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Jonathan Story

China and the global business system

Wrecker of stakeholder?

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## China in the global business system: Wrecker or stakeholder?

Jonathan Story

*Abstract.* In the western debate about China's emergence, two contending, contrasting views of China may be heard. One holds that China is a threat to the global polity, ruthlessly pursuing its mercantilist and nationalist agenda. The other holds that China is in transition to market democracy and irrevocably caught in the web of global interdependence. The argument here is that these descriptions of China domestic and external policies are complementary, and not exclusive, but that it is the condition of interdependence with the rest of the world which predominates in the minds and the behaviour of the leadership. That will remain the agenda for decades to come. For the rich powers of the developed world, the choice is between putting up the barriers against China, as the anti-globalisation forces at work in their societies want, or treating China as a pillar of the global system, and agreeing on a gradualist policy of transition to a fully fledged market-democracy. *Key words:* China, growth and mercantilism.

### 1. Introduction

Twenty years after the collapse of the communist system, the Group of Twenty (G 20) summit of heads of state and government in London on April 2-3 2009, marked the formal advent of a new global polity. The global financial crash, starting in mid-2007 in the United States over the rise in defaults in mortgage payments, clearly illustrated the deep interdependence of the world economy and polity. The twenty states represented in London accounted for over 85 percent of the world economy. In purchasing power parity (PPP) terms, China's economy was not only by far the most prominent of the BRICs; it was the second largest national economy in the world after the US, 1.7 times larger than Japan's and nearly three times that of Europe's manufacturing champion, Germany. As if to underline China's new status, Presidents Obama and Hu Jintao met on the sidelines of the

summit in what has been described as the G2, and agreed on a "strategic and economic dialogue" group to meet in Washington later in the year.<sup>1</sup> On the other hand, India's Prime Minister, Manmohan Singh, took the unusual step of stating in an interview to the Financial Times that India's democracy ensured that the country's economy was "more durable" than China's party-state dictatorship.<sup>2</sup>

These two versions of China's rapid emergence as a power on the global stage have been in circulation for well over two decades. One stresses China's successful transformation away from the inherited Maoist policies of class war at home and abroad to pursue development at home and to embed China in an interdependent world economy.<sup>3</sup> To the extent that nationalism is present in this version of China's policies, it is no more present than in a reasoned pursuit of national interest and in particular of a determination among China's collective leadership to promote China's status in world affairs. The other portrays China's successful emergence as a threat. China, the argument runs, has not changed. It remains what it has been since 1949: a Marxist-Maoist-Leninist party-state pursuing a nationalist agenda of re-asserting China's imperial position across Asia; in essence, unreformed at home; prepared to manipulate Chinese xenophobia as interest dictates; and prepared to play the game of international interdependence in disguise of its stated objective to achieve world status on the sly.<sup>4</sup> Deng Xiaoping outlined his key principles for handling China's foreign policy in a statement that became known as the 24-character policy. "Observe developments soberly, maintain our position, meet challenges calmly, hide our capacities and bide our time, remain free of ambition, never claim leadership". The advice runs like a central thread through China's policy style since the end of the cold war.

So let us briefly chart the record of China's economic performance, as a prelude to presenting the case of China as a threat, and as a predatory mercantilist which has helped de-stabilise the global economy. In the second part of this chapter, we can then adumbrate the alternative argument that economic growth opens new challenges and opportunities for China's leadership to develop a more moderate, if assertive set of national goals in the global polity. In this perspective, the overriding factor

influencing Chinese policy is that the country is trapped in irreversible interdependence with the rest of the world.

## 2. China's economic performance: 1978-2008

China could only climb on board the East Asian economy by turning its back on Mao. The deed was done at the Third Plenum of the 11<sup>th</sup> Chinese Communist Party Congress held in December 1978, where the party announced its shift away from focus on the class struggle to economic development. This shift in ideology paved the way for reform, the essence of which was to introduce more market around the plan.<sup>5</sup> Subsequently, China bought into the Asia Pacific growth package, promoted exports, encouraged inward investment, developed special economic zones, attracted investment, and opened up infrastructure for development. To leave no doubt about the direction of policy, Deng Xiaoping visited Nissan Motors in Japan in 1979, where he wrote in the visitor's book: "learn from the great diligent, valiant and intelligent Japanese people".<sup>6</sup> The results were remarkable. Over the next three decades, China's GDP per capita rose at an annual average of eight percent, 400 million people were lifted from poverty, and China became the world's second largest economy, overtaking Japan, at least as measured in purchasing power parity.<sup>7</sup> As China prospered, the Soviet Union collapsed.

China's growth was comparable only to Korea's, and far exceeded that of other large developing countries, such as India or Indonesia. It accounted for nearly two-thirds of the increase in total income of low-income countries. Equally notable is how wide this growth has been spread across China. When income growth of the 30 provinces is measured over the period 1978-1995, and considered for a moment as twenty countries, China held 20 of the world's fastest growing economies in those years.<sup>8</sup> Even so, China's per capita income in PPP in 2006 was 18 percent that of the US, 23 percent of Japan and 26 percent of Taiwan's. Despite this extraordinary economic performance, it was still evidently a low-income

country, with low productivity per head and therefore in a good position to achieve a rapid catch-up.

Indeed, its abundant human resources, if well deployed and utilised in an increasingly competitive economy, could continue to drive China's super-growth forwards for decades. In terms of national income, high savings rates will tend to fall off as the population ages, but rising productivity in the use of labour, capital and management is likely to ensure rapid rises in wages, thereby expanding the growing domestic market. This is likely to ensure its continued attractiveness as a venue for foreign investors, especially as the under-developed service sector expands. In 2004, the Beijing Bureau of Statistics mobilised an army of statisticians to measure the economy in closer detail, and came up with the finding that the value of the Chinese economy should be raised by 17 percent, on the grounds that the small-scale service providers had not been adequately accounted for.<sup>9</sup>

By 2008, China had risen up the ranks from number 32 world exporter in 1978 to number three world exporter and importer, just behind Germany and the US. Exports grew at double digit rates, and the structure of exports shifted from half of total exports in the 1980s in primary goods to 90 percent in manufacturing goods. Indeed, since 1998 when the yuan was pegged to the dollar, China has been integrated as a production platform for multinationals in the corporate value chain of the whole of Asia. Foreign investors account for up to 60 percent of total exports, and a similar volume of imports.<sup>10</sup> Initially, these investments into lower value added assembly in China were motivated by the search for low labour costs. About 65 percent of the growth of exports in the 1990s and early 2000s was attributable to foreign firms investing in China.<sup>11</sup> But as the structure of the Chinese economy changed to become much more market-friendly, productivity in manufacturing grew as high as 15-20 percent per annum.<sup>12</sup> Rapid rises in wages followed, compounding China's attraction to foreign investors.

