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### Creating a Comprehensive Policy Toward China

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**Creating a Comprehensive Policy Toward China**

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The Greater Chinese Economy,  
sponsored by the  
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Murray Weidenbaum

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An old Mandarin proverb on China states, "If you think you understand, you don't really understand." That warning also sums up the challenges that face Americans in dealing with this fascinating part of the world.

When viewed separately, each of the many aspects of policy involving China—economic, political, military, and environmental—is difficult but perhaps manageable with reasonably tough decision making. However, taken together, we can begin to see the complicated interrelationships. For example, more open flows of trade and investment are likely to generate a higher living standard in China—and also enhance its ability to expand its military establishment and thus increase political tensions. Moreover, higher levels of output are likely to generate more environmental pollution.

The challenge of reconciling these factors becomes even more overwhelming when we introduce the possibility of significant change in the economic outlook China is facing. However daunting that task, we must attempt it.

### **Economic Relations**

Let us begin with one of the more measurable clusters of U.S.-China relationships—the economic. First of all, any way we look at it, China is becoming an important economic power, once again. Using a form of comparing national economies known as purchasing power parity (PPP), the Chinese economy is now more than half as large as that of the United States and larger than Japan's.

China is a major trading partner of the United States. More than \$60 billion of commerce flows each year between the two nations. But the term "partner" is a euphemism for a very uneven set of commercial flows. The United States imports from China more than four times the dollar amount of our exports to them. This relationship is far more out of balance than our trade with Japan. Yet, unlike the case of Japan, most of the opposition to continuing normal trading relationships with China does not arise from those who believe they are hurt by the large excess of imports. Rather, it emanates from groups concerned with noneconomic factors, notably the harsh treatment of religious minorities, political dissidents, and Tibetans.

Aside from low-priced clothing, toys, and electronic parts, trade with China is not a significant portion of the American economy. However, the United States is the destination of almost one-third of China's exports. Our commerce is a key way in which that na-

tion acquires technology. Our trade also generates a substantial part of China's large accumulation of foreign exchange.

The Chinese economy has been growing on average at double-digit rates for the two decades since Deng Xiaoping began his liberalization effort. However, a similarly optimistic forecast for the next two decades is not realistic. An array of economic, political, social, and cultural barriers face China's continued rapid development.

So far, China has emerged relatively unscathed from the financial problems besetting East Asia, but that is more report than forecast. China's estimated 1998 expansion rate of 5 to 7 percent, although lower than recent years, continues its position as the Asian growth leader. Some signs of weakness are visible, notably sluggish exports and stagnant industrial production.

What would be the impact of a major slowdown in the still rapidly rising Chinese economy? Let us assume that China's gross domestic product in the coming decade no longer grows at 10 percent a year, but at half that rate. Five percent is still respectable by the standard of the more mature Western economies, which average half of that.

The impacts of such a scenario are likely to be negative for the American economy, but uneven and limited. Our exports to China, modest to begin with, would rise more slowly than they now do. A few sectors would be affected, mainly machinery and equipment, chemicals, aircraft, electronics, and agricultural products. Not much change would occur at first in their exports to us. Our trade deficit with China would rise only a bit, but enough to exacerbate what to Americans is already a contentious issue of domestic policy. The larger trade deficit also would reduce the chances of Congress approving "fast track" and granting more U.S. funding to the International Monetary Fund (IMF).

The positions taken by American business would hardly be uniform. Companies that export to or invest in China would continue to support open trade. However, those hit by competition from low cost imports of consumer products have not been fans of improved Sino-American relations, nor are their employees or adjacent communities.

A rising trade deficit with China would generate more support for the market-opening moves on the part of China that official policy in Washington continually promotes. Yet, these trade talks would be heating up just when the Chinese saw their economy weakening. They would be less motivated to respond in a positive manner.

Nevertheless, serious institutional barriers to a more balanced flow of U.S.-China commerce deserve the attention of both govern-

ments. In contrast to the open U.S. market, numerous obstacles face American exporters to China, such as onerous licensing procedures. Compulsory registration applies to about 400 products, typically electrical products and machinery. Moreover, U.S. producers of computer software, video tapes, compact discs, books, and motion pictures suffer because their products are frequently copied illegally in China. This intellectual piracy reduces potential U.S. exports to China and to the rest of the world by about \$2 billion a year. "Piracy," it should be noted, is a Western concept and not an Asian one.

