The "Landing Zone" for US–China Relations

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Opinion Piece

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ABSTRACT
The strategic competition between the US and China is widely perceived as a zero-sum contest in a technological setting, which leads to "winner-takes-most" economic outcomes and radically reframes national security risks. This framing precludes meaningful cooperation and has put the relationship on a destabilizing trajectory. Historically, technological revolutions have transformed not only production systems but also governance structures and international relations. The emergence of a US–China duopoly, the decline of Europe's centrality, and the fracturing of postwar institutions that are now well-advanced have set the stage for an unprecedented systemic shift. This paper examines the conditions under which a cooperative transition, featuring shared monetary and institutional burdens, could emerge by drawing parallels with past monetary and trade realignments, including the Bretton Woods transition and the Smithsonian Agreements. The proposed "landing zone" for relations involves a realignment of the global financial architecture and a resolution to the trade war that draws on the language of the populist trade economics literature. This literature frames the "exorbitant privilege" of the US dollar (USD) as an "exorbitant burden", which, in turn, establishes a diplomatically feasible framing for interim solutions on tariffs and trade and on money and exchange rates, which is grounded in sound economic theory. The critical role of charting this metaphorical landing zone for US–China relations, which would serve as a new strategic equilibrium on which to build a new global governance structure that is consistent with the transformed technological and economic conditions, will fall to a Track 2 Process.

INTRODUCTION

The postwar international institutional framework and security structure is extinct in all but name. This was dramatically underscored in a UN resolution on Ukraine by Washington siding with Moscow and against its Western partners, absenting itself from the G20 in South Africa, demolishing its international aid agency, and formulating tariff policies that undermine the most fundamental principles of the postwar trading system.

How this came to be – and particularly why now – emerges clearly from an "ages of capital" framing of the evolution of the global economy. In this framing, the introduction of a new form of productive capital asset not only changes the economy's production system but has pervasive repercussions: everything changes, including the organization of economies, political alignments, social organization, and international institutional relations. Historically, there have been the following major transitions:

- From an agrarian economy, in which land was all-important, to an industrial economy, in which scalable manufacturing dominated.
- From an industrial economy to a knowledge-based economy, in which intangible intellectual property captured economic rent.
- From a knowledge-based economy to a data-driven economy, in which data captures the economic rent.

The disruption today is rooted in the emergence of the data-driven economy, ca. 2010, and the transition now underway to an age of artificial intelligence (AI).

WHAT CHANGED AND WHY?

The technologically driven transition to a data-driven economy had three specific consequences:

1. This new economy emerged in two locations – the US and China – setting the stage for a new duopoly of power as Europe shrank into insignificance in the new economy.
2. China's entry into the data-driven economy contemporaneously with the US (and with a scale advantage) greatly narrowed the technological advantage the latter had enjoyed during the knowledge-based economy era, when it rose to its unipolar moment.
3. Socio-political changes in the US caused a phase change from the Wilsonian institutional/progressive mode that had prevailed throughout the postwar period to a Jacksonian isolationist/realist mode under President Trump.

The Obama Administration, the last in the line of Wilsonian postwar administrations, approached the rising China challenge by building institutions. It framed the Trans-Pacific Partnership (TPP) as a means to ensure that it was the US that "wrote the *rules*" for Asia–Pacific commerce, not China. The US used *rules* – i.e., complaints under the World Trade Organization (WTO) dispute settlement mechanism – to force China to comply. The US backed this up with military might, setting out a new Air–Sea Battle Doctrine, which was explicitly designed for conflict in the West Pacific.

China responded with its own institutional initiatives the Belt and Road Initiative (BRI), which adopted an idea originally proposed by the US of reviving the ancient Silk Road as a means of integrating Afghanistan into the Western sphere of influence; the Asian Infrastructure Bank; and a TPP competitor, the Regional Comprehensive Economic Partnership (RCEP). It also built up its navy. However, it did not threaten the rules-based. Indeed, it adopted a business plan based on succeeding in that order, in particular, by building up its innovation system infrastructure in the following ways:

- Expanding its tertiary education system, with a focus on STEM disciplines;
- Training thousands of patent examiners;
- Setting up specialized intellectual property courts;
- Participating actively in standards-setting bodies to help China win standards-essential patents;
- Setting up a Nasdaq-style technology board for equities; and
- Putting the power of the state behind innovation.

