

Myths and Realities in Sino-American Relations¹

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We're at a turning point in Sino-American relations. That means we're at a turning point in world history. What we do in the next few years will be scrutinized by historians centuries from now. It is important to address the patterns of thought behind China policy.

The toughening of the U.S.-China relationship is inevitable. China has changed in multiple adverse ways. One needs only to say the words Xinjiang, Hong Kong, Huawei, intellectual property, Canadian hostages, South China Sea, Fox Hunt, influence groups, to see the need for a more demanding relationship. Unpredictable U.S. policy has made things worse. The toughening toward China includes almost the whole Western world and China's vast maritime periphery from North Korea around to India.

¹ This is a lightly edited transcript of a lecture given for Harvard's Fairbank Center for Chinese Studies and its Mossavar-Rahmani Center for Business and Government on November 12, 2020. Brief sections of the text were omitted from the oral presentation due to time constraints.

But the U.S. response has been based heavily on myths. My first few sentences about the myths will sound partisan, but I promise to offend everybody.

Nine myths

Myth 1: Trade. President Trump has said that cutting off all relations with China would save us \$500 billion. That's based on our trade deficit, which he blames on China. The trade deficit does not measure net benefits from an economic relationship. The famous example is that when China assembles a Nike shoe and sends it back to the U.S., the trade deficit shows \$100 but only \$2 stays in China for the assembly and the benefits go predominantly to Americans.

For parts of the Trump era China's trade surplus has been about 1 percent of its economy, which is almost perfect balance, so China is not the problem. The overall U.S. trade deficit is basically what we save minus what we spend, and Trump's tax cuts have greatly increased that difference. He launched a trade war to reduce the trade deficit and restore manufacturing jobs, but his policies increased the U.S. trade deficit, reduced manufacturing jobs, and raised costs for American families.

The balance of interests depends on a different calculation. China is now the center of gravity of the global consumer market. For half a century the U.S. baby boomer was the center of gravity. But we baby boomers now have gray hair, if we have any

hair at all. If America cuts itself off from the new center of gravity, GM dies immediately, the broader U.S. automobile complex collapses, Hollywood shrivels, Nike is beaten by competitors, Boeing collapses, Apple declines, U.S. luxury goods makers mostly go out of business, the U.S. global role in the art and music industries atrophies. And much else. America must manage both that reality and the serious problems with China.

Myth 2: The roots of engagement. Leading advisors to President elect Biden have spread the myth that our engagement with China was based heavily on a belief that economic engagement would make China a democracy or a at least liberal, Western-style society.² Notwithstanding some quotations from past presidents' political hype, and regrettably unfulfilled extrapolation from the 1990s, when there were enormous increases in personal freedom in China and indeed the Carter Center and the International Republican Institute were helping organize village elections in China, with the support of the Communist government, the official arguments, the decisive arguments in Congressional testimony, were always about

² Kurt Campbell and Ely Ratner, "The China Reckoning: How Beijing Defied American Expectations," **Foreign Affairs**, March/April 2018, <https://www.foreignaffairs.com/articles/china/2018-02-13/china-reckoning>. While their characterization of the political intentions of U.S engagement with China is flat wrong, their characterization of the economic evolution is deceptive half truths. Xi Jinping's reactionary policies are as disappointing as they say, but one must add that the Chinese economy is in many ways more open to U.S. goods and investments, for instance in cars, than allies Japan and South Korea.

peace and prosperity. Congressional testimony focused on issues like balancing the Soviet Union, peace in Korea, non-proliferation, anti-terrorism, environmental cooperation, and business opportunities and problems. They did cite improvements of rule in law in China and indeed that has happened (from a low base).

On politics, at the most important turning point, namely the debate over depriving China of Most Favored Nation status, the most popular argument in Congress was the exact opposite of the Biden advisors' view: led by Nancy Pelosi, the predominant Democrat view asserted that continuing to have normal trade relations with China would appease and encourage dictatorship, not that it would induce democracy. Economic arguments made by the business community were decisive.