A slowdown in China's growth will alter adversely the expectations of U.S. and other Western investors. Surely there would be less support for the unrestrained enthusiasm of the late Ron Brown, then Secretary of Commerce: "China...is the pot at the end of the rainbow." Many corporate investors would reevaluate their China commitments, especially those whose rosy profit expectations had not been achieved.

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A recent survey of 96 multinationals operating in China reported that 62 percent had overestimated the market potential and an almost equal number (61 percent) had experienced poorer profit performance than they had expected. Those percentages do leave room for some outstanding successes. Procter & Gamble dominates the market for soaps and shampoos. Coca-Cola far outsells Hainan coconut juice, and Ken-de-ji is well known in the largest cities (that's Kentucky Fried Chicken to Westerners).

A reduced inflow of new foreign capital would worsen the slowdown in the overall Chinese economy. China, however, is unlikely to accept passively a major reduction in its economic growth. It says it needs to expand 8 percent a year to maintain social stability and to continue its ambitious reforms to force state-owned enterprises to meet market competition.

Beijing already has announced a massive infrastructure construction program, of \$750 billion or more. That action could be

counterproductive if it crowds out private and local investments. To some extent, China can rely on an expansionary monetary policy to boost domestic demand. Yet, if pushed too far, this type of policy could renew inflationary pressures, which would worsen its already difficult competitive position in East Asia.

Should China respond to its economic difficulties with a substantial devaluation of its currency, such a destabilizing event would reverberate across East Asia. The United States likely would be drawn in, either as a direct source of financing or via the IMF. In an increasingly global economy, the fates of China and the United States have become intertwined. A sharp and sustained decline in China's growth rate would not be good news for Americans.

### Political Relations

The political relationships between China and the United States are even more difficult to fathom than the economic. President Clinton describes the current state of Sino-American ties as "a strategic partnership." Yet few aspects of a true partnership are present. It is Japan that cooperates with us in a variety of important foreign policy activities, including financing a considerable portion of the Gulf War. We also share a common outlook toward democracy, private enterprise, and personal freedom.

On the other hand, there is no direct basis for confrontation between China and the United States. We do not share a common border nor do we hold competing claims for territory. However, significant differences in fundamental values are clearly visible in terms of the treatment of citizens by the government, especially in regard to personal freedoms—political, economic, and religious.

The limited amount of individual liberty available in China galls many Americans. Especially upsetting is the persecution of Christian groups and the jailing of political dissidents. It is difficult for the United States to accept the idea of a "partnership" with a nation that engages in such offensive practices.

On the positive side, in recent years China has relaxed the rules governing everyday life for the typical citizen. A substantial decentralization of power has taken place and greater latitude has been provided to private enterprise. The impacts of Western culture and commerce have been pervasive, especially in the larger cities.

U.S. corporations doing business in China serve to advance our human rights goals. They create safer workplaces, follow more progressive personnel practices, raise living standards, and bring in new ideas, attitudes, and ways of thinking. American compa-

nies, such as Mattel, have adopted codes of conduct requiring local subcontractors and suppliers to avoid child labor and other practices inconsistent with U.S. standards. More indirectly, commercial products and advertising carry a powerful implicit message of personal choice.

Substantial portions of the population recognize such American brand names as Coca Cola, Jeep, Head and Shoulders, Marlboro, Mickey Mouse, and Kodak. Young women wear miniskirts and use Western-style makeup.

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A major slowdown in the Chinese economy could interrupt the limited trend toward liberalization, and perhaps even reverse it. A weaker economy would strengthen the position of old-line communists. Because Western investment has been accompanied by Western culture and attitudes, a diminished presence by American business would reduce the prospects for China eventually moving to a more open political system.

### Military Relations

The military area generates great uncertainty for American policymakers. China is in the midst of a major effort to upgrade its military capability. The acquisition from Russia of destroyers with supersonic missiles is a cogent example.

Is China motivated by the desire for regional hegemony? Its highhanded treatment of other nations in some of the islands in the South China Sea certainly worries them at times. The 1996 episode of China's missile testing in the Taiwan Straits raised tensions in the region.