The decisive factor in shaping the rivalry between the two was the socio-political change in the US. During the knowledge-based economy era (1980-2010), the capture of a rising share of national income by intangible capital assets and the skills-bias in the nature of technological change concentrated wealth in the college towns that anchored the innovation system and the university-educated professional class that administered the system. US international politics reflected and projected the progressive values of this demographic and its economic interests (i.e., the capture of economic rents through traditional intellectual property). With the data-driven economy, wealth flow shifted to the campuses of the handful of emerging superstar firms, which were often established and run by college dropouts. The university system came under consolidation pressure and investment in academic credentials ceased to guarantee higher returns, leaving a growing cohort of the population burdened with unrepayable debt. This began their slide from the professional "elite" class into the growing "precariat" class that elected Donald J. Trump.

The sensational breakthroughs in generative artificial intelligence (AI) in the early 2020s are now again transforming the economy by adding a new form of capital asset – machine knowledge capital – to the production function. Machine knowledge capital competes with human knowledge capital but has the huge advantage of being scalable, whereas human capital is not. The changes in society will be as profound as the introduction of the machinery of mass production, which competed with manual labor but had the huge advantage of being scalable (unlike manual labor). The share of national income captured by capital of all sorts – machinery, traditional intellectual property, data assets, and AI or machine knowledge capital – will grow and so will the ranks of the precariat. National politics and international relations will inevitably adapt.

THE CONDITIONS THAT DEFINE THE CONTEXT FOR THE "LANDING ZONE"

The transformation of an institutionally anchored rivalry over the capture of the economic rents flowing to the new capital assets of data and AI into a full-blown trade war has irrevocably set the global system down a path to a new equilibrium. The context for the transition to a new equilibrium has the following features:

- There is a new "Middle Earth" – comprised of the US and China – which is in a state of conflict short of direct kinetic war. There is also a Global North that consists of the former US alliance system of Europe, Canada, and the Western Pacific Rim; a Global South that is now largely left to fend for itself; and a Central Eurasia of warring states, from Russia to Israel.

- Both great powers have an isolationist tendency: in the US, isolationism emerges from the political economy of populism, which is taking firm root. In China it emerges from the security-driven "dual circulation" concept. Since neither has sufficient scale to replicate the global economy domestically, trade will continue.
- The international role of the USD, its perpetual current account deficit, and its provision of a broad security guarantee ("Pax Americana") are inextricably bound up together. The unilateral termination of Pax Americana by the Jacksonian America of Donald Trump means that the other two features cannot continue.
- The trade system for connected devices and AI will differ from the trade system for "inert" products because of the profoundly different national security implications.
- The system of capital flows will similarly have to be modified to reflect the new possibilities of operating across borders in virtual modes.
- The system of exchange rates, which serves both trade and capital flows, will change. As Robert Mundell argued: "Strong currencies are the children of empires and great powers. The dollar became the greatest currency of the 20th century because it was comparatively stable, and America became the superpower. As the US came to dominate the international monetary system, the dollar elbowed out gold as the principal asset of the system." (Mundell, 2000).

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THE CO-OPERATIVE TRANSITION

In a cooperative transition, the US would share the privileges and burdens of hegemony with China. This would start with the provision of the international vehicle currency.

In the US populist narrative, the dollar's "exorbitant privilege" is transformed into an "exorbitant burden", whereby America is "forced" to be the consumer of last resort and to absorb the excess savings of the rest of the world, in particular, the excessive savings of "predator" countries (e.g., Germany and China) that suppress consumption and subsidize manufacturing. The resulting unhappy equilibrium for the US is deindustrialization; the loss of the learning-by-doing benefits of manufacturing; and the loss of good jobs and the social consequences that flow from that, including "deaths of despair" and drug abuse. While the US covets the exorbitant privilege, it wants to shed the exorbitant burden. Since they are one and the same thing, the compromise is to share both with China.

