Economic Policy under Trade War Conditions: Can China Move Beyond Tit for Tat?

Barry Naughton

It has proven extremely difficult for China to deal effectively with Donald Trump's economic agenda. Beijing responded first with a classic "tit for tat" response, but has now moved to a broader defensive position. This has involved a concerted effort to stabilize expectations and a shift to more expansionary policies. Whether these policies will be adequate remains to be seen, but it is already clear that "tit for tat" has failed to meet China's needs.

China has attempted to deal with the policy challenge from Donald Trump. However, since it is difficult for anybody to discern what the Trump administration actually wants, it has been extremely difficult for Chinese policy-makers to determine an effective response. In essence, Chinese policy-makers have hunkered down, responded to the U.S. with (mainly) tit-for-tat measures, stood by virtually all of their existing policy orientations, and simultaneously dialed up—made more expansionary—virtually all macroeconomic policies. These are reasonable policy responses, but they are unlikely to be sufficient in the medium term.

Trump v. China

There is no doubt that China has been blindsided by Donald Trump. The Chinese leadership, along with many others, took Trump to be fundamentally transactional, a *businessman*. Chinese policy-makers responded to his election by reaching out through personal connections to the Trump business empire, and especially to the Kushner-Trump family. They also prepared to "deal," that is, to negotiate a government-to-government agreement that would give Trump some of what he wanted. However, negotiations failed after Trump twice abruptly rejected tentative deals that his negotiators had hammered out, apparently in good faith, and recommended to their boss. In July 2017, Commerce Secretary Ross initialed a preliminary agreement of modest but detailed and concrete concessions by China to resolve specific problems. This "first step" agreement was abruptly rejected by Trump. In May 2018, a U.S. delegation headed by Treasury Secretary Mnuchin and U.S. Trade Representative Robert Lighthizer arrived in Beijing with a maximalist list of demands that essentially would have required China to abandon all its current economic policies.[1] Nevertheless, a Chinese delegation, headed by Vice-Premier Liu He, came to Washington for the second time in mid-May and, in negotiations presided over by Treasury Secretary Mnuchin, made substantial commitments to increase purchases of U.S. goods and reduce the bilateral trade deficit. This negotiation also came to nothing when Trump again vetoed the deal.

Leaving aside the question of whether the outcome of these two negotiation processes was ever of much value, the way the process was handled put Chinese policy-makers in an extremely awkward position. It's not clear what the American "ask" was or is. It's also unclear what the basis for negotiation would be: is there some set of feasible concessions that the US would settle for? Can Trump take "yes" for an answer? China has now *twice* negotiated with Trump, only to have Trump back out of both tentative deals.

At this point, even if China wanted to offer something to re-start progress toward a deal, who would they talk to? Trump has intentionally created a management team in which responsibility is dispersed among several different advisers with incompatible preferences and approaches. Commerce Secretary Ross and Treasury Secretary Mnuchin are far more transaction-oriented than U.S. Trade Representative Robert Lighthizer or special adviser Peter Navarro. Trump encourages the diversity of views and perhaps even the personal animosity among the trade advisers, which erupted in May in a shouting match between Navarro and Mnuchin on the lawn in front of their Diaoyutai (Beijing) negotiations. The range of opinions among advisers insures that no matter who the Chinese talk to, President Trump will make the final decision, but also that the Chinese have no idea what Trump's actual bottom line is. Trump has thrown the Chinese off balance, so there is no way forward for negotiations at the present time. .

"Tit for Tat" Strategies and Two-player Games

If the U.S.-China "trade war" is seen as a two-person game—that is, between the U.S. and China alone—then social science theory provides some guidance to appropriate strategies. In particular, a "tit for tat" strategy—one of "equivalent retaliation"—is optimal in many cases and robust to a variety of real-world counter-strategies.[2] In a tit for tat strategy you start out cooperating, but respond immediately to any "defection" (selfish action by the counterpart that exploits prior cooperation). However, if the counterpart returns to cooperation, you immediately resume cooperation, leaving the counterpart to learn that cooperation pays off, without having to "teach him a lesson." Despite the name, "tit for tat" is basically a cooperative strategy that starts out nice and is always forgiving. But it also relies on the counterpart clearly perceiving that their non-cooperative behavior will be immediately met with equivalent retaliation. True to the strategic guidelines, China's initial response was to be cooperative—or at least to appear cooperative—and come to the table to negotiate a settlement.