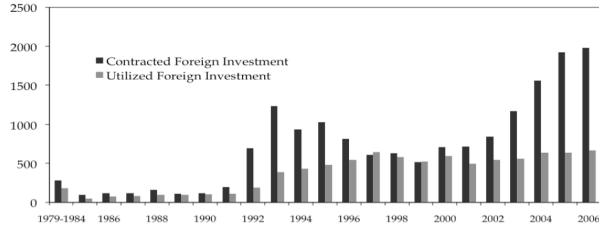


Figure 1. Annual inflows of FDI to China: contracted and used amounts (US \$100 million). Source: China Statistics Yearbook.

Not surprisingly, such hyper-competitiveness quickly moved the size of China's trade surpluses with the two trading giants of the US and the EU up their scale of concerns. Both the US and EU agreed to bring China into the WTO in 2002 with a view to encouraging Beijing to accelerate market liberalisation. China's dollar surpluses with the US and the EU meanwhile helped to finance imports of components from the Asia-Pacific, and earn the dollars to pay for China's growing oil and minerals dependency. With China in the WTO as of 2002, East Asian countries found that the competitive pull of China on foreign investors obliged them to accelerate their own market-friendly reforms. The most visible sign of this rapid entry of China to global markets has been the sharp rise in China's creditworthiness on global capital markets as foreign exchange reserves rose from \$10 billion in 1990 to over \$2 trillion end 2008. But equally China's unprecedentedly large reserves symbolised China's nationalist approach to economic policy. So is China a wrecker in the world economy, or has China operated as a stakeholder in the global system?

### 3. The China Threat

In the China threat narrative, the Communist regime deploys all its skills to consolidate its hold on the country as it transits into becoming a successful developmental and authoritarian state. Its consolidation represents a fundamental challenge to the US global mission to re-fashion the world in its own image.<sup>13</sup> So conflict with the US for world leadership is inevitable. There has been no change in the nature of the political system since 1978. The Chinese people, prompted by the regime, has internalized past resentments at China's abasement as justifying the expectation that others should stand aside as the country enters into its rightful inheritance as the world's No. One power. As China's capabilities grow, so will the stress and strains in the global polity as the global economy adjusts to China's rise. What matters here is less the evaluation of China's behaviour and purposes—they are known in advance—than the metric of growth in China's military capabilities, and underpinning that—of China's emergence as a hi-tech superpower. The US will resist China's rise. Policy in China as in the rest of the world is therefore advised to prepare for the clash for world leadership, as the balance of global power shifts to Beijing. Indeed, that shift is happening already, so that the certainty of the future should be colouring policy now.

What is the evidence to support such a thesis? Definitely, there are plenty of texts to indicate that nationalist ideas are alive and well in post-1990 China. Typically, these texts are steeped in pessimism. In one version, written by Wang Shen, a confidant of one of the regime's "princelings", or sons of prominent regime members, and published in 1994 as a best-selling book, *Viewing China Through a Third Eye*, unless a thorough-going authoritarianism is adopted, China is headed

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for collapse in the manner of the Soviet Union.<sup>14</sup> Rather than class struggle, the masses must be won over by prosperity. That can only be done by the maintenance of existing political structures, in the name of a neo-conservative programme, emphasising harmonious Confucian social order and discipline. The masses have to become steeped again in "the lofty and noble traditional culture of the Chinese people",<sup>15</sup> as an alternative ideology

to the West's hymn favouring a "peaceful evolution" towards western-style democracy. Without doubt, this strand of neo-conservative thinking within the party-state about China's future is open to criticism as fascist in inspiration.<sup>16</sup>

Such deep pessimism has its counterpart in a Darwinist view of international relations, whereby the only constant in international affairs is conflict. According to one much-cited study by two senior PLA colonels, *Unrestricted Warfare*, the US has mastered the art of total war, where all means - from currency manipulations, to media control, or psychological warfare and drug smuggling—are deployed to assert control over contenders and challengers.<sup>17</sup> The key to confronting the US challenge, the colonels argued, was for China to build up its comprehensive strength, especially its economic capabilities, and to play to the weaknesses of the US. To avoid the fate of the Soviet Union, which challenged the US head-on in an arms race, China had to accommodate the US as the sole world power, rather than defy it from a position of relative weakness. In the longer term, China's interest was to strive to create a peaceful international environment, conducive to economic development.<sup>18</sup> This meant the pursuit of reunification with Taiwan through peaceful means, and enhancement of a Chinese pole in a multi-polar world. In international fora, China should take the lead in building a new political and economic order with less inequality between the rich and the poor. China would join the lead group of countries in world affairs, on its own terms, while acting as the champion of developing nations. In short, the US was an indispensable partner, but also an unavoidable rival.

There is plenty of evidence that such ideas find their way into policy. In international affairs, China, the argument runs, is in the grip of a relentless "nationalism of grievance and thwarted grandeur".<sup>19</sup> Ambition is fired by a widely-shared and deep-seated psychological need in China to compensate for past humiliations, through the return of Hong Kong (1997), Macao (1999) and Taiwan to the motherland, and to resist any pressures from abroad to loosen control over Tibet or Xinxiang province. In repeated Defense White Papers, the United States is described as the main threat to world peace and stability. Through NATO, or its network of global

alliances, the US continues its cold war strategy, and operates as a self-appointed global policeman. China's task is therefore to "say no" to US hegemonism, build up its power base, and nurture its grievances until the moment is ready to strike.<sup>20</sup> In the meantime, China is to pursue a policy of prestige, evidenced through such diplomatic successes as winning the International Olympic Committee's vote for Beijing to host the Olympic Games in 2008, through sustained rapid economic growth, or by developing satellite capabilities. Technological advance would be served by industrial espionage,<sup>21</sup> and by continued investment in military related R&D. "We must dance with the wolf", President Jiang Zemin asserted in reference to US-China relations.<sup>22</sup>

China will challenge the US as its power capabilities expand, the China threat thesis holds. China's intent is to acquire comprehensive power capabilities-economic, military, technological and civilizational. The richer it becomes, the more the neighbours come to depend on China as their prior business partner. This imperative of getting access to China's ever larger internal market is bound to raise China's ability to shape their policies. In

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addition, along with economic growth comes the rapid rise in the size of the military budget since the 1990s, and investment in hi-tech capabilities for warfare on land, sea, air and space. The conclusion of the US Department of

Defense Report, *The Military Power of the People's Republic of China*,<sup>23</sup> is that China is modernizing its army to fight and win short-duration, high-intensity conflicts along its borders. China's "ability to project conventional military power beyond its periphery remains limited", the report states, to achieving a short-term objective of preventing Taiwan's independence, or bringing about a negotiated agreement favourable to China. But the longer-term goal is to catch-up with the world's leading defense powers by 2020. By that time, China's civilizational pull on the rest of the Asia Pacific could have made serious inroads into US influence in the region.<sup>24</sup>

