Enlightened partnership needed

Xi and Trump must work hard to stop the possibility of a widening divergence between China and the US

Stephen Roach

From the days of Chairman Mao Zedong and Richard Nixon, it has always been tempting to assess the Sino-US relationship through the lens of leadership personas. Such is the case today in the aftermath of the recently concluded meetings between President Xi Jinping and US President Donald Trump that took place in Beijing from Nov 8 to 10.

Both leaders have large personalities and seemingly commanding views of the ethos of their respective nations. Yet they still need to work hard to dispel the possibility of a sharp and widening divergence between two powerful nations.

This divergence is most evident in the worldviews of the two countries. The so-called Chinese Dream is all about the rejuvenation of a once powerful nation, its outward-facing aspirations of leading a new wave of globalization underpinned by the Belt and Road Initiative, which seeks to revive the ancient Silk Road routes. That stands in sharp contrast with an inward-looking United States and its “America first” mind-set.

Both approaches are championed and well-articulated by their leaders, albeit from very different perspectives. That is especially the case in economics terms — long recognized as the bedrock of the Sino-US relationship.

In the late 1970s, the two economies were struggling. The US was in the grips of wrenching “stagflation”, and China was in near shambles after two decades of social and political turmoil.

Convinced that economic growth was the antidote, the US and China turned to each other for support — establishing a codependency that persists to this day. A production-focused Chinese economy took dead aim on external demand from the US. And a consumer-focused, savings-short US economy turned to low-cost imports and surplus savings from China in order to make ends meet.

China embarked on a 30-year 10 percent growth binge and the US, assisted by the Federal Reserve’s successful anti-inflation campaign, was able to regain its prowess as the world’s most powerful economy. On the surface, it was a seemingly ideal solution for two growth-starved nations.

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Unfortunately, that perception led to a complacency that ignored serious problems brewing beneath the surface in both economies. Lacking in domestic savings, the US’ consumer-led growth solution could only be finessed by imported foreign savings, which, in turn, entailed massive trade deficits and a concomitant loss of competitiveness in world markets. China’s production-oriented growth solution was mirrored by a suppression of household consumption — still less than 40 percent of its GDP today.

Just as the two nations were facing unsustainable economic conditions in the late 1970s, the imbalances of codependency led to new problems. A mutually beneficial economic relationship bought time, but did so with an increasingly shorter fuse.

And so, amid the great flourishes of what China dubbed a “state visit plus”, Trump and Xi brought considerable baggage to their recent exchange in Beijing. But they also brought new ideas.

Three weeks earlier, Xi had opened the 19th National Congress of the Communist Party of China with a sweeping vision of a “new era” that was framed by a rethinking of the so-called principal contradiction of unbalanced and inadequate economic development. At the same time, Trump was pushing hard for the US Congress to enact massive tax cuts — underscoring America’s own principal contradiction.

Of course, the US tax plan has been billed as just the answer to Trump’s promise to “make America great again”. The contradiction arises out of affordability. The Trump administration is clinging to the view that the tax cuts, which the Congressional Budget Office estimates could add more than $1.5 trillion to budget deficits over the next decade, will be self-financing.

Such claims are both dubious and risky. In 1980, when former president George HW Bush first sounded the alarm over what he called the voodoo economics of such “dynamic scoring,” the US economy had a much greater margin of error. Net national savings stood at 7.2 percent of national income in 1980 — four times the current 1.8 percent rate. Today’s razor-thin savings cushion offers no leeway for an accounting gambit.

This is of great relevance to the main economic complaint that Trump delivered during his just completed, five-country Asian swing: That the US has been unjustly wounded by bad trade deals, which have led to massive deficits with a few countries like China, Japan and the Republic of Korea, to say nothing of bad deals with North American Free Trade Agreement partners Mexico and Canada.

This argument is seriously flawed. Lacking in savings and wanting to consume and grow well beyond its means, the US has no choice other than to import surplus savings from abroad and run massive balance-of-payments and trade deficits to attract foreign capital.

In 2016, the US ran trade deficits with 101 nations — a multilateral imbalance that belies the bilateral fixation of the US president and congress. With the Trump tax plan likely to deepen the US budget and savings deficits, the principal economic contradiction of the US will only worsen in the years ahead.

That does not appear to be the case with China. The restatement of its principal contradiction at the recently concluded 19th National Congress adds important ideological support to the analytical case for consumer-led rebalancing featured prominently in China’s 12th and 13th Five-Year Plans.

Just as it did in 1981, when it focused on the principal contradiction of “backward social development”, today’s China has updated and recast its strategy in both ideological and analytical terms.

The structural transformation of the Chinese economy that falls out of this approach is not without consequences for its codependent partner, the US. As China shifts from surplus savings to savings absorption — drawing down its outsized 45 percent domestic savings rate to fund the safety net of the Chinese people — it will have fewer savings to loan to the US and subsidize the safety net of the American people.

Yet with the budget deficits of Trumponomics likely to require more surplus savings from abroad, China’s shift to savings absorption comes at a particularly vulnerable time for the US.

That’s not to say China has it all figured out. Rebalancing is a broad and amorphous prescription — in effect, the resolution of the “soft” principal contradiction of unbalanced development.

If China is to realize its own aspirational objectives as a Great Power by 2050, as Xi stated without equivocation in his address to the 19th Party Congress, it will need to sharpen its focus on the resolution of a number of important “hard” contradictions — especially State-owned enterprise reform, capital markets development and social safety net reforms. China needs to resolve both its soft and hard contradictions.

Consequently, notwithstanding the theatrical staging of the recent Xi-Trump meetings, a growing disconnect is increasingly evident between the US and Chinese economies.

The US shows little inclination to resolve its own set of contradictions — especially, with the Trump administration and congress willing to exacerbate the US savings dilemma in the years ahead. China, by contrast, seems more determined than ever to tackle the strategic challenges of a new era.

Codependent relationships are inherently reactive. When one partner changes the terms of engagement, the other often feels scorned, lashing out in response. China is changing. The US is not. The Trump blame-game mentality borrows a page right out of the script of the scorned partner.

The Beijing Nov 8-10 exchange between Trump and Xi was steeped in ceremony and displays of personal power. But the daunting geostrategic problems that both nations face — not just in the Democratic People’s Republic of Korea and the South China Sea but also the mounting tensions of deglobalization and trade protectionism — can only complicate looming tensions on the economic front. An enlightened partnership is sorely needed.

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