

# US-China Trade/Technology War: Xi's Strategic Game of GO

## Executive Summary

The Sino-US trade war has sparked dissent in China, leading to criticism of President Xi Jinping for defying former paramount leader Deng Xiaoping's dictum of "Hiding the Brightness". However, Xi was able to rally support from party elders like former president Hu Jintao and former premier Li Peng in a counter-attack against former president Jiang Zemin's faction. Xi's grip on power is now unassailable, largely because he has consolidated total control over the military as well as the People's Armed Police Force.

Xi cannot afford to back down too much from his signature visions of "One Belt, One Road" and "Made in China 2025", which legitimize both his rule and the removal of term limits on his presidency. Consequently, he is likely to play the nationalist card to rally the people behind him.

Privately, an increasingly number of Chinese analysts are pessimistic that a deal can be reached as they believe that nothing short of a total surrender can satisfy the US. They perceive Washington's demands that China abandons its industrial policy and gives up on its developmental model of state capitalism are intended to thwart China's technological progress and undermine its future development.

Consequently, Chinese policymakers have concluded that they must prepare for the worst by focusing on "preserving stability at all cost." The Politburo met on 31<sup>st</sup> July and called for more expansionary fiscal and monetary policy, as well as "Six Stabilizations: stabilize employment, stabilize housing prices, stabilize foreign trade, stabilize financial sector conditions, stabilize investment, and stabilize expectations."

It sounds like a rallying call by a leadership girding for a long-drawn war.

## **(1) Trade War Sparked Dissent; Xi Slated for Defying Deng's Dictum of "Hiding the Brightness"**

In the ongoing Sino-US trade war, China's retaliation in August on the one hand, and considerable restraint on the other, are indicative of China's latest strategy. It is to show sufficient firmness so as not to appear weak to both its domestic audience and the Trump administration, but to avoid provoking the US into further "tit for tat" moves.

US President Donald Trump on 2<sup>nd</sup> August escalated trade tensions when he directed the US Trade Representative (USTR) to consider more than doubling the proposed level of additional duty to 25%, which will apply to the list of USD200 billion of goods imported from China. The list was unveiled on 10<sup>th</sup> July, with a rate of 10% suggested then. China responded a day later with retaliatory tariffs at four different rates of 5%, 10%, 20%, and 25% on USD60 bn of US goods, with an estimated weighted applied average tariff rate of 18%. China also announced that the timing of execution of those retaliatory tariffs will depend on US actions.

Indeed, signs of China making conciliatory moves even as it keeps pace with US escalation, have picked up visibly in recent weeks. News headlines coming out of China have moved beyond improved foreign

investor access to the car and financial service sectors, to new joint venture announcements in the air travel, e-commerce as well as food & beverage industries.

Politburo meeting decisions at the end of July explicitly included the protection of foreign investor interests, as well as opening the domestic market to foreign players, to China's long term objectives. China is signalling that it would not target or punish US companies operating there. This is China's strategy of getting powerful Wall Street lobbies and US corporates operating in China to be on their side in this tech war that is masquerading as a trade war.

It is worth noting that some time back when nascent calls for the boycott of US products surfaced in domestic social media, the government's army of social media watchers swiftly quashed those rumblings. China has also interpreted Trump's earlier decision on ZTE as indicative that the intention of the trade war is not to defeat China and the Chinese people. Instead, President Trump is seen to have left room for negotiation.

With pressure from the trade war intensifying, some signs of internal power plays have surfaced in party media outlets like the People's Daily, CCTV, and Xinhua News. For example, on the 9<sup>th</sup>, 12<sup>th</sup>, 15<sup>th</sup>, and 18<sup>th</sup> of July, President Xi Jinping's name did not appear in the headlines of the People's Daily. This has very rarely been the case since Xi came into power during the Communist Party of China's (CPC) 18th National Party Congress in November 2012.

