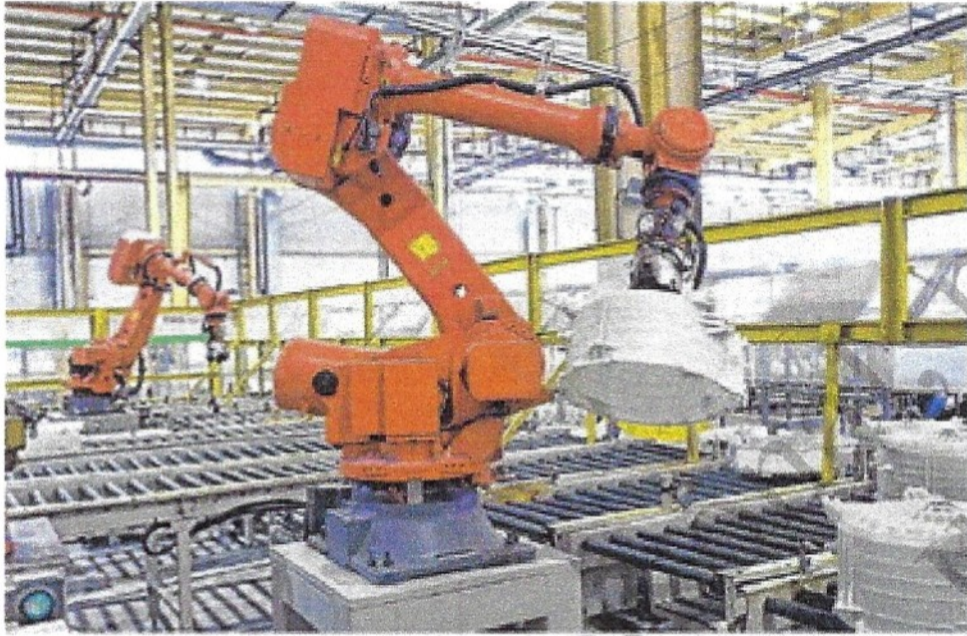


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Robotic arms grab parts of washing machines on a production line in Qingdao, China.



Xi's Industrial Policy of Everything

CAPITAL ACCOUNT

By Greg Ip

In the decades since China joined the world economy, U.S. presidents have traveled to Beijing with a predictable list of demands: stop stealing intellectual property, don't force technology transfer, open your markets. Donald Trump followed the script on his visit in 2017.

To repeat those demands this past week would have been pointless. Those demands reflect a view of Chinese industrial policy (broadly, government support for favored sectors) that is woefully out of date.

Xi Jinping has elevated Chinese industrial policy into something the world has never seen. It targets almost every industry and region, demand and supply, services and goods, the sophisticated and the mundane. Its goals are economic, technological and strategic. Its tools are micro- and macroeconomic.

There's no obvious solution. Trump reportedly secured agreements by China to purchase soybeans, energy and aircraft, withhold military equipment from Iran, and open up more to U.S. business. But none of this will stop China from swallowing ever more global market share.

(1)

Rhodium Group, a research organization, in a sobering new report prepared on behalf of the U.S. Chamber of Commerce, identifies the key features of what it calls China's "industrial policy of everything."

Many Chinese products now match or beat Western competitors on quality and price without government help. Yet rather than dial back support, Beijing keeps broadening it. The country's five-year plan issued in 2021 listed 19 priority sectors. The latest, released in March, lists 24, adding "brain-computer interfaces" and "nuclear fusion energy."

While sexy products such as smartphones and electric vehicles hog the limelight, China's ambitions also cover the mature and the mundane.

The "Made in China 2025" plan released in 2015, which caused so much consternation in the West, earmarked 10 industries for self-sufficiency. The 2023 update dropped one and added seven, including ma-ture industries such as household appliances and textiles.

Chemicals are a good example: Global exports of tetrachloroethylene, used in dry cleaning, have risen 25-fold since 2019. Exports of o-Xylene, used in plastics and coatings, have climbed 12fold.

Chemicals also illustrate the emptiness of China's promises to cut back on overcapacity, which has depressed prices and profits. Rhodium reports that a 2025 directive promised to address petrochemical overcapacity, but only plants more than 20 years old were targeted, accounting for 5% to 6% of capacity. Far from shrinking output, the plan aimed to shift the industry from bulk to high-value chemicals and boost output 5% a year.

Rhodium reports that once Chinese firms reach technological parity with their competitors, they take market share at breathtaking speed. In 2016, Rhodium estimates, China controlled more than 50% of export volumes in 163 industries out of about 2,000 for which data are available. By 2024, that had risen to 315.

China's massive trade surpluses are often attributed to weak domestic demand. Yet China can create demand when it wants. To nurture its drone industry, Beijing encourages numerous sectors to integrate drones, "complemented by public investment in enabling infrastructure, including the use of local government special bonds," Rhodium writes.

Xi once regarded services as inferior to the "real" economy. Not any more. State directives single out high-value services such as biopharma contracting. It saw sales double between 2018 and 2022, and they are projected to double again by 2027, Rhodium concludes.

National security is integral to Xi's industrial policy. Eliminating imports makes China less vulnerable to foreign pressure, while increasing export market share makes others more vulnerable to Chinese pressure.

Thus, Xi prioritizes "chokepoint" products that are critical to larger supply chains, such as organic chemicals and machinery, Rhodium reports.

China routinely retaliates against unfriendly governments by weaponizing its market—that is, shutting out their exports. Weaponizing chokepoints is more potent, with potential to shut entire production lines. Even the U.S. sought a trade-war truce when China put export controls on rare earths and critical minerals. "As dependence on China increases, the capacity of foreign governments to mitigate that dependence diminishes," Rhodium warns.

The pervasive nature of China's industrial policy makes it hard for competitors to counter. Trump's tariffs, for example, have driven down the U.S. trade deficit with China. But China has redirected exports to other markets. And because Chinese inputs are omnipresent in global supply chains, the value of Chinese content entering the U.S. can remain steady even as imports drop.

This could be addressed through tariffs on Chinese content, regardless of where the product originated, or through tighter rules of origin, a particular thrust of Trump's trade negotiators.

But that wouldn't solve the competitive threat. The U.S. could ban every Chinesemade product, but those products would keep gaining market share abroad, threatening U.S. leadership. For example, Chinese electric vehicles may

incorporate Chinese software and artificial intelligence. As those EVs gain market share abroad, Chinese software and AI may supplant U.S. rivals as the global standard.

This calls for a joint response by all market-based democracies to Chinese industrial policy. But U.S. allies' willingness to coordinate with the U.S. on China has eroded under Trump.

The Achilles' heel of Chinese industrial policy is its cost and waste. China runs bigger budget deficits relative to economic output than the U.S. Outside advanced manufacturing, the economy is moribund, weighed down by debt, deflation and aging demographics.]

Many critics thus expect, even hope, that Chinese industrial policy will eventually implode under the weight of its own contradictions.

But there's no guarantee of that soon. To paraphrase an adage about markets, China can stay irrational longer than foreign competitors can stay solvent.

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Saturday, 05/16/2026 Page .A002

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