

**Outlook** Perspective

# Which country is better equipped to win a U.S.-China trade war?

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Beijing has more advantages, but Trump is making our economy more like China's.

By [Eswar Prasad](#)

The United States and China are clearly on a collision course. Chinese companies abscond with intellectual property, and President Trump introduces tariffs on Chinese goods; President Xi Jinping responds with his own levies, so Trump adds more. China allows the value of its currency to fall, and the United States [brands](#) it a currency manipulator. We are now on the verge of all-out economic warfare.

These are the world's two largest economies, and the collapse of trade between them would hardly bring either one to a grinding halt. But the combatants are not evenly matched. China might seem in a better position to cope with a trade war, since it is a heavily managed economy and the government squashes political resistance. Yet its every maneuver carries enormous risks. Meanwhile, Trump, who manages a durable and flexible economy, is not exactly seeking victory for the American way of doing business. His approach, in some ways right out of Beijing's playbook, would make our economy quite a bit more like China's.

The breakdown in trade between the two countries is already causing pain in both economies, as [soybean farmers](#) in the Midwest and Chinese [textile exporters](#) in Guangzhou can attest. The battle will intensify if rising tensions close off investment flows and dampen the movement of tourists and students between two countries. But the U.S. economy is about 50 percent larger than China's, and is less dependent on trade, so its prospects look better. And China exports more to the United States than it imports from the United States (a fact that clearly riles up Trump and was a key instigator for the trade war). So the near-term pain will be greater for China.

But Beijing does have some advantages. One is the structure of its (mostly) command economy, which is dominated by state enterprises. The majority of banks in China are also state-owned, making it easy for the government to generate a surge of cheap credit — and the subsequent investment that boosts growth. The second advantage is the structure of China's political system, in which dissent is easier to shut down and bad

Still, even a state-dominated economy with many economic weapons has to be cautious about which ones it uses; some of them could backfire badly.

One of China's greatest weapons in a trade war is its ability to disrupt the work of American companies that want to sell into China's enormous and fast-growing markets or that use China as part of their global supply chains. But other foreign companies and investors could also begin to see China as an unpredictable and volatile business environment, unconstrained by the rule of law. This would hurt China's plans for modernizing its economy with the help of foreign investments and foreign technological and managerial expertise.

China could also further cheapen the value of its currency, the renminbi, to offset U.S. tariffs. Here, too, the government faces constraints. Fear of a major devaluation could cause foreign investors to pull their money out of China, and domestic investors might follow. This happened in 2014-15, when a modest government-orchestrated devaluation [set off](#) panic-driven capital outflows in anticipation of further depreciation.

Moreover, even an autocratic government cannot count on getting carte blanche from its people. Xi is not immune to domestic political pressures and must carefully manage the tricky balance between using nationalist sentiments as a rallying cry and actually delivering good economic performance.

Theoretically, China can stimulate a flagging economy by ordering a burst of investment that boosts gross domestic product growth in the short term. But this would probably generate more bad loans in an already [fragile](#) banking system. A protracted trade war would also halt even modest momentum toward market-oriented reforms, a putative [objective](#) of the Chinese government. This would hurt the economy's long-term growth prospects. And China's plan to shift the focus of its economy from staid and inefficient state enterprises to high-productivity and high-value industries will fall short if it loses access to technology from the United States and other Western nations.

In some ways, Trump seems more constrained than Xi because of America's democratic political system, its more laissez-faire economy and the limits on his executive power. But he, too, has some elements in his favor as he does battle with China. Trump has the advantage of managing an economy that is enormously flexible and resilient. And getting tough on China [resonates](#) not just with his political base but even with Democrats, many of whom have long called for aggressive U.S. action against Chinese trade and currency practices, even if they

Yet in exercising his power, he could end up making America's economy a bit more like the state-dominated one operated by Beijing — and, in so doing, permanently damage the U.S. free market. To rescue the agricultural sector from the consequences of the trade war, Trump has already **dispatched** \$28 billion in government subsidies. He has also jawboned American companies to move their production bases back to U.S. shores, rather than letting them make their own commercial decisions. Trump has even **pressured** the Federal Reserve, whose independence is seen as sacrosanct, to lower interest rates and **suggested** that the Fed should help drive down the value of the dollar. With such moves, he risks undermining the true strengths of the United States: the institutions that make the U.S. dollar and the American financial system so dominant.

What's worse, Trump suggests that the rule of law is up for negotiation. After imposing sanctions on Chinese technology companies such as ZTE and Huawei for running afoul of U.S. rules, he **hinted** that those sanctions could be negotiated away as part of a trade deal. He is **fighting** a Pentagon process that could award a defense contract to Amazon, whose CEO (who owns The Washington Post) has criticized him.

China has made its lack of independent institutions a source of strength in dealing with external economic aggression. In that model, Trump sees something Washington should copy — and seems ready to abandon what makes the United States special. This truly is a trade war with no winners.

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