This anomaly could be an indication of the behind-the-scenes struggle being played out within state media, where former president Jiang Zemin's faction continues to have significant influence, due to loyalist holdovers from the Liu Yunshan era. For a decade until he stepped down in 2012, Liu headed the Propaganda Department of the CCP, which oversees the news organisations in China and enforces media censorship.

Significantly, on the 2<sup>nd</sup>, 3<sup>rd</sup>, and 4<sup>th</sup> July, the People's Daily website had published three editorial opinions, entitled "Forgot How to Write an Article?", "Aren't the Chinese Confident?" and "Is the Writing Style Trivial?", to criticize the boasting and self-aggrandising style of articles in the Chinese media on Xi's China dream epitomised by the "One Belt, One-Road" initiative and the vision of "Made in China 2025".

This has given rise to a chorus of rising criticism that Xi should not have so casually discarded former paramount leader Deng Xiaoping's strategy of "hiding your strengths and biding your time" during Xi's first term in office, when he made clear his determination to replace the US as the region's leading military and economic power.

Deng Xiaoping's 20-Character Strategy of "Observe calmly; secure our position; cope with affairs calmly; hide our capacities and bide our time; be good at maintaining a low profile; and never claim leadership." ("冷静观察、稳住阵脚、沉着应付、韬光养晦、有所作为") first emerged in 1990 in response both to the global backlash from the 1989 Tiananmen Square crackdown and to the CCP's sense of alarm following the collapse of the communist states of the former USSR and Eastern Europe. These basic principles formed the bedrock of China's strategy on how to protect its national interests while increasing its interactions with the world.

Additional signs of dissension within Zhongnanhai also began to emerge in July. As of 30<sup>th</sup> July, Wang Huning, the party's Number 5 leader who is also in charge of propaganda and the media has "disappeared" from public view for more than 24 days. Intriguingly, between 26<sup>th</sup> June and 4<sup>th</sup> July, Wang made four

public appearances. On 4<sup>th</sup> July, Wang also participated in an important meeting, but at this meeting, Wang Huning's treatment was very strange for a leader of his rank. Not only did he not sit on the dais, he also did not make a speech. He hasn't been seen since then.

Within the party, there has been rising criticism that the CPC think-tank headed by Wang seriously misjudged US President Trump's trade policy, and is considered to be one of the important reasons for the CPC's retreat in the ongoing China-US trade war.

## **(2) Xi's Rallying of Support from Party Elders for a Counter-Attack**

Intriguingly, after over a week of silence, CCTV News on 16<sup>th</sup> July led with four news items related to Xi. On 17<sup>th</sup> July, most front-page space of the People's Daily covered news related to Xi Jinping. On the same day, three of the top four news items in Xinhua Net were all related to Xi, except the odd one out which was about Premier Li Keqiang.

On 29<sup>th</sup> July – the day that Xi Jinping returned to Beijing after his 10-day overseas state visits - former president Hu Jintao's son Hu Haifeng gave a prominent interview and re-emphasised Xi's instructions for Party Unity. The intention was to help Xi stabilise the political situation, which may affect the dynamics of the upcoming Beidaihe Conference of senior leaders. Hu Haifeng's statement was clearly representative of the attitude of Hu Jintao, or even the entire Communist Youth League faction, which also includes Premier Li and Politburo Standing Committee (PSC) member Wang Yang. This is clearly a great setback for Jiang Zemin and former vice president Zeng Qinghong's faction, which intended to undermine Xi's position by rallying other factions together.

Hu Haifeng had been promoted to the position of Party Secretary of the prefecture level city of Lishui in Zhejiang province on 4<sup>th</sup> July, making him the youngest municipal party secretary at age 46. During the promotion, it was indicated that the younger Hu received special attention from President Xi.

