China presses on America's pain points in the trade war

Beijing is focusing its response and wants to avoid escalation

As the US-China trade dispute ramps up, with the announcement of $200bn-worth of new tariffs on Chinese imports, Beijing is savouring a quote from Mao Zedong. In a contest with a foe of great strength, Mao said, "injuring all of a man's 10 fingers is not as effective as chopping off one, and routing 10 enemy divisions is not as effective as annihilating one of them". China is adopting the same strategy in dealing with rising trade tensions. The concern in Beijing is that this trade war is not really about surpluses or unfair practices, but about Chinese aspiration. In the Bill Clinton era, the US viewed China as a "constructive strategic partner". The administration of George W Bush saw the Chinese as "responsible stakeholders", while Barack Obama sought to build a relationship with Beijing based on "mutual respect". But by the time of the Trump administration's first national security strategy, published in December, China had become the US's principal "competitor". So what does "chopping off one finger" signify in this context? It means focusing on pain points; going after a narrow set of products in the US, goods which have easy substitutes readily available in other markets — soyabeans from South America, for instance. Another tactic that China has up its sleeve is to try to win over American businesses. Showering them with licences, contracts and projects, and opening up sectors such as entertainment, health and finance, is a much better strategy than punishing them — at least in the short term. Whether Donald Trump stays in the White House for four years or eight, American business is here to stay and will continue to wield significant influence. The Chinese will avoid escalation at all costs. Just as in conventional warfare, there are weapons one deploys and others that are off limits, so China believes that a turn towards "financial war" is something it cannot afford. Dumping US Treasuries is one option that it will rule out. The last thing the Chinese want to see is upheaval in their own financial markets. With domestic debt at worrying levels, and equity and housing markets vulnerable, even mild turbulence would be likely to push down exchange rates and see capital flows dry up. The government knows better than to expose an already frail financial system. Nevertheless, China regards western complaints about its trade practices as tendentious and unfounded. According to the American Enterprise Institute, a think-tank, Chinese companies made 202 investments, including mergers and acquisitions, in the US between 2005 and 2016. Only 16 of them, totalling $21bn, were in technology sectors. The majority of investments were in real estate. Even the recent report by the Office of the US Trade Representative on China's behaviour in the technology sector, which was based on an anonymous survey whose sample size remains unclear, indicates that only about 19 per cent of companies felt pressured to transfer technology. Furthermore, for a long period of time, the US's main preoccupations were China's current account surplus and under-valued exchange rate. The current account surplus fell from about 10 per cent of gross domestic product to 1.3 per cent in 2017. The renminbi has appreciated by 25 per cent against the dollar since 2005. And China's payments of licensing fees and royalties for the use of foreign technology quadrupled over the same period, making it the second-largest payer of technology licensing fees in the world. While China will be willing to make concessions in the interests of harmony, it will not abandon its development model. That is something on which Beijing will not compromise. The trade war may just be a larger strategic trial of strength between it and the US. Tough battles lie ahead. The writer is an associate professor of economics at the London School of Economics.