China is extremely practiced at delivering "equivalent retaliation," that is at administering a "tit" for a "tat." Indeed, China has invested substantial resources of time and effort to establish a strongly credible tit-for-tat position with respect to the many issues of direct concern to China. For issues of direct concern, China has established almost a kind of tit-for-tat machinery so that carefully calibrated punishment can be meted out to counterparts. A good example would be the punishment meted out to South Korea after it allowed the THAAD anti-missile system to be deployed on its territory. Not only has China punished Lotte, the company that allowed its golf course to be converted into a missile base, it has discriminated against Korean products and refused licenses to Korean on-line games through the present.[3] These measures have the nice feature, from the Chinese perspective, that they administer pain that is clearly felt, but are partially deniable on the Chinese side.

Chinese leaders clearly understand that the credibility of their retaliatory response is a key element of their "soft power." On June 21, 2018, Communist Party General Secretary Xi Jinping met with the Global CEO Council to outline China's position. The Global CEO Council was set up in 2013 as a kind of outreach group, giving foreign executives the chance to meet regularly with Premier Li Keqiang and other economic policy-makers. Xi (for the first time) met with a group of about twenty executives, including several important American CEOs but an even more impressive list of Europeans.[4] Xi reportedly explained to the assembled CEOs that "In the West you have the notion that if somebody hits you on the left cheek, you turn the other cheek; in our culture we punch back."[5] Xi's comment is perhaps a little unfair to both cultures. It misses something in Confucius and certainly over-estimates the importance in Western society of the teachings of Jesus Christ. Still, it sends a clear message and the time for subtlety is past: China will respond in kind to US moves, that is, follow a policy of tit-for-tat. However, as discussed later, that strategy isn't really working for China right now.

Hunkering Down on Industrial Policy

In addition to the trade conflicts, China was forced to respond to the sanctions against ZTE, a leading manufacturer of telecom equipment. ZTE had been found in violation of US sanctions against Iran and North Korea; after accepting punishment for the sanction violations, ZTE had then taken steps to reward the perpetrators and shield them and the company from future scrutiny. This flagrant double-dealing was detected, and a harsh penalty imposed on the company by the U.S. Department of Commerce on April 16. ZTE was banned for seven years from purchasing American components, on which their manufacture of mobile phones—and much else—depended.[6] The company was forced to suspend business until, most unexpectedly, Donald Trump directed Commerce to work out a solution that would allow ZTE to stay in business. That was finally achieved in June 2018, with a $1 billion fine (making a total of more than $3 billion that ZTE will pay for its sanctions busting) and a special compliance unit installed onsite.

Formally, the ZTE case has nothing to do with the U.S.-China "trade war," being a separate sanctions-related case. However, it is hard for anyone to believe that the draconian penalty imposed on ZTE was not at least influenced by the increasing tensions over technology policy. After all, the sanction would have removed ZTE from action during the entire period in which new "fifth generation" telecom equipment is being rolled out.

In the event, Xi Jinping responded promptly to the shock of the temporary ZTE sanctions. In a visit to Wuhan ten days later, Xi toured chip manufacturing plants bankrolled by central government money, and exhorted China to "discard illusions" and recognize that mastery of critical technologies must "depend on our own efforts." Moreover, Xi said, China could rely on the superiority of the socialist system, which turns out to be the system's ability to "concentrate resources in order to achieve great things."[7] Only a week later, a second round of fund-raising was announced for the National Integrated Circuit Investment Fund. This new fund will raise 150-200 billion RMB, more than doubling the overall size of the fund.[8] Moreover, industry insiders quickly noticed an uptick in the fund's willingness to fund new projects. Finally, at the end of July, the State Council announced a reorganized and expanded Science and Technology Leadership Small Group.[9] Clearly, China pushed back on industrial policy, refusing to consider US demands that industrial policy be scaled back.

