



Insights

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China

Trade Tensions, Talks with North Korea and Term Limits

A discussion between Teneo Senior Advisor and Director of the Carnegie-Tsinghua Center in Beijing, China, Paul Haenle and Kevin Kajiwara, Co-Head of Teneo Intelligence.

Teneo Senior Advisor Paul Haenle, former China Director and White House representative to the Six-Party Talks on the National Security Council staffs of former presidents George W. Bush and Barack Obama, and Kevin Kajiwara, Co-Head of Teneo Intelligence, discuss the developments in US-China relations, including the trade and economic relationship, North Korea, and recent political developments in China, including the major outcomes of the National People's Congress. In addition to serving as a Senior Advisor to Teneo since 2012, Paul is also the founding director of the Carnegie-Tsinghua Center at Tsinghua University in Beijing.

Kevin Kajiwara (KK):

Thank you for joining our latest Teneo Insights call. The topic today is a big one – China - and there's a lot to discuss, and for that we are joined today by my colleague, Paul Haenle. There have been a lot of developments as of late on the China front. Most obviously would have to be the trade tensions between the United States and China. In addition, there are the outcomes of the National People's Congress (NPC) and, the solidification of the key roles in the leadership in China, the geopolitics of US-China relations, and of course, the very secretive – but in plain sight – visit by Kim Jong-un to Beijing and the upcoming meetings between the North Korean leader and South Korean leader, President Moon Jae-in, and then, potentially, President Trump in May.

To begin, let's talk about the 19th Party Congress that took place in October of last year, and how the outcomes of that have shaped the more recent developments that we're looking at as 2018 starts to unfold.

Paul Haenle (PH):

I'm glad you went back to the 19th Party Congress, because I think it was a significant event and I think it affects the calculus and all that we're looking at today and all the subsequent issues that you talked about.

The bottom line is President Xi came out of the 19th Party Congress in October as they like to say here in Beijing, "large and in charge." He has effectively become China's most powerful leader since Mao Zedong, with a sweeping charter revision with his name affixed to it that was enshrined in the Constitution. His foreign-policy initiative, the "One Belt One Road Initiative," was also written into the Constitution, along with the anti-corruption campaign, and a number of his other initiatives, like the "Chinese Dream," and a very ambitious military reform plan.

I think all of this gives President Xi a platform to exert pretty much unassailable influence for the remainder of his time on earth. There is no logical successor to Xi Jinping in the Politburo Standing Committee – people were looking for that. At the beginning of the 19th Party Congress, he issued his work report in a three-and-a-half-hour speech, which I think really caught the attention of not only the citizens here in China, but the international community. He talked about a narrative which stated that: during the era of Mao Zedong, China stood up. During the era of Deng Xiaoping, China got rich. And this current time period is the dawning of a new era, where China will become strong not just here in Beijing and in China, but also internationally. And I think it reflects an increasingly powerful China that's become more assertive on the international stage, moving away from



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Deng Xiaoping's doctrine of "hide your strengths and bide your time." The work report presented by Xi at the 19th Party Congress laid out a roadmap to turn China into a leading global power by 2050, and all of that is very significant.

KK:

The big takeaway here is that Xi consolidated power in a very significant way, and China as a whole has emerged strong and confident. So, following the 19th Party Congress last October we've gone on to the "Two Sessions" meetings, where we saw the formalization of several major leadership roles. Perhaps you could talk a little bit about how the "Two Sessions" builds on the 19th Party Congress outcomes. But also you alluded to the position that Xi has now established for himself – does it also speak to a certain degree to potential institutional weakness if so much power is consolidated under one person? We now don't have much visibility as to what a succession process after Xi might look like. Perhaps you could also speak about the leadership under Xi Jinping, including the re-emergence of Wang Qishan and the economic leadership. Also, the point of turning away from the Deng policy – given that China's great growth and emergence on the global scene occurred primarily under the system developed by Deng Xiaoping. Are they moving away from that, and will that have consequences for China's further opening, growth and innovation?