Engagement with China is the biggest single reason that the world has experienced half a century of big power peace and the most extraordinary increase in prosperity in global history. No longer is Africa stagnant. No longer does Latin America lead the world down in every financial crisis. The poorest countries, the most unstable ones that create the most security concerns for America, are raw materials producers and Chinese demand has lifted them up. For the first time in 315,000

years, mankind has more food and basic goods than it actually needs. Inflation was banished. When China became predominantly a services economy from 2015 onward, mankind decisively shifted from backbreaking manufacturing work to healthier services work. The poorest Americans have benefited enormously from the availability of inexpensive goods assembled or manufactured in China. American companies have flourished globally because of the efficiencies created by supply chains that run through China.

China's theft of intellectual property and denial of market access have become severely damaging. They require firm action. The U.S. must diversify away from total dependence on China for things like rare earths whose supply curtailment in economic war or hot war could cripple it. But Americans' future is not improved by a false ideological revision of history to dismiss engagement with China as a failure. So far it has been one of the great successes of human history.

Myth 3: Jobs. Faced with a technologically-driven decline of manufacturing jobs that has proceeded steadily since 1947, both parties in our Congress have found it politically convenient to blame China, rather than technology, for the decline. They can then ignore the desperate need for measures to alleviate the suffering of vast numbers of Americans whose jobs have been displaced by technological or market

changes. Manufacturing jobs are going the way of agricultural jobs, which once employed 98% of our workers but now more like 2%. China's loss of manufacturing jobs is a large multiple of America's. McKinsey forecasts that the world will lose 800 million manufacturing jobs by 2030.³

Even the research showing real U.S. job losses of perhaps 3 million from business relocations to China is partial. We do not know how many of those companies would have shed jobs anyway due to financial or technological challenges. This is not a minor footnote; look at Intel's current damaged position because it failed to outsource in time. And we do not have research showing how many jobs China has saved. GM was about to become insolvent when the opening of China's market made it salvageable. The U.S. auto industry employs 17.9 million people and GM was the largest of three big companies. It is impossible to estimate how many car jobs China's WTO-related liberalization saved, because it depends on the details, but it was a seven-figure number and such positive numbers are never counted.

Research by MIT's David Autor and others shows that, if the company in the company town goes down, people sit around feeling helpless. The market does not

³ For more data and analysis on manufacturing jobs and output, see William H. Overholt, "The Great Betrayal: How America's elites are failing to confront the challenges of trade politics," *The International Economy*, Winter 2017, http://www.international-economy.com/TIE_W17_Overholt.pdf

clear. People need government help. But the strategy of the Democrat Congressional leadership is to follow the lobbying rhetoric of the manufacturing unions: For them the solution to the tragedy of flyover country is to blame China. Because of their manufacturing union political base, the Democrats refuse to confront the reality that the only solution is to help our population shift into service sector jobs. They create the false hope of getting manufacturing jobs back, and they belittle the service sector as flipping burgers for McDonalds. China lost nearly 45 million manufacturing jobs while the U.S. was losing 3 million, but Chinese leaders moved most of those displaced people into services while American leaders just tried to shift the responsibility.

As a result, America's domestic social crisis and the rage against the political elite intensify. The Trump supporters are not irrational to abandon the Democrats and establishment Republicans for a leader who implicitly promises to bust up a bipartisan establishment that ignores their plight. As long as Pelosi and her supporters of the manufacturing unions lead the legislative Democrats, and McConnell and the Republicans squeeze down expenditures to solve social problems, the U.S. relationship with China will be worse than it needs to be and worsening domestic social stresses guarantee another worse Trump in our future.

As shown by Pew research polls, support for democracy itself is declining in America.

Pelosi Democrats, traditional and McConnell Republicans, and Trumpism are a symbiotic system in which each part supports the other. A democracy that fails to take care of its people is an unstable democracy.

In the late 20th century Congressional China policy was determined by a dominant political center—leaders like Democrat Bill Bradley and Republican Richard Lugar. The crucial House Asia Pacific Subcommittee Chair was a solid policy wonk, Stephen Solarz. The reactionary union left and the ideological anti-communist right agreed on a radically sinophobic China policy and disdained pragmatic calculations of the national interest, but the extremes then had minimal leverage over policy. In the new century the center has vanished, leaving the extremes in charge. Congressional China policy is just a tail on this domestic political dog.

