

China's Challenge to the Global Economic Order

IS A NEW APPROACH NEEDED?

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Background

- China has reached the status of a global economic superpower, joining the United States and the European Union in that category. It has the world's second-largest national economy with exchange rates calculated at purchasing power parity and the third-largest economy at market exchange rates. It is also the second-largest exporter, and in 2008 it had the world's largest current account surplus and foreign exchange reserves. Its growth has averaged 10 percent for 30 years, an achievement without precedent in modern times. Real GDP is 15 times the level of only 30 years ago, when China embarked on its reform process. China's own growth is slowing sharply in the current global economic slowdown. Nonetheless, given its vigorous policy response, its growth is likely to remain in the range of 7 to 8 percent in 2009, making China the likely chief driver of world growth.
- China's willingness to cooperate with the rest of the world is clouded by the fact that it is also still a poor country with massive problems related to the environment and growing inequality among its citizens. It is also difficult for the world to deal with a country that maintains heavy state involvement in its economy coupled with an authoritarian political system.
- By virtue of its dependence on trade and receipt of large capital inflows, China is more deeply integrated into the world economy than either of the other two superpowers. Hence, it has a major national interest in the stability and effectiveness of global trade and the monetary system. But can that integration be translated into cooperation? Early in its reform process, China proclaimed an interest in playing a role in the international economic order. The International Monetary Fund (IMF) and the World Bank contributed to China's early development success. Indeed, China used its membership in the World Trade Organization (WTO) a decade ago to promote internal reform. Recently, however, China appears to be undergoing a significant shift in its attitude, raising doubts about its willing-

ness to cooperate with the United States and the rest of the world. At a time of turmoil in the world's financial markets, it has not played a role at the institutions that oversee and stabilize the global system in a way that is commensurate with its economic superpower status or even contributes positively to systemic stability.

Current Situation

- The record of recent years suggests that China is increasingly pursuing strategies that conflict with international norms, rules, and arrangements. China is hardly alone in deviating from some rules of the game. But as a newcomer to superpower status with heavy dependence on open trade and financial markets, China has a keen national interest in fortifying the system rather than weakening it. China's approach on these issues appears to result less from a cohesive strategy than one driven by piecemeal reactions to individual issues.
- China's cooperation with international institutions and cooperation with other countries has been made more difficult because of economic discontent among its own citizens. Protests against the Communist Party's leadership have erupted over environmental issues and a perceived unfairness of international rules under which it is expected to live. Economic nationalism is on the rise, reflected in a new anti-monopoly law governing mergers and acquisitions with foreign firms. The Chinese government's claim to legitimacy continues to rest on its ability to deliver rapid economic growth while addressing these domestic concerns.

Implications

- The current global system comprising the United Nations, the WTO, the IMF, the World Bank (all of which were established after World War II), as well as the Group of Seven (G-7) is far from perfect. Some of China's criticisms are valid. The global economic architecture is outdated and ineffective.

Implications *(continued)*

But the emergence of an Asian economic bloc under China's leadership, which appears to be in the making, is not necessarily a healthy alternative. Past challenges to the system by the Organization of the Petroleum Exporting Countries (OPEC) and Japan reflected a desire to join the system, not undermine it. China's rise may be much more significant than these past cases.

- It is not the case that the system has worked brilliantly for the United States either. The United States has won several disputes with China using the WTO process, but its victories have yielded modest results. The IMF has failed to press China to stop its currency manipulation.
- Faced with these difficulties, the United States should adopt a new approach that places less emphasis on integrating China into the existing global system and more on forging a true bilateral partnership with China to reform the system itself and provide new leadership for it. The two economic superpowers should increase joint cooperation on a range of issues. This "G-2" approach would acknowledge China as a legitimate architect and steward of the international order, and participant in its organizations, while recognizing China's discomfort with a system that it inherited but did not help create.
- The United States must develop new ways of pressing old issues. The American hard-line on trade and currency issues has been unsustainable (because of a parallel American desire to maintain Chinese cooperation on political and security issues and the gains to many Americans from current economic relations with China) and in any case largely ineffective. Two issues that could be the focus of a new partnership are global warming and a code of conduct for sovereign wealth funds. A G-2 arrangement, not explicitly named as such, would of course need to keep Europe, Japan, the oil-exporting countries, and other players involved. A larger framework involving these countries will also be necessary. But the G-2 approach would build on the Strategic Economic Dialogue set up by former treasury secretary Henry M. Paulson Jr. by arranging annual or semiannual meetings between the leaders of the two countries.

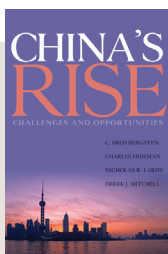
(Paulson himself urged in an article in *Foreign Affairs* that the new president take the Strategic Economic Dialogue "to the next level.") The G-2 approach (which the historian Niall Ferguson refers to as a partnership of "Chimerica") could be used to persuade China to play a more active role in revitalizing and reshaping the world economic order. The advent of a new administration in 2009 is an excellent time to shift the approach with China.

FOREIGN AID

- China may already be the largest donor of foreign aid. But by ignoring international assistance norms—by rejecting human rights, labor standards, poverty alleviation, environmental concerns, and good governance as part of its aid programs—China poses a direct threat to the achievements of foreign aid developed over the last 25 years.
- The conditions that China does enforce are almost wholly political. These include China's insistence that the recipient countries support China on global issues and in the United Nations and the creation of favorable trade relationships. These run counter to international norms and could undermine the development reform process.
- By presenting aid recipients with an alternative to the conditions required by the West, China is undermining the foundation of the existing international aid system.

ENERGY

- China will become the largest consumer of energy over the next decade and has been a major contributor in the dramatic rise in oil prices.
- China's policies of providing significant support to Chinese oil companies overseas and its willingness to barter aid and international support for oil with countries like Sudan and Iran have challenged both the international energy system and the efforts of the UN Security Council.
- The United States' rejection of the proposed takeover of Unocal by China National Offshore Oil Corporation (CNOOC) in 2005 reflected an unwise unwillingness to permit normal and reasonable Chinese investment in energy resources. China should be encouraged to compete freely for investment opportunities and in the process become a constructive partner in ensuring global energy security.



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