These dramatic events led to the fairly wide propagation of a narrative in response to US actions: the US had shown itself to be an unreliable supply partner, this story goes, and China "learned a lesson" and has been forced to take on a more self-reliant role. In this version of reality, increased Chinese self-reliance and a bigger effort may end up fostering its technological development and may cause U.S. advantage to slip. However, this fairly widespread moral tale doesn't fit the facts. In the first place, Chinese policy-makers have long complained about foreign dominance of "core technologies." China launched the push for "indigenous innovation" in 2006 with a statement that experience had shown that core technologies will not be voluntarily shared, and it has called for control of core technologies ever since. U.S. dominance of some core technologies can thus hardly be a surprise to Chinese policy-makers. Of course, U.S. actions revealed something about the willingness of the U.S. to behave in a certain way, but nothing at all about the underlying technological landscape. Second, ever since the National Integrated Circuit Investment Fund was established in September 2014, IC manufacturing efforts have essentially had unlimited funding, precisely in order to master these same core technologies. Through the end of 2017, the National IC Fund had already committed a cool 118.8 billion RMB (US $18.3 billion, or 86 percent of its total raise capital) to semiconductor investments. In other words, they had been spending the money raised in the first round so rapidly that a new round was inevitable. (The first round spending, incidentally, had already included an investment of billions of RMB in ZTE's semiconductor affiliate, in which it had a 24 percent stake).[10] Moreover, the National IC Fund, while enormous, is just a drop in the bucket of the total funding pouring into state-run "industrial guidance funds." Thus, it is hard to find an actual change in Chinese industrial policy, other than an escalation of rhetoric. Finally, given the sums China is already pouring into high-tech industrial policy, it is unlikely that a top-down, politically enforced mandate to spend even more money, even more quickly, will really be good for China's semiconductor industry in the long-run. Since money isn't the problem, just spending more of it quickly won't help

New Jobs for Liu He

A reorganized Science and Technology Leadership Small Group (S&T-LSG) was announced in early August, and while this group is not new, it does reflect the concentration of economic policy decision-making in the hands of Liu He. As pointed out in the previous issue of *China Leadership Monitor*, the allocation of responsibility among vice premiers had been changed at the March National People's Congress (NPC). The former unified Science and Education portfolio exercised by Liu Yandong in the previous administration was split, with science and technology under Vice Premier Liu He and education under Sun Chunlan.[11] Therefore, it is routine that the S&T-LSG should be redefined to exclude education, and that Liu He, vice premier in charge of science and technology should be (operational) vice-chair, while the Premier Li Keqiang is the (nominal) chair. It is perhaps more significant that the staffing functions for the S&T-

LSG have been moved from the State Council Office to the Ministry of Science and Technology, and that the membership has been expanded to include more of the powerful economic ministries, expanding from 11 to 14 members. On balance, the reorganization gives Liu He more direct influence over technology policy.[12] In a parallel development, Liu He on July 26 presided over the first meeting of a reconstituted State-owned Enterprise Reform Leadership Small Group (SOE Reform LSG).[13] Previously chaired by Vice-Premier Ma Kai, this group should also fall under Liu He's responsibility as vice premier.

The announcement of these two new posts at government LSGs is thus routine administrative follow-through to Liu He's position as vice premier with oversight of the economics portfolio. However, it is significant that they were both announced in late July and early August, evidently a vote of confidence in favor of Liu He's continuing influence. Liu He's political position could not possibly have been helped by the fiasco with the Trump negotiations, but the new appointments show he hasn't been hurt by them either. In fact, these two new LSG appointments are the culmination of a process by which Liu He, already the most influential economic adviser, has assumed strong formal, governmental positions that reinforce his authority.