Addressing the social problems of the manufacturing sector transition is difficult. It will certainly require large expenditures and moderation of the egregious inequalities of contemporary America. Beyond that, it requires experimentation in the manner of Roosevelt in the 1930s and careful study of successes and failures in Europe. Failure to try is failure to save U.S. democracy. And if Washington does not

address its social problem, as a prerequisite to moving forward on international trade and investment integration, it will be unable to maintain a fully competitive and growing economy because most other countries are progressing with trade agreements while the U.S. is stalled. More broadly, will be difficult for the U.S. to be the global leader if, in an era of geoeconomics, it is isolated in its reaction to globalization.

Myth 4: China as superman. When China announces that it's going to take over all key industrial technologies, much of Washington believes it, panics, and overreacts. China's 2025 and 2035 plans are in part re-runs of Japan's industrial policy in the 1970s, which also panicked Americans. Japan had some very expensive successes with industrial policy--decreed by top leaders giving advantages to favored companies in favored industries. They had even more very expensive failures. Their last big effort was called the Fifth Generation computer/Artificial Intelligence program, which resonates with the focus on Artificial Intelligence today. It frightened Americans and was a total flop.

China has more money for subsidies than Japan did, but China also has Japan's problems plus some uniquely Chinese ones. Moreover, China's resources are going to be more squeezed in the future. Xi Jinping's overarching priority for political

control is at war with his economic ambitions. Now the Party Committee has final say over all strategic business decisions, even in private companies; imagine what would happen if Washington put a politician in final control of business decisions at Apple. Private sector investment in China has been devastated by policy changes since 2013. Americans who fear China should welcome China's waste of resources on key parts of its industrial policy; it has subsidized its semiconductor industry with \$103 billion so far and fallen further behind.

The U.S. and its allies can bolster their own semiconductor industries while maintaining a private sector, competitive system. When a Chinese product, like Huawei with 5G, threatens to dominate the world because its competitors are largely excluded from the China market, the West should ban that product. But broad, panicky protectionism is counterproductive.

Myth 5: Foreign policy militarization. This myth is never spoken but is implicit in the way Congress has allocated foreign policy resources since the end of the Cold War. Budgets reflect an implicit fallacy that, in the search for national security, only military power counts. Congress has gradually gutted the budgets for State, AID, and USIS. It has allowed the roles of crucial institutions like the World Bank, the IMF, the WTO, and others to atrophy by stalling increased funding and refusing

governance reform. Meanwhile Washington has spent \$6.4 trillion on recent wars and much more on top of that in preparation for potential wars. Trump caricatured this process, but it has been inexorable and bipartisan since the early 1990s.

No strategy recommended this overmilitarization. Military leaders—people like General Mattis, General McMaster, Secretary Gates--have denounced the starvation of complementary institutions like State. The problem is structural. In wartime, or during a hair-trigger Cold War, a sober, frightened Congress allocates funding according to relatively coherent strategy. In peacetime Congress allocates resources more by constituent lobbying and campaign donations. The military industry spent \$112,500,000 on lobbying in 2019, and an enormous additional amount in campaign contributions and in subsidizing think tank and scholarly studies that constitute indirect lobbying. The other vital institutions like the State Department had negligible lobbying support.

Myth 6. Overmilitarization complements the myth that war with China is inevitable or almost inevitable. I'm going to say things here that some of you have heard me say before. I've been saying them in various ways for 45 years, but political scientists ignore them because they don't fit a standardized incestuous discourse. I'm going to keep saying them because I think they are a matter of life and death.

Perhaps the most influential baseline view of the U.S.-China relationship is the Thucydides Trap. From the time of ancient Greece through World War II, when a rising power met an established power, war resulted roughly three out of every four times. Putting aside that fourth time, which is important, political scientists have been unwilling to confront the way things have changed since World War II.

From ancient Greece through World War II, important conflicts were typically between neighbors, with each power using its military to grab territory from its neighbors: Athens and Sparta; Germany and Britain.

Post-WWII conflicts are not like that. Two things have changed:

- We've learned how to grow economies much faster, making economics more decisive for international influence.
- And military technology has become hugely more destructive. Both sides are likely to lose if one or both pursue the military power-grabbing path to big power leadership.

