6. U.S.-China Relations In 2019

AN ADDRESS TO THE ASIA SOCIETY
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China's President Xi Jinping and US President Donald Trump at the Great Hall of the People in Beijing. Nicolas Asfouri. AFP. Getty Images. 2017.

TODAY IN WASHINGTON, D.C., the United States, and the world marks the passing of President Bush Sr. President George H. W. Bush was a truly remarkable president. For those of us engaged in the business of the world—the first Gulf War, the end of the Cold War, and the reboot of the U.S.-China relationship in the early 1990s after the implosions of 1989—President Bush Sr. was a truly remarkable American, and a truly remarkable American president. And we honor him this day.

Over the last 12 months, much of Asia has been turned on its head through the new dynamics we have witnessed in U.S.-China relations and on North Korea. It was only 12 months ago that the United States and North Korea appeared to be on the verge of armed conflict as "Rocket Man" was threatened by President Trump with "fire and fury" over the North's continued nuclear weapons program. Twelve months later, President Trump and Kim Jong-un appear to be the best of friends following their historic summit in Singapore, and despite the fact that there seems to have been negligible substantive progress on denuclearization, the thaw in inter-Korean relations has been unprecedented.

Twelve months ago, President Trump had just returned from his state visit plus to Beijing, where it seemed Trump's anti-Chinese rhetoric of the 2016 campaign had finally been put to bed. But 12 months later, China and the United States are now in the middle of a still unresolved trade war, while the administration has declared that America's 40-year-long era of strategic engagement with China is now over and a new period of strategic competition has begun.

Twelve months ago, the American, European, and Chinese economies and markets were roaring. Whereas 12 months later, they are beginning to slow, albeit for different reasons, causing concerns about the sustainability of long-term growth, employment, and income levels.

If a week is a long time in politics, in international politics and economics, a year is an eternity. And China remains a dominant driver in all three of these major unfolding changes. During the course of this year, we have all been wrestling with three big questions: How is China changing under Xi Jinping? How is America changing under Donald Trump? And to what extent have the traditional moorings of the U.S.-China relationship of the last 40 years now been severed, in which case what, if anything, can now anchor the relationship into the future?

During the course of this year, we have all been wrestling with three big questions: How is China changing under Xi Jinping? How is America changing under Donald Trump? And to what extent have the traditional moorings of the U.S.-China relationship of the last 40 years now been severed, in which case what, if anything, can now anchor the relationship into the future?

In other words, are we now, as Graham Allison warns us, "destined for war"—either cold, medium, or hot? Or is a new strategic equilibrium now possible between the two countries, based on a new common strategic narrative for the relationship that can be shared and observed in both capitals. The truth is, these are genuinely hard questions. They force us to think clearly about one another through the fog of perception and misperception. They force us to think clearly about our values, our interests, and our identity. And they force us to think through carefully what is essential, what is nonessential, where there should be compromise, and what should remain contestable.

I do not intend to try to answer all these questions today because they require further thought, although I am deeply conscious of the fact that they must be analyzed and answered soon. That's because we are now in potentially dangerous terrain—some sort of "no man's land" between one set of strategic assumptions about each other that have stood for several decades, and a brave new world where everything may be up for grabs.

Over the last 12 months, we have, however, made a start in a series of addresses aimed at analyzing core aspects of the collective challenge we are facing. In March, I spoke at West Point on the question of what does Xi Jinping want, while in June at the Lee Kuan Yew School in Singapore, I began to analyze the Marxist origins of Xi's emerging worldview. In September, I spoke on America's response to Xi Jinping through a new declaratory doctrine of strategic competition and posed a series of questions for U.S. policymakers as they seek to operationalize that strategy. I also spoke in Silicon Valley on what strategic competition might look like if allied to a high-technology war between the two countries. And most recently in Jakarta, I sought to analyze what this emerging strategic cleavage between Washington and Beijing means for Southeast Asia, which has become the "New Great Game" for strategic influence as ASEAN itself continues to hedge against a rising China and what is perceived to be an indifferent, uncertain, and potentially unreliable America. We need also to analyze other regions within a similar frame, including Africa, Eurasia, the Middle East, South Asia, and Latin America. There are commonalities but differences across them all that we need to understand.