In the previous administration, Liu He exercised enormous influence through his direct access to Xi Jinping and organizationally through his staffing of two key Party leadership small groups (LSGs).[14] While Liu was nominally a vice-head of the National Development and Reform Commission (NDRC), in practice he was disjoined from the government apparatus. This has now changed dramatically: following his elevation to vice premier at the March National People's Congress, Liu now heads the top level government Commission that oversees finance (the Financial Stability and Development Commission)[15], plus the two re-organized government LSGs described here. At the same time, he has maintained his position in the key Party LSGs, to say nothing of chairing a number of other less important groups. Thus, a remarkable panoply of institutional positions has been rolled out for Liu He, strongly cementing his position as the most influential economic policy-maker in China. Moreover, as discussed in the two pervious issues of *China Leadership Monitor*, actual policy outcomes strongly correspond to Liu He's economic views and program. Liu He has a dominance of economic policy that can only be compared to Zhu Rongji's dominance when he was vice premier from 1991 to 1998. The failure of the Trump negotiations has certainly not led to the marginalization of Liu He.[16]

Stabilizing Public Opinion and the Policy Environment

The Trump-initiated trade war has clearly been a shock to sentiment in China. The stock market—as measured by the Shanghai Composite index—was by August 6 down 24 percent from its peak on January 24, qualifying as a bear market. The RMB closed at 6.87 to the U.S. dollar on August 3, down from 6.4 on June 14, an almost 7 percent depreciation in only six weeks, relatively abrupt for the Chinese currency. Moreover, the shock of the Trump challenge has caused an unprecedented wave of public grumbling: some thought that China had been boastful and unnecessarily provocative by constantly promoting its technological achievements and was unprepared for a premature confrontation with the U.S.[17] As a result, the first objective of Chinese policy-makers has been to reinforce sentiment and stabilize economic expectations.

As is generally the case, China's policy effort had a propaganda and media component designed to "steer public opinion." References to "Made in China 2025" have been dramatically scaled back, reporters have been instructed to downplay fluctuations in the US position, and a "business as usual" atmosphere has been intentionally fostered. Gradually, policy-makers have taken steps to stabilize markets, beginning with the exchange rate (stabilizing at 6.85 after August 3) and the stock market (recovering slightly after August 6). As some of the shock wears off, we can anticipate that media will gradually dial up the nationalist rhetoric and present China as being calmed engaged in a long-term struggle with an adversary that seeks to prevent its rise.

Policy-makers gradually pulled together their response and then rolled out a package of policy measures in three key meetings at the end of July and early August. Central to the three was the Politburo meeting of July 31, 2018 that took place after Xi Jinping's return from Africa and the Middle East.[18] On this day, state media also revealed that on July 17, Xi had met with non-Party figures, predominantly in the CCP-allied "democratic parties." The message from that meeting was being transmitted through internal channels, and only then two weeks later given a formal imprimatur by the Politburo meeting.[19] The fact of the meeting in itself was not unusual: Xi had met with virtually the same cast of characters six months earlier to "hear their views" on economic policy. What was unusual was the extraordinary stress on stability: We must "stabilize employment, stabilize finance, stabilize foreign trade, stabilize foreign capital, stabilize investment, and stabilize expectations," Xi said.[20] Moreover, achieving this stability would require outreach and consistent messaging, "strengthening connections to the masses and guidance of their thought, to make them objectively see the current situation, so they will believe that we have the ability to overcome every risk and challenge with the strong leadership of the Communist Party center and the common effort of all the Chinese people, along with the solid foundation and rich experience we have built up through 40 years of reform, the vast domestic market, and the resilience, potential, and room for maneuver of [our current] economic development,."[21]

At the Politburo meeting itself, the message of stabilization was repeated, but along with two other commitments. The first was to make policy modestly more expansionary, and particularly to increase fiscal outlays. The second was to maintain the three "difficult battles" that are Xi Jinping's signature objectives for the 2018-2020 period: de-risking the financial system; eliminating poverty; and improving the environment. Maintaining these goals will not be easy, of course, since they compete for available resources, as discussed in the following section.

The third important meeting was that of the Financial Stability and Development Commission (FSDC), on August 2, only two days after the Politburo meeting.[22] The FSDC meeting emphasized the de-risking and de-leveraging would continue, but shifted the emphasis perceptibly towards law enforcement and regulatory control. It acknowledged that smaller and private firms were having trouble accessing credit, and it indicated that work would focus on getting credit flowing better to all parts of the real economy, while maintaining the process of deleveraging for large state-owned firms. Clearly, the FSDC is trying to navigate a middle path, maintaining movement on deleveraging while trying to ensure that there is amble credit in the economy has a whole. It is also faced with the formidable task of translating competing policy demands into a coherent policy package.

