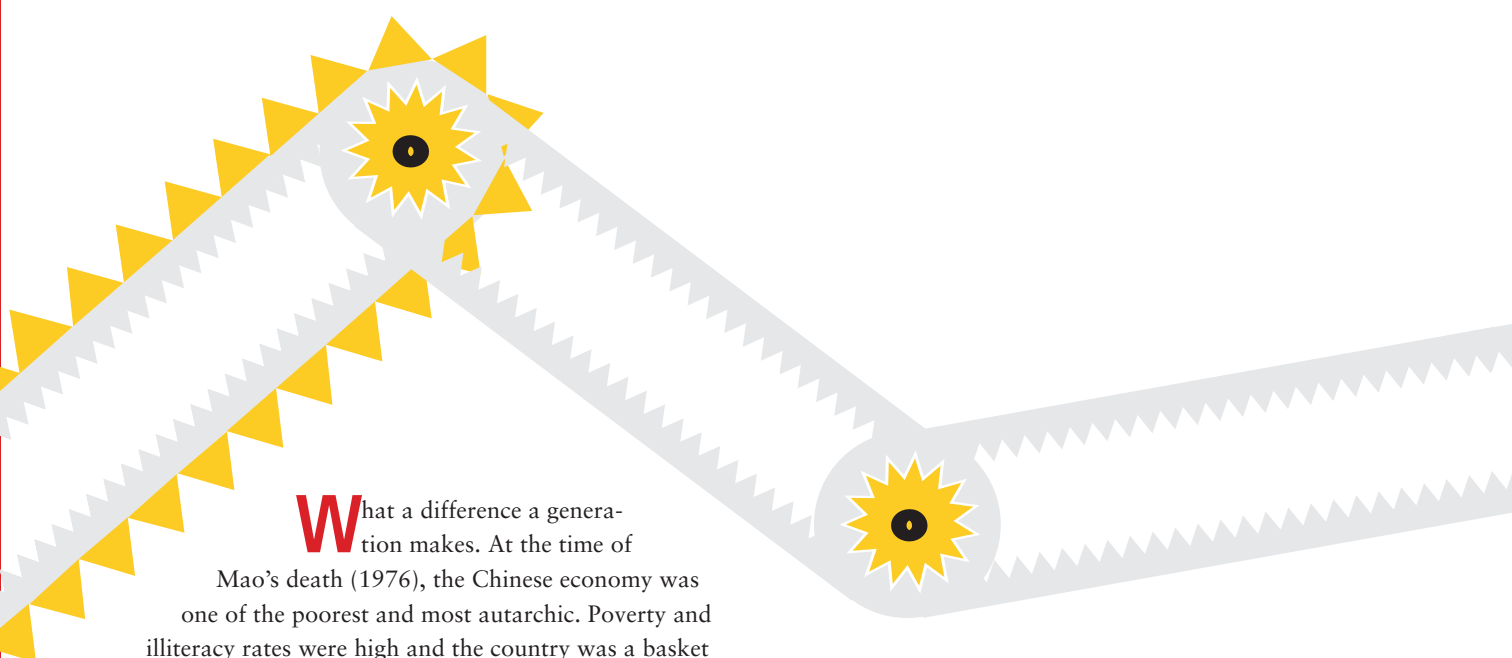


# Will China Revolutionize the Global Economy?

*By Dali L. Yang*



**W**hat a difference a generation makes. At the time of Mao's death (1976), the Chinese economy was one of the poorest and most autarchic. Poverty and illiteracy rates were high and the country was a basket case of despotic misrule. Today, China's per capita GDP has surpassed 1,100 dollars in nominal terms, bringing China into the ranks of the lower middle income countries (as defined by the World Bank). Life expectancy in Beijing and Shanghai is on a par with New York's. In nominal terms, the Chinese economy is still only the sixth largest. There is little doubt, however, that China has become a major engine for global growth and the world's rising economic powerhouse.

The official plan of the Chinese government is to quadruple China's 2000 GDP to U.S. \$ 4 trillion with a per capita income of about U.S. \$ 3,000 by 2020 (based on current exchange rates). This assumes a 7.2 percent annual growth rate – conservative by China's growth trend for the past quarter century – and would make China's GDP second only to that of the United States. In purchasing power parity terms, China's GDP will likely have matched that of the United States by around 2020.

#### **Engaged trader**

China's rise is apparent in western stores filled with goods labeled "Made in China." Starting with a few tentative steps in the 1970s, China has become the world's third largest foreign trader. A milestone was set at the end of 2001 when China finally became a member of the World Trade Organization (WTO).