PH:

Starting with the National People's Congress (NPC), what they call here the "Two Sessions" (which just took place and ended on March 20th) Chinese leaders wanted to show a connection between the NPC and the 19th Party Congress that took place in October.

Following Xi Jinping consolidating power in a very significant way at the 19th Party Congress, the main goal of the NPC was to bring the government closer to the Chinese Communist Party (CCP). China announced a major plan to restructure its government departments so that policymaking could become more efficient by merging smaller organizations with overlapping or similar functions,

and getting rid of a number of agencies, as well. As a result of that reshuffling, several functions will be taken away from the National Development and Reform Commission (NDRC). Those functions will be given to other government agencies, an action that reflects a weakening of the NDRC and the extension of power by the CCP.

You also mention a number of personnel changes and I'll just highlight a few of them. I think the most important is Wang Qishan; he is the former head of the anti-corruption campaign, a former member of the Politburo Standing Committee, and is very close to President Xi Jinping. He came out of a short retirement; he stepped down at the 19th Party Congress, and then at the NPC, just a few months later, was named Vice President. I was in a meeting with him earlier this month and he started out the meeting by saying, "I don't have a job right now, but I've met with 30 American delegations since the end of the 19th Party Congress." I only mention that because I think there's a message there, which is that he is going to play an important role in US-China relations going forward. Wang Qishan was Hank Paulson's counterpart in the Strategic and Economic Dialogue (S&ED) back when Wang was Vice Premier. He knows the United States. He's considered a firefighter here in China – somebody who can sort out difficult and critical issues. He is now the Vice President and has graduated from the Politburo Standing Committee. As such, he is in a very interesting, and I would say, very powerful position. My guess is that the Chinese government will most likely try to align him with US Vice President Mike Pence, which would be an attempt to match Wang with a high-level US counterpart, somebody who might not get fired. I think everyone else besides the Vice President is at risk of getting fired in the Trump Administration. Pence, of course, was elected by the American people and would be more difficult for Trump to fire.

The other person who is important to mention is Liu He, a long-time economist and trusted advisor to Xi Jinping. He comes out of the NPC as Vice Premier and has been put in charge of managing China's financial and economic affairs. He's the one negotiating around the current Section 301 investigation, attempting to avoid a trade war. And then finally, two appointments at the People's Bank

of China (PBoC) are worth noting. Two very interesting, Western-trained, relatively liberal officials – Guo Shuqing and Yi Gang – were named to lead the PBoC. Together, they form a powerful, reform-oriented team that will be leading China’s financial de-risking.

Finally, any speculation that Xi was planning to move a potential successor in place by 2022 was removed when the NPC passed an amendment to remove term limits for the Chinese presidency. You asked a question about this, Kevin, and whether it reflects strength or weakness in the system going forward. I think that in the short-term, it’s perceived as a strength, as it means that China has a strong leader who is clearly in charge. I think there’s a view here in China that this will allow China to tackle some very difficult issues.

The positive for Xi Jinping is if things continue to go well for China, of course he’ll get the credit. However, if China runs into some serious problems over the long-term (whether it’s an economic downturn or other issues like a souring of US-China relations), he will then of course be the one that people look to when assigning blame. So, from a longer-term standpoint, I think it could potentially be a very big weakness.

KK:

You alluded to US-China relations and I want to get into that a little bit more, but maybe we could start out by talking about China’s relations with the world more broadly. Everything that you have talked about with regard to the evolution of China’s leadership, particularly with Xi Jinping, comes in the context in which China has risen in importance as a global economic player on the world stage. Much continues to be made of Xi’s now famous appearance at the World Economic Forum in Davos last January, the same week that Trump gave his dystopian inaugural address, which was contrasted with Xi championing the global free trade system. Then you also have an ongoing discussion about a relative decline in US global hegemony. So, with that backdrop, China is clearly asserting itself on the global economic stage, but also through programs such as the One Belt One Road Initiative and through its military ambitions in the South China Sea and elsewhere. With this confidence and consolidation of power coming out of the 19th Party Congress and the Two Sessions, how do you think this

is being received by other countries globally – including the international community in general, but also, more specifically, other powerful countries in the region such as Japan, South Korea and India, etc.?

