The President of the United States is espousing an “America first” policy that purposefully reduces US participation in global security and economic affairs. It is far from clear to what extent this will be implemented: key cabinet secretaries publicly disavow such views and profit motives align powerful American interests against a de-globalization agenda. But one way or another – by Trump’s convictions or sheer internal distraction arguing about them – American global presence is likely to moderate significantly, leaving a void in the international system.

This is the first time that the United States has willfully turned its back on the opportunity to lead the course of world affairs.

Trump’s “America first” policies will leave a void in the international system. Is China ready to step in and assume the mantel of world leader? Regardless, shaking things up might prove a good thing: business as usual is not healthy for China or the world. A course correction in Beijing could help turn the tide on the current de-globalization trend.

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since war-weary Americans rejected President Wilson’s proposed League of Nations, in March 1920. Republicans doubled-down on an anti-League platform to win Warren Harding the presidency later that year, promising normalcy, serenity and restoration. During America’s subsequent sabbatical from world affairs, discordant monetary policies primed the international economy for the explosion of 1929; an aspirational Japan was given room to militarize in Asia; and European politics were consumed with zero-sum strategies that left Germany increasingly bitter and nationalistic.

Mindful of the lessons of history and the consequences it bore, can China step into this vacuum and play a greater global role? The question is natural. No nation is ratcheting up its capabilities as rapidly as China, swelling as quickly its share of global GDP, or asserting as loudly its intention to stand up abroad. If China says it wants a bigger global role and behaves like it wants a bigger role, shouldn’t we expect China to take a bigger role?

HOW LIKELY IS A US-CHINA HAND OFF? The answer is less obvious than it might seem, and not only because projections of America’s demise are premature. China’s capacity to play an expanded global role depends on fundamental reforms at home. President Xi himself oversaw the Communist Party’s 2013 reform manifesto – the 60 Decisions of the Third Plenum – stating that China could not assure its own future let alone take up its global destiny if it did not complete a set of challenging economic reforms. Objective measures, and leading Chinese officials, indicate that this reform work is badly behind schedule and not nearly on track.

But doubts about China’s economic stability, and thus its ability to shoulder burdens abroad (which Donald Trump is looking to offload), are not stopping President Xi from offering a rousing pledge to lead globalization, as he did at the January 2017 Davos World Economic Forum. Nor do they stop Pre-
nier Li Keqiang from writing for Bloomberg that, “In a world with a plethora of uncertainties, China offers an anchor of stability and growth.”

“Never let them see you sweat” seems to be the political philosophy of our times. But in considering China’s capacity to deliver on globalization, we must pay attention not just to what Beijing says, but to what it does. Consider four dimensions of global leadership on which China will have to deliver: innovation, trade, direct investment and financial account opening.

INNOVATE AND REFORM TO REMOVE GLOBAL GROWTH BOTTLENECKS. The international economy delivers material gains because its rules let innovation and technological change flow across borders. Protection keeps out competition – fair or unfair – but holds innovation at bay as well: with less disruption comes less welfare too. The United States has led the push for rules-based liberalization since 1945, tolerating more unfair trade than other nations in order to promote the benefits, which it enjoyed in ample measure as well. As Washington abnegates that role, will Beijing pick it up? So far from embracing Chinese innovation leadership, many advanced economies today are focused on containing the damage they fear from Chinese industrial policies, which they deem to be self-serving and injurious to the healthy functioning of OECD markets.

*Made in China 2025,* Beijing’s current industrial policy, calls for pushing non-native manufacturers out of China and then out of their global market shares. Far from being a narrow policy, this program touches at least a third of Chinese industry: to match China, any other country would virtually have to abandon the free market. To most advanced economy observers, this appears to be incompatible with global innovation leadership.

Therefore, the first limit on China’s ability to step into America’s global shoes is the time it will take to build trust in the broad-mindedness of Chi-
Chinese intentions. This is not just an abstraction. Key stakeholders other than the United States – including Britain, Germany, Canada and Japan – are increasing scrutiny of Chinese investment proposals for threats to their innovation cultures. Beijing can turn this trend around: but doing so will require profound changes in Chinese treatment of foreign firms at home, protection of intellectual property, due process and rule of law, and reform in financing for industrial policy and other elements effecting competition policy. China’s State Council now says that Made in China 2025 subsidies will be available to foreigners too, not just indigenous firms, but it will take years of clear affirmative action to demonstrate evenhandedness at this point, given the evidence of growing nativism.

TRADING PLACES? The most tangible element of globalization is goods trade. President Xi has promised to “vigorously foster an external environment of opening-up,” and “to conclude open, transparent and win-win regional free trade arrangements”. That is an encouraging, and useful, pledge. The problem is that for the past decade the actual pattern of Chinese goods
trade has drifted inexorably in the other direction, toward persistent surpluses with every region of the world except Oceania. Europe, North America, South America, Africa and even the Middle East and the rest of Asia consistently run trade deficits with the aspiring heir to America’s global role. A services trade deficit nominally reduces the merchandise imbalance a bit, but for most of China’s trade partners – as for President Trump – the manufacturing sector remains front and center. China trumpets the potential spending power of “700 million overseas visits” by Chinese tourists a year. But that is not the same as manufacturing export opportunities. A significant portion of Chinese services trade appears to disguise capital flows masquerading as commerce. While copious, China’s actual consumption of foreign services abroad is not as much as reported.
Perhaps more worrisome, from a leadership perspective, Beijing regularly reminds foreign partners that Chinese tourists are not to be taken for granted, but are a tool of economic statecraft that can be turned on and off at China’s pleasure. Countries which displease China’s leadership are regularly threatened with a loss of Chinese tourism. Such politicization of the opportunities offered by globalization changes the meaning of China as a replacement for American internationalism.