In my remarks today, part of the same series, I want to look at the state of the relationship at year's end in the aftermath of the Buenos Aires Summit; the impact of the continuing trade war on China's unfolding domestic economic policy debate and where that may lead in the future; as well as what the prospects are for the overall U.S.-China relationship for the year ahead. I'm always challenged by Henry Kissinger, who enjoins us in strategic analysis to understand first and foremost what we are seeing, and to ask ourselves also what we are not seeing. All before going onto the critical question of policy: "what then is to be done?"

THE BUENOS AIRES SUMMIT

What Presidents Trump and Xi Jinping did in Buenos Aires was buy time. Three months' worth, in fact. Which is good when measured against the alternative, which is a full-blown trade and broader economic war between the two countries starting next month. Which, in turn, had the potential to trigger a further collapse in global market sentiment, particularly coming on the back of other negative trends emerging in both the U.S. and Chinese domestic economies. But even from those of us who have been arguing publicly that, on balance, a deal of some sort between the Chinese and the Americans was more probable than not: one swallow doth not a summer make. Much can still unravel. Both Trump and Xi have indeed bought valuable, though limited, time for themselves and the world. But for a number of different reasons.

To begin with, there are five complex baskets of policy disagreements to work through. First, the current annual $370 billion bilateral trade deficit needs to be reduced. Then there are the possible cuts to tariff rates themselves. The Chinese average tariff rate currently stands at about 9.8 percent compared with an American average tariff rate at 3.4 percent. Then there are those industry sectors that are most politically sensitive in each economy, led by agriculture: Republican-voting farmers in the United States, matched by

China's historical paranoia over national grain self-sufficiency. Then there are the three hardy perennials: intellectual property protection, forced technology transfer (an American term), and the use of the full resources of the Chinese state to support China's stated national industrial strategy (Made in China 2025) to dominate global advanced technology markets and product standards by 2030. These three are the really ugly ones. Setting a deadline of March 1, 2019, to resolve these five problems is smart. Particularly if it's driven hard by the prospect of a further working-level summit with Trump and Xi later in March, although I note that a number of trade professionals have argued that 90 days is so ambitious that it's unrealistic and sets both sides up for failure.

This 90-day pause also serves Trump and Xi in other ways. By March, Trump will have a fuller idea of the lay of his domestic economic and political landscape. He will then know the extent of any significant softening in the economy already induced by monetary policy tightening by the Federal Reserve Board, and the extent to which the American economy could then sustain further tariffs should the efforts of Chinese and American officials have come to naught. On the political front, the Mueller investigation should also have reported by March. If the results of the investigation are seriously bad for Trump, then we should be alert to the possibility of Trump having a renewed interest post-Mueller in doubling down against China—if, in fact, he is found then to have been compromised in his dealings with Russia. That certainly would be an "X factor" that our Chinese friends are worried about.

March, however, also presents Xi and his chief economic adviser Liu He with opportunities of their own. On the international front, March might enable Xi to take a bold trade message to Davos in January, should he decide to go. China has sought to mobilize global sentiment in support of its efforts to uphold the global economic and environmental order. A major Chinese announcement on trade liberalization across the board, not just on a bilateral basis with the United States, could indeed take the world by storm. It would also send a stark signal to the world on the 40th anniversary of the Chinese economy's "reform and opening up." And that indeed could represent a serious new challenge to American global leadership.

Furthermore, a serious commitment to trade liberalization from Beijing, accompanied by the underlying message of competitive neutrality between foreign firms and domestic firms, as well as between private firms and state-owned enterprises, would reinforce Liu's valiant efforts in recent months to reprosecute the full implementation of China's stalled "phase two" economic reform program first announced in 2013. This is something that China desperately needs for its own economic interests.

This takes us to the core question of the organic relationship between any concessions that China might offer U.S. trade and economic negotiators bilaterally, and those things that Chinese economic reformers understand need to be done in any case domestically, if indeed the economy is to be able to have strong, sustainable growth into the future.