Adapting Macroeconomic Policy

Essentially, policy-makers have three instruments to help steer the macro-economy: monetary or credit policy; fiscal policy; and exchange rate policy. A unique feature of the Chinese system is that policy-makers have a high degree of discretionary control over each of these levers. It must be emphasized that this high degree of discretion does *not* mean that these instruments can be deployed however policy-makers want—there are complex trade-offs associated with each of the instruments. However, it does mean that policy-makers can move multiple levers in the same direction when they choose. Moreover, given Liu He's strong influence over every aspect of economic policy-making, it is reasonable to expect Liu He to make use of the interaction of different instruments. In fact, what we have seen over the past few months is a moderate adjustment of each instrument to make policy more expansionary.

Monetary policy for the past eighteen months or so has been focused on the process of "de-leveraging." Bank money flowing into the "shadow banking" system has been throttled back, and interest rates have been relatively high. Meanwhile, regulatory oversight has been strengthened through new institutions and tougher enforcement. The objective has been to gradually nudge the system towards greater financial stability by convincing companies (and local governments) to repay existing loans, borrow less, and write off bad debts. Some initial progress has been made, as evidenced by a stabilizing overall ratio of debt to GDP.[23] Now, policy-makers are easing up on this policy, but they do not want to abandon it. Short-term interest rates have come down, but funding costs for small and medium enterprises are still quite high. So policy in this one area has become more expansionary, but policy-makers do not want to move too quickly because they are trying to hold on to the de-leveraging and de-risking policies.

Fiscal policy is also set to become somewhat more expansionary. Here the focus is on local government finances. Since the partial fiscal reforms adopted in 2014-2015, local government finances have become somewhat more transparent and more regularized. Local governments are now expected to go through formal channels to raise money for local development programs. In fact, the total amount of local government bonds outstanding has continued to increase at a fairly rapid rate (rising to 16.6 trillion RMB at the end of June from 14.7 trillion at the end of 2017). In the meantime, local governments are seeking additional funding sources by turning to public-private partnerships (PPP) and raising new industrial sector guidance funds. Since fiscal reforms have never been pushed through to the level of defining new taxes and expenditure responsibilities, local governments continue to face real limitations on their financial resources. It is not so easy to make fiscal policy more expansionary.

Exchange rate policy is also difficult to carry out. Although China maintains substantial controls on capital outflows, money has a way of finding loopholes and leaking out if the incentive to do so is large. Policy-makers have numerous tools to affect exchange rates, including the stringency of capital controls, intervention in foreign exchange markets, changes in domestic interest rates, and liberalization of access to domestic capital markets. Exchange rate outcomes are the result of a complex interplay of government intentions and market responses. Whatever is the most immediate cause of the depreciation of the RMB by 7 percent in June and July, it had the ultimate effect of making Chinese exports cheaper (and imports more expensive), thus giving a modest boost to the economy at the cost of providing less credible support to a strong RMB.

The point is that all three of the macroeconomic instruments have moved in the same direction. Monetary, fiscal and exchange rate policy have all become slightly more expansionary, giving China a modest extra margin of support for the next stage of the trade wars. This meeting essentially said—though not in these words—"modestly adjust all the Keynesian levers." That is, make fiscal policy slightly more expansionary, keep monetary policy basically stable but ease slightly; increase outlays for infrastructure and industrial policy. Combine that with depreciation of the RMB. These four or five expansionary measures are each modest on their own, but added together will have significant impact.

Why doesn't "tit for a tat" work for China?

The policy stance described above is coherent, essentially giving Chinese policy-makers maximum leeway to respond to a challenging situation. However, it also represents an implicit recognition that tit for tat responses to the Americans haven't been working. Some explicit recognition of this has come in recent Ministry of Commerce statements that indicate China will not respond dollar-for-dollar with US tariffs, but will impose lower tariffs on U.S. exports where there are few or no competing suppliers.[24] This is a reasonable response, but it also reveals the deeper problems with tit-for-tat in the trade arena. It is not simply that China imports so much less from the U.S. than the U.S. imports from China—and therefore has a much narrower scope for retaliation—it is that tariff retaliation consists in putting a tax on your own citizens. The more you benefit from trade, the less you can gain from taxing your imports. There just isn't that much benefit to the Chinese economy from taxing imports of airplanes, computer chips or, for that matter, soybeans. Nor does it harm the Americans very much, since there are limited alternate suppliers and global markets adjust to equalize prices among those suppliers.