As a result the path to becoming or remaining a great power has been primarily economic. This is a fundamental shift in the way the world works. To miss that is like an economist missing the industrial revolution.

U.S. *economic* strategy won the Cold War. It delivered decisive aid and institution building programs, starting with Greece and Turkey. Then, using the Bretton Woods system organized around the World Bank, the IMF, and the WTO, it created a global network of development centered on Washington, uplifting friends and allies in a way that was sustainable and continually growing. In contrast, the Soviet Union poured the bulk of its resources into the military and into maintaining an extractive empire; it bankrupted itself. America required a superior military to protect its economic strategy but this was an *economic* victory.

Similarly, Japan became a big power without much of a military. Germany became Europe's leader through economic superiority. South Korea overcame its total inferiority to North Korea and its economy is now 50 times larger than North Korea's. Indonesia was the sick man of Asia when it claimed most of Southeast Asia but neglected its economy, then became the region's accepted leader when it abandoned most territorial claims and focused on its economy .

In China, Deng Xiaoping cut back the military from 16 percent of GDP to 3 percent and settled 12 of its 14 land border disputes in order to focus on economic growth. The subsequent economic takeoff made China a major power well before the

current military buildup began. China's global leadership position lives or dies on domestic economic growth and its international economic strategy.

So the path to becoming a successful big power has become an economic strategy protected by a strong military—or an ally with a strong military. Predominantly economic strategies differ from military strategies in that both sides can win. When Germany and France war, one wins and one loses. When the U.S. and Japan, or the U.S. and China, compete for leadership, both can prosper. That is a vital aspect of US-China rivalry. If the protagonists recognize the new post-World War II realities, then the risk of hot war is drastically reduced.

Of course, if either the U.S. or China behaves like a pre-World War II power, if it abandons its successful economic strategy and focuses on military competition, it can make the Thucydides Trap a self-fulfilling prediction. We are falling into that trap. Then Graham Allison's recent book, **Destined for War**, provides a brilliant exposition of the consequences. But gratuitous escalation of the risk of military conflict is not a law of history, particularly post-World War II history. A substantial part of the increased risk comes from our failure to understand that the geopolitical game is now primarily a geoeconomics game. As shown by its Belt and Road Initiative, China has a much better understanding of the new game.

Myth 7. The U.S. cannot live with a big country that has a different system from ours. That makes China an unlimited threat. This argument, led by a former aide to Vice President Cheney, Aaron Friedberg, now at Princeton, is very influential, especially at the Pentagon. That argument has historical roots in the conflict with Soviet communism and Nazism, which were determined to foist their systems on the rest of the world by force. But different systems can coexist for historical periods of time. Tsarist Russia, the Muslim Ottoman Empire, and democracies coexisted for long periods of time. The eventual conflicts were not primarily over regime type.

The U.S. rivalry with China is not like the ideological conflict with the Soviet Union. While China has geopolitical issues with democratic neighbors like South Korea, the Philippines, Singapore, Thailand, India, Sri Lanka, and Australia, it is not trying to change their systems into something more like China's. Unlike Putin's Russia, China is not making systematic attempts to undermine democracy in Europe and the U.S. Today's world does have an ideological proselytizer, namely the United States. While China argues that every country should choose its own system, Washington thinks every country, of every culture, at every level of development, should emulate the U.S. or European democracies. While U.S. ideals of freedom and

democracy are quite attractive around the world, in many developing democracies like the Philippines only a small elite knows how to organize and win elections and only a small elite can comprehend or pay for litigation in an American-style hideously complex legal system. These countries typically provide wonderful education and health to a tiny elite, but do not take care of their people, so the people support a Duterte in the Philippines or a Modi in India or admire superior Chinese economic support for the people.

The weaknesses of many democracies in taking care of their people are their problem and America's, not China's. In the 1930s, the democracies also had terrible weaknesses rooted in failure to solve socio-economic crises, but they found ways to take care of their people and were so successful that they fended off fearsome challenges. If America has to fear a challenger that says, every country should choose its own system, we need to identify reforms that will make a Duterte or a Modi or a Trump superfluous.