The prospect of China exerting a civilizational pull on Asia Pacific, while remaining a party-state dictatorship poses a direct threat to western political values of democracy and human rights for all. When democracy

and human rights are discussed within party precincts, the emphasis is placed on the party-state's role as the promoter of a state of law, as the guarantor of human rights and as China's guarantor of stability. The theme was picked up by President Hu Jintao, who oversaw the publication of a White Paper on Democracy, published in October 2005, and entitled "Building of Political Democracy in China".<sup>25</sup> Referring to the CCP's proclivity to gradual reform, the White Paper stated that there was still a long way to go in building political democracy in China, adding that the country meanwhile was under management of a safe pair of CCP hands. To dispel any doubts on the matter, the White Paper defined democracy as "the Chinese Communist party governing on behalf of the people...while upholding and perfecting the people's democratic dictatorship". Such a unitary system, regime opponents argue, provides permanent incentives for incumbents to preserve their privileges, and to postpone to a distant future any greater participation of citizens in the making of policy.<sup>26</sup> China has no institutions to curb the predatory power of the party-state, which enjoys unchallenged capacity to coerce, co-opt or convert opponents to its preferences.

China's rise is bound to create stress in the global political economy. The country's demand for farm, raw material and energy products is transforming the structure of world trade and influence shaped by the preponderance acquired in the world economy by the prime centres of industrial power over the past two hundred years. In the developed world economies, workers lose jobs as technologies and know-how are transferred to plants in Asia.<sup>27</sup> China with its legions of well-trained engineers will excel at hi-tech manufacturing and innovation, while remaining the location of choice for low-end production, on account of its low-cost, highly skilable work-force and rapid improvement in infrastructure. This process challenges the distinct strategies of Japan and the US to replace manufacturing by moving to higher ground as exporters of hi-value added services and technology. The unstable politics associated with China's rise also risks spilling over into Asia's fragile balance of power, where Japan, Russia, India and the countries of South-East Asia are all wary at the giant's emergence.<sup>28</sup> The conclusions for US China policy, besides brokering a

democratic alliance of states to contain China's rise, is to press China into adopting democratic reforms, and to adopt global norms of conduct at home and abroad.<sup>29</sup> US policy, the 2006 *US Quadrennial Defense Review* states, seeks to encourage China to choose a path of peaceful economic growth and political liberalisation, rather than military threat and intimidation".<sup>30</sup>

In the meantime, the leadership prefers to remain ambiguous about China's longer term purposes, and wraps itself in a flag of nationalism, of greater Chinese patriotism, of Asian values, or Confucian paternalism.<sup>31</sup> Such haziness in defining its symbols suggests that the inscrutability of China's motives may be ascribed to the unchanged nature of the regime, and to un-resolved questions about China's relations to others, involving differing definitions of what is Chinese.<sup>32</sup> China is a threat precisely because its destination is known.

#### **4. China as a mercantilist**

The economic dimension of the China threat thesis holds that China is a mercantilist state trading nation, one which seeks all opportunities to run large trade surpluses and build foreign exchange reserves<sup>33</sup>. This is the substance of the argument of China as a wrecker of the global trade regime. At the time of China's WTO accession, China had moved from being with Albania in 1978 one of the most closed economies in the world, to being number seven world exporter, with 3.9 percent of world exports; and number eight world importer, with 3.4 percent world imports. Between 2001 and 2008, China's exports grew at 25 percent and imports at 23 percent per annum, making China number two world exporter with nine percent of world exports, just behind Germany, and number three world importer with seven percent of world imports, just behind the United States. Even more noticeably, exports from China in 2007 accounted for one third of the US trade deficit, and for 85 percent of the total extra-EU trade deficit. Not surprisingly, western public opinions have come to see China as deeply chauvinist. An FT poll, coinciding with Beijing's crackdown against Tibetan

dissidents, and the Han Chinese support for the government, found that 35 percent of respondents in Italy, France, Germany, Spain and the UK, saw China as a bigger threat to global stability than any other state.<sup>34</sup> The Pew Global Attitudes Project<sup>35</sup> recorded a growth in the percentage of US respondents who considered that Chinese growth was a “bad thing”.

What are the specific reasons, beyond the political dimensions of China as a threat, that inform China’s reputation as a nationalist and mercantilist state? One consistent theme running through the Chinese leadership’s reforms since the late 1970s has been admiration for the achievements of the countries of the Asia Pacific. At different times, Japan,<sup>36</sup> the single party city state of Singapore,<sup>37</sup> Taiwan<sup>38</sup> or South Korea have been proposed as models from which mainland China can learn.<sup>39</sup> One of the key documents of the China transition, the “Decision on Issues Concerning the Establishment of a Socialist Market Economy”, drawn up under the direction of then party Secretary General Jiang Zemin, and adopted at the 14<sup>th</sup> Party Congress in November 1993, is clearly influenced by the model of the Asian developmental state. A priority aim is to establish “a modern enterprise system”, with many characteristics of the Japanese and Korean models in the sense of being state-led, national capitalist in inspiration, and concerned to create large, home-bred and owned industrial and service conglomerates. The leadership prompted a policy described as “grasp the large and let go the small” (*zhua da fang xiao*), involving the identification of “pillar industries”, such as petroleum, and automobiles, the formation of joint-stock enterprises, the reduction in ministerial controls, and the de facto privatisation of the smaller state enterprises. Joint ventures between state enterprises and foreign corporations were encouraged with a view to promoting inward technology transfer.

Another consistent theme running through the Chinese leadership’s reforms since the late 1970s has been the nationalist appeal to overseas Chinese, many of whom fled the mainland at the time of the communist takeover in 1949. In December 1978 at the Third Plenum of the 11th Central Committee, Deng Xiaoping announced the official launch of the Four Modernizations, formally marking the beginning of the reform era. The aim of the Four Modernizations in the fields of agriculture, industry, science and

technology and national defense was to make China a great power in the 21<sup>st</sup> century. To give credibility to his appeal, Deng in 1982 had the Chinese government make a constitutional commitment not to nationalise or expropriate assets of foreign investors without “due cause and compensation”. His call was heard. Between 1979 and 1993, the countries dominated by the overseas Chinese—Hong Kong, Singapore, Taiwan, Macau and Thailand alone—accounted for 81.2 percent of enterprises with operations in China and for 84.6 percent of the total value of FDI there.<sup>40</sup> In 1992, the overseas Chinese held full ownership of 8,000 subsidiaries in China, while Japanese corporations owned 311 and Americans, just 39. In the following decade, the largest inward investors were again the overseas Chinese. Two fifths of Taiwan’s overseas investment went to the mainland, making it the second source of inward investment after Hong Kong. These investments were primarily targeted at labour intensive, and low tech activities, and located along the special economic zones of the Pearl River Delta, that border Hong Kong and Macau.<sup>41</sup> In turn, this inward flow deepened China’s integration in the production and trade networks of Asia Pacific. Deng’s appeal was to a Greater China patriotism, whereby all Chinese, whatever their political orientation, would work together for the greater benefit of the home country.

