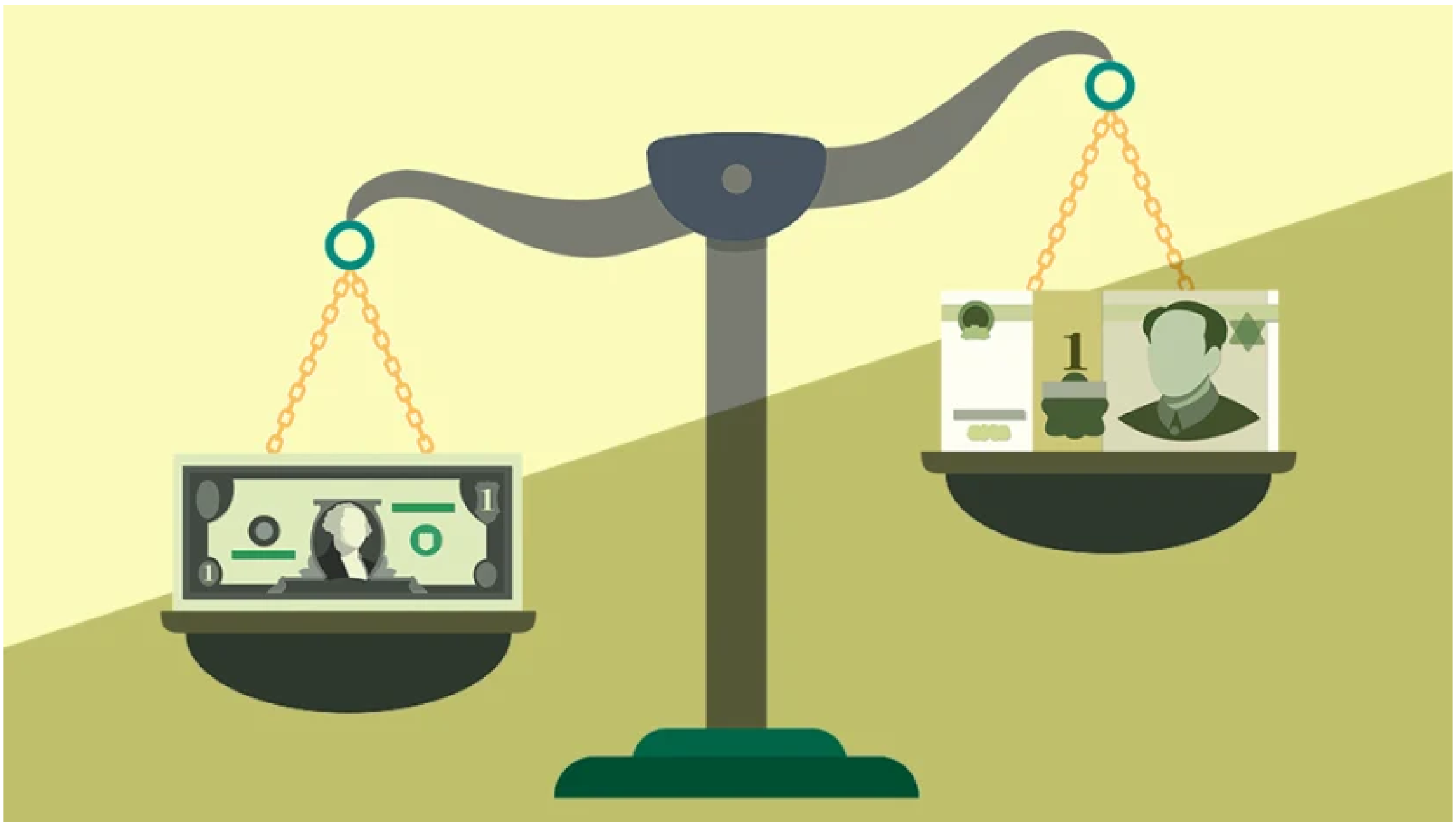
ANALYSIS

China isn't cheating at trade. It's just running America's old plays.

The West didn't play by these rules to get rich. Why should China?



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JEFF SPROSS
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Ask American politicians why we're in a trade war with China, and they'll probably tell you it's because China cheats: They use tariffs, technology transfer, and other policies to gain an unfair advantage in global competition.

But ask Chinese officials, and they'll probably say they're doing what's necessary to develop economically. As big as China's economy is, its economic output per person is still quite low. The Chinese might tell you America isn't demanding they stop cheating; rather, it's demanding rules that guarantee China can never develop.

And frankly, they'd probably be right.

Now, the global free trade order — which is enforced by a web of institutions like the World Bank, the International Monetary Fund, and the World Trade Organization, with the U.S. and a few other Western governments backing them up — has imposed a relatively coherent set of rules on countries over the last few decades. Those rules not only emphasize the free movement of goods and trade across borders, but of capital and finance as well. The rules try to minimize public subsidies and direct industrial policy, while promoting balanced government budgets and tight money — all of which ensure that economic development is directed overwhelmingly by private investors. China really does flout those rules. And you could understand why other countries that follow the rules, even at significant cost to themselves, would get very annoyed.