CHINA'S CHANGING DOMESTIC ECONOMIC NARRATIVE

Those who follow the Chinese economy closely understand the significance of the economic reform blueprint first released by Xi Jinping's administration in November of 2013. This came earlier in his period in office. After a fierce internal debate in its preparation, agreement was finally reached on its central organizing principle, that "the market play the decisive role in resource allocation." The decision incorporated 60 different reform measures covering 10 broad categories of trade, cross-border investment, state-owned enterprise (SOE) reform, competition policy, financial system reform, fiscal policy, innovation policy, labor, environment, and land reform. This was a conscious effort by China's economic leadership at the time to transform China's historical economic growth model over the previous 35 years to what became then universally known as "the new model."

The old model, as we are all familiar, was based on two pillars: labor-intensive, low-cost manufacturing for export, reinforced by high levels of public investment in national economic infrastructure. The new model was based on three pillars: high levels of domestic consumption; private sector-driven innovation following the completion of the SOE-driven infrastructure build, and a sustainable development revolution.

Implementation began in 2014–15, but the Party's confidence in the market was dealt a body blow by the implosion of Chinese equity markets and broader financial markets in August 2015. From that time on, as we at the Asia Society Policy Institute have tracked through our "China Economic Dashboard," the pace of implementation of the reform program slowed drastically, and in most areas ground to a complete halt. Harsh capital controls were also imposed on China's capital account, making it much more difficult for private firms to expand their operations abroad. At the same time, because of legitimate fears about the size of China's debt-to-GDP ratio, driven in large part by an out-of-control shadow banking sector, as well as ballooning local government debt, the central government began a national deleveraging campaign, which over the last several years has also resulted in credit being withdrawn indiscriminately from otherwise profitable private firms. At the same time, Chinese SOEs were given a new lease on life where the national deleveraging campaign has had less effect on SOEs than their private sector counterparts.

Furthermore, there has been the rolling impact of China's anticorruption campaign that has fundamentally slowed government decision-making processes as officials sought to protect themselves from political exposure, which meant that the private sector-driven development projects also began to slow significantly. To this was added Xi Jinping's emphasis on the central role of the Party and the primacy of ideology, resulting in an enhanced role for Party secretaries operating within private firms. And, on top of all the above, there has been considerable confusion as to the precise implications of China's so-called mixed ownership model—whether it was an invitation for private firms to absorb poorly performing public trading enterprises, or whether in fact it was creating a fresh opportunity for SOEs to "nationalize" well-performing private firms.

All these factors had been unfolding across the Chinese economy over several years prior to the beginning of the U.S.-China trade dispute in the first half of 2018. The net effect of all of the above has been a growing number of anecdotal reports pointing to the significant slowing of Chinese economic growth during 2018 with private sector firms, concerned about an increasingly adverse policy environment, refraining to invest in further expansion of their enterprises, either at home or abroad. By the time the annual leadership retreat occurred at Beidaihe in August of this year, reports had begun to come in from across the country that China was facing a serious domestic crisis of private sector business confidence with potentially profound implications for future growth.

FROM ADVERSITY SPRINGS OPPORTUNITY: COMPETITION POLICY REFORM

It was at about this time that those who have long understood the continuing imperatives of China's market economic reform agenda saw an opportunity emerging out of adversity—namely, to bring about the next wave of competition policy reform within the Chinese economy by opening China to more foreign competition, thereby lifting long-term productivity growth. It will be recalled that competition policy reform had long been a key component of the original 2013 national economic blueprint, but it had been allowed to slide.

The need for a more effective competition policy was particularly felt within China's poorly performing financial services sector. In any efficient market economy, the effective allocation of capital across competing corporate needs, based on the business case advanced by would-be borrowers, and the associated risk taken on by lenders, is fundamental to sustainable economic growth. By contrast, China's financial services industry has developed inefficiently, despite the growing number of domestic private players within it, because capital allocation decisions are driven less by market considerations than by political or administrative necessity.