A third feature which China has borrowed from the Asian developmental state, it is argued, is to protect-in and export-out. Like Japan or Korea, China has come to run huge trade surpluses, driven in its case by the urgent need to create up to 20 million jobs a year. Though the longer term trend is towards a tighter labour market as the population ages, there is an ample reservoir of under-utilised labour in the rural and township areas, equivalent to upwards of 450 million people. The speed at which this surplus labour is absorbed depends on the pace of urbanisation, which in turn is linked to China’s integration into the world economy. The faster that urban higher productivity jobs grow, the faster the surplus labour population can transfer out of rural low productivity sectors. Applied to China, this theory (the “surplus labour model” developed by the West Indian economist, Sir Arthur Lewis) suggests that China is at least two or more decades away from reaching the point where rural and urban wages

converge. As the country's accelerated transformation from a largely rural towards an urban-based economy is far from complete, so China's trade surpluses are likely to be a feature of the world economy for decades to come.

What is more, the unreformed nature of the regime makes a mockery of the leadership's frequent claims to be promoting a level playing field for all companies.<sup>42</sup> The country continues to run as a "non-market economy", where trust is minimal and cheating is widespread. The result is that Chinese firms depend for their short term survival on imported technologies, and are prone to cheat, counterfeit, sweatshop, bribe or pollute in a constant struggle to keep cost leadership in their markets.<sup>43</sup> They carry these practices into international trade. Meanwhile, the opacity of China's polity has restricted Beijing's ability to live up to its commitments. Not for nothing is China the prime target in terms of the number and severity of anti-dumping measures.<sup>44</sup> Eighty per cent of fake goods intercepted at EU borders came from China, while in the US consumers faced killer pet foods, tainted toothpaste, poisonous toys, or seafoods laced with antibiotics supplied out of China. Far from being a champion of open markets, China in such conditions plays the wrecker in competition, undermining the trust on which the politics of international trade depends.

China's role as wrecker is further compounded by China's predatory approach to global resources.<sup>45</sup> The party-state actively backs Chinese companies to secure proprietary access to minerals and send the fuels back to China via ship or pipeline. This opens China to the accusation of undermining the co-operative approach whereby mineral resources are developed for sale on global markets, and not tied to consumption in any one country. In addition, adherence to the principle of non-interference in domestic affairs—the foreign policy counterpart to the regime's continued monopoly on power—has enabled it to aid and abet oppressive regimes in Myanmar, Zimbabwe or Sudan, praising their "special paths to development". As Wen Jiabao stated at the China-South Africa Business Cooperation Forum in Cape Town in 2006: "We do not seek to export our own values and development models to Africa".<sup>46</sup> As the world's largest developing country, and permanent member of the Security Council, China

is laying claim to global leadership of the developing world and as a pathfinder towards a new politics beyond imperialism.

In relations with the major western powers, China has consistently managed an aggressive currency policy. In 1994, China's currency, the yuan, was devalued by 400 percent, as part of the leadership's broader set of industrial and financial reforms. The devaluation prompted a rapid surge in the trade surplus with the US, the EU and Japan. For eleven years, through the Asian financial crash of 1997-98, China maintained a policy of pegging its currency (the renminbi or yuan), to the US dollar at an exchange rate of roughly 8.28 yuan to the dollar. In June 2005, the top leadership—after lengthy deliberations—decided to revalue the currency by 2.1 percent against the US dollar. Cumulative appreciation of the renminbi against the US dollar since the end of the dollar peg in June 2005 reached 15 percent in January 2008. Given labour productivity increases at 9.5 percent per annum (from 1994–2004),<sup>47</sup> driven by massive restructuring and marketization, a step-by-step approach to currency policy would ensure China a highly competitive exchange rate into the future.

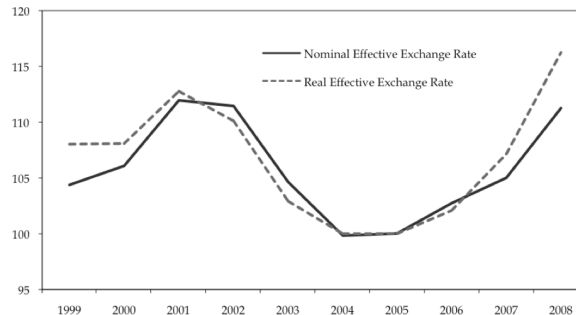


Figure 2. China's exchange rate: Nominal and effective. Source: Based on BIS data 2008.

Access to world markets through WTO accession formed a central component of the leadership's strategy to accelerate economic and social transformation through growth. Additional stimuli came from a massive infrastructure program, launched to counter the downturn of 1997-98, and from a managed currency, resulting in a surge in China's growth rate from an eight percent average from 1998-2001, to a ten percent average from 2003-2005, to over 11 percent average from 2006-2008. Growth in turn fed China's attraction to the leaders of Africa, Latin America and East Asian countries in 1997-98. As China's war chest of foreign exchange reserves accumulated, so did China's international financial clout. Initially, both the US Treasury and the Chinese leadership united to torpedo Japan's idea of September 1997 to create an Asian Monetary Fund to help stabilize regional currency relationships. Beijing and Washington both suspected that Tokyo's intent to establish the yen as a regional reserve currency. But at the May 2002 Financial Ministers meeting of the 10 ASEAN countries, plus China, Japan, plus South Korea (ASEAN+3), the path was smoothed for the Chang Mai initiative, whereby swap accords among ASEAN countries were in effect extended through a network of bilateral accords to include China, Korea and Japan. China pledged a billion dollars to the process. Then, in response to the global financial crash of 2007-9, China set up a series of currency swap arrangements with other central banks including Argentina, South Korea, Indonesia, Malaysia and Belarus.<sup>48</sup> In May, Japan, China and South Korea created a \$120 billion liquidity fund to replace the previous web of bilateral currency swap arrangements between the 13 ASEAN member countries, with China and Japan contributing 32 percent each to the fund, Korea 16 percent, and the rest made up of contributions from the 10 ASEAN members.<sup>49</sup>