PH:

The narrative that the Chinese leadership and President Xi Jinping have presented both at the 19th Party Congress and then during the NPC is particularly strong – it’s very forward-looking for China, and my sense is that it largely caught the international community by surprise.

Everyone on the call who follows China will know that China’s rise and rapid economic growth is not new, but what is striking is how quickly China has become stronger, more confident and outward looking.

In his work report at the 19th Party Congress, Xi Jinping called on China to become the torchbearer in the global fight against climate change and talked about China as a global leader in trade and economics. He suggested that China would not only be a major economic power, but also a cooperative influential power with a system of government and a system of development that could serve as a model for other developing countries. That narrative caught the international community, and the United States in particular, by surprise. Whether you’re looking at China from the US, or from Europe, or from inside the Asia Pacific region, clearly you’re seeing a more powerful China and one that wields more influence, not only regionally, but globally. In the US, this shift has sparked a debate on whether US policy towards China has been successful or not, and a lot of analysts are now saying that efforts by the US to try to integrate China into the international system and shape its rise to become more of a market economy and a liberal democracy have failed. There’s a number of analysts, policymakers, think tanks and academic institutions that are suggesting that the US move to a policy that does more to balance China, and potentially confront China in areas where there is a sense that US interests are being undermined. That debate, which has been going on for the last few years within think tanks, is now deeply embedded in US foreign policy, as it’s part of the National Security Strategy document released by the White House in December 2017, which singles out China – together with Russia – as a strategic

“competitor.” The National Defense Strategy coming out of the Department of Defense also paints China and Russia with more or less the same brush. China, of course, doesn’t like that – as both the Chinese Foreign Ministry and the Defense Ministry have criticized Washington’s “Cold War mentality” – but the notion of dealing with a stronger, more influential, more powerful China is something that I think the world is currently trying to grasp and grapple with.

KK:

To that point, what do you think at this point is China’s plan with regards to how they play US-China relations? You made the point about Wang Qishan and possibly aligning him with Vice President Mike Pence, but in an environment in which you’ve got the recent ascendancy of John Bolton and Mike Pompeo, and on the trade and economic front Robert Lighthizer and Peter Navarro, it could be difficult to find moderate allies. China has a plan for 2030 to 2050. In the US, with Congress having passed the omnibus spending bill, there seems to be the view in Washington that their work is done until after the mid-term elections. This all makes for an unusual environment in the US. As such, does China view the current US political environment as just an unusual phase to get through the hope that a more normalized US relationship will return after that? Or do they view it as being a secular change in US engagement in the world and perceptions of how global trade ought to operate?

PH:

I’d start out by saying a little over a year ago, I think here in China there was a lot of enthusiasm about the idea of Donald Trump being President of the United States. Many Chinese thought that since Trump was a businessman and was not as concerned about human rights issues (which is a big deal for the Chinese) that he would be more of a transactional kind of “dealmaker” and many Chinese thought this would mean that China could deal with him more effectively. And even though he seemed a little unpredictable and unconventional, China could work through that. I think that over time it seems to me that the Chinese are now becoming increasingly concerned about both President Trump himself and the type of advisers that he’s surrounding himself with.

If you look, for example, at the US-China trade tensions that we’re seeing, I would say that Chinese leaders certainly are not looking for a trade war, or some major crisis in US-China relations, as they’ve got a very difficult, complex domestic agenda to manage. While their international objectives are more ambitious than they have been previously, I think it’s important to point out that they’re still really focused mostly on domestic issues, and a trade war would make tackling these issues more difficult.