On the other hand, the current weapon procurement effort may be defensive in nature. China's military capability is rudimentary compared to the United States. Its troops are poorly equipped by our standards, and their weapons, in the main, are considered to be obsolete. The Gulf War demonstrated that such large stockpiles of outdated equipment are of little use against a

more advanced opponent. Moreover, China lacks the ability to project its power over water in any substantial way. It possesses a total of 57 surface ships and 7 modern submarines. Thus, China presents little direct military threat to the United States, but it could be a substantial destabilizing force in East Asia.

Financed by its economic growth, China is procuring more sophisticated aircraft, ships, and missiles. Over the past decade, it has acquired some high-tech equipment from the cash-strapped countries of the former Soviet Union.

At present, there seems to be little potential for extensive military action outside of an unintentional blunder into armed conflict. Taiwan quickly comes to mind in this connection. China's desire for a strong military establishment may be understandable when viewed in the light of its long history of defeat and exploitation by foreign aggressors. Yet, over the centuries it has played that role itself in Southeast Asia.

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It is not clear how an economic slowdown would affect the Chinese military establishment. Economic growth enables Beijing to invest in technological modernization. Such financing might be curtailed in a weaker economy. Yet, rising unemployment could generate severe social and political pressures on the Beijing regime. Diverting public attention from internal problems via an international incident involving military action surely has historical precedent.

China's extreme dependence on its domestic coal supply for energy also could generate serious problems. The vast and still mainly untapped oil and gas reserves of the South China Sea are an important potential alternate source of energy supply for China. Overlapping portions of that strategic area are also claimed by Vietnam, Malaysia, Brunei, Taiwan, and the Philippines. Furthermore, all ocean shipping among those six countries, as well as the transport of oil from the Persian Gulf to Japan, takes place across the

South China Sea.

Thus, indirectly, a slowdown in China's economic development might reduce one important potential for military confrontation. It would ease the pressure to secure additional energy sources. Under such circumstances, the South China Sea would present less of a potential military flashpoint than is the current outlook.

### Environmental Issues

Environmental issues are a relatively new aspect of international relations, and one in which American and Chinese interests could readily collide. The December 1997 meeting in Kyoto on global climate change yielded a proposed treaty that would commit the United States to a major reduction in emissions of carbon dioxide (CO<sub>2</sub>), which are generated primarily by using fossil fuels. The treaty, which requires Senate approval, would effectively exempt China and other developing nations from its tough restrictions. That generates serious political difficulties in the United States. Last fall, the Senate pledged to defeat any climate change treaty that did not include the developing nations. Reconciling the Senate position with the Kyoto agreement will focus heavily on the role of China, a prime emitter of CO<sub>2</sub>.

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*The bright side of a slowdown in its economy is that it would dampen—but not eliminate—the now sharply upward trend in China's energy consumption*

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Poor countries like China believe that they cannot afford to sacrifice current income to avoid the uncertain costs of environmental damage 50 or 100 years from now. Even though air pollution is a visibly serious problem (coal generates 75 percent of its energy), China considers use of scarce resources for ecological purposes to be a rich country's luxury. Thus, trying to convince that nation to limit its energy consumption while the major Western countries use 5 to 10 times as much per person will probably prove futile—unless wealthier countries such as the United States pay the global costs of reducing fossil fuel usage.

The bright side of a slowdown in its economy is that it would

dampen—but not eliminate—the now sharply upward trend in China's energy consumption, and hence in its generation of CO<sub>2</sub> and other global warming emissions.

In the longer term, there is an important negative side to any extended slowdown in China's development. When countries reach per capita income of about \$10,000 a year, they begin to take a more active role in environmental improvement—because they believe they can afford to. A curtailment of China's growth would delay the achievement of that happy condition. Its per capita income now is less than \$5,000.

### Reconciling Divergent Interests

When asked the meaning of the French Revolution, Zhou Enlai was supposed to have replied, "It is too soon to tell." In this vein, it is with some reluctance that I will try to pull together the various strands of Sino-American connections. Policymakers in both the United States and China face fundamental challenges in attempting to deal simultaneously with a host of contentious economic, political, social, religious, military, and environmental issues. Not all of these serious matters can be solved soon. It would be sensible to focus on the highest priorities.