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"global imbalances". China's growing trade surpluses could not be accredited to protectionism, as imports were surging. But they could be accredited to imbalances developing across the Pacific, prompted by fiscal laxity in President George W. Bush's Washington. The stimulus to demand generated by US deficit spending prompted Americans to borrow, consume and import, while the Chinese saved, invested and exported. It was not up to China to revalue, by anywhere from 20-50 percent against the dollar as some economists were arguing, so much as for the US to get its own house in order. As the Governor of the Central Bank, Zhou Xiaochuan, explained in a speech in Kuala Lumpur, Asian peoples shared Confucian values, and valued thrift, self-discipline, a low profile and were against extravagance.<sup>50</sup> Only because the US had the privilege of running the world's reserve currency, he implied, could it finance such huge deficits, unlike in 1997-98 when Asian countries came under IMF supervision. The lesson then for Asian countries had been: do not run out of foreign currencies. In 2009, the lesson being drawn was to diversify away from dollar assets, and to consider the creation by the IMF of a reserve currency to replace the dollar.<sup>51</sup> For that to happen, China's transition to a modern economy has a very long way to go

China's endemic mercantilism is also seen as a root cause of the decline in political support for the WTO. Mexico, Caribbean countries, Africa and India all felt the onslaught of Chinese price competitiveness, and protective US or EU responses to them, on their domestic markets.<sup>52</sup> Multinationals based in the US, the EU and Japan faced workforce concern at the prospective outsourcing of their jobs to a country seen as "sweat-shopping its way to success".<sup>53</sup> Asia Pacific countries saw China after the collapse of their currencies in 1997-98 walk away with the prize as prime target for 70 percent of all foreign investment going to Asia. Meanwhile, accusations multiplied of China using guerrilla trade tactics to frustrate access to domestic markets. To defend its rural population dependent on farm-based activities, Beijing used quarantine, licensing requirements and genetically modified organisms (GMO) restrictions in order to hinder trade. On industrial trade, the party-state adapted laws, set up bureaucratic structures and procedures to meet WTO accession treaty commitments but

continued to give preferential treatment to national champions, to preserve party-state business networks, and failed to implement effective patent policing. Interviews with managers of foreign companies showed widespread reluctance to locate R&D facilities in China.<sup>54</sup> Market access to those parts of the service sector under party-state tutelage, particularly telecommunications, banks, and insurance, have been limited.<sup>55</sup> By contrast, in those sectors which the party-state wished to promote, such as the venture capital market or software, the market was dominated by foreigners.

Not least, China's entry to the WTO, the critics maintain, has weakened international co-operation. Already open to charges that it is undemocratic, China's accession does the organization no favours.<sup>56</sup> China has gone outside the organization and multiplied bilateral trade deals with partner countries. China joined with Brazil and India for more liberalisation of farm markets by rich countries, while rejecting liberalisation of their own. This was the issue on which the Doha round of trade negotiations—which began in 2001 in Doha, the capital of Qatar and where China's was ushered into membership—repeatedly faltered. But the roots of the problem lay in a prevailing mood of national egotism, where the game of international trade politics was seen as getting others to make concessions while making as few as possible yourself. This, the critics maintained, was a fair description of China's approach. The Cassandras who had warned against China's accession to the WTO could draw some retrospective comfort that their position had been vindicated.<sup>57</sup>

##### 5. China's successful osmosis.

China is irreversibly trapped in the web of global interdependence. This is the substance of the view that expressions of nationalism are subordinate in the practical affairs of China to the not necessarily compatible aims of the leadership to stay in power, and to do what has to be done if the complex of forces unleashed by Deng's Open Door policies are to be mastered. China's "common marketization" is a pragmatic, managerial strategy by the Communist leadership to lead the country to prosperity. Change comes

about through reform by enlightened leaders whose mandates for modernisation are constantly renewed by the challenges facing the country as it develops. The leadership sticks to its step-by-step approach, but there is no disputing that the only viable option for China is to head in the direction of more market and more democracy. The only disagreement between regime reformers and the western powers is over the sequencing of

*"All pressures point towards some sort of crisis within the coming fifteen years that will enable liberal-minded reformers within the regime to outmanoeuvre conservative interests within the party."*

reform, whether building a state under the rule of law should come first, or priority should be given to the development of democratic institutions. In global affairs, the Chinese leadership wants China to be a worthy member of the lead group of world powers, and to adopt the norms already elaborated by the "international community" as benchmarks for policy. The agenda derived from this narrative

is for both China and the rest of the world to engage in developing their relationships, for the western powers to cultivate an objective alliance of interests with regime reformers, and for all to rely on the favourable tide of events.

China is set on the way to become a "market democracy". There is no going back. All pressures point towards some sort of crisis within the coming fifteen years that will enable liberal-minded reformers within the regime to outmanoeuvre conservative interests within the party.<sup>58</sup> As a result of the reforms introduced by the CCP itself, the private choices of citizens now lead the market on which government's strategy is predicated,<sup>59</sup> shifting the balance decisively against the regime's ability to survive in its present form. China's ever more pluralistic society is served by a widening group of skilled workers,<sup>60</sup> private business people,<sup>61</sup> lawyers, entrepreneurs and professionals. Meanwhile, a widening swathe of workers, peasants, pensioners, migrant labourers, religious believers, and urban or rural dissidents, remembering the years of protest during the Cultural Revolution, have staged ever bolder and better organized demonstrations across China in their struggle for political rights.<sup>62</sup> Only by determined leadership for accelerated reform can China's aspirations to stability, wealth

and global status be secured for the longer term. Management of this elite led transition is the major challenge that lies ahead, and when it occurs, China's embrace of democratic rule will be one of the defining moments of world history in the 21<sup>st</sup> century.<sup>63</sup>

China's gradual transition out of authoritarianism is seen as part of a worldwide trend, initiated in the 1970s in southern Europe, extending then to Latin America, to Asia and to the countries of the Soviet bloc.<sup>64</sup> Gradualism is the key to success; not for China the Big Bang reforms of the Soviet Union and the eastern European states, too reminiscent of Mao's Big Leap. The regime's strategy is much closer to that of its Asian neighbours, especially to South Korea, than to its discredited former communist companions.<sup>65</sup> The method is predicated on leadership control over the agenda of the transition, as Hu Jintao clearly stated in the preface to the 2005 White Book, entitled "Building of Political Democracy in China" ().<sup>66</sup> Beijing knows that the China of tomorrow with a per capita income of \$10,000 will require dramatically different governance from the China of today with per capita income of \$1,700, let alone the China of 1978 when annual income per capita was \$200 (CSIS, IIS, 2006). The appropriate policy sequence is thus: start with economic reforms; lay the foundations for the rule of law and the separation of powers; accompany this by granting greater de facto freedoms for the citizenry. The whole process is eventually capped by the process of regime transition to democracy. Meanwhile, the leadership's strategy is to provide political stability and prosperity, because that is what the majority of Chinese people want.<sup>67</sup>

The changes in China are clearly recorded in the shift in ownership patterns of enterprises. In 1980, almost all output came from state enterprises. In the 1980s, the country's expansion was driven by the expansion of township and village enterprises, formerly Mao's communes; since the early 1990s, the growth of the private sector has been the main feature of China's economy since 1992.<sup>68</sup> Its new status was officially recognised at the Fifteenth Party Congress held in September 1997, and private ownership and the rule of law were incorporated into the Chinese Constitution in March 1999. Further reforms to protect private property and the rights of entrepreneurs were introduced by the CCP's Politburo in

October 2003. In that year, private Chinese companies were earning a 15 percent rate of return on their physical investments, and their export-market share had jumped five times over the previous five years.<sup>69</sup> Overall, the private sector in China accounted for three-quarters of all exports in 2003. China had become an Adam Smith economy, run by a Marxist-Leninist-Maoist party-state.