There is a second problem. To a certain extent, it seems that the Trump administration's objective is not to punish China, but rather to disengage from China. Thus, Robert Lighthizer, who appears to be the current "swing voice" in US trade policy has been quoted as saying that it isn't his goal to "change the Chinese system. If they want to do it, that's fine, but I have to be in a position where the United States can deal with it, where the United States isn't a victim of it."[25] In other words, Lighthizer appears to look forward to a world in which US tariff barriers are permanent, insulating the U.S. from Chinese industrial policy (and, of course, from the efficiency benefits that cooperation with China brings). This type of objective is impossible for the Chinese government to respond to by tit for tat strategy.

Yet there is an even more fundamental issue. The "trade war" between the U.S. and China is not truly a two player game. It is a multi-player game, involving a broad sweep of developed and developing economies. Since the game is multi-player, coalitions matter. Since the U.S. is taking steps to pull away from globalization, the best strategy for China is to assemble a broad pro-globalization coalition that could be counterposed to the newly unilateralist U.S. It doesn't take a rocket scientist to see the potential in such a coalition. Chinese strategic thinkers quickly seized on it as a possibility after Trump's election. Xi Jinping presented himself as a champion of globalization at Davos in early 2017, and he reasserted the idea at the Bo'ao Forum in April 2018. Yet so far progress in this direction has been minimal.

Progress does not have to be so limited. To a certain extent new alliances appear spontaneously as China responds tit for tat to American policies measures. For example, tariffs on automobile imports: China has combined retaliatory tariffs on car imports from the US with generalized tariff reductions. Thus, China reduced tariffs on automobile imports from 25 percent to 15 percent, while imposing a retaliatory tariff on US autos that raised their total tariff to 40 percent. As a result, European, Japanese, and Korean exporters now enjoy a 25 percentage point advantage over American car exports in the Chinese market.[26]

Why then have Chinese policy-makers made so little progress toward assembling a coalition against American policies? The most fundamental problem, of course, is that China is much less open to trade and incoming foreign investment (especially in services) than are OECD countries, and even most developing countries. This is true whether you look at tariffs, regulation, or market access rules. China's credibility as a leader of a free trade, globalization bloc is therefore close to non-existent.

This means that to assemble a winning coalition, China will have to adopt more dramatic reforms and opening of its economy. Indeed, Chinese economists and even policy-makers recognize this point in practice. They have repeatedly declared their intention to move forward with reforms. They have released statements declaring that barriers to foreign investment in, for example, financial services will be lowered and eliminated within two years. The problem is that such statements have been made before and not followed through; and already counter-vailing regulatory measures have been put in place to limit the significance of any market opening. More broadly, talk is cheap. Demonstrating willingness requires actions that are verifiable in order to establish a credible reputation for openness and fair play.

This is the fundamental issue that limits China's ability to use tit for tat policies. After all, China could always retaliate against American firms operating in China. These American firms do $500 billion worth of business in China, as much as the trade deficit that Trump finds so upsetting. So China does have the capacity to hit back at American businesses, and is already doing so to some extent, imposing additional regulatory scrutiny and slowing down customs clearances, for example.[27] But this is not really a winning strategy because such behavior quickly eliminates any credibility China might be starting to build up through additional reform and market opening measures.

For most foreign businesses and governments, the problem in China is not merely that China has an "industrial policy" (lots of countries do), but that industrial policy provides a screen behind which policy-makers manipulate parameters in order to systematically disadvantage foreign firms to the benefit of Chinese firms who may be their patrons. Government intervention is pervasive and increasing, sometimes for broad developmental objectives and sometimes to support favored businesses and interest groups. China can punish U.S. firms more, and no doubt some European, Korean, or Japanese firms will take advantage of the opportunities. But in the long run, those firms will also register the fact that Chinese policy has remained non-transparent, biased, and readily changeable.