Myth 8: Xi Jinping's China is just doing what China always intended to do, and China will always be like this, only worse. On the contrary, China is always changing. The urban reformist liberalizing China of Deng Xiaoping and Jiang Zemin was radically different from Mao's murderous agrarian populist China. Their successor, Hu

Jintao's China, was a tremendous reaction against the social stresses caused by his predecessors' market reforms, a fearful step back from both social and market liberalization. Xi Jinping was chosen to deal with the centripetal forces of Hu Jintao's decade: indecision, stalled reforms, ministers not listening to the prime minister, local governments ignoring the center, the private economy overrunning the state economy, civil society threatening the role of the Party, the military leadership focused on making real estate deals rather than learning to shoot straight.

Generational change comes fast and hard in China. Xi Jinping's centralization of power has addressed the fears of disintegration created by his ineffectual predecessor, but in an extreme and reactionary form that has unsettled much of China's elite. He has brought fundamental change to China. For instance, I was involved with the top Chinese leaders making decisions about Hong Kong in the 1990s and they were sincere about their promises they made regarding Hong Kong. They would be appalled by what Xi has done. The idea that there is an insidious, hidden, permanent determination, one that was always there and always will be, behind Xi's extreme political repression is a sinophobic fantasy. The only constants are the determination that China will become rich and powerful and safe and the hope that one day it will be the world leader.

Xi was given a mandate to centralize power and to restore market reforms. He has performed excessively on the first and negatively on the second (notwithstanding some financial opening). The economy will suffer from his mistakes. He has stepped on the toes of all important elites. His political position parallels Donald Trump's; he has a loyal, nationalistic, populist social base but has alienated much of the elite. His base is much deeper than Trump's so he will last longer, but it is precarious for any politician to have alienated so much of the elite. Change will come. The next version of China will be either much better or much worse. America must be prepared for either. It would be a history-changing error to lock in a permanent cold war.

Myth 9: China's Belt and Road Initiative, or BRI, is an insidious attempt to subordinate developing countries through debt and was designed as an effort to undermine the postwar Western global system.

The fable of a deliberate debt trap, endlessly repeated by Assistant Secretary of State Stilwell and many other senior officials, has been thoroughly refuted by every empirical study, from the Rhodium Group in New York to Chatham House in London. BRI has many problems, including a buildup of debt from ill-conceived projects, and from projects unfortunately timed just before the pandemic. The debt problems

pose serious problems for China's banks and China has been struggling to solve them. Sometimes, as with Hambantoto Port in Sri Lanka, a Chinese company gets enticed into a bad deal by a corrupt local administration. The deal becomes a white elephant when the politics changes, then revives when elections bring back the original party.

The problems of BRI projects are largely the same ones that America found objectionable with Japan a generation ago—corruption, unreasonable subsidies, tied aid, low quality goods. Americans negotiated with Japan and with Europeans who then provided tax deductions for bribes. Eventually the parties converged on some basic standards. China's BRI reforms of April 2019 were very similar to some of the early Japanese steps. Recent retrenchments acknowledge the severity of the problems.

In conception, BRI was the ultimate tribute to the Western system. The U.S. won the Cold War by creating a community of prosperity led by development banks (World Bank, ADB, others) that lent for infrastructure, institutions to create common standards and manage crises (the IMF, GATT/WTO), and institutions to expand trade and investment.

China's BRI emulates that: development banks lending for infrastructure, efforts to create common standards for everything from railroad gauges to information technology, institutions to enhance trade and investment (the Comprehensive Regional Economic Partnership), and a crisis management system of currency swaps.

As with other early parts of BRI, the currency swap system was not an attempt to undermine existing institutions. It simply underwrote an expansion of the Shangri-la currency system developed by Japan and ASEAN after failures by the U.S. and the IMF in the Asian Financial Crisis. The initial BRI institution, the Asia Infrastructure Investment Bank, was carefully designed to be compatible and complementary with the World Bank and Asian Development Bank. Jin Liqun, its first leader, was chosen because he was an idealistic alumnus of both the World Bank and the ADB. The U.S. denounced the AIIB, saying it would use low standards unless other countries stayed out and pressured China, and urged its allies to reject it. Other countries did the homework that the Obama administration failed to do and realized the value of the new institution. 103 countries, including most U.S. allies, joined and the AIIB has justified their decisions; a high proportion of AIIB projects are joint with the World Bank or ADB and therefore meet their standards.