On 2<sup>nd</sup> August, Minister of Transport Li Xiaopeng, the eldest son of the former Chinese premier Li Peng, was appointed as President Xi's Special Envoy to attend the Handover Ceremony of the Colombian Presidency on 7<sup>th</sup> Aug. This is an unusual elevation of an ordinary cabinet minister to the international stage, and pulled the still influential Li Peng further away from the Jiang faction's orbit. This move further undermined the Jiang faction's attempt to unite the elder leaders to undermine Xi through an enlarged meeting of the Politburo before the Beidaihe meeting. It is unlikely that the Jiang faction will succeed in taking advantage of the trade war to undermine Xi.

Another factor which protects Xi from negative fallout arising from any missteps in the trade/tech war is Xi's firm grip on the current Central Military Commission (CMC). It consists mostly of Xi's drinking buddies from his time serving in Fujian province in the 1990s and a fellow princeling, as illustrated in the collage.

The CMC is China's highest military command authority and has direct control over its nuclear weapons. It is usually chaired by the General Secretary of the Communist Party, a post currently held by Xi, who is assisted by 2 Vice Chairmen in the CMC.

### Members of Central Military Commission (2017-2022)



One of the two CMC Vice Chairmen is Xi's fellow princeling Zhang Youxia, whose late father Zhang Zongxun was a 3-star general. The children of Chinese communist officials who held senior positions prior to the mid-1960s are commonly called "princelings." The junior Zhang fought in the 1979 Sino-Vietnamese War and one of the few battle-tested Chinese generals currently in service. The other CMC members Wei Fenghe, Li Zuocheng, and Miao Hua became buddies with Xi during his 17 years in the south eastern province of Fujian as a government official.

In 2007, the wily Jiang Zemin and his ally former vice president Zeng Qinghong supported Xi as then President Hu Jintao's successor. They believed Xi to be politically weak as he appeared to not have the backing of any faction, and didn't have a network within the military. They saw him as a man with a harmless smile who could easily be controlled, not someone with steel in his spine.

Xi kept a low profile throughout his career, and quietly cultivated his fellow Beijing princelings who held strong positions in the military as well as the core of the party's power structure. He had also laid the foundation during the early days of his career by cultivating the loyalty of those who became military leaders 25 years after they first got to know Xi. These moves played out over a quarter of a century were totally outside the radar screen of Jiang, Zeng, and all others who could have obstructed Xi's path.

Consequently, Xi's consolidation of power after 2012 was extremely swift, as well as totally unexpected, by both the White House and the Chinese.

His power grew even further from 1<sup>st</sup> January 2018, when the Chinese People's Armed Police Force (PAP) was brought under the control of the CMC. The 1.5 million strong paramilitary PAP are dressed in green uniforms instead of the blue largely used by the civilian People's Police. It is in charge of law enforcement as well as internal security, and originally controlled by the State Council before it fell under the CMC. Xi in turn controls the CMC. He is now largely unassailable.

### (3) Internal Divisions on the Appropriate Responses to Trump

The trade war has severely undermined the position of Xi's close confidante Vice Premier Liu He. Xi has cast China's external ambition with his plan for "One Belt, One Road", while "Made in China 2025" is the jewel of his domestic vision.

While the trade war has led to domestic backlash and serious criticism, Xi cannot afford to back down too much from his signature visions which legitimize both his rule and the removal of term limits on his presidency. Consequently, he is likely to play the nationalist card to rally the people behind him. While China may not be a democracy, the opinion of 1.4 billion people still matters, no matter how strong a grip on the media, internet, and security forces one may have.

Xi sees himself as the new Han Wudi, the Great Emperor Wu (157 BC – 87 BC) of the Han Dynasty (206 BC–220 AD) of China. Wudi was the seventh emperor of that dynasty and ruled for 54 years, a record that remained unbeaten until the Qing Dynasty's Kangxi Emperor (1654-1722) more than 1,800 years later. Wudi's reign was the culmination of the great Han Dynasty that gave its name to the Han Chinese ethnic group, which accounts for over 90% of Chinese nationals and is the world's largest ethnic group at 20% of global population. The Han Dynasty vastly expanded its territory, developed a strong, centralized state, and promoted Confucian doctrines in the fields of history, as well as social and cultural studies. As far as Xi's plans to build a similarly glittering legacy go, this trade war is very much an unforeseen and unwelcome disruption.

