chinese intellectual property and technology transfer policies, ensuring that trade tensions will not end soon
- It seems unlikely that a broad trade accord can be negotiated before the 2020 U.S. election
- U.S. farmers have suffered the most in the trade dispute, though they are the primary beneficiary of Trump administration programs to offer trade-based assistance
- U.S. companies will continue to face great uncertainty about the outlook for additional tariffs, while the process of reaching decisions on exclusion requests remains slow and opaque

U.S.-China Technology Competition

- A key driver of concerns about China in both the Trump administration and Congress is the challenge/threat posed by Chinese information technology and communications firms
- Such concerns have focused most heavily on ZTE and Huawei, which have been the targets of actions by both Congress and the administration
- The administration has moved aggressively to encourage U.S. allies not to use Huawei to develop their 5G networks, while also targeting the Chinese firm with actions aimed at limiting its ability to do business with U.S. firms or U.S. state and other government agencies
- Concerns about competition from Chinese ICT firms were a key driver in enactment last year of major export-control legislation
- The Trump administration is currently implementing those export-control reforms, which focus in particular on so-called emerging “critical” technologies
- U.S. companies and business associations are concerned that the new export controls could have a negative impact on the development of new technologies by U.S. firms
- Washington policy makers are particularly concerned about 5G technology, though there are sharp disagreements about how best to encourage the development and deployment of 5G in the U.S.

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Concerns About Chinese Investment

- Chinese investment in the U.S. surged between 2014 and 2016, fueling concern in Washington about China “buying America”
- The overwhelming majority of Chinese investment, in value terms, was in acquisitions rather than greenfield investments
- Chinese firms invested in many U.S. sectors, but the largest investments were in information and communications technology, real estate and hospitality, infrastructure, and agriculture
- Chinese investment has slowed sharply since Donald Trump became president, partly due to a rise in U.S.-China tensions and increased scrutiny of Chinese investments
- Concerns about Chinese direct investment, particularly in technology sectors, was a key driver in passage last year of the *Foreign Investment Risk Review Modernization Act*
- FIRRMA significantly expanded the authority of the Committee on Foreign Investment in the U.S. to review inward investments, not only from China but from other countries as well

China and Asia-Pacific Security

- Concerns about security and military challenges posed by China are helping to shape the debate in Washington over the whole range of U.S.-China policy issues
- U.S. policy toward China was based for decades on the belief that expanded economic engagement would drive political liberalization within China and greater Chinese support for global norms
- This attitude shifted sharply, starting before the 2016 U.S. election, and U.S. policy is now premised on seeing China as a leading competitor and even a threat in Asian-Pacific security
- U.S. support for Taiwan, which is strong and bipartisan, is certain to remain a source of U.S.-China tensions as Beijing continues to push for reunification with Taipei
- The protests in Hong Kong are a key point of tension with China, particularly since the protestors have broad bipartisan support in the U.S. Congress
- Japan-China relations have improved over the past few years, but continued regional security disputes and competition in key markets ensure that bilateral tensions will remain
- Relations between China and Russia have improved greatly, with increased cooperation on regional defense and security issues and on economic development projects

Scenarios and Projections: 2020 and Beyond

- To assist in projecting future trends in U.S.-China relations, we provide three simply structured potential alternative scenarios:
 - **Scenario One, "Engage and Embrace,"** is based on the concept that the U.S. and China have a common future founded on increasing collaboration and mutual growth. The U.S. policy response in this scenario is to put a premium on advancing intertwined economic growth, mutual engagement, and a doubling down on collaboration and openness.
 - **Scenario Two, "Business As Usual - But with Limits,"** is based on the belief that "Engage and Embrace" is not adequate for defining relations with China, and that a more hard-headed and pragmatic approach is needed. The U.S. policy response in this scenario is one of selectively working with China, but also in taking concerted action to protect technologies and companies from predatory Chinese behavior, and to use bilateral and multilateral pressure to limit Chinese behavior that works to the detriment of the U.S. and its allies.

- **Scenario Three, "Significant Decoupling,"** is based on the belief that China represents a deep and serious threat to the future of the United States. The U.S. policy response in this scenario is wide-ranging, aggressive, and coordinated with key U.S. allies, focused on slowing China's rise and blocking its drive for hegemony.
- In looking ahead at which direction relations with China are trending, we offer several signposts for assessing future directions in U.S.-China relations:
 - **Signpost 1: U.S.-China Trade Disputes:** The deals reached in the next few months, and the upcoming decisions on whether to levy additional tariffs, will offer a short-term indication of where the U.S.-China relationship is headed at least until the 2020 U.S. elections, though the impact of such decisions will continue to be felt after those elections as well.
 - **Signpost 2: Limits on Chinese Foreign Investment:** The future trend on the strictness or flexibility of new regulations related to inward FDI, as well as actions by CFIUS in reviewing proposed investments, will be key signposts of where the broader U.S.-China relationship is headed.
 - **Signpost 3: U.S. Restrictions on Huawei and ZTE:** The decisions made on policies toward these Chinese telecom companies will help determine whether we are headed to a bifurcated world in terms of 5G and other technologies, with some markets tied to Chinese technologies while others are more closely tied to U.S., European, or Japanese technologies.
 - **Signpost 4: China and Hong Kong:** Should China feel sufficiently threatened, it might escalate to a heavy and damaging crackdown - perhaps not unlike Tiananmen Square - that would have dramatic and long-term impact on the entire region and could lead to a sharp escalation of tensions between China and the U.S. and leading U.S. allies.
 - **Signpost 5: China and Taiwan:** While the current Hong Kong protests are closely watched in Taiwan and are raising deep concerns over how close Taiwan should get to Beijing, the risk of aggressive Chinese action toward Taiwan remains real.
 - **Signpost 6: China, North Korea, and the U.S.:** A dramatic increase in tensions between Pyongyang and Washington could have a significant impact on the U.S.-China relationship as well, as President Trump may try to pressure President Xi to influence North Korea to enter into serious negotiations with the U.S.
 - **Signpost 7: Cultural and Educational Interaction:** The loss of Chinese talent at U.S. universities and companies could limit innovation in the U.S., and greater scrutiny of Chinese involvement in academic and cultural institutions in the U.S. is increasing and may further complicate overall relations.
 - **Signpost 8: Public Opinion toward China:** Increasingly negative attitudes toward China in the American public could strengthen the hand of hardline China critics in Congress and the Trump administration, and make it more likely that U.S. lawmakers embrace tougher policies toward Beijing.
 - **Signpost 9: China and the 2020 U.S. Elections:** The outcome of the 2020 U.S. presidential and Congressional elections will clearly have a significant impact on U.S.-China relations, and early signs are seen in the policy positions staked out by President Trump and the Democratic nominee during the election campaign.