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China - playing by the rules?

By Chris Lewis

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I understand why the Chinese government behaves the way it does. With 1.3 billion people (2008), who can blame it for trying to maximise its economic position.

But there should be limits to the West's tolerance of China's mercantilism, despite its increasing importance to the global economy as China's share of global GDP increased from 3 to 7.5 per cent since the end of 1997 and its share of global trade from about 3 to over 8 per cent.

I do not accept the argument that, because the economic growth China is experiencing benefits major resource providers like Australia, "We therefore shouldn't let commentators from China's industrial competitors, like the US and Japan, worry us about China's economic rise" as "there are no limits on China mercantilist policies because they are appropriate, effective and flexible".

Nor should we wait for China's communist party to promote and accept a more extensive civil society despite some optimism that China's domestic Internet system will expand so quickly and become so vibrant that "tens of millions of tech-savvy inquisitive minds will have the ability and the compulsion to scale any fire walls Chinese authorities erect".

Most recently, China led India, Brazil and South Africa to thwart US-led attempts at the Copenhagen summit to get developing economies to commit to legally binding cuts to their greenhouse gas emissions.

On Christmas day, the leading dissident, Liu Xiaobo, was sentenced to 11 years in prison on the charge of "incitement to subvert state power" because Liu had published six articles and help draft an online petition calling for greater political freedom. Liu had previously served three years in a labour camp for calling for the release of demonstrators after the Tiananmen Square protests.

There is also the issue of Internet censorship in China with Google threatening during January 2009 to leave China unless its government stopped censoring its search results after Chinese hackers stole valuable corporate software code and broke into the Google mailboxes of Chinese human-rights activists. Google also noted that hackers also infiltrated 20 other large companies (including the internet, finance, technology, media and chemical sectors).

And this month, Zhu Weiqun, executive vice minister of the Communist Party body that communicates with the Dalai Lama, warned "If the US leader chooses to meet with the Dalai Lama at this time, it will certainly threaten trust and cooperation between China and the United States".

Something needs to be done to maintain Western influence sooner rather than later. While the US currently relies on China for its purchase of 23 per cent of Treasury Securities alone (as of September 2009), it (along with the EU, Japan and others) has the clout to resist China's mercantile behaviour. According to the CIA World Factbook, the US, EU and Japan still comprise 61 per cent of world GDP.

It is, today, misleading to call China a poor nation given its large trade surpluses (\$US290 billion in 2008), its position as the world's greatest exporter (\$520 billion in the first six months of 2009), its ability to implement a \$US586 billion stimulus package in early 2009, and it holding \$US2.4 trillion of reserves (increasing by about \$US450 billion in 2009). Add to this, China has 825,000 individuals with wealth of more than 10 million yuan and 51,000 people more than 100 million yuan.

And China's supposed commitment to equality is laughable. According to China's National Bureau of Statistics, China invested just 5.2 per cent of its GDP in 2008 (or 10.9 per cent of public finance expenditure) on social security with city residents usually enjoying better social insurance than those living in rural areas where 56 per cent of China's population lives. Even the US, deemed the most neoliberal of Western nations, spent 16 per cent of GDP on social transfers in 2005 compared to the OECD average of 20.5 per cent (OECD 2009 Factbook).

At the same time, the share of wages of China's national disposable income declined from 53 to 41 per cent of GDP between 1998 and 2005 (Ashok K Lahiri, "Limits of mercantilism", *Business Standard*, November 28, 2009).

No wonder China has the spare cash to build impressive infrastructure, such as high-speed trains connecting China's major cities, while also finding enough resources to fund corrupt governments and poor societies to boost Chinese influence and acquire more raw materials.

So how long are we (Westerners) going to merely accept our relative demise to an authoritarian nation with little regard for political freedom?

Not for much longer I hope.

As Paul Krugman recently argued, China is indeed utilising a combination of capital controls and intervention to achieve greater economic performance at the expense of the US. While its trade surplus was temporarily depressed by the world trade collapse, he pointed to Blanchard and Milesi-Feretti (of the IMF) projecting that China will achieve a current account surplus of 0.9 per cent of gross world product for 2010-2014. Krugman predicted that this would come at the expense of another 1.4 million US jobs ("Macroeconomic effects of Chinese mercantilism", *New York Times*, December 31, 2009).

Two years earlier (February 7, 2008), Professor Peter Navarro told the US-China Economic and Security Review Commission that China has a clear historical pattern of strategically deploying its excess foreign reserves to achieve other economic goals other than to maximise its financial return. This is illustrated by China using vast sums of export dollars by issuing bonds to Chinese citizens at high interest rates. China's central bank then buys US bonds at substantially lower interest rates to boost its exports and create jobs by keeping its yuan pegged and undervalued to the US dollar.

Navarro also pointed to the Chinese government's "wide range of WTO violations, including the widespread use of export subsidies and import barriers; rampant counterfeiting and piracy that provide Chinese manufacturers with real cost advantages; and lax health and safety regulations far below international norms that likewise provide production cost advantages".