On 24<sup>th</sup> July, analysts in Beijing and Hong Kong noted that China has already replaced the word "Hegemonism" (霸权主义) with "Bullying" (霸凌主义) in reference to US actions in the trade war. "Bullying" is a milder term compared with "Hegemonism", as the former does not have the connotation of identifying an enemy, and is more like a comment on bad behaviour.

Since the trade war's outbreak, Chinese propaganda has noticeably softened from the tough stance at the outset. The original slogan of "a tooth for a tooth" (牙还牙), the Mandarin version of "an eye for an eye", has practically disappeared. There have been directives from the party that required the media to use the term "trade friction", rather than "trade war". Personal attacks against President Donald Trump was also prohibited.

Prior to June 2018, Liu He led three rounds of trade discussions with the US, during which the two sides failed to come to an agreement. This failure had already caused anxiety among high-level officials in China.

Liu He is a liberal economist with an attitude towards the US that is moderate compared with Xi's more robust, nationalistic stance. In the PSC, both Premier Li and Liu He did not want a trade war with the US, along with fellow moderates like Wang Yang.

However, Xi refused to relent on trade policies the US took issue with, especially with regards to technology transfer and the targeting of strategic industries. Xi's close protégé and China's third-highest ranking leader Li Zhanshu's position is closer to Xi's. Li is a member of the PSC and also Chairman of the Standing Committee of the nearly 3,000-strong National People's Congress, the world's largest parliamentary body. The military has so far remained silent, but could inject its hawkish views into the discourse if Sino-US trade relations turn more acrimonious.

US Trade Representative Robert Lighthizer noted that US-China trade tensions is a long-term issue that will take years to resolve. Trump imposes high tariffs to create leverage for the conduct of trade negotiations with other countries. Trump's trade policy is geared towards the ultimate goal of "zero tariffs, zero non-tariff barriers, and zero subsidies".

#### (4) Beidaihe Meeting in August and the “Unity of Thought”

Xi and the rest of the CPC’s top leaders were absent from the public eye for two days at the start of August, gathering at the Beidaihe beach resort approximately 285km east of Beijing so that Xi can work on achieving “Unity of Thought”.

Police in Beidaihe on 31<sup>st</sup> July implemented a "No Fly Zone" and issued a traffic control notification that extends till the middle of August. That same day, the official microblog of the Beijing Public Security Bureau issued a notice temporarily controlling small, low-altitude, low-speed airborne craft until 31<sup>st</sup> August.

This gathering normally includes PSC members, Vice President Wang Qishan, all members of the Political Bureau, as well as senior government and military officials, as well as the Zhongnanhai Royal Team, national experts in scientific research, and think-tank scholars.

It is noteworthy that Vice President Wang Qishan, who is not even a central committee member, attended the secretive Beidaihe meeting. It is likely that Wang is the key master mind helping Xi to formulate a strategic response to Trump’s gambits. Wang is nicknamed the “fire brigade chief”, a nod to his sterling track record in managing major crises like the 2003 Beijing SARS epidemic and the 2008 global financial crisis. Among China’s senior leadership, Wang has the most extensive knowledge and experience in dealing with the US in negotiations.

In May 2018, Wang became the top-ranked member of the CPC’s Central Foreign Affairs Commission after Xi and Li Keqiang. The Commission is China’s top policy-making body for foreign affairs, and includes other heavyweights like PSC members Wang Huning and Han Zheng, who is the most senior of China’s four Vice Premiers assisting Premier Li.

Some liberal economists in China have argued that China’s extensive tariff and non-tariff barriers have actually benefited only certain vested interest groups like SOEs, and the large state-owned banks. On the other hand, Chinese consumers as well as small and medium enterprises are victims of these protectionist policies. As an illustration, some have argued that former premier Zhu Rongji’s liberalization of China’s industries and retail sectors after it joined the World Trade Organisation have benefited Chinese consumers and improved China’s international competitiveness. They thus have a more sympathetic view of the pressure the Trump administration is currently exerting on China with regards to its pre-existing trade barriers.

