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China Knows What It Wants—the U.S. Still Doesn't

China, prioritizing Huawei, focuses on long-term growth while U.S. endgame is muddy

By Greg Ip

In its trade negotiations with China, the U.S. should have all the leverage. It buys far more from China than vice versa, is sole supplier of numerous critical technologies and commands more loyalty from the rest of the world.

But China brings one powerful advantage of its own: clarity of purpose. Though its negotiating priorities change, over the decades its goal has remained the same: moving steadily up the development ladder while remaining a one-party state. The U.S. ban on supplying key inputs to Huawei Technologies Co. was an existential threat to the next stage in that development, competing globally in the world's most advanced technologies. Thus, when President Xi Jinping met President Trump on the sidelines of the G-20 summit in Osaka, Japan, this past weekend, his main condition for restarting negotiations was to lift the ban.

U.S. leaders, for their part, have long been divided over whether to treat China as a partner that can be managed or a rival that must be ostracized. The Trump administration is itself split, and the president's decision to give Huawei a temporary reprieve has left the endgame as muddy as ever.

China joined the World Trade Organization back in 2001 as a way to discipline its inefficient state-owned enterprises, secure access to foreign markets, and stoke export-led growth. Along with an undervalued Chinese currency, WTO membership attracted a flood of foreign capital and expertise that turned China into the world's factory floor.

That led to widening Chinese trade surpluses and deepening friction with the U.S. Beijing addressed those tensions by letting its currency, the yuan, rise in value. Its priorities then shifted from attracting foreign investment and export-led growth to cultivating domestic champions. So even as China's trade surplus began shrinking as a share of national output, Western companies faced tightened access to the Chinese market and pressure to transfer technology and know-how to Chinese rivals.

China is now embroiled in a tariff war over U.S. efforts to end that discriminatory treatment. Yet its priorities have again evolved, from protecting domestic champions at home to nurturing global champions in the most advanced industries, from energy-efficient cars to artificial intelligence.

“The Chinese are still highly protective of their domestic market, but what they identify as most worthy of protection has changed over time and moved up market as their ambitions in technology have expanded,” says Scott Kennedy of the Center for Strategic and International Studies.

Huawei isn't just any company; it is the leading supplier in arguably the world's most important technology, fifth-generation telecommunications networks, and a considerable source of national pride.

Huawei and state-owned ZTE Corp. and State Grid, the electricity monopoly, are strategic "tools to push China up the tech ladder," says Derek Scissors of the American Enterprise Institute. "They're at the heart of [Xi's] approach to China's development."

The U.S. campaign against Huawei began as a national security matter based on the company's potential to become a conduit for Chinese government spying. It is now integral to the broader debate over how to treat China.

American leaders thought WTO accession would strengthen the rule of law in China while encouraging economic and political liberalization. By the end of the Obama administration those hopes had been dashed, and the Trump administration has repudiated that view altogether. Yet it has yet to settle on an alternative, and Huawei symbolizes the divide.

U.S. Trade Representative Robert Lighthizer has long argued China has exploited the WTO to run huge trade surpluses, steal intellectual property, coerce foreign companies into transferring their technology, and subsidize domestic firms. Yet he also believes China can be made to behave with an alternative set of rules, and sees Huawei as an unrelated national security issue.

By contrast, the hawks close to Mr. Trump believe China's system is fundamentally incompatible with that of the U.S. and its allies. To them, blacklisting Huawei potentially matters more than tariffs in keeping China from displacing the U.S. economically and militarily. "This radical cadre of the Chinese Communist party has been running against the West for 15 or 20 years," one of those hawks, former adviser Steve Bannon, told CNBC last week. "Huawei is a dirty bomb inside industrial democracies." Secretary of State Mike Pompeo earlier this year accused China of wanting to "divide Western alliances through bits and bytes, not bullets and bombs."

Yet Mr. Trump subscribes to neither of these world views. He judges China by the same transactional metrics he judges all countries: deficits, dollars and Dow points. On Saturday, explaining the Huawei reprieve, he said: "We sell to Huawei a tremendous amount of product." He also justified his decision a year earlier to suspend a ban on selling to ZTE at Mr. Xi's personal request because they paid the U.S. a steep fine and "they also have to buy American product. Buying American product is very important to me."

Successful negotiation depends on knowing your own bottom line. That is something the U.S. still appears to be figuring out.