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Viewpoint: Taking the pulse of U.S.-China relations

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Crises can bring people together, united by a common purpose, or it can drive them apart. So far, the Covid-19 crisis is driving the United States and China even farther apart. Here's where things stand:

On the U.S. side President Donald Trump has suggested, without evidence, that the virus escaped from a government lab in Wuhan. Chinese investment in the U.S. is now subject to greater scrutiny under new rules formulated by the by the Committee on Foreign Investment in the US. The Commerce Department's review of U.S. technology exports with potential "military end use" has tightened; another proposed rule would give Commerce broad powers to unwind deals impacting internet and communications technology supply chains. Huawei remains a target, with a new U.S. proposal in May to bar foreign semiconductor manufacturers that use U.S. equipment or software from shipping semiconductors to Huawei without government approval. Other nations are being pressed by the administration to enact similar restrictions, an argument it appears to be losing. Through all this U.S. government officials increasingly depict China as an adversary, an assertion that without more nuance could prove self-fulfilling.

China for its part, is asserting power across a broad front internationally and has reacted aggressively to questions regarding the origin of the virus, attacking governments that have proposed international enquiries. Inside China, scientists conducting research on the topic are required to submit their work for government review before it can be published. This lack of transparency undermines trust and discourages cooperation. The recent decision at the National People's Congress to apply Chinese national security laws in Hong Kong has exacerbated tensions further.

All this is happening in the midst of the worst economic crisis since the Great Depression. Tensions are reflected in falling investment in both directions: according to the Rhodium Group Chinese venture investment in the U.S. in the first quarter was down $1 billion from one year earlier (which was already a bad year) and Chinese FDI in the U.S. was at its lowest level since the global financial crisis; U.S. direct investment in China is continuing but flat and venture investment is slowing.

Global health crises call for leadership and cooperation. During the global financial crisis of 2008-09 U.S. and Chinese leaders consulted closely on measures to revive the global economy. Not so today.

But there's also a counter-narrative. Most U.S. companies operating in China want and expect positive commercial relations to continue. U.S. and Chinese companies and scientists are working together closely to address the Covid-19 challenge across a broad front. So, despite diverging paths at the national level, private and sub-national cooperation remains strong.

The other piece of good news is that the Phase 1 trade agreement signed in January is working — up to a point. The deal itself is a modest step that paused the escalation of tariffs. China agreed to increase purchases of U.S. agriculture and manufactured products by $200 billion over two years, address technology transfer and intellectual property concerns, and open markets to financial services such as insurance, banking, payments services and securities. The hardest issues — relating to China's industrial policies — were left to a Phase 2 negotiation and most of the tariffs imposed during the trade war remain in place. These deep and possibly intractable issues threaten future conflicts.

But let's work with what we have. Key parts of the Phase 1 agreement are being implemented in good faith by China. Financial services markets have opened and U.S. companies are stepping in. Technology transfer concerns were already addressed through a new Foreign Investment Law. A roadmap for how China will continue intellectual property reform has been released. Longstanding regulatory barriers in agriculture are also addressed, in fields such as agricultural biotechnology and phytosanitary standards. Implementation is a concern, but key commitments are being met.

Meeting quantitative targets for Chinese purchases of U.S. goods and agriculture is proving more difficult. Most observers believe the targets were unrealistic to begin with, but with Covid-19 slowing China's economy and with the world economy in recession hitting those marks will be harder. U.S.-China trade is falling, not growing, and exports of both agricultural and manufactured products are down.

What to do? The agreement includes a force majeure clause and if both countries agree the terms can be changed. If another downward spiral in relations is to be prevented the Phase 1 agreement must be made to work. China should be expected to deliver on its commitments, but on terms that are practical in today's conditions. A successful Phase 1, modified or repackaged, can demonstrate the willingness of both countries to work together toward shared goals. An abrogation by either side would be unwarranted as well as destabilizing.

Decoupling of the two economies is already happening through the actions of both governments, starting with supply chains and tech. The scope of separation, however, should be limited.

These are the world's two largest economies, and a complete decoupling is neither desirable nor possible. To find a new floor, both governments should come to an agreement on areas where interests will diverge, areas where cooperation should continue, or even areas where both could lead. That process of pragmatic alignment should start with the Phase 1 agreement, which at this moment is pivotal and needs to work.

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