#### (5) Stabilizing the Domestic Economy

As part of efforts to buttress the domestic economy and weather stormy Sino-US trade relations, Xi on 31<sup>st</sup> July hosted a meeting of the CPC Central Committee’s Political Bureau. The three main topics of the meeting were: analysing and studying the current economic situation, deploying economic measures for the second half of the year, and reviewing the CPC’s Regulations on Disciplinary Actions.

At its conclusion, the meeting decided on six specific requirements:

1. Implementing a proactive fiscal policy and maintaining a prudent monetary policy
2. Increasing the strength of the infrastructure sector
3. Keeping a firm grip on the policy of de-leveraging and addressing financial risks
4. Unwavering implementation of major initiatives for further economic reform

5. "Resolutely curbing" the rise in housing prices, safeguarding the people's livelihoods, and maintaining social stability
6. A focus on the "Unity of Thought"

In a coordinated move, the People's Bank of China imposed 20% reserve requirements on some foreign-exchange forward contracts, making it more costly to short the Chinese Yuan. This helped offset negative sentiment from the tariff announcements, and halted the currency's slide. It also signalled that the PBOC will not use deliberate currency devaluation as a weapon in the trade war. It will, however, tolerate further market-driven Yuan depreciation, as long as it does not trigger capital outflows.

Many Chinese analysts are not optimistic that a deal can be reached, as they believe that nothing short of total surrender can satisfy Washington's demands that China abandon its "Made in China 2025" policy, as well as fully privatize all its state-owned enterprises. These demands are completely unacceptable to the Chinese leadership.

The worry is that what Washington really wants is to thwart China's technological progress — or even worse, precipitate a regime change. "The confrontation between the US and China is not a trade war, nor a currency war or even a technological war. It is an ideological conflict, and (it is) becoming a full cold war," said one expert on US relations at a Chinese government-affiliated think-tank.

Chinese policymakers seem to have concluded that events are out of their hands, so they must prepare for the worst — or in the Party's favourite euphemism, "preserve stability." It is telling that the Politburo met on 31<sup>st</sup> July and called for looser fiscal and monetary policy to "stabilize employment, stabilize foreign trade, stabilize foreign investment, stabilize investment, and stabilize expectations."

## (6) A Potential Deal, or a Darker View of Trump's Real Intentions

Around 4,000 years ago in ancient China, a board game called Weiqi (围棋 or "encirclement game.") developed and eventually spread to Japan and is now known to the world as "GO". GO is an elegant game of balance and strategy. The game is far less about surrounding and capturing, than it is about establishing your own territory in an area of the board and placing stones on key points to gain territory. If a stone or group of stones on the board is completely surrounded on all sides, then those stones are "captured" and removed from the game. At the end of the game, the player with the most territory is the winner.

Stones placed farther apart from each other have the potential of more territory, but also run a higher risk of being separated and killed. GO features multiple battles over a wide front, rather than a single decisive encounter. It emphasizes long-term planning over quick tactical advantage.

The number of possible positions in the ancient game of Weiqi has been estimated to be larger than the total number of atoms in the entire universe, which is estimated at 7 times 10 to the 81st power for all the atoms in all of the stars in the universe.

Former Secretary of State Henry Kissinger noted that it is critical to understand the Chinese intellectual game of strategic encirclement. He remarked that the western intellectual game is chess. Chess is about victory or defeat. In chess, all the pieces are in front of you at all times, so you can calculate your risk. On the other hand, with GO, the pieces are not all on the board, and your opponent is always capable of opening up a new front or destabilising you by introducing new pieces in unexpected locations on the board.

Trump's trade war would have been a great threat to China prior to Xi's consolidation of power at the 19<sup>th</sup> party congress in October 2017. Had he been weakened by the escalating trade war earlier, Xi would not have been able to marginalise the Jiang faction, dominate the central military commission and the PSC, pack two thirds of the politburo and central committee with his supporters, and push through the constitutional amendment removing the presidency's term limit.

