How to *Win* the Economic War With China

By Robert D. Atkinson

The need for a new "Washington Consensus."

While the last decade has seen a renewal of interest in the age-old practice of using economic means to pursue foreign policy goals, there is no consensus on the kind of economic statecraft the United States should now be practicing. With the increasing centrality of the techno-economic challenge from China, it's time to move from an Economic Statecraft 1.0 (ES 1.0) premised on using U.S. strength to support friends and punish adversaries, to an Economic Statecraft 2.0 premised on husbanding U.S. strength while limiting the relative techno-economic advance of China.

ECONOMIC STATECRAFT 1.0

For much of the twentieth century, especially after World War II, the United States has used economic and trade tools to support foreign policy goals. ES 1.0 has taken two main forms. The first is economic sanctions that seek to change a foreign state's behavior, or at least impose punishment for a transgression. Examples include the Carter administration's grain embargo on the Soviets after their invasion of Afghanistan, and the George H.W. Bush administration's export restrictions on sales of telecom equipment to China after Tiananmen Square.

The second includes actions to strengthen allies or bring nations into the U.S. orbit. U.S. trade policy after World War II was premised on asymmetrical market opening (the United States being more open than many of

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DATI BENDO

The Main Battle Ground: *"Technological innovation has become the main battleground of the global playing field, and competition for tech dominance will grow unprecedentedly fierce," says* **Chinese President Xi Jinping.**

its trading partners) to win the goodwill of other nations and support our allies economically. Most development aid is also ES 1.0.

ES 1.0 tools have been premised on overwhelming U.S. techno-economic strength and a willingness to spend that capital to achieve foreign policy goals. For most of the Cold War era, foreign policy goals—containing Soviet communism, above all—trumped domestic economic policy considerations, and as such the U.S. foreign policy establishment held disproportionate sway over the U.S. domestic economic policy establishment (if there even was such a thing). As political scientist Samuel Huntington wrote in 1978 in the journal *Foreign Policy,* "Economic capabilities and economic relations must serve the basic U.S. foreign policy objectives of encouraging East-West cooperation, containing Soviet expansion, and promoting American values." Indeed, there did not appear to be any thought given to the competitiveness impacts, including of the Bush administration's telecom equipment export controls, even though they arguably accelerated the rise of China's telecom equipment industry (such as Huawei and ZTE) by five to ten years. Continued U.S. techno-economic superiority was taken for granted. As former Senate Finance Committee Chairman Russell Long (D-LA) asserted, to "save the world from a great war," the State Department believed "it would be worth giving away every industry we have."

Moreover, America's techno-economic dominance gave U.S. policymakers very powerful tools to wield. In 1980, the United States manufactured more than 40 percent of the world's high-technology goods, compared to just 18 percent today. Because the United States was so dominant, even unilateral export controls could have significant negative impacts on their targets.

THE NEW WORLD ORDER

This has all changed. The United States is no longer the world's advanced industry leader. As of 2020, China produced almost 18 percent more than the United States across ten of the most technologically advanced and strategically important industries in the global economy—from computers and electronics to pharmaceuticals, machinery and equipment, and motor vehicles. With more than one-quarter of global output in those industries, China's production exceeded that of all other nations—and outside of the top ten producers, it exceeded all other nations combined. For the United States to match China's advanced manufacturing output as a share of its economy, U.S. production would have to double output in nine out of those ten industries.

Moreover, China does not seek "Ricardian" comparative advantage in some industries it might be inherently good at; or even to vigorously compete for competitive advantage in a few advanced industries, as Asian nations such as Japan, Korea, and Taiwan have done. It seeks to win what it sees as a techno-economic battle across a broad front of industries. As Chinese President Xi Jinping has stated: "Technological innovation has become the main battleground of the global playing field, and competition for tech dominance will grow unprecedentedly fierce." Note the terms "battlefield" and "dominance."

America's comparative weaknesses in the face of a determined adversary underscore why it is time to add a new dimension to U.S. economic statecraft, one focused on changing the balance of techno-economic power.

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In his 1945 book, *National Power and the Structure of Foreign Trade,* economist Albert Hirschman, referencing twentieth-century Germany, wrote that Germany's rise showed that "it is possible to turn foreign trade into an instrument of power, of pressure and even of conquest." Likewise, in 1952, as the Cold War was heating up, U.S. economist Yuan-li Wu called for "international economic measures to enhance the strength of a country relative to an enemy." Today, America should not copy China and employ ES 2.0 for conquest. But it should use ES 2.0 to change the relative balance of techno-economic power back in its own and its allies' favor.

While ES 1.0 was often used to change the behavior of adversaries through sanctions and other punitive measures, ES 2.0 cannot be used that way because even when combined with allies, U.S. power is almost never enough to deter the Chinese Communist Party from pursuing its goals. We saw that during the Trump administration when heavy tariffs failed to slow down China's mercantilist assault on innovation industries.

