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After China’s Hubris, It’s Trump’s Turn

Once confident U.S. was in decline, Beijing finds itself with a weak economic hand

A magazine featuring U.S. President-elect Donald Trump at a Beijing bookstore on Monday. The headline reads "How will businessman Trump change the world." *PHOTO: AGENCE FRANCE-PRESSE/GETTY IMAGES*

By

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SHANGHAI—China’s belligerence during the Obama era began with hubris—a conviction that post-financial-crisis America was in irreversible decline and its own rise was unstoppable.

That triumphant sense of destiny abruptly ended decades of foreign-policy caution. Chinese dredgers ripped up South China Sea reefs to build militarized islands. Paramilitary fleets swarmed around islets disputed with Japan in the East China Sea. And China served notice that it not only intended to contest the U.S.-led regional security order, but also reshape the global financial architecture. Nothing symbolized that ambition more than Beijing’s successful effort to persuade the International Monetary Fund to ordain the yuan a global reserve currency.

Today, as Beijing tries to figure out how to play Donald Trump, the economic fortunes are reversing.

The U.S. economy has new wind in its sails. Investors are betting on a fresh gust from Mr. Trump's pledge to splurge on public works and cut taxes. Stocks are hitting highs; the dollar is surging.

Meanwhile, the Chinese economy is struggling. Just months after the yuan formally joined the world's top currency elites, it has become a symbol not of China's economic ascendancy but its decline. Chinese citizens are scrambling out of the yuan, spooked by slowing growth, soaring debt and a property bubble.

The yuan has dropped more than 6% against the dollar this year and is now at eight-year lows. Beijing has discovered that the prestige of reserve-currency status, which required China to allow greater cross-border capital flows, has become a liability. Authorities are reimposing restrictions.

Worse, liberalization in the financial realm was supposed to spur overhauls in the real economy, particularly the laggard state-owned industrial sector.

That project is now largely abandoned, threatening China's long-term prospects.

It isn't a crisis yet; the government still has plenty of financial firepower left. But one is brewing.

How does all this play into U.S.-China relations on the eve of a Trump presidency?

Mr. Trump accuses China of "raping" America by stealing its jobs through unfair trading practices. During the campaign, he threatened to label China a currency manipulator and slap punitive tariffs of 45% on Chinese exports. On Sunday, he raised the stakes exponentially by positioning Taiwan as a bargaining chip—continued U.S. adherence to a "one-China" policy, which underpins the U.S.-China relationship, in return for Chinese concessions on flashpoints such as trade.

Mr. Trump clearly thinks he has the upper hand. "We have trade power over China," he told the Washington Post before his election.

On the Chinese currency, though, Mr. Trump is hopelessly out of date: China is trying to prop up the yuan—the opposite of manipulation Mr. Trump suggests.

On trade, although the headline data shows China accounted for 50% of the U.S. trade deficit last year, that number gives a highly distorted view since around 37% of those exports consist of imported parts, mainly from Japan, South Korea and Taiwan, Deutsche Bank Chief Economist Zhiwei Zhang said. In value-added terms, he calculates, China accounted for just 16% of the U.S. deficit, slightly ahead of Japan and Germany.

A trade war with China, Mr. Zhang notes in a report, "would be a war against all participants of the global supply chain, including U.S. companies."

As for dragging Taiwan into the trade dispute, if Mr. Trump tries that as president it will almost certainly backfire. No Chinese leader could bargain over Taiwan and hope to hold on to power. And no other issue would be more likely to inflame China's nationalistic public and put pressure on the government to lash out, perhaps militarily.

Of course, Mr. Trump's economic policies are untested. The Organization for Economic Cooperation and Development says they could either boost U.S. and global growth, or spoil it all if they led to trade protectionism that invited retaliation.

Don't entirely count China out, either. The Cornell economist Eswar Prasad, an expert on the Chinese currency, says that while the yuan's "value and prestige have both taken a beating," this could turn out to be "just temporary stumbles" if growth continues at a decent clip and the government recommits to economic overhauls.

David Dollar, formerly the U.S. Treasury's China emissary and now a scholar with the Brookings Institution, argues that if Mr. Trump wants to play hardball in pursuit of balanced trade, he should try to force China to open up its markets and allow U.S. companies to export more products and services. A potentially fruitful way to apply pressure, he writes, would be to restrict the acquisition of U.S. companies by Chinese state enterprises.

As Mr. Trump prepares to ascend to the presidency, however, he risks succumbing to a similar hubris that overcame China, miscalculating both strategically and economically just as China overreached at a moment of U.S. weakness. The consequences for both countries could be even more destructive.

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