On 31<sup>st</sup> July, US Commerce Secretary Wilbur Ross argued that the strong US economy made it a good time to take on China, since it could absorb the resulting short-term pain. However, he also said the administration expected to reach a negotiated settlement in its trade war with Beijing that would deliver results for US businesses. He wryly remarked that "At the end of the day, it's not in anyone's interest to have this go on for 100,000 years."

On the other hand, there are few signs of improvement. Larry Kudlow, the top White House economic adviser, recently accused Xi of blocking the Chinese team from making a deal. Serious observers in Beijing noted that China is reluctant to negotiate because Trump has a habit of undermining his own economic officials, including Treasury Secretary Steven Mnuchin and Ross.

From the Chinese point of view, it has to be a direct deal between Xi and Trump. China strategists noted that both Jean-Claude Juncker's and Kim Jong Un's direct dealings with Trump resulted in deals that stuck for the EU and North Korea respectively.

An optimistic scenario is for Xi to meet Trump at the UN meeting in New York in September to settle on a compromise in time for Trump to claim credit for the US mid-term elections in November. The deal could include serious concessions from China on tariff and non-tariff barriers, market access, and better Intellectual Property Rights protection. As China has been preparing the ground for such concessions in its recent trade liberalization measures, the deal can be credibly sold domestically as part of China's process of market-based reform that will drive job creation and improve income growth as well as consumer welfare.

An equally, if not more likely, scenario is that China feels it has made sufficient concessions and Trump doesn't get a deal. A darker view of Trump's intentions would likely rapidly come to prevail in China.

Privately, an increasing number of Chinese analysts are pessimistic that a deal can be reached; as they believe that nothing short of a total surrender can satisfy the US. They perceive Washington's demands that China abandons its industrial policy and gives up its developmental model of state capitalism are intended to thwart China's technological progress and undermine its future development.

Consequently, Chinese policymakers have concluded that they must prepare for the worst by focusing on "preserving stability at all cost." The Politburo met on 31<sup>st</sup> July and called for more expansionary fiscal and monetary policy, as well as "Six Stabilizations: stabilize employment, stabilize housing prices, stabilize foreign trade, stabilize financial sector conditions, stabilize investment, and stabilize expectations."

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Looking beyond 2019, strategists in China calculate that its bargaining position could be increasingly enhanced. The US economy is at a cyclical high. US GDP rose at an annual rate of 4.1 per cent in the second quarter, the strongest quarter of growth since 2014. However, this growth could be a short-term



blip brought about by tax cuts that gave people a little extra money in their pay check but is unsustainable in the face of mounting federal debt, higher tariffs, and the prospect of a trade war that could hurt large portions of the US economy.

Notably, the tax reductions and spending increases by the Trump administration and Congress added an estimated 0.8 percent to quarterly GDP growth. In addition, another 0.6 percent of growth in the second quarter was from farmers rushing to export more soybeans, particularly to China, before soybean tariffs went into effect.

Former Federal Reserve chairman Ben Bernanke noted that the stimulating benefit of the tax cut “is going to hit the economy in a big way this year and the next year, and then in 2020, Wile E. Coyote is going to go off the cliff.”

With expansionary fiscal and monetary policy, China could calculate that Xi’s political position is strong, the country is relatively cohesive, people can be rallied around the flag, and the economy could be improving over the next two years from a cyclical low.

On the other hand, for the US, the economy’s cyclical high cannot be sustained, the country is fractious and polarised, while impending price increases resulting from Trump’s tariffs could alienate his key support base of lower-middle-income. Hence China is likely to wait out Trump, especially if his party loses control of Congress after the November mid-term elections.

If such calculations prevail in Zhongnanhai, the present trade war could drag on for a sustained period, and a compromise deal would only be reached after both sides feel sufficient pain.

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