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China's economic reformers are fully seized of the dimensions of this problem in the heart of the Chinese financial system. The reformers see the future lying not just in bringing China's grossly indebted second-tier banks and SOEs back within reasonable borrowing limits from their previous borrowing and lending habits. They equally recognize the structural importance of introducing market disciplines for capital allocation decisions for the future. In other words, it's not just the matter of cleaning up decisions from the past. It's also about creating a functioning market framework for the future so that scarce financial capital is allocated rationally, and corporate debt burdens do not simply blow out once again.

Chinese reformers also see the greater introduction of wholly owned foreign financial institutions into the Chinese domestic market as a new way of grafting these market disciplines onto the Chinese system. This differs qualitatively from previous Chinese approaches to allow limited foreign financial institutional participation within China—where foreign presence has largely been limited to minority stakes in second-tier banks with the limited policy objective of Chinese banking officials "learning" how Westerners do these things, before eventually asking said Westerners to leave. The alternative approach is to fundamentally shake up the Chinese system from the top down, by introducing large-scale foreign competitors across the breadth of the financial services industry in order to force Chinese firms to be more efficient.

This year, for example, we have seen a number of foreign investment limitations eased for entry into China's $45 trillion financial services sector. These have included the following:

- Foreign investment limits on securities companies and mutual funds were raised to 51 percent in April and set on a three-year path to allow full foreign control. Indeed, last Friday, UBS became the first foreign securities firm to be approved for majority ownership, with applications from JPMorgan and Nomura in process.
- Foreign insurance firms are now to be allowed a controlling 51 percent ownership of domestic insurers as of May of this year. And German insurer Allianz was approved to be the first wholly owned foreign insurance company on November 25. French firm AXA has quickly followed, purchasing the outstanding share of its previous joint venture on November 26.
- Foreign ownership limits on banks and other debt managers were also removed in August. Previously, foreign firms were limited to 20 percent as a single entity, or 25 percent as a group. To date, however, no foreign firms have applied to use the new regulations.

ADDITIONAL SUPPORT FOR THE PRIVATE SECTOR

Financial services reform driven by increased foreign participation is one thing. Wider reforms to promote China's somewhat beleaguered private sector have also been forthcoming. On November 19, the State Administration of Taxation issued a policy note outlining 26 concrete measures centered on reducing the tax burden for private firms.[6] According to the State Administration of Taxation, these were not yet fully utilized. Nonetheless, in the most recent quarter, there were over 143 billion RMB ($21 billion USD) in tax deductions for Chinese small and medium-sized enterprises, a 41 percent increase from the third quarter of 2017.

Beyond these various reform measures, there have also been recent announcements from the central government aimed at improving credit availability to Chinese firms. The Party secretary of the People's Bank of China on November 7 outlined the new so-called 1-2-5 policy.

- This was a directive for at least one-third of new corporate loans from large banks to be extended to private firms
- At least two-thirds of new loans from small and medium-sized banks
- Over the next three years, for at least 50 percent of all new corporate credit across the banking system to be extended to the private sector

FIRST STEPS TOWARD A NEW CHINESE POLITICAL ECONOMY?

To repeat: the key to the success of this newly emerging political economy in China is the extent to which China's economic reformers are able to develop a domestic political narrative within the Party and the country that explains any "external concessions" to the U.S. administration as necessary internal reforms to undergird China's long-term economic growth prospects.

This is a tough challenge given that over the last several years at least, Xi Jinping's political center of gravity has lain elsewhere. Namely, his predilection for a stronger Party, stronger politics, and a more nationalist

[6] See Li Xia, "China to Ease Tax Burdens for Private Enterprises," Xinhua News Agency, November 19, 2018, http://www.xinhuanet.com/english/2018-11/19/c_137617997.htm.

posture. Nonetheless, it seems that Xi Jinping has now had a large encounter with economic reality—Chinese style. Namely, that the Chinese private sector really matters. Furthermore, if this economic policy correction continues, basically from left to right, then this may turn out to be a seminal period of reform indeed.

There are grand precedents in recent Chinese history for such economic policy corrections to occur. Barely three years after Tiananmen, Deng Xiaoping undertook his famous southern expedition, where he told China to redouble its efforts in economic reform and opening to the world. And China did. Five years later, Jiang Zemin, in the midst of the Asian financial crisis, said to China's emerging entrepreneurial class to "go out into the world." And they did. Five years after that, Zhu Rongji in 2002 secured China's admission into the World Trade Organization, heralding the next phase of China's economic reform program, including China's emergence as the global export superpower it has since become.