However, I think that you do see a growing confidence among Chinese leaders. I’ve had the opportunity over the last month to meet with officials such as Wang Qishan, Yi Gang and Wang Yi, and they don’t come across as overly anxious or worried about the trade tensions. Now some of this is probably posturing, but I would also say that you’re seeing a much more confident and stronger China after the 19th Party Congress. I also think Chinese officials derive some of this confidence from seeing China develop political strength against the backdrop of major political shake-ups happening elsewhere around the globe, such as the rise of populism in Europe and the political dysfunction they see in the US. Chinese leadership views China as having a relatively stable economy and solid GDP growth, and looking around the world at other countries who are having difficulty economically, you’re hearing more Chinese talk about the strategic advantage their system gives them, where they are allowed to be more long-term, as opposed to the US and other Western democracies, who are very short-term orientated in that they are focused on addressing short-term political imperatives. For example, China sees Donald Trump pushing for some short-term, visible political victories that he can leverage in advance of the mid-term elections, while at the same time, some are recognizing that there’s a longer-term, more structural challenge in the economic and trade relationship between the US and China. There is some frustration from Chinese officials that they’re having to respond to what they see as Trump’s political imperatives in a domestic political context in the United States.

KK:

Let's unpack the trade issue a bit further. Obviously, 2017 was characterized by a lot of tough rhetoric coming out of the transition and out of the new administration, and in China I think that it was clear that Xi Jinping wanted to have global economic and strategic stability heading into the 19th Party Congress so that he could accomplish what he needed to accomplish. This meant that China was determined not to rock the boat or take the bait. On the other hand, the Trump Administration also did not follow through on a lot of its early rhetoric. It did not declare China a currency manipulator, for example.

But now, as we get into 2018, and as you suggest we are hurtling toward the mid-term elections (which are of critical importance for a host of domestic political reasons) we are starting to see action being taken. There are all kinds of caveats to all of this action on trade and we still haven't touched upon the action being taken on the intellectual property front. And it seems like China's reaction has been targeted and specific, but as you point out, they do recognize that there are some legitimate imbalances, and there are some profound issues going forward in the longer-term, particularly on technology-related issues, that ultimately need to be worked out.

What do you think the approach is in terms of China dealing with these tensions, especially in anticipation of the actions being taken by the US potentially becoming more pointed?

PH:

There is a growing acknowledgement from the Chinese leadership that China probably needs to open up in terms of market access, and needs to deal better with intellectual property issues (such as the issues of forced technology transfer). These are all structural issues in the US-China economic and trade relationship - but China is also hearing many more complaints from our friends in Europe.

Chinese leaders' response to this criticism is to say that China joined the WTO in 2001. China is still a developing country. China is not a developed country. We recognize that there are imbalances that have come up. We recognize

that China needs to open its markets, and with China going into the 40th anniversary of its reform and opening up launched under Deng Xiaoping, they hope to really pick up the pace of the opening of their markets. But Chinese leaders also say that these imbalances have developed over a long period of time and, therefore, it will take a long period of time to address those trade tensions and the market access issues.

In the United States, there's bipartisan support that China needs to open its markets. It needs to stand down on forced technology transfer issues and the other structural issues we see in the economic trade relationship and it needs to do it very soon and there's an urgency to it. This is not unique to Donald Trump. I would argue that if Hillary Clinton had become President, she would have been pushing on the same issues, as would Jeb Bush.

So, on one hand, I do think the Chinese recognize the importance of market reform, because they're hearing calls for it not just from the United States, but also from Europe. Unfortunately, the US seems to be hitting everybody with its Section 232 tariffs and other trade actions - including our friends in Europe - because this is one issue really where we could come together with Europe and approach China with some of our friends and allies in the Asian Pacific region. But, unfortunately, the Trump administration appears to be using a shotgun approach to this, which allows China to stand back and say: "The US is really the problem, it's not us. The US "America First" approach is protectionist. We, on the other hand, China, are champions of the global economic and trading system and, as you can see, the United States is hitting everyone - Europe and friends and our partners in the Asian Pacific."

