

Trump needs to take a step back to win his trade war

President Trump needs a trade deal with China in order to claim he is delivering on his promise to improve the terms of trade for the US. For a deal to be struck, however, he needs to scale back his overambitious list of demands



President Donald Trump shakes hands with Chinese President Xi Jinping during a meeting on the sidelines of the G-20 summit in Osaka, Japan

Another disappointment

Market optimism increased after Presidents Trump and Xi decided last month to resume negotiations. Since then, China's official news agency Xinhua has said some Chinese companies are seeking new purchases of US agricultural products. This is a step in the right direction, but not more than a very small step. Markets could be in for another disappointment because, as of yet, there are no other concrete signs that negotiators are getting closer to a deal. On the contrary, China has demanded that the US lift all tariff hikes before a deal can be cut, which doesn't align well with the American approach to keep the pressure on even after a deal, to enforce Chinese compliance. US weapons sales to Taiwan and the subsequent Chinese threat to put all American companies involved on a black list, have also not helped to create a positive negotiating climate.

Trump never misses a chance to say that China needs a deal much more than the US. And looking at trade alone, he's right. After all, American demand for Chinese products contributes more than

four times as much to Chinese GDP than the contribution of Chinese demand to US GDP. This explains why China was willing to make concessions during the first round of negotiations in the spring of 2018. In those talks, led by Treasury Secretary Steven Mnuchin, China offered to raise its imports of US products by \$70 billion, an increase of more than 50%. China also offered to open up its financial, automotive and energy markets.

Mnuchin thought he had put together a pretty good deal, but long term China hawks Robert Lighthizer and Peter Navarro dismissed it as insufficient and convinced the President to scrap it.

US trade representative Lighthizer and trade advisor Navarro are known for their decade-long fierce criticism of China's economic policy and they see Trump's presidency as a golden opportunity to address their issues. As a result of their influence, the US is demanding, not just lower Chinese import barriers to get the trade deficit down and fewer restrictions for foreigners to invest in China, but a much broader wish list, which includes China giving up its ambition to become a market leader in various high tech markets in 2025. For China, this is unacceptable interference with its right to determine its own economic policy.

Overplaying his hand

By continually hiking tariffs on Chinese imports, Trump has been trying to push China into accepting these far reaching demands.

Aiming high and piling on the pressure has always been Trump's favourite strategy. But this time it could get him into trouble. He has had little success with this tactic for over a year now. In the final phase of the unsuccessful negotiations last spring, China took on a tougher stance and there are no signs yet that this has changed. Giving up sovereignty is simply not a price that China is prepared to pay for the sake of frictionless trade with the US.

To avoid overplaying his hand, Trump will have to scale down his demands. Free trade with the US is worth a lot to China, but demanding that China give up its ambition to conquer tech markets is pushing it too far. The US blacklisting of tech company Huawei has been seen by China as part of America's plan to stop the economic progress of Chinese tech companies.

A less confrontational approach by the President would help as well. Trump's communication style is not always perceived by the Chinese as respectful, which increases the domestic pressure on Chinese leaders to be tough as well.

Treating the Chinese as an equal partner creates a more positive negotiating climate in which other differences- for example regarding the enforcement mechanism of a trade deal- could be resolved more easily.

Another round of tariffs

For now, there are no signs that the US administration is prepared to water down its demands and change its negotiation style. Given the much tougher public stance of the Chinese authorities, further concessions would be a face losing event for Chinese leaders which also makes it unlikely that a deal will be cut anytime soon.

As a result, the two sides seem to be too far apart and the negotiating climate has deteriorated too much for a deal to be struck anytime soon. This makes it likely that a new round of negotiations will be unsuccessful as well. Chances are that the President will then follow through

on his threat to extend the tariff hike to all imported goods from China. In which case, China will retaliate.

A deal after all

In the end, however, both sides have a strong incentive to strike a deal. Hoping for a more pro free trade democratic US president in 2021, China could, as President Trump suggested last week, decide to wait until after the US elections before it is willing to compromise. But a further deterioration in the tit-for-tat trade war will lead to significant economic damage for China because of its dependency on US demand.

Yet Trump also needs a deal. China is responsible for half of the overall American deficit in traded goods and Trump has vowed to take action. If he fails to get a result, he will only be able to point to the renewal of the Nafta trade agreement and a few smaller deals with countries on their exports of steel and aluminium to the US. That won't be enough for the president to claim he has successfully reduced the trade deficit.

As such, the US administration has a strong incentive to drop some of its most far reaching demands, which in turn would allow China to make concessions of its own. If an agreement is to be reached in the near future, Trump will need to back down.