It may well be that we are witnessing a policy redirection of a similar order of significance with what is unfolding now. Certainly a careful reading is warranted of Xi Jinping's speech of September 27 on the economy;[7] Vice Premier Liu He's of October 19 on the private sector,[8] and perhaps most significantly of all, Liu He's comprehensive statement on China's future economic direction outlined in his address to the Hamburg economic forum in late November on the eve of the G20 summit.[9]

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Of course, many things can go wrong with all of this. Policy momentum may stall. Chinese bureaucrats may simply hedge their bets and sit on their hands. Even worse, they may simply resort to the vast array of nontariff barriers at their disposal to undermine the letter and the spirit of reforms to China's overall trade and investment policy environment on the ground. And beyond all that, China's private sector, still facing significant restrictions on the capital account, may not respond positively to what the Party and the government are now telling them to do, on the grounds that there is too much policy and regulatory unpredictability for them to have sufficient confidence to invest in the future.

That's why it will be critical to see China's emerging data on private fixed capital investment to see whether Chinese firms have bought the Chinese leadership's new policy message, thereby unlocking a further period of reform, opening, and sustainable economic growth.

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[7] Xi Jinping, "Three Talks about the Private Economy in a Month: Xi Jinping's Speech Revealed What?," China Communist Party News Network, October 26, 2018, http://cpc.people.com.cn/xuexi/n1/2018/1026/c385474-30364832.html.
[8] Liu He, "Chinese Vice Premier Vows Unwavering Support for Private Sector," Xinhua News Agency, October 19, 2018, http://www.xinhuanet.com/english/2018-10/19/c_137544504.htm.
[9] Liu He, "The Hamburg Summit: China Meets Europe" (Keynote Address, Hamburg Summit, Hamburg, Germany, November 27, 2018), https://hamburg-summit.com/images/summit/2018/Speeches/13_2018-11-27_HS2018_Keynote-speech-Liu-He.pdf.

PROSPECTS FOR 2019

Against this general economic background, what then are the prospects for the U.S.-China relationship for 2019? By March, it's probable that there will be an agreement between China and the United States on the quantum of bilateral trade deficit reduction and the import decisions that China will make to bring that about over time. As for tariff reform by March, that is possible, although the degree of technical difficulty remains significant. If it's a tariff line by tariff line approach, given the multiplicity of tariffs that currently apply to the overall trading relationship, this may well blow out way beyond March. If, however, Chinese economic reformers take a more dramatic approach by committing to zero tariffs over time, and challenging the Americans to do likewise, that would be precisely the sort of measure that could be announced relatively rapidly. It would, however, run totally against the grain of half a century of training of Chinese trade bureaucrats to give away nothing if at all possible—let alone be seen to "give away everything" in one fell swoop.

The reform of so-called forced technology transfer, within the contractual arrangements between Chinese and American enterprises, should be relatively straight forward. This, however, is different from how contractual arrangements may be interpreted on the ground, even in the absence of any specific technology transfer provisions. Intellectual property (IP) protection is deeply problematic. Not only are there traditional forms of commercial espionage, there is now cyber espionage as well. Previous agreements reached under the Obama administration could be reconstituted. But the critical problem remains jurisdictional enforcement of breaches if and when discovered. One possible mechanism for building confidence is for all relevant contracts between Chinese and foreign firms to be made subject to international commercial arbitration regimes located in either Singapore or Switzerland. These could be designed in a manner to specifically deal with IP protection. The recourse to international commercial arbitration is now relatively common around the world. If China objected, it might also be possible to develop China's own domestic international commercial arbitration system. But for foreigners to have confidence in this system would require China to appoint qualified foreigners to its panel of arbitrators. Other countries already do this. China could do the same. But in the absence of an independent Chinese legal system, even in the commercial law, this would seem logically to be the only way through this continuing thorn in the side of the relationship.