At the time this was typical of much Chinese policy. The early reformist Chinese leaders admired Western markets and even much of Western politics as models for emulation. They sought to join the system. China sought to contribute more to the World Bank and IMF, but the U.S. Congress preferred to hobble the institutions rather than accept more Chinese influence. China sought negotiations to limit weaponry in space, but was told to buzz off; the U.S. was going to rule in space and wasn't going to accept Chinese intrusions. China has been a big contributor to the U.N., including the largest contributor of peace-keeping troops, and by all accounts its troop contribution has been constructive. (Obstructive approaches in the UN commissions on human rights and standards came later.) The U.S. attitude was pretty consistent: Chinese membership in Western institutions was fine as long as they didn't get uppity. They were not allowed to be full proportionate members. If the Chinese formed institutions that were compatible with Bretton Woods, Washington would try to hobble them.

The U.S. not only sought to limit China's institutional roles. It allowed its own successful institutions to deteriorate. The World Bank, IMF and ADB were held back by Congressional stinginess. After the Mexican crisis in 1994, Congress forbade the kind of rescue that Treasury had conducted, even though the rescue cost the U.S. nothing. That hobbled U.S. response to allies Thailand and Indonesia in the Asian

Financial Crisis of 1997-1998. A vacuum emerged. Japan tried to fill the vacuum with its own Asian version of the IMF but Washington shot it down. But Japan and ASEAN did create a regional currency swap system to fill some of the vacuum; that was small and ineffectual until China joined. The BRI responded to a \$12 trillion gap, identified by the Asian Development Bank, part of the Bretton Woods system, in needed Asian infrastructure spending. The China-led Regional Comprehensive Economic Partnership, alongside Japan-led CPTPP, fill trade gaps left by the difficulty of WTO revision and the U.S. dropping out of TPP.

The Global Financial Crisis and the rise of Donald Trump and Boris Johnson convinced a large part of the Chinese establishment that Western models were too vulnerable to instability and irrationality, leading them to assert a more distinctive Chinese approach.

On the other side, the more repressive Hu Jintao government, the extremely repressive Xi Jinping government, China's maritime overreach, and China's obsolete assertion of developing country privileges alienated the West.

What China has grasped is the lesson of America's Cold War victory. Geoeconomics is the key to leadership, and Bretton Wood-type institutions are a tested key to international economic leadership. When China focuses on creating a circle of

development in Africa, while the U.S. focuses on sending special forces teams, China wins every time. Instructively, the biggest enhancement of U.S. influence in Africa was President George W. Bush's program to ameliorate the AIDS crisis.

The U.S. has forgotten the lesson it taught the world. The U.S. needs to remember the lesson and restore economics to the center of U.S. policy. And the U.S. should celebrate every development success with Belt and Road. Every country that is stabilized can save us \$1 trillion in anti-terrorism expenses.

[Influence of the myths](#)

The mostly bipartisan myths harm Americans economically and they lead gratuitously toward Cold War or shooting war. If China seeks to militarize the Philippine territory of Scarborough Shoal, let us prepare for a fight. If China threatens freedom of the seas, we must fight. When predatory Chinese practices threaten Western economies, we must ban their Huawei's. When Chinese abuse of Uyghurs in Xinjiang makes them moral pariahs, let America lead the denunciations. When China employs economic warfare against U.S. allies, as it does ever more frequently, let us find ways to support the allies and retaliate. When Chinese army officers pretend to be normal students in order to steal technology, let us put them

in jail. These are important issues to be addressed firmly. But to stumble into cold war or hot war based on myths would be a historic tragedy.

We still need to engage with China on climate change, the environment, non-proliferation, Korean peace, terrorism, piracy, space, economic development programs, and global financial stability, and U.S. companies still need the Chinese market. The world is complex and U.S. policies have to be complex.

The overarching issues

If we want peace and prosperity, the most fundamental issues are two.

First, The U.S. must accept China as an equal, in all major institutions and in all major global decisions.

Conversely, China needs to act like a mature world leader. It can't be an accepted leader while claiming obsolete developing country privileges, nursing grudges for a long-ago century of weakness, or taking advantage of its smaller neighbors.

These are easy to state, but they are difficult challenges for both countries.