A useful starting point is to note that China's isolation is ending. Today it is more open to the influences of Western culture and business practices than ever before. Its senior officials say they want their country to be a full participant in the world economy. They acknowledge that this requires China to move to a market economy and to modernize its society. Yet China is not a member of key international organizations, formal and informal, such as the WTO and the annual economic summits.

The United States is in a special position to aid China in its entry into that "club." After all, we are one of the newer members. We also have a major stake in China's success in its effort to move out of its isolationist setting. As a key Pacific power, it is to our benefit to encourage the rise of a China that interacts regularly with and is at peace with its neighbors.

China and the United States are complementary in terms of their basic economic needs and resources. We are China's leading export market as well as the most logical partner to help upgrade its technology through investment and joint venturing. In turn, China is the most promising new market for American business and agriculture.

China's huge development and infrastructure needs can pro-

vide enormous export and investment opportunities for U.S. companies seeking geographic diversification. In the important area of higher education, U.S. colleges and universities are a popular place for wealthier Chinese to send their children, especially for graduate education. Such activity has the added potential of generating personal and intellectual bridges between the two nations.

However, China's distance from the West is greater than a glance at the globe suggests. Central differences exist in historical experience, cultural orientation, and political and social institutions. The rule of law is still essentially a foreign concept. Viewed in this light, let us see how we can deal with the main issues that will either separate our two powerful nations or bring them closer.

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It may be surprising for an economist to start with military rather than economic issues, but matters of war and peace are fundamental. The continued expansion of China's military power should be acknowledged as potentially destabilizing. However, the sensible response is not to try to talk Beijing out of what it thinks is a reasonable position.

Instead, we should simply but clearly note that, in terms of our vital interests, the expansion of China's armed strength provides a compelling justification for the maintenance of a substantial U.S. military presence in East Asia. The United States maintains security alliances with Japan, South Korea, the Philippines, Thailand, and Australia. Yet a China that is secure from foreign threat and can protect its legitimate sovereignty is desirable for both Asian and American vital interests. On the other hand, coercive pressure by China against its neighbors in the South China Sea or against Taiwan only serves to escalate tensions in East Asia.

Anyone who follows domestic political trends in the United States knows that strong pressure exists for devoting an increas-



ing share of the federal budget to domestic matters. Our willingness to assign a significant amount of our military resources to East Asia reflects the high priority that we give to stable relations in that region.

In the area of economic policy, the United States remains the main bulwark of free flows of commerce and capital across the globe. Nevertheless, because we are a democracy, we respond to the concerns of our citizens as expressed in the political process. Thus, when Chinese officials dismiss these concerns as “just domestic politics,” they demonstrate that they do not yet understand how a democracy works.

It is unrealistic for China to expect that we can maintain a fully open market in the face of the following combination of adverse factors: (1) a host of barriers to U.S. exports to China, (2) severe restraints on the operations of U.S. firms in China, (3) lack of a functioning legal system that provides local citizens as well as foreigners with essential protection of individual liberty and property, and (4) overt discrimination against and persecution of people that many Americans identify with.

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*In developing closer relations with China, trade-offs are inevitable.... Our government must balance concern for human rights against other important interests which also have significant moral aspects—such as peace, national security, and prosperity of our citizens.*

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Nevertheless, it is counterproductive for us to try to tell China what to do under those circumstances. It is most appropriate for the United States to clearly explain our position, motivation, and actions. We sincerely hope that China continues to open up its economy and to achieve more of the freedoms to which the citizens of other advanced societies have grown accustomed.

However, if it chooses not to take these enlightened positions, China will postpone the time when it gains full membership in the global marketplace and the family of modern societies. Clearly our preference is to welcome China into that desirable relationship sooner rather than later.

In developing closer relations with China, trade-offs are inevitable. While private organizations emphasizing single issues

are free to take absolutist positions, it is foolish for governments to do so. Our government must balance concern for human rights against other important interests which also have significant moral aspects—such as peace, national security, and prosperity of our citizens.

The United States maintains peaceful and friendly relations with many nations that do not share our fundamental beliefs. But those relationships are not nearly as strong or as enduring. A virtuous circle is possible. Closer economic and individual ties in turn can lead to improved mutual understanding—and vice versa. Thus, we should welcome the development of improved relations with China and further progress in the day-to-day interactions of our citizens, but we should be prepared for less happy outcomes.