On China's use of state subsidies in support of its national plan for domestic and international high-technology market domination, it is difficult to identify any readily available solution. The uncomfortable reality is that all countries use varying levels of government support for their indigenous technology industries. Even if we were to mandate a maximum proportion of state support for a given firm (either by way of state research and development support or other related tax breaks), the problem would invariably arise as to how all of this is measured. I am not therefore confident of a negotiated outcome in this area. America may simply need to outcompete "China at its own game" in terms of a radical increase in public investment in research and development across the full spectrum of information technology and biotechnology sectors. The major public universities would, I'm sure, welcome this with open arms.

As indicated above, we should also not rule out the possibility in 2019 of China pitching any tariff reforms that it is prepared to implement to resolve the U.S.-China trade war to the wider international community as well. We should not rule out the possibility, for example, that if China were to undertake something dramatic—like a commitment to zero tariffs over time—that such a commitment would not just be made on the basis of reciprocal actions by the United States, but by all WTO member states. Indeed, this would represent an almost irresistible geopolitical opportunity for China to champion global free trade and to arrest the global trend toward protectionism that currently threatens the wider global economy. Furthermore, we should not rule out the possibility that China approaches the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP-11) member states to negotiate possible accession to the TPP. This would comprehensively outflank the United States within the Asia-Pacific region. It would also turn out to be supremely ironic that a TPP originally designed by the Obama administration as part of its pivot to Asia ended up including China but not the United States. China, when it sees a political and market opening, can be remarkably fleet of foot. The technical negotiations would, of course, be formidable. But there is already evidence of a softening in traditional Japanese reservations toward possible Chinese accession as evidenced during Prime Minister Shinzo Abe's recent visit to Beijing.

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On the wider foreign policy and security policy front, 2019 is likely to see China increasingly pull its head in. There is already evidence of a normalization in relations with Tokyo. The Japanese coastguard has published data already indicating a radical reduction in the frequency of Chinese incursions into the Senkaku/Diaoyudao area in the East China Sea. China is also seeking to deescalate tensions with the ASEANs over the South China Sea through an intensification of its negotiation of a "code of conduct"—although maritime incidents with the United States have continued to be sharp, and may well get sharper if the United States implements a more vigorous campaign of freedom of navigation operations in the coming year. China has also sought to deescalate tensions with India following the bilateral summit with Prime Minister Narendra Modi in Wuhan in April 2018. That is likely to continue through the Indian national elections due in 2019. China may also begin to moderate its posture toward Taiwan during 2019 given the remarkably poor results of the Democratic Progressive Party in the most recent Taiwanese local government elections. This, of course, would change radically if the United States proceeds, as is likely, with a further significant arms sale to Taiwan.

Across Eurasia, the Belt and Road Initiative (BRI) continues to be implemented. But for those observing China closely, the BRI now attracts considerably less political fanfare within China, at least over the last several months. It's still too early to tell. But already there is a debate underway in Beijing about revising certain BRI modalities. The Sri Lankan case looms large in the minds of the Chinese official class. So, too, does the long-term affordability of this multitrillion-dollar project. We may therefore be seeing less Chinese triumphalism over the BRI in 2019 than we've seen the last couple of years.

Common to all these adjustments in the year ahead is a general tactical approach that until such time as China is able to finally bed down the fundamentals of its trade, investment, and economic relationship with the United States, it is wise for China to reduce tensions between Beijing and other countries and regions of the world.

As for China's engagement in the wider international system during the course of 2019, China is likely to continue to be the newfound champion of the WTO. It is also likely to sustain its posture on global climate change action that it agreed to under the Paris Accord. In other words, China is likely to use the period ahead to consolidate and expand its role within the existing institutions of international governance, rather than the continued construction of new institutions of international governance that lie outside the UN and the Bretton Woods system.

Of course the BRI and the Asian Infrastructure Investment Bank will continue, but there may well be a parallel reduction in the global profile attached with China's more recent institutional innovations. Among some of the more sober minds in the Chinese foreign policy establishment, it's better to focus instead on the existing machinery of the global rules-based system, particularly when the United States is demonstrating systematic contempt for those very same institutions.