In addition, China is a prime beneficiary of what Peter Nolan, the China expert from the Judge Institute, Cambridge UK, has called the global business revolution.<sup>70</sup> Over 60 percent of Chinese exports have been attributable to foreign firms investing in China. This was not fortuitous. As Long Yongtu,<sup>71</sup> China's WTO negotiator, argued to the party cadres, China had to grasp the opportunity provided by the grand scale adjustment going on in the world's industrial structure. This meant joining the WTO and inserting China at the heart of global value chains—the new and revolutionary coordinated production and delivery processes, comprising all steps leading to an ultimate "downstream" sale from the initial "upstream" raw material processing.

While inserting itself deeper into global value chains, China's leadership has elaborated a foreign policy concept well adapted to the politics of complex interdependence. The new concept was presented in September 1997 by Foreign Minister Qian Qichen.<sup>72</sup> It stated that China's achievement of "comprehensive strength" should be complemented by incorporating economic security within a broader and sustainable concept of national security. Our aim, the Foreign Minister explained to the participants of the Asia Regional Forum (ARF), "is not to defuse a common threat, but rather to achieve a common goal, that is regional peace and stability".<sup>73</sup> This required discarding the Cold-War mentality—an evident reference to US policy to strengthen its alliances across Asia and in Europe. Security was best assured by cultivating mutual trust and developing partnerships based on friendly and stable state-to-state relations. Bilateral diplomacy predicated on a muting of differences about domestic politics, and on the principle of equality among states, was to be complemented by multilateral diplomacy in regional and global fora, and on the organization

of regular official visits and summit meetings between top government leaders.<sup>74</sup>

China's foreign policy concept thus involves full participation in international organizations, adherence to international norms of diplomatic intercourse, and democratization of international relations as the banner behind which China's stakes its claim for leadership in world affairs. This is one component of China's diplomatic style which differs from that of the US and the EU, which the regime tends to equate with old world practices of power politics and privilege. Another differentiating factor of Chinese from western diplomacy is the preference to mute criticism of domestic political regimes. This contrasts with the western view, expressed by the EU Commission, where the emphasis is on global convergence of domestic norms. The EU strategy is to engage with China in order to accelerate China's "transition to an open society based on the rule of law and the respect for human rights".<sup>75</sup>

As far as international affairs are concerned, the softer approach inherent to China's new concept for security policy conforms to Beijing's preference to minimise the costs of its emergence as a great power. Creating well-disposed nations around its borders is clearly a less expensive way to manage China's rise to prominence than to trigger a counterbalancing reaction among frightened neighbours.<sup>76</sup> To this end, China's diplomatic practice has converged on the ideals and the practice of other states. Widely recognised norms such as the peaceful settlement of disputes, the promotion of cultural or economic exchanges and international co-operation to combat the new security challenges of terror and crime are embedded in Chinese diplomacy. China is the largest supplier of personnel to UN peacekeeping operations, an active participant in arms control diplomacy, has promoted "strategic partnerships" with its neighbours, and has settled over three quarters of its 23 territorial disputes with neighbours.<sup>77</sup> In short, the dominant strand in China's foreign policy is to

**"China's foreign policy concept thus involves full participation in international organizations, adherence to international norms of diplomatic intercourse, and democratization of international relations."**

engage with the main western powers, and to embrace transnational forces and multilateral institutions as allies in "democratizing" international relations.<sup>78</sup> Globalization can be considered as China's tool to constrain US primacy.

## **6. China as a stakeholder in the world political economy**

It follows that China's joining the world trade regime has been good for the Chinese society and good for the world. That is the essence of the case in favour of China's participation in the WTO, and its open market policies. Most importantly, Chinese fears that their domestic market would be swamped by foreign competitors have turned out to be erroneous. One of the main reasons for entry to WTO was to strengthen Beijing's powers over local governments, and to create a level playing field for all companies. The party-state's policies of modernisation could only be implemented in the long run by creating a large internal market, overcoming local government-sponsored protectionism,<sup>79</sup> and reducing the incentives for foreign companies to cherry-pick between provinces as preferred locations for investment. Though foreign corporations were doing particularly well in highly protected sectors,<sup>80</sup> even prior to WTO entry, Chinese companies controlled 85 percent of domestic demand for industrial goods. Domestic corporations have less than 70 percent market share in only two sectors— instruments and electrical and electronic machinery, and below 80 percent in transport equipment and machinery.<sup>81</sup> This suggested that mainland Chinese producers stood to benefit extensively by WTO entry, as they learnt to drive costs down, and productivity up. As Long Yongtu, China's chief negotiator at WTO, stated, we joined the WTO "to push forward economic reform...so that China can participate fully in economic globalization".<sup>82</sup>

The balance of evidence is that Beijing took its commitments in the WTO accession agreements seriously. The Ministry of Foreign Trade and Economic Cooperation (MOFTEC) established three offices—the Department of WTO Affairs, the China WTO Notification and Enquiry Centre and the Fair Trade Bureau for Import and Export, along with an

office to deal with complaints from foreign companies.<sup>83</sup> In 2001, the State Council stipulated a measure to forbid regional blockades in market activities, set about dismantling non-tariff barriers, adapted the Chinese accounting code to global accounting standards, relaxed technology transfer requirements for foreign investors, favoured the development of private companies and allowed all companies to engage in international trade. Studies showed evidence that price behaviour across the whole of China was becoming more inter-related,<sup>84</sup> and cross-border mergers rose as the markets opened up to foreign corporate purchases of local companies (though measures were introduced in 2006 to protect Chinese “brand names”).<sup>85</sup> This translated into improved efficiencies in the Chinese economy, recorded by the rise in labour (much less in capital) productivity, wages, incomes, and imports. It was not just that China shot up the rank of major importing countries from six in 2001 to three by 2007. China’s imports on goods alone by 2007 equalled in value nearly twice those of India, Russia and Brazil together. China had become a locomotive of world growth precisely because it followed an open trade policy.