Just as the dollar "elbowed out gold" as the US became the dominant power, so must China's rise be accommodated by "elbowing *in*" a role for the renminbi (RMB). This would allow China to share the US's exorbitant privilege, while taking on part of the associated burden. Again, Mundell shows us the way: this could be easily achieved by a USD–RMB peg along the lines he suggested in 2000 for a USD–euro–yen peg at the then prevailing parities of 1:1:100. This solution would substantially increase the monetary mass at the heart of the global monetary system, imparting greater stability, and allow an orderly reduction in US external debt and a build-up of China's.

This solution would necessarily require a significant rebalancing of the US and Chinese current accounts, which, in turn, would necessarily involve an RMB–USD realignment. The US could claim it achieved what it wanted – a strong dollar, as insisted upon by US Treasury Secretary nominee Scott Bessent, and a lower valuation, as required in the view of the nominee for the US Council of Economic Advisers, Stephen Miran. A stronger RMB would support increased consumption in China as is universally desired (including by Chinese authorities).

A necessary corollary, however, is that the US would have to stop building the Second Great Wall of China – this one intended to isolate China from the rest of the world rather than to keep the Mongols out of China. This could be done as part of a transactional deal, an approach favored by Donald Trump, such as a Phase Two trade deal.

For its part, China would have to undertake additional unilateral measures, including reflating its economy by monetizing a significant portion of the debt of local governments and the banking system and, at the same time, launching a major international bond program to provide the liquid RMB assets held abroad to underpin the RMB's new international role.

We could think of this as a version of the Smithsonian Agreements of December 1971, which were put together by the group of ten leading industrialized countries. In hindsight, the Smithsonian arrangements served as an interim step for the transition from the Bretton Woods system to what would become the international dollar system. Under these agreements, the gold convertibility of the USD was removed, the USD was devalued against the yen and deutschmark, and the Bretton Woods intervention bands were widened to permit a greater flexibility in exchange rates. As these arrangements unraveled, the structure of the post-Bretton Woods system took shape incrementally. The European Communities first formed the "Snake in the Tunnel" (with currencies aligned with the deutschmark). This then became the "Snake in the Lake", as the system of floating exchange rates took hold. This then eventually became the euro. The rest of the world was left free to adopt any exchange rate management system they desired (apart from pegging to gold) under the Jamaica Accord of 1976.

The G7 emerged from the initial meetings that were convened by US Treasury Secretary Goerge Schultz of the then systemically important economies (the US, UK, West Germany, France, and Japan) to manage this emerging system. In time, it would broker the coordinated interventions pursuant to the Plaza Accord of 1985 to lower the value of the dollar and the Louvre Accord of 1987 to arrest the decline in the dollar's value, which had been reinforced by the Plaza Accord.

Similarly, today, the rest of the world would have to take care of itself.

The Global North's small, open economies (yes, the EU is a small, open economy in the world of data and AI), from the eastern borders of the EU through to Canada and the Western Pacific Rim, would have to band together and re-arm to avoid predation. This includes predation from an expansionist US, which has threatened hostile takeovers of Canada, Greenland, and Panama. This also includes predation from China, which unleashed Russia on Ukraine through the "no limits" pact between Xi Jinping and Vladimir Putin, pressed its claims in the South China Sea, insisted on asserting full sovereignty over Taiwan, and recently conducted live-fire naval exercises off the coast of Australia.

The Global South, which faces the highest tariff wall under the Trump Reciprocal Tariff, combined with a full elimination of international development assistance, has been left to manage its relations with China, either through the one-on-one relationships favored by China through its BRI or through some coordinated mechanism in which the countries of the Global South effectively unionize to gain bargaining power in their role as hewers of wood and drawers of water for the advanced industrialized world.