It is historically unprecedented to be in the midst of a debate about whether the world's largest economy and oldest continuing democracy can happily coexist with the world's second-largest economy and oldest continuing civilization, given that the latter has never exhibited...any attraction to liberal democratic norms. But grapple with the debate we must.

Taken together, these are nonetheless likely to represent tactical rather than strategic shifts in China's overall posture toward the United States, third countries, and the wider international system. China is likely to use 2019–20 to form a deep judgment about what happens to the future of U.S. politics. Will Trump be derailed by Robert Mueller? What will China policy be like if Trump is weakened by Mueller? Would Mike Pence be even more hard line than Trump on China? And would a Democratic Party candidate, if successful in 2020, adopt an equally hard-line strategy toward Beijing, and if so, how would it differ from the Republicans?

On these big strategic questions, the Chinese system moves deliberately slowly. It seeks to analyze carefully the operating environment in which Chinese strategy and tactics are deployed. And while China's leadership has already concluded that there is indeed a deep shift in American attitudes to China, they are still uncertain as to what precise shape and form this will take in the future. Tactically, therefore, China is likely to seek to buy time to reach these conclusions. And in the meantime, to deescalate tensions wherever possible, both with Washington and other capitals, while China seeks to reach a more fundamental judgment about America's future strategic direction and political resolve.

This is consistent with China's predilection for the long term, rather than the short. At present, China sees Trump as being a problem for the next two years for China, possibly not longer, before being replaced by another political leader with different priorities. Whereas China equally assumes that Xi Jinping will be leading China not just for another two years, but probably another ten. Or even more.

CONCLUSION

As I said at the outset, we are dealing with profoundly complex questions. Indeed, it is historically unprecedented to be in the midst of a debate about whether the world's largest economy and oldest continuing democracy, can happily coexist with the world's second-largest economy and oldest continuing civilization, given that the latter has never exhibited in its history any attraction to liberal democratic norms. But grapple with the debate we must. And resolve it we must as well, one way or the other.

This is despite the fact that we must do so in the midst of an increasingly polarized debate in both countries about the other. Americans believe China is stealing their future. They are angry. They have finally woken up and are fighting back. The Chinese, whether they are on the right or the left of their own debate, believe that the Americans are now deliberately containing China because Americans cannot cope with the idea of ever being number two. Particularly if number one happens to be Asian.

The debate is therefore a highly charged one. Which is why we need to be careful about the manner in which it is conducted in both our countries. In America, as in other countries, I am concerned about the rise of "neo-McCarthyism" in a debate that conflates concerns about the actions of the Chinese Party and state on the one hand, with the actions and attitudes of Chinese Americans on the other.

The recent report on foreign interference in the United States and a number of other countries is a case in point. Foreign interference, from whichever country, is an entirely legitimate subject for debate. After all, that's why democracies have laws, courts, law enforcement agencies, intelligence services, and other institutions preserving the careful set of checks and balances guarding our civil liberties as well as protecting us against internal and external threats to our security. That's why the best solution to questions of foreign interference lies in a policy of full transparency on the part of any institutions receiving foreign funding. It's when things are done in secret that we should be particularly concerned.

But that's also why it's critical to constrain the terms of the debate so that the patriotism of Chinese Americans is not brought into question. I'm concerned that in the current febrile political environment, this could occur. I presume that's why the recent report on foreign interference in this country has attracted dissenting submissions from among its authors, namely, Susan Shirk.[10]

Having read Susan's dissent, I support her reflection. I have also noted Bill Bishop's observation about the title of the report and its conflation of the Chinese Communist Party with the simple word "Chinese," capable, as Bill says of sparking anti-Chinese sentiment in general.

So as we advance this hard debate on this country's future with China, let us learn from the events of the last Cold War, Joe McCarthy, and his committee on un-American activities. This debate requires full candor—not a show trial. We are all better than that.

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[10] Larry Diamond and Orville Schell, *Chinese Influence & American Interests: Promoting Constructive Vigilance* (Stanford, CA: Hoover Institute Press, 2018), https://www.hoover.org/sites/default/files/research/docs/chineseinfluence_americaninterests_fullreport_web.pdf.