Indeed, it is ironic that today when China proclaims its willingness to lead a pro-globalization coalition, it is actively engaged in tit for tat retaliation against two countries that are natural members of any such coalition. South Korea, as described earlier, is still being penalized for the offense of defending itself against North Korean missiles, and Australia is being punished for domestic policies that China doesn't like and for supporting the U.S. in the South China Sea.[28] Surely, Korea and Australia would be much more valuable to China as allies in a broad coalition of free traders, but to get to that point China would have to drop its tit for tat retaliations, and it just isn't ready to do that.

Conclusion

China has managed to put together a coherent response to the inscrutable trade policies of the Trump administration. Those policies stress tit for tat in the trade arena, and a coherent bundle of expansionary policies in other arenas. Yet this policy package remains defensive and reactive. A bolder policy of accelerated reform and less government intervention could catapult China into a leading global position at a time when the policies of almost every other country seem cramped and incomprehensible. The opportunity is waiting for China, but it seems that today's China does not have sufficient appetite to take a leading role.

---

[1] Keith Bradsher, "U.S.-China Trade Talks End With Strong Demands, but Few Signs of a Deal," *New York Times,* May 4, 2018. Accessed at https://www.nytimes.com/2018/05/04/business/china-us-trade-talks.html

[2] A vast literature was initiated by Robert Axelrod, *The Evolution of Cooperation.* New York: Basic Books, 1984.

[3] Eun-jin Kim, "China's Unfair Practice: China Permitted No Korean Games for over a Year," *Business Korea*, August 10, 2018. Accessed at http://www.businesskorea.co.kr/news/articleView.html?idxno=24240. This is no joke: the Chinese game market, the largest in the world, has 583 million players and was worth $27.5 billion in 2017.

[4] Zhou Xin, "Which American CEOs did Xi Jinping meet in Beijing? UPS, Pfizer, Goldman all on the list," *South China Morning Post,* June 22, 2018. Accessed at

www.scmp.com/news/china/economy/article/2152063/which-american-ceos-did-xi-jinping-meet-beijing-ups-pfizer. US CEOs from Goldman Sachs, UPS, Pfizer, Cargill, and Hyatt (7 in all) attended, as did 9 from the EU, including most of the big European equipment producers, and 3 from the UK. The European name list probably sent as clear a message as did Xi Jinping's words.

5 Lingling Wei and Yoko Kubota, "China's Xi Tells CEOs He'll Strike Back at U.S.," *Wall Street Journal,* June 25, 2018. Accessed at https://www.wsj.com/articles/chinas-xi-tells-ceos-hell-strike-back-at-u-s-1529941334

6 Bloomberg News. "The U.S. Has Banned Chinese Telecoms Firm ZTE From Buying American Tech for Seven Years," April 17, 2018. Accessed at http://fortune.com/2018/04/17/zte-american-tech-ban-sanctions/

7 Xinhua News Agency. "Xi Jinping visiting Wuhan: in critical technologies we have to abandon illusions and be self-reliant" 习近平考察武汉：科技攻关要摒弃幻想靠自己. Xinhuanet. April 26, 2018. Accessed at www.xinhuanet.com/2018-04/26/c_1122749077.htm

8 Wu Lihua 吴黎华 "The second phase of fundraising for China's big fund is underway; hundreds of billions for the IC production chain" 国家大基金二期正募集，千亿布局集成电路产业链. Economic Reference News 经济参考报. May 3, 2018. Accessed at http://www.xinhuanet.com/power/2018-05/03/c_129863740.htm

9 State Council Office 国务院办公厅 "On establishing the State Science and Technology Leadership Small Group," 关于成立国家科技领导小组的通知. July 28, 2018. 国办发〔2018〕73 号. Accessed at http://www.gov.cn/zhengce/content/2018-08/08/content_5312519.htm

10 Wu Lihua, op. cit.

11 Barry Naughton, "Xi's System, Xi's Men: After the March 2018 National People's Congress," *China Leadership Monitor*. No. 56.

12 Li Keyu 李可愚. "State S&T LSG established; Premier is the leader, PBC and SASAC members," 国家科技领导小组成立：总理挂帅 央行与国资委负责人入列 *National Business Daily* 每日经济新闻 August 9, 2018. Accessed at http://www.nbd.com.cn/articles/2018-08-09/1243782.html. The former LSG had disappeared from press reports in any case, probably indicating that responsibility for S&T policy had been seized by other parts of the bureaucracy.