But there's also this: Neither America nor Britain nor the other major Western powers became rich by following these rules themselves. Indeed, China's current strategy is basically a mishmash of what Western countries did from the early 1800s through the end of World War II. "Between 1816 and the end of the Second World War, the U.S. had one of the highest average tariff rates on manufacturing imports in the world," the economist Ha-Joon Chang noted in 2003. Add in the inherent costs of oceanic trade, and "we can say that the U.S. industries were literally the most protected in the world until 1945." It was none other than Alexander Hamilton who made the case for protectionism and direct industrial policy, to lift a young America's living standards.

Over its history, the U.S. has used subsidies and industrial policy to support everything from agriculture to transportation to health research. Once it gained its freedom from Britain, America was absolutely shameless about snatching technology and intellectual property from its former colonial master. British entrepreneurs and inventors were paid to resettle in the States, bringing their ideas with them; Americans copied British plans and industrial designs under cover of diplomatic tours; occasionally, America rewarded people for outright stealing tech from Britain.

By comparison, China's "forced" technology transfer is pretty tame: It's simply a condition placed on any foreign investor who voluntarily decides to do business in China's domestic market.

As for Britain itself, it built up its wool manufacturing in the late 1500s through primitive industrial policy. In the 1700s, it lowered tariffs on imports of raw materials, but raised them on imports of manufactured products — it wanted to keep the resources coming in, but protect its own supply chains. In the mid 1800s, Britain pulled off the original "technology transfer" with China *as its victim*: Britain sent agents through the country to gather tea plants and seeds and agricultural practices. That allowed Britain to marginalize China in the global tea market and laid much of the economic foundation for the British empire.

There's a similar story with different variations for France, Germany, Sweden, and others. In 1885, the German economist Friedrich List acerbically noted that great powers tended to grow their own industries through protectionism, until they were big enough to be basically free trade policies, and demanding others do the same. That phrase provided the title for Ha-Joon Chang's article. (And later a book.) It also raises the final question: Under the modern free trade regime, is development for poorer countries even possible?

The answer appears to be no. Opening up their economies to foreign investors tends to trap developing economies in a pernicious cycle: Investors don't want to turn these countries into industrial powerhouses; they just want to extract cheap labor and natural resources to feed already existing supply chains in the West. That leaves poorer countries providing the world low-cost exports, while importing expensive end products. They get stuck in permanent trade flow imbalances, build up big debts in currencies they don't control, and then the foreign investors panic and pull out. The developing country's economy crashes, and it goes through a decade or so of crushing austerity to pay off its foreign debt and rebalance its trade. Then the whole cycle starts over.

China's been open to foreign investors, but it's used them as leverage to build up its own technological know-how. Meanwhile, it's been happy to employ tariffs, capital controls, and domestic industrial policy to protect itself. Having thumbed its nose at the global free trade regime, China is now one of the few developing countries of the modern era with steadily rising living standards.

None of this makes China a put-upon innocent, mind you. China's internal industrial policy actually leaves a lot to be desired. It expertly played the U.S. dollar's global dominance to build an export-led economy and run a permanent trade surplus against America. But by relying on American demand for its products, China has often ignored the chance to support its own citizens' consumption with a bigger welfare state. That, combined with credit economy that's still ruled by an autocratic one-party state. Not to mention its export and currency strategy helped wreck the U.S. working class.

Yet the fact remains that global free trade is a game that's largely rigged against China and the rest of the developing world. For all his bluster, Trump's trade war looks destined to preserve that game as is. And you can hardly blame China for refusing to play a game it can't win.

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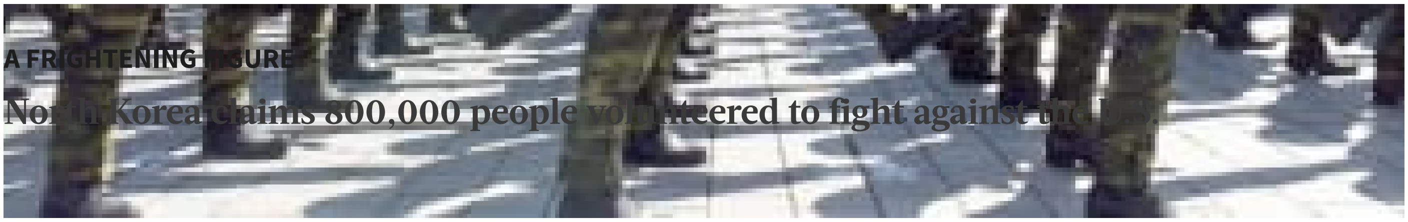

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