The growing presence of China, India, and other new players in the international trading system has made for a more competitive global market for both manufactured goods and certain services. It has also spawned a voracious appetite for energy and raw materials. As China, India and others join in the competition for secure supplies of oil, gas, and other natural resources against established players in the U.S. and Japan, they have already reshaped these markets (and raised prices for all consumers).

Some foreign observers look back at the pages of history and worry that China's rise and its quest for energy independence might be destabilizing. So far the Chinese oil majors have invested in oil, gas, and other resource

assets throughout the world by playing by existing rules of the game. As the workshop of the world, China will need access to global markets for its goods at least as much as it needs oil and other supplies. Such interdependence means that China will not be able to continue to develop if it seeks oil and other supplies by non-peaceful means.

#### **Defender of the liberal international economic order**

China's market-based approach to coping with its energy and resource hunger is part of a general trend toward global integration. To those who were concerned that China might become an obstacle to further trade liberalization once it joined the WTO, China in its short history in the WTO has generally been on the side of more free trade, not less. Whereas pre-reform China was one of the most vocal critics of the liberal international economic order, it is today one of its biggest beneficiaries.

Economic interests, not Marxist principles, are turning China into a major advocate for the liberal international economic order. As Chinese producers, propelled by intense domestic competition, seek to capture more foreign markets, we expect the Chinese government to continue to promote liberalization in the trade of commodities and manufactures. It will fight hard against protectionist measures imposed by developed economies and competitors such as Mexico. It will also work hard to preserve the gains it stands to make from the ending of the Multifiber agreement.

While China liberalizes its own economy, members of the Chinese elite have already begun to remind Americans to keep to the vision of globalization rather than adopt "beggar thy neighbor" policies. This may seem an odd role for a country still being led by a Communist Party, but it is a natural position for a low-cost producer and rising economic power to take. The Chinese are acting much like the United States once did to Great Britain a century earlier. Isn't imitation the sincerest form of flattery?

### Responsible big country

While the Doha round of the WTO talks has stalled, China has injected fresh energy into trade opening by signing landmark framework agreements with ASEAN (the Association of Southeast Asian Nations) and Australasia. Here is a striking case of how China can use its trading prowess for constructive purposes. Only a few years ago much of the talk in Southeast Asia was about the China competition and threat. As China becomes the largest trading partner for one country after another in the region, it is increasingly embraced as the partner of opportunity.

The historic agreement between China and Southeast Asia promises to create, by 2010, the world's biggest free trade area by population (though Cambodia, Laos, Myanmar and Vietnam will not join until 2015), rivaling the EU and the North American Free Trade Agreement. As an expression of its good faith, China quickly offered an "early harvest package" in 2003 by making tariff cuts on imports of selected farm products from Southeast Asia and has since made major progress in further negotiations on the ASEAN-China FTA agreement, including tariff cuts on about 7,000 items beginning on July 1, 2005.

China's bold moves to promote free trade with Southeast Asia and Australasia have also prompted Japan, South Korea, and India, among others, to seek similar deals on their own and thus have the potential of stimulating a virtuous cycle in Asian multilateralism. China has also made a proposal for an East Asia Free Trade Area encompassing China, Japan, the Republic of Korea and the 10-member ASEAN nations. The moves toward regional economic integration have also spilled into other spheres. Between ASEAN and China, in particular, the economic initiatives are complemented by an action plan, agreed to in November 2004, to step up political consultation and security dialogue.

China's rising economic strength has already begun to translate into more international influence. Its steady hand during the Asian financial crisis in the late 1990s won it many plaudits, especially from distressed Asian neighbors. Its ability to forge free trade agreements is another indication. More recently, China – the world's largest developing nation and until recently a major aid recipient – pledged more than U.S. \$ 83 million (plus

millions more donated by corporations and individuals) for the Asian Tsunami relief. Though China's contribution was dwarfed by those of Australia, Japan, and the United States, it was the largest humanitarian aid initiative China has ever made and served to help China project a kinder and gentler image to its stricken neighbors. In subtle ways, the Chinese leadership's embrace of free trade and multilateralism, in the context of American unilateralism, has allowed the Chinese leadership to wield substantial "soft power" regionally.

Increasingly China's leaders are applying their deal making skills to other areas. China has made major investments in Latin America (albeit with mixed results).