China has fast become a trade power in its own right. Comparing China of 1978 and that of 2010 is comparing night and day. In 1978, China was an impoverished country, cut off from the rest of the world. By 2010, the National Bureau of Statistics places the expanding middle class at 170 million. China ranked second in terms of GDP in purchasing power parities. As a recipient of inward investment, China was in the top rank of recipients. These changes were reflected in broad public support for the government’s open market policies. Despite all the harshness of life for many Chinese citizens, the welfare of Chinese people in 2005 as measured in the UN’s Human Development Index was comparable that year to Singapore’s in 1980. This improvement in China’s prospects is paralleled by near universal approval of global trade among the China public (in India, too).<sup>86</sup> Equally, the Chinese are convinced that the 2008 Olympics—awarded to Beijing in 2001, China’s *annus mirabilis* when it was given WTO accession and chosen to host the 2008 Olympic Games—have benefitted China’s image around the world.<sup>87</sup> China’s success reinforces the country’s support for the government’s Open Door policies.

China’s entry to the WTO symbolised not just a commitment of the leadership to reform of domestic institutions, but a return of China to the global economy after a century of absence. The result has been to transform the Chinese and the world economy. China’s exports have risen in volume while their relative prices have fallen, entailing adjustment costs for workers, capital and management in China and around the world. The resulting changes in relative prices of world imports and exports have altered countries’ terms of trade, while within countries some workers have gained and others have lost. Countries with an acquired advantage in skilled work, such as Germany, have benefitted, while countries with low skilled labour—typically in southern Europe and Mexico—have suffered.<sup>88</sup> More intense competition from China kept prices down,<sup>89</sup> and helped western central bank’s anti-inflationary policies.<sup>90</sup> In particular, China acted as an engine on growth for its Asian,<sup>91</sup> Latin American<sup>92</sup> and African suppliers: China’s imports between 1997-2007 rose by 477 percent, and 79 percent of China’s imports were sourced from other developing countries. As Malaysia’s Finance Minister II Jamuludin Jargis had prophetically argued in 2002: “My colleagues and I agree that concerns on diversion of FDI, competition in export markets and a loss of market share are far outweighed by the opportunities in china’s domestic market”.<sup>93</sup>

China, furthermore, has been a major stimulant to world trade. China’s imports have been growing twice as fast as developing country imports for the last decade, and three times faster than industrial country imports. US exports to China grew ten percent faster to China than to the rest of the world. China is opening its markets faster than any country or group of countries of similar size have ever done. It has become a regional manufacturing base for the production of consumer goods, and a growing importer of intermediary goods as its trade barriers fall. As a result, greater specialisation has emerged among Asian countries, with China being the central link between Asian trade partners and industrial countries markets.<sup>94</sup> In agriculture, China’s low tariff rates, modest farm subsidies, and widening quotas allow growing markets for farm product exports from the Americas, the EU and Australia, as well as from rice suppliers, like Thailand and Vietnam. China’s rapid growth has provided major export

opportunities to raw material suppliers, such as South Africa and Brazil, and to oil exporting countries. Most of the hard bargaining between China and its trade partners in the entry talks concerned telecommunications, financial services and the delivery of professional services, where rich country corporations have a comparative advantage—as well as widening market shares in China despite the problems they face in the form of party-state determination to keep control over financial flows, media and communications. The coverage and depth of the concessions made have been termed the most radical reform program negotiated in the WTO under the General Agreement in Trade on Services (GATS).<sup>95</sup>

China has everything to gain by playing in the court of the great trading powers as a constructive partner. When China took up its seat in the UN in the early 1970s, similar concerns about China as a wrecker had been expressed. Such fears proved unwarranted. Of all permanent members of the Security Council, since 1972 China has made least use of the veto;<sup>96</sup> China also proved to be a responsible member of the UN and of its agencies, and has not sought to change the ways decisions are made.<sup>97</sup> Its new foreign policy, elaborated in the 1990s, adheres to the norms and procedures of the international society of states. A practical benefit for China as a WTO member has been that it now co-writes the laws on international trade together with the lead powers, rather than have the rules written for it on the outside. Sitting at the world's top trade and investment table adds to the leadership's domestic prestige, and also enables China to either champion the cause of developing countries or to maintain special relations with the US, the EU and Japan. For China's prime foreign policy objective is prestige, and recognition of its weight in world affairs by the powers that be. As long as that is forthcoming, China will do everything to shore up its credibility as a reliable trade partner. In brief, China has turned out to be a team player, a pillar of international society.

The one area where there is a clear clash of principles between the western powers and China is over its policy of "non-intervention" in internal affairs of states. But even here, it is possible to argue that China is learning that the realities of global interdependence and the concept of sovereignty—aptly termed by Stephen Krasner as "organized hypocrisy"—

are not readily compatible. Because business is urgent, China makes deals with regimes, whatever their rulers' practices at home may be. But the limits to challenging the western powers are drawn by the fact that Chinese diplomacy is loath to alienate the US, and to a lesser extent the EU, on whom it depends for exports and technologies. Experience also shows that on many occasions, it is far from evident that the interests of China and other developing countries may be readily aligned. As a competitor, China's message to developing countries is not so much defense of state sovereignty, as the flip-side of the sovereignty argument: use your sovereignty to get your own house in order. This is easier said than done in regions such as the Mid-East and Africa, and it is in these regions that the "non-intervention" principle barely serves as a guide to realities on the ground. For the realities are that China is becoming entangled with the rest of the world. That is the essence of China's Go Out policy.

Closer to home, Greater China ambitions are best fulfilled for China within the WTO, as illustrated by China's entry ahead of Taiwan in 2001. Entry of mainland China alongside Taiwan leaves open the prospect of evolution in China's "sort-of communist" polity, to paraphrase Ronald Reagan, and also buys time during which santong (the three direct links of trade, post and travel) and siliu (the four exchanges—academic, cultural, economic and athletic) are encouraged. These two are the first steps, according to Beijing, along the way to implement the formula of "One Country, Two Systems". WTO membership, in short, helps to foster interdependence between Taiwan and the mainland, leaving the future open to further rapprochements.

China furthermore has little incentive to become another Japan when circumstances over sixty years after the end of the world war are so different. Japan's business system built up in the 1950s was closed and geared to "export out, protect in" has little to recommend it as a model for China in the 21<sup>st</sup> century. China's economy is incomparably more open and its business system in dynamic transformation as it seeks to adapt

*"China furthermore has little incentive to become another Japan when circumstances over sixty years after the end of the world war are so different."*

procedures and institutions required in a market economy.<sup>98</sup> The reason for the huge surpluses accumulated since 2001 is not that foreign corporations have found the Chinese market impenetrable, but that Chinese household and corporate savings rates have aggregated year-on-year to 40-45 percent of national income. As national income equals consumption, plus saving, plus imports, high savings come at the expense of lower consumption and lower imports. In other words, China is producing more than it consumes.