Finally, the revised monetary arrangements would permit a climbdown from the tariff wars that have been waged in open violation of WTO rules. Ideally, the parties would return to the negotiating table to revise, as necessary, commitments made in the pre-digital age to adapt to the national security realities of a connected world, working within established WTO mechanisms (Article XXVIII of the GATT and Article XXI of the General Agreement of Trade in Services (GATS)), or by creating new tariff lines for connected devices, which could be considered to be unbound under prior WTO schedules.

Importantly, from the perspective of the US, this orderly transition would accommodate a smoother transition in the value of assets underpinned by the system of global governance that the US is abandoning, than otherwise might be the case.

To give a specific example, Tesla's market capitalization at its peak was almost US$1.4 trillion (it has plunged beneath the US$1 trillion mark due to Elon Musk's behavior on the public stage). BYD – which manufactures as many electric vehicles as Tesla and, in the opinion of some, produces better cars – has recently broken through the US$200 billion market cap mark. This unsustainable gap in valuation is repeated endlessly: the West, broadly speaking, controls most of the world's market capitalization of firms and most of its international intellectual property receipts. However, China's convergence to the technological frontier and its proven capacity to establish world-class firms means this will not continue. The main benefit of an orderly transition is that it will allow this reconciliation to happen gradually.

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THE "CRASH-LANDING ZONE"

To paraphrase Dostoevsky, every cooperative transition is similar, and every non-cooperative transition is catastrophic in its own way. China appears to be pulling back from its second cultural revolution by re-embracing the role of private firms and the market, as evidenced by the public spectacle of President Xi's meeting with technology leaders. Meanwhile, the US under the Trump–Musk regime is now plunging headlong into its second cultural revolution (the first, of course, being the Civil War between the industrial north and plantation economy south).

The US has now lost three wars to the People's Republic of China (PRC):

1. It backed the nationalist regime of Chiang Kai-Shek, which was pushed off the mainland in 1949.
2. After North Korea was obliterated in the first 30 days of the so-called Korean Police Action by US air power and the forces of General Macarthur moved effectively unopposed to the Yalu River, so-called "volunteers" from the PRC pushed back the UN-sanctioned forces to the demilitarized zone (DMZ).
3. Its economic and technological war to halt China's rise has failed, as evidenced by the shock of the DeepSeek event.

The first two ended in ceasefires without formal resolution. It is now time for this to happen with the third one.

If internal US checks and balances fail, the landing zone for US–China relations will be a "crash-landing zone" – a disaster. The changes in international institutional arrangements will happen abruptly, without pre-negotiation, meaning that the implications for asset values are unknowable – as the consequences of the Nixon Measures show.

Things would fall apart. After all, how likely is it that Taiwan, given the US's inconsistency and its extortion of Ukraine, would choose to continue with a US security guarantee rather than accept the PRC offer from the of a status equivalent to Hong Kong's in perpetuity? Then, of course, who knows what would happen?

THE "STAIRCASE" TO A SOLUTION

While there have been numerous calls for a new Bretton Woods conference, the current geopolitical and economic conditions more closely resemble those that motivated the 1933 London Monetary and Economic Conference. The objective today would be the same as it was in 1933: to stop digging deeper into the metaphorical "hole" in which the world has sunk and build a "staircase" so we can climb out. However, the London Conference failed and the result was a "crash landing" – the Second World War.

The London Conference failed because the analytical/conceptual framework was not in place. As Eichengreen and Uzan (1993) put it, "Lacking a shared diagnosis of the problem, they were unable to prescribe a cooperative response." The first step should, therefore, be taken by a Track 2 process to establish an analytical/conceptual framework to reconcile the objectives of the US populist trade economics with economic laws. It would also outline the shape of a cooperative solution, based on sharing the privilege and burdens of hegemony. This would establish a new strategic equilibrium, upon which a new global governance structure, consistent with the transformed technological and economic conditions, could be built. In the first instance, a proposed interim solution on tariffs and trade (ISTT) is required to go with an interim solution on money and exchange rates (ISMX). This could then be put to G20 leaders, who could in turn build the rest of the aforementioned metaphorical "staircase".