Openness to two-way enterprise foreign direct investment (FDI) – inbound and outbound – is another major aspect of globalization. China has been relatively open to FDI from abroad, and over the past five years it has freed up controls on Chinese firms going global. In 2016, this amounted to $46 billion in flows to the United States and over $40 billion to Europe.

When advanced economies talk about the global economy, they very much have in mind investment by multinational companies. To sell many products and services to consumers abroad it is necessary to invest in those foreign markets so as to be able to carry out sales, marketing, after-service, brand management and other activities. However, several trends are dampening the applause for inbound Chinese dealflow.

First, subsidies are pushing Chinese buyers to go especially after semiconductors and other sectors with national security sensitivities; this has attracted intense concern from defense departments and strategic analysts. Second, while China’s outbound flows have grown, FDI into China has fallen steeply over the past two years due to lagging reform and reluctance to face new competition. This gives rise to shrill new calls for “reciprocity” both in Europe and North America. Third, and particularly awkward, balance of payments problems caused by China’s slow reform progress have tempted Beijing to restore the capital controls removed five years ago; this has startled investors, put outbound deals at risk and made inbound investors wary of getting
their money back (see figure 2). President Xi’s pledge at Davos – that over the next five years China would attract $600 billion in FDI and make $750 billion of outbound investment – strikes many as oddly pre-cooked for a nation claiming to embrace the market. It also appears presumptuous to assume that greater Chinese access abroad than foreign access in China will be considered “win-win”. With the European Union and the United States debating changes to their open door policies, this is not an easy time for China to assume global leadership.

FINANCIAL ACCOUNT LIBERALIZATION. China has trumpeted intentions to stoke the global economy with its financial globalization. There are plans to recycle trillions of dollars in foreign reserves built up from decades...
of current account surpluses, to increase portfolio investment outflows and inflows, and to ramp up massive development assistance credits abroad through programs such as “Belt and Road”. Beijing points to 100 countries and international organizations that have “given warm responses and support to the initiative,” arguing that China can be a catalyst for infrastructure development throughout the world.

However, it is not clear that China is presently capable of financing this vision. Shortcomings in China’s reform process have amplified private capital outflows, balance of payments concerns, and a rapid erosion of foreign exchange reserves that had not been seen for a generation. In response, Beijing has pulled back nascent steps to make the renminbi an international currency and re-imposed capital controls on outflows of US dollars and other global currencies that had previously been relaxed. If China’s banks concentrate their global loan portfolios in Belt and Road economies (such as the country’s largest external borrower today, Venezuela), concerns about their debt-recovery prospects, already worrisome at home, will be multiplied abroad.

There is no question that China’s financial globalization has the potential to facilitate a new era of global growth, regardless of whether the United States wants to pass the baton. China’s more than 1.3 billion people will quintuple their incomes before they finish catching up to OECD averages, stoking demand and worldwide output growth in the process, and serving as an example to billions of others further down the ladder. And indeed, current pressures may nudge Beijing closer to making the requisite progress on reforms. Transforming domestic capital markets and opening up to foreign investors could even in turn improve the two-way balance of payments, permitting China to participate in global finance and restoring the constructive narrative that has slipped.
READY OR NOT. Some of the scariest moments in the global economy over the past century have entailed discovering correlations where not expected. Today’s ten trillion dollar question is whether China’s capacity to add to global growth is dependent on a global economic superstructure maintained by the United States. If so, then instead of seizing the opportunity of American withdrawal to claim the mantel of international economic leadership, China will soon reveal its limits. Whether China can contribute to growth for other nations – rather than continue to run a net surplus with the world – is not a subjective question. We understand the relationship of incomplete domestic economic reforms in China as related to its ability to assume a larger global role. Based on that, it is not currently possible – not to the extent that Beijing is promising, or to the degree some have hoped (or feared) – for China to offset American withdrawal. In fact, it is more likely that American withdrawal end up triggering a Chinese pull back from globalization too. Ironically, that might not ultimately be a bad thing. Business as usual was not healthy for China or the world. Believing it could eke out a few more years to defer the really hard – if necessary – reforms, China was wasting time. A hard reckoning forced by external disruption may be more likely to catalyze needed domestic changes than acute internal problems, which can be hidden in an authoritarian state. If Beijing shifts from favoring industrial welfare to bolstering consumers, domestic consumption growth can make up for negative growth from a falling external imbalance. Structural adjustments such as these, and evidence of willingness to support innovation even at the expense of national champions, would win China credit for turning the tide on the de-globalization trend currently underway. And of course, such a course correction would resolve some of the worries that are feeding the OECD anti-globalization backlash in the first place.