This showed up in the current account. With a small deficit recorded under services, and rising income from international business, the current account surplus mushroomed from 1.3 percent GDP in 2001 to 11.5 percent in 2007. Taking into account inward and outward direct investment flows, and the limited movement under short-term capital flows, the net recorded movements on capital account were small, as may be expected given prevailing capital controls. But the controls did provide an additional incentive to foreign investors to get into the China market,<sup>99</sup> as evidenced in the financial account, where the largest item was inward direct investment, amounting to 3.3 percent GDP in 2001, and rising to 4.4 percent GDP by 2007. The Central Bank actively absorbed this huge inflow of funds, partly by accumulating foreign exchange reserves, partly by re-investing abroad and partly by accepting an expansion in the domestic monetary base. Foreign exchange reserves stood at a colossal \$2 trillion dollars by end-2008, and rising at an accelerating rate of over \$500 billion dollars a year. These assets give the Chinese state the means to re-capitalise banks, continue preferential lending to enterprises within the party-state family, buy US Treasury bonds, bribe dictators, bail out western banks and purchase equity in mineral operations around the world. The counterpart to that is that foreign corporations in the China market seek a return on capital of 15 percent per annum, whereas the returns for Chinese paper invested, say, in the US Treasury bond market is four percent. As Charles Dumas of Lombard Research has demonstrated, China makes one to two percent interest on its dollar reserves. It then loses regularly on the exchange rate as the dollar falls relative to the renmimbi, and suffers an inflation rate of 6 percent per annum, for a total return in local currency of about minus 15 percent. That is a loss, which Dumas calculates as amounting to about 7-8

percent gnp a year.<sup>100</sup> In other words, it is not China that is fleeing the world, but the great economic powers which are fleeing China.

The lesson for the party-state is clear enough. Rapid development of the internal market is the way to reduce the dangerous over-dependence on foreign export markets which has characterised the years 2001-2008. For the leadership, that means pushing ahead on the broad WTO-based reform programme to ensure more efficient financial, product and labour markets. The construction of a country-wide transport and communications grid does much to complement progress on product markets. On labour markets, the government's intent is to manage the transition of China from a rural to an urban population over the next twenty years, and not to adapt a laissez-faire policy based on opening its huge rural populations to the full blast of competition on China's food markets from suppliers abroad. The party-state is more than aware that if it is not seen by Chinese citizens to work on their behalf, its legitimacy is challenged.<sup>101</sup> Here, China is not alone in defending its rural populations: in different ways, all major participants in ongoing trade negotiations—Japan, the EU, the US, or India—do so too. What China's membership does provide the leadership is a platform to train the global spotlight on rich countries' protectionist policies, as an alternative to western focus on China's shortcomings in human rights. In effect, it delivers developing countries the moral high ground on a plate: global trade will boom or shrink for many years yet, depending on whether or not the rich countries comply with their commitments in the WTO. That, rather than developing countries' import substitution policies of yesteryear, is the main threat on the way to shared global prosperity in the post-cold war world.

## 8. Conclusion

So what is the conclusion to be drawn from these two views of China as a threat to the global polity, ruthlessly pursuing its mercantilist and nationalist agenda, or of China in transition to market democracy and irrevocably caught in the web of global interdependence? Let us take the

first, widely held view of China as pursuing a mercantilist and nationalist agenda, and focus on currency policy and the policy of non-intervention in the affairs of states. Currency policy is driven by Beijing's aim to keep the growth engine running in order to absorb un-and under-employment, and the non-intervention policy provides the fig leaf to procure food, minerals and energy resources from anywhere, at nearly any price, to feed China's hunger for resources. Both of these policies may be seen as feeding off past humiliations at the hands of western imperial powers, and as giving priority to the pursuit of national interest—in this case understood as economic growth and modernization as the royal way to status and standing in world affairs. What matters in this interpretation of Chinese policy are the results, not the means to achieve them.

But equally, China is irrevocably embedded in global interdependence. There is no exit, and there is no going back. The communist party-state is in charge, but it has little option other than to supervise the country's transformation to a market society. China's deep embedding in the global economic structure has fundamentally altered the balance in China between authorities and markets. The driving forces behind this process will continue to operate, such as the innate animal spirits of the Chinese and foreign business community, the hard work of Chinese people, the growing flexibility of the economy, and its opening on to world markets.

China's WTO membership has been beneficial to the world and to China-but on the proviso that the United States as the consumer of last resort has been able and willing to absorb them. China's trade surpluses have grown to record sizes, and have had significant distributional implications around the world in terms of gains and losses of income and employment. But they have benefited consumers and helped central banks keep inflationary pressures down. And they have not grown so much because of protectionist reflexes—though these are widespread—as because as long as China's households and companies save as much as they do, the country is in structural surplus with the rest of the world and over-exposed for its continued growth on the ups and downs of world markets. High saving is one of the prime sources of "global imbalances", which have been

accentuated by China's mercantilist exchange rate policy. Combined together, high saving and managed exchange rates have managed to make China maximally vulnerable to slowdown in its major markets of the US and the EU.

There can also be little doubt that the Chinese leadership takes the country's WTO commitments seriously, not least because creating an efficient internal market is manifestly in China's national interest. A competitive internal market makes the going that much more difficult for western companies; it creates multiple opportunities for local firms; China's negotiating leverage to grant or deny access rises as the market develops,

*“Growing interdependence with the rest of the world, and particularly with Japan, the US and the EU ensures that China's interest is to play as a lead member of world trade and investment powers. China has all to gain as a constructive partner.”*

and China can look forward to confirming its position at the centre of the Asian economies. China has no intent to wreck the global system on which its future depends. Nonetheless, China's entry to the WTO has coincided with a weakening of the international institutions created

after World War II to foster co-operation between states. The Doha round has not been concluded; the IMF's claim to set the rules for international finance have been challenged; the World Bank's priorities have been questioned; the UN Security Council has failed to deliver global security; the EU has failed to create a coherent European polity; global terrorism, crime, disease and ecology all require co-operative efforts.

This holds three implications for Chinese and world policy. First, China requires a peaceful world to be able to focus on its internal development. That will remain the agenda for decades to come. The transformation of China's business system is the key to its insertion, satisfactory or otherwise, into world trade. That transformation spells further adaptations, which in the longer run amount to regime change towards constitutional governance—China-style. Second, it follows that China may be advised to tilt towards the interdependence-as-a given end of its foreign policy, rather than to the mercantilist end. That means taking into

considerations the politics of the international business system, especially as it evolves in the United States and the EU. Third, for the rich powers of the developed world, the choice is between putting up the barriers against China, as the anti-globalisation forces at work in their societies want, or treating China as a pillar of the global system, and agreeing on a gradualist policy of transition to a fully fledged market -democracy. Expanding China's domestic demand to reduce overdependence on world markets is a step in that direction. But only if the world economy stays afloat. If it sinks, all bets are off – in China as in the world.

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