ES 2.0 also cannot be based principally on limiting Chinese miliary capabilities, as the Western bloc's coordinated export controls were designed to do toward the Soviet Union. China seeks at least military parity with the United States, but it also seeks hegemony through techno-economic dominance. Moreover, like the United States, China's military capabilities depend on strong dual-use industry capabilities. China's dominance in civilian shipbuilding helps its military shipbuilding. Its strong position in chemicals helps its weapons systems. Its commercial space strength helps its military space efforts. And so on. A narrow focus on limiting China's military capabilities, as the Biden's administration efforts with semiconductor export controls have illustrated, will not suffice.

As China seeks to replace the United States as the global hegemon, it views techno-economic superiority as a key weapon. China wants a world in which it controls the commanding heights of advanced industries so that it will be difficult for the United States to wield economic weapons against China and easier for China to wield such weapons against the United States. Imagine a world in which China's advanced production is double or even triple that of America (as opposed to just 18 percent greater), and China leads in many next-gen technologies such as quantum, space, artificial intelligence, autonomous systems, and synthetic biology. That is the future that the Chinese Communist Party is working to achieve, and unless the United States is okay with sinking into global economic irrelevance, as the United Kingdom did after World War II, it is not a scenario that U.S. leaders can allow to emerge.

At its most extreme, China wants to turn the United States into what Alexander Hamilton warned of: a nation of "hewers of wood and drawers of water." China is happy to sell America advanced goods while importing financial services, educational services, tourist services, and agricultural products. But as Hamilton foresaw: "The independence and security of a country appear to be materially connected with the prosperity of its manufacturers." (Today, one might add software producers.)

ECONOMIC STATECRAFT 2.0

The United States is still figuring out the parameters of ES 2.0. But the new dimension of techno-economic statecraft must be based on recognizing weaknesses instead of leveraging strengths, on weakening China relative to the United States instead of changing the Chinese Communist Party's behavior, and on advanced industries instead of the broad economy. In other words, ES 2.0 must be about changing the relative balance of techno-economic power in favor of the United States. As such, ES 2.0 needs to be quite different than ES 1.0.

This raises the question of whether domestic advanced industry policies should be considered part of ES 2.0. But at the end of the day, this is a semantic distinction. To be sure, the United States needs to slow down

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China while speeding itself up through a coherent and well-funded advanced industry strategy. But for sake of focus, ES 2.0 should encompass only non-domestic steps to change the techno-economic balance of power.

This entails going beyond "de-risking," the politically safe alternative to acknowledging techno-economic war. Most of the context for de-risking has been covid-related supply chain disruptions. That can't be the organizing principle for ES 2.0. Absent massive spending to build up large buffer stocks of a wide array of products and materials, there is little the United States can do to limit such future "black swan" supply chain disruptions. So the issue is not de-risking supply chains globally; it's about reducing China's ability to weaponize trade against the United States.

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Before listing some steps for an ES 2.0 agenda, it's worth noting there will be significant resistance to this new approach. According to Huntington's 1978 *Foreign Policy* article, there is "a pervasive ideology that sanctifies independence, rather than the subordination, of economic power to government." In other words, the entrenched conventional view is that if the United States has to take economic statecraft actions of any kind, it should only do so reluctantly and work to ensure the steps are limited and temporary so we can quickly revert to the natural state of affairs: unfettered global integration. But we never had unfettered globalization. Free trade was something the United States practiced and preached, but Japan, Korea, and Europe never fully embraced the Anglo-American vision of free trade. They combined access to global markets with their own "Listian" industrial policies (based on the writings of German-American economist Friedrich List) to advance their own advanced industries.

As such, there is no going back to the "end of history" world of global free trade. This means that the United States should begin by establishing a club of nations to stand as an open and free trade alliance outside the now largely ineffective World Trade Organization, while at the same time embracing ES 2.0 against China, ideally with our core allies. Membership would require dismantling most protectionist policies against each other, combined with a willingness to take needed steps to limit the gains of China from mercantilist actions.

While it's beyond the scope of this article to lay out a full economic statecraft agenda to bolster U.S. techno-competitiveness, here are seven action items:

■ Push back against other nations' mercantilist practices targeting key innovation industries. While America realistically can't force China to change, it can exert enough pressure to limit anti-innovation policies by the European Union, Korea, India, Brazil, and many other nations. This requires pushing back much more strongly against practices such as data localization, unfair antitrust action against U.S. firms, discriminatory internet regulations, unequal tariffs, and others. At the same time, the U.S. government should renounce its own anti-competitiveness actions, including its own embrace of neo-Brandeisian antitrust policy and EU-style precautionary regulations at home. If the United States is to win the techno-economic war against China, it will need strong companies that can compete successfully with China's state-backed champions—and U.S. and allied nations' policies need to support, not attack, them.