It has also traditionally expended substantial efforts on Africa. On January 1, 2005, it made good on an earlier commitment to expand African exports by abolishing tariffs on 190 goods (including food, textiles, minerals and machinery) imported from 25 African nations. From Southeast Asia and Central Asia, to North Korea, and the Iraq debate, Chinese leaders have shown themselves to be able to take a leadership role. These and other developments are part and parcel of China's newfound mantra to be "a responsible big country." They are also harbingers

of what may come. Just imagine the size of China's economy is three-to-four times larger than it is now, one can immediately realize how much more influence China would be able to wield.

### Money does NOT buy everything

For the foreseeable future, however, China's strength will be more in the sum of its parts. At the corporate level, in spite of Lenovo's purchase of the IBM PC business and a host of other deals, China has so far produced few globally competitive companies. China's top money-makers today are the likes of PetroChina, China Mobile, and so on – virtually all state-controlled firms in heavily-regulated sectors.

Given that Chinese companies only had to face market competition recently, it is hardly surprising that few Chinese firms have become true global players. Yet Chinese investments overseas have already reached the no. 5 rank. Give them another decade or two, some Chinese companies are likely to emerge as truly competitive globally.

With growing confidence, China has also started to project an image for China befitting its growing status

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and thus to boost what Joseph Nye calls “Soft Power.” There is a national initiative to dispatch more Chinese teachers abroad and promote the learning of Chinese. Chinese Cultural Centers have already been opened in Egypt, France, Malta, and South Korea.

Yet influence does not necessarily engender affection. While China and ASEAN have largely been able to warm up their frosty relations, it would be a much taller order for China and its Northeast Asian neighbors to overcome their historical animosities. Deepening Sino-Japanese commercial ties have been accompanied by rivalry over oil and gas and growing Japanese concerns about Chinese military power. Indeed, just as China has become Japan’s largest trading partner, a survey of Japanese attitudes in 2004 found that the percentage of Japanese who feel friendly toward China fell to just 37.6 percent (compared with 71.8 percent toward the U.S.), the lowest since the survey began in 1975 (refer to: “Poll Shows Japanese Frosty Toward Chinese,” Reuters, December 18, 2004). In this respect, it would require significant new thinking, political imagination, and leadership to overcome major historical suspicions among these countries. China’s promotion of an East Asia Free Trade Area seems a good start, but it would take more than that.

#### **Domestic constraints on China’s international influence**

Even in the best circumstances, China’s rise to global leadership will not be smooth. Needless to say, potentially the greatest threat to China’s international engagement, despite the growing economic interdependence between Mainland China and Taiwan, would be military conflict across the Taiwan Straits. Should such a conflation occur, much of what is discussed here would be adversely impacted.

Suppose cross strait conflicts are contained, China’s leaders must still grapple with a large number

cal and social system still has much rigidity that demands further reforms and refinements. Growth at all costs has already resulted in sharply rising income inequality, substantial social strains, and severe environmental damage. Longer term, rapid ageing, at twice the pace of Europe, will demand fundamental reconfigurations of macroeconomic and welfare policies and may constrain government policies and curtail growth prospects.

Ultimately the Chinese leadership’s ability to project influence abroad is hobbled by the profound contradictions that have bedeviled its domestic rule. Saddled with outmoded ideological shibboleths but unable to jettison them, the Chinese leadership has accumulated a makeshift theoretical baggage, currently under the rubric of Marxism, Leninism, Mao Zedong Thought, Deng Xiaoping Theory, and the theory of the Three Represents. For China’s leaders, the bottom line is the continuation of one-party rule. While they have adopted pragmatic socio-economic policies, they have worked hard to beef up internet surveillance and other subtle and not-so-subtle forms of control and quash any signs of organized political dissent. All told, even China’s rulers would not point to this combination with pride.

The gaping moral vacuum and democracy deficit within gives a precarious and inward-looking character to Chinese governance and thus serves to constrain its global reach. Simply put, while its economic ascent wins grudging respect and offers many attractions for investors and trading partners, China’s leaders can hardly offer

China as a model of governance, let alone democratic governance, for the rest of the world. In this respect, China will need to combine its global economic strength with domestic political reforms before it can become a true global leader.

All in all, over the next two decades China’s profile and weight in the global economy will have grown substantially higher than today, yet the internal strains will have remained substantial.

China’s rapid ascent in the economic ladder of success has already begun to reshape the global economic order in significant terms. Nonetheless, the combination of massive aggregates and yet modest per capita figures underscores the challenges for China’s governance and further integration into the global system. ■



of challenges. Economic growth tends to fluctuate and China’s politi-