More recently, China's \$585 billion stimulus program discriminated against foreign companies bidding on government projects such as the \$2 billion of new spending to be spent on its state-owned railway system with the high-speed line from Beijing to Shanghai not allowed to use foreign technology. Further, China in April 2009 also passed a law that bans foreign companies from delivering express mail inside China, despite FedEx (US) and DHL Worldwide Express (Germany) lobbying for years. There was also China's delayed issuing of third-generation (3G) wireless licenses which has now resulted in Chinese firms moving far ahead of foreign rivals in terms of winning contracts.

So what can the West do?

According to Syetarn Hansakul (Deutsche Bank Research), there is little chance of a full-scale trade war between the US and China. Though it was inevitable that China would retaliate against the US decision to impose emergency tariffs on Chinese-made tyres, Hansakul believed that commonsense would prevail as both sides will realise the expensive cost of a full-blown trade war given that it ran the risk of spreading to other sectors with severe repercussions for global trade, which was projected to contract by around 10 per cent in 2009.

But I am not sure about how long much more trade conflict can be avoided as US democratic politics and its foreign policy will be influenced by what happens in its economy. If China continues to gain at the US's expense then a backlash against the Chinese government will occur.

Unequal economic development may be accelerating between China and the West. While Barclays Capital estimated in late 2009 that China's manufacturing output rose more than 30 per cent since January 2008, it declined 10 per cent in Japan, Europe and the US. In January 2010, it was also noted that unemployment again increased in 39 US states in December, that many cities already had a 30 per cent poverty rate, and that a record 40 million Americans are living on food stamps (Bill Bonner, *The Daily Reckoning*, Australia, January 27, 2010). It remains to be seen what will happen in Europe given its own financial problems.

There is already considerable sentiment in the US for a more aggressive approach, given one estimate that the true US unemployment rate was now 17.5 per cent and that 2.3 million US manufacturing jobs were lost between 2001 and 2007 to the US-China trade deficit (Thomas J. Gibson, "US needs to challenge China's protectionist policies", *The American Iron and Steel Institute*, November 21, 2009).

US workers are suffering from the increasing influence of China. For instance, a recent Chinese purchase of wind-power operations in Texas stipulated that the wind turbines would be made in China with the \$US1.5 billion project creating up to 3,000 jobs in China but only 330 jobs in the US (Gibson 2009).

Thomas Gibson (representing the American Iron and Steel Institute) urged the US government to uphold concern about safety issues in regard to Chinese products, including toys which can make children sick; from sulphur-laden construction materials to shoddy structural steel; while also urging the US government to promote domestic manufacturing jobs which would ensure a greener global environment due to greater environmental protection when compared to China (Gibson 2009).

With US jobs lost to cheaper exports, many Americans end up in jobs that do not compete in trade, such as restaurants and retailing, where labour productivity is about 50 per cent lower, thus slicing about \$US400 billion off US GDP while US multinationals profit from Chinese protectionism by relocating jobs to China, India and other Asian destinations. No wonder foreign direct investment into China increased from less than \$500 million in 1982 to \$40 billion annually in the early 2000s reaching \$121 billion in 2007.

Sure Kentucky Fried Chicken and McDonalds dominate China's fast food industry and General Motors and Volkswagen were the biggest car sellers in China in 2009 (now the biggest car market in the world), but who knows what an increasingly arrogant China will do in the future to achieve further material gain.

As noted recently, China's General Administration of Customs in December 2009 indicated for the first time that exports were greater than imports for refined oil products. While this may be blamed on China's over investment in capacity, it may also signal bad news for refined oil product exporters such as Japan and Singapore (Leo Lewis, "Chinese figures rise in influence", *The Australian*, January 19, 2010).

It is naïve to believe that China has any other purpose besides upholding its national interest. Take the comments of a Chinese official at a China Mining Conference in Beijing during November 2008 who stated publicly that responding quickly to opportunities offered by financially weakened minerals and metals suppliers was clearly in the interests of individual Chinese firms which should uphold "their national duty".

Western nations should act to address any harm caused by China's currency manipulation and other forms of protection.

Further, Western nations should insist that Chinese government companies (under their sovereign wealth funds) do not gain a controlling interest in major Western companies where it may influence managerial decisions related to offshore production, R&D, and technological transfer.

And to achieve important goals to achieve international co-operation on measures to deal with the environment, tougher economic measures (such as a carbon tax on Chinese exports) may be necessary.

If China still refuses to play by the rules of various international institutions and conventions (albeit dominated by the West), so be it. A trade war with China will cause problems as much higher domestic costs in Western societies will initially diminish consumption patterns, although higher national savings will open up more industry possibilities over time.

But to do nothing it is to accept the demise of Western influence and the rise of authoritarian China, a probability that will doom the world to a type of political and economic leadership that will result in a much less fair and prosperous world.

With President Obama indicating during February 2009 that the US would get tough with Beijing on trade and currency to ensure American goods did not face a competitive disadvantage, the battle may have begun. It remains to be seen where the current war of words between the US and China will lead.

Chris Lewis has an interest in all economic, social and environmental issues, but believes that the struggle for the 'right' policy mix remains an illusive goal in such a complex and competitive world.