The announcement on the USTR 301 investigation was designed to target China and this really, I think, turned up the heat with respect to China. China's first response was not to the 301 actions, it was to the 232 action, and they were fairly swift, measured and I think, well-calibrated in the execution of that response. China proposed some reciprocal tariffs of \$3 billion and included things like US pork, steel, pipes, fruits and nuts, but it stayed away from some of the more big-ticket US export items like soybeans, which would really affect Donald Trump's base of support in the US.

I think China is hoping that there's still room to negotiate this. The US administration did respond by saying it wanted China to drop the tariffs on autos. It wanted China to buy more semi-conductors. And so, we're beginning to see the US actually give China some of the things that it hopes that they'll do. We may start to see the beginning of a negotiation and we'll see how this plays out.

The USTR will come out with its list on April 6. The business community will have 30 days to comment. And then, Steven Mnuchin (US Secretary of the Treasury) has 60 days from the beginning to report to the President.

So, we're in a negotiating period with China and I think China would like to avoid a trade war, but, at the same time, Donald Trump will probably move to get some political victories in advance of the midterms.

KK:

So, if we had to bottom-line this, it seems as if the trade actions taken by both sides allowed plenty of time for negotiations to occur. And very specifically, to your point, the Chinese seem very cognizant of the need for the administration to score some victories heading into the midterm elections – and seem poised to accommodate this within reason. They've got significant action that they could take, were this to escalate, that they are holding in reserve, with Xi's leadership stretching out into the indefinite future, recognizing that a trade war is not good for anyone (neither of the countries involved and certainly not for the global economy) and that there needs to be continued economic growth and jobs for the population. And so, do you think, given this, that the Chinese are going to continue to take as thoughtful and measured an approach as possible here?

PH:

I think that's right, Kevin. The agricultural producers in the US are at the greatest risk and this is also a part of Donald Trump's base of support. President Trump won eight of last year's top 10 soybean-producing states in the 2016 election, so voters in these states are an important part of Trump's base. I think it's significant that you haven't seen China respond with respect to soybeans. Sorghum is another one to look for as a possible target area.

The Chinese have said, over the past several months, there's a lot that we could do to buy products and help Donald Trump's base of support, but the flipside is also true - there's a lot that they could do to hurt Donald Trump's base of support and I think they're holding that back because they're trying to avoid the worst outcome.

KK:

I now want to turn briefly to the North Korea situation. Obviously, much of last year was characterized by an increasing redirect between the United States and North Korea and, of course, the North Korean testing program, both on the nuclear weapons front, as well as on the missile and ICBM front. And then, we've had a dizzying number of events occur over the course of 2018, starting with Kim Jong-un's New Year's address. Then his family's appearance at the Olympic games. He has offered to meet with Trump, and now, in advance of both the President Moon meeting later in April and the anticipated Trump meeting in May, he's gone to Beijing and met, for the first time, with President Xi. China has really inserted itself into this process, which is a complicating factor going forward. What do you make of this, right now?

PH:

I would start out by saying, this meeting in Beijing that took place in cloak and dagger secrecy is a pretty significant game-changer. The way I would describe what happened is, when President Trump announced that he was willing to meet with Kim Jong-un, it surprised a lot of people, including many of his advisors. It surprised our allies like Japan. It also surprised the Chinese.

On one hand, I think China was pleased because China has always said, this is a US-North Korea problem and the US needs to step up and engage North Korea in diplomacy. So not only were the Americans willing to engage in diplomacy, it was at the Presidential level.