■ Limit technology export controls. It seems as if the U.S. government sees everything in economic statecraft as a nail for which the hammer of export controls is the only available tool. While some export controls are warranted, overly broad controls limit U.S. sales and firm capabilities. The key is finding the right balance between limiting Chinese technological advancement and not imposing damaging limits on U.S. sales. This also applies to proposed congressional limits on U.S. firms' tech transfers to China. Of course, China violates WTO prohibitions on requiring technology transfer in exchange for market access (although this is largely unenforceable in the WTO). That's why Congress has proposed limiting U.S. tech transfers to China. But unless a reasonable share of our allies participate in such a regime, the result will just be reduced U.S. sales with little negative effect on China as China turns to other foreign companies for needed investment.

■ Broaden CFIUS. Like much of U.S. economic statecraft, the Committee on Foreign Investment in the United States is charged with protecting U.S. defense capabilities. The battle, however, is not just for military supremacy, but for broad, dual-use supremacy. As such, CFIUS reviews should limit most, if not all, Chinese acquisitions and investments in U.S. companies with more than minimal technological capabilities.

■ Do more to block imports of Chinese goods and services that benefit from innovation mercantilist practices. Just as many wars are won by capturing the most territory, the techno-economic war with China will be won or lost by gaining the most market share in key industries. This is because most advanced industries are characterized by increasing returns to scale. The greater the global market share, the greater the advantage a firm has. The converse is also true: When companies lose global market share, they can go into a cycle of decline with less revenue affording less investment, and then less innovation producing even less revenue. As such, Congress should reform Section 337 of the 1930 Tariff Act to make it easier for the United States International Trade Commission to impose exclusion orders on Chinese goods made unfairly. At the same time, the federal government should support the sales of most products to China. Panicked views that we should completely decouple from China, including not selling them things like commodity-based computer chips, internet services, or other items, only reduces U.S. firms' global market share and increases China's.

■ Empower the U.S. Export–Import Bank. The Ex-Im Bank plays a key role in helping U.S. exporters gain sales. While Congress and the current Ex-Im Bank leadership have made changes in how the bank operates, more is necessary. First, Congress needs to fully reauthorize the Bank in 2026. Second, Congress should update the Ex-Im mission from U.S. job creation to U.S. global competitiveness, which would allow it to support a wider range of deals for U.S. firms. Third, lawmakers should allow the bank to finance weapons systems exports, something it cannot do now. Fourth, Congress should allow the bank a loss ratio of 10 percent on all deals where the U.S. firm is going up against a state-backed Chinese firm. Otherwise, U.S. firms will continue to lose deals to Chinese government-backed firms in third-country markets. Currently, the Bank must earn a return every year of at least 2 percent on its loans. China's development banks, whose capitalizations dwarf the Ex-Im Bank's capitalization, are not constrained by this.

■ Establish a NATO for trade to coordinate actions against Chinese economic aggression. China has weaponized statecraft to punish countries that have taken steps or made statements it does not like. Because the Chinese market and economy is so large, it can impose painful sanctions on other nations. A NATO for trade—an alliance of democratic nations—would work cooperatively to defend each other against Chinese economic intimidation.

■ Stop defending the strong dollar. The overvalued U.S. dollar is a tax on U.S. exports and a subsidy on U.S. imports, including from China. Yet economic statecraft 1.0 sees having the dollar serve as a strong reserve currency as a key tool that gives Treasury the power to punish other nations. But a strong dollar that is strong merely because U.S. policymakers want to keep it strong (and because foreign policymakers have a competitive desire to help them) only sets up America to lose the techno-economic war by raising the price of U.S. exports and lowering the price of imports.

Notwithstanding the need to move to ES 2.0, embracing and enacting it will require a new "Washington Consensus." The traditional one that praised free markets, limited government, and complete global integration had its moment in the sun, but today it is no longer an effective guide. It is akin to fighting a war by sending peace delegations. Yet what appears to be replacing the Washington Consensus—an anti-corporate, anti-trade, neo-New Dealism—cannot be the guiding doctrine, either. That version of techno-economic statecraft would have the United States use its power primarily to help low-income consumers and workers, fight global warming, and boost human rights—all important goals, to be sure, but all goals whose pursuit risks enabling Chinese techno-economic advance relative to the United States. And should the United States lose the techno-economic competition against China, it won't have the power to advance those or any other goals. Instead, the new Washington Consensus should coalesce around the doctrine of national developmentalism, which holds that the key role of the state is to foster industrial and economic development and that international economic policy should be crafted to maximize U.S. economic competitiveness and national strength. ES 2.0 will need to be a key component in this new economic doctrine for the twenty-first century. ◆

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