13 Xinhua News Agency, "Personnel of State council SOE Reform LSG Adjusted," 国务院国有企业改革领导小组组成人员调整. July 26, 2018. 国办发〔2018〕64 号. Accessed at http://www.xinhuanet.com/renshi/2018-07/26/c_1123181461.htm; Xinhua News Agency "Liu He presides over the first meeting of the SOE Reform LSG," July 26, 2018. Accessed at http://www.gov.cn/xinwen/2018-07/26/content_5309562.htm

14 These were the Finance and Economy LSG, where he served as office head, and as the head of the Economics and Environment Civilization Subgroup of the main Party body charged with overseeing economic reforms (the Comprehensively Deepening Reform LSG).

15 Ji Bao 季豹. "What signal is sent by the 6 new demands of the Financial Stability Commission?" 金稳会 6 大新要求传递哪些信号. China Fund Report 中国基金报.

August 3, 2018. Accessed at http://finance.sina.com.cn/china/gncj/2018-08-03/doc-ihhehtqh4387714.shtml

[16] As suggested, for example, by Willy Wo-lap Lam, "Xi's Grip Loosens Amid Trade War Policy Paralysis," *The Jamestown Foundation China Brief.* August 1, 2018. Accessed at https://jamestown.org/program/xis-grip-on-authority-loosens-amid-trade-war-policy-paralysis/

[17] Bloomberg News, "China Begins to Question Whether It's Ready for a Trade War," June 25, 2018. Accessed at https://www.bloomberg.com/news/articles/2018-06-25/as-trade-war-looms-china-wonders-whether-it-s-up-for-the-fight

[18] 中共中央政治局召开会议 习近平主持会议
2018-07-31 18:45:31 来源： 新华网 http://www.xinhuanet.com/politics/2018-07/31/c_1123203915.htm

[19] Xinhua News Agency, "The Party Center calls a meeting with Non-Party Figures; Xi Jinping chair and gives an important talk," 中共中央召开党外人士座谈会 习近平主持并发表重要讲话.. Xinhua, July 31, 2018. Accessed at http://www.gov.cn/xinwen/2018-07/31/content_5310840.htm

[20] "稳就业、稳金融、稳外贸、稳外资、稳投资、稳预期." Xinhua, July 31, 2018.

[21] Op. cit.

[22]China Government Network, "The State Council Financial Stability and Development Commission held its Second Meeting," 国务院金融稳定发展委员会召开第二次会议. August 3, 2018. Accessed at http://economy.caijing.com.cn/20180803/4495783.shtml; Ji Bao, *op. cit.*

[23] Thomas Gatley, "Softening Up On SOE Deleveraging," Gavekal Dragonomics Ideas, August 9, 2018.

[24] Tom Mitchell, "Trump's tariffs prove tougher obstacle than China expected," *Financial Times,* August 11, 2018. Accessed at https://www.ft.com/content/6961fa60-9c53-11e8-9702-5946bae86e6d

[25] Victoria Guida, "Chinese leaders 'absolutely confused' by Trump's demands on trade," *Politico*. June 23, 2018. Accessed at www.politico.com/story/2018/06/23/trump-china-trade-confusion-635865

[26] Trefor Moss "U.S. Car Makers Left in the Dust as China's Tariff Cut Boosts Europe, Japan," *Wall Street Journal.* August 10, 2018, accessed at https://www.wsj.com/articles/u-s-car-makers-left-in-the-dust-as-chinas-tariff-cuts-boost-europe-japan-1533901068

[27] Wendy Wu, "Beyond tariffs: China's 'precision strikes' on US businesses," *South China Morning Post*. August 5, 2018. Accessed at www.scmp.com/news/china/diplomacy-defence/article/2158361/beyond-tariffs-chinas-precision-strikes-us-business

[28] Rob Taylor, "Sour Grapes: Why Australian Wine Can't Get Into China," *Wall Street Journal,* May 27, 2018. Accessed at https://www.wsj.com/articles/australian-wine-trade-corked-as-china-retaliates-against-meddling-claims-1527426000