So, on one hand they couldn't complain, on the other hand, it would have not initially involved the Chinese leadership, had those meetings gone ahead as planned. The South Korean president and the American president would have met with Kim Jong-un before the Chinese president, President Xi.

North Korea is a country that China fought a war with and that they have an alliance relationship with (even though it's quite strained right now). As such, the Chinese leaders did not think that it was appropriate that their president would be marginalized in this, that these diplomatic developments would be taking place with China really on the sidelines, as a spectator, not at the table, influencing and making sure that their interests are protected and so, the Chinese leadership took very aggressive steps to rectify that problem.

Now, they're in a better position because they are part of the diplomacy going forward. They've got a hand on the steering wheel in terms of what direction this takes, which works in China's favor. It also works in North Korea's favor. Kim Jong-un is now in a stronger position as he approaches the negotiations with President Moon and President Trump. For example, he may have secured some economic relief from the sanctions from China. That's not clear yet, but it's possible. But I think the most important thing is, Kim Jong-un has managed to prevent a unified front from the other negotiating parties by arranging separate meetings with China, South Korea and the United States, and maybe even Japan in the future, and he's given up nothing so far.

Finally, it also puts more pressure on President Trump. If the Xi Jinping meeting had not happened, he could have gone into that meeting with Kim Jong-un and if it failed, he could have simply blamed it on Kim Jong-un or he could have blamed it on South Korea by saying that the message they brought back from North Korea was not factual. But now, with a successful meeting between Xi Jinping and Kim Jong-un, and with what will probably be a somewhat successful (because President Moon wants it to be successful) South Korea-North Korea meeting, Donald Trump and the US administration will be the third meeting and pressure will be put on that meeting to ensure it runs as smoothly as the others. If that meeting doesn't go well, then the US is at risk of looking like the country that caused the diplomacy to fail. So China has, as a result of meeting with Kim Jong-un, put more pressure on the Trump administration in terms of this upcoming meeting.

KK:

So perhaps I could just ask one final question. And that is the point of Taiwan, as trade isn't the only issue that causes tension between the US and China. There was a bit of a

diplomatic wrinkle early in the Trump Administration when the President made the call to Taiwan and subsequently then sort of reaffirmed the One-China Policy. What is the current status of the Taiwan issue, particularly as it pertains to the US-China relations in the context of everything else here?

PH:

It's something that I hear fairly often now from Chinese government officials and Chinese scholars and experts here. I think that the issue of Taiwan is a bit of a looming matter that is becoming more important. You mentioned the call with Taiwanese President Tsai Ing-Wen that rattled the Chinese. It also rattled many Americans when Trump said he wasn't sure he was going to abide by the One-China Policy. And we saw in mid-March President Trump sign the Taiwan Travel Act, which encourages visits of US officials to Taiwan. And shortly after that in President Xi's speech at the end of the NPC, he vowed to protect every inch of China's territory and said that "acts and tricks to split the motherland would be doomed to failure and condemned by the people and punished by history." That was a veiled threat to the US because I think what China sees with the US government is more hawkish advisors in the different cabinet agencies, and many that seem pro-Taiwan in their view. The Deputy Assistant Secretary, Alex Wong, traveled to Taiwan to attend a high-level function in Taipei, and this caught the attention of the Chinese. Senators John Cornyn and James Inhofe also sent a letter to President Trump suggesting that US F-35 fighter jets be sold to Taiwan. Our unofficial embassy in Taipei is called the American Institute in Taiwan; they've moved locations and have a new facility and that's going to open soon and there's rumors circulating around that the US might even send a US Senator to the opening ceremony of that new facility. At the end of the day, this is an issue that is very sensitive for the Chinese - I think that they're watching it very, very closely. And in many ways, it's more significant of an issue and more sensitive of an issue to the Chinese than even the trade and economic issues, because I think the Chinese government feels they have room to negotiate when it comes to trading and economics. When you talk to them about Taiwan, they say that there's no room to negotiate, so it's something to watch.



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