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In the Land of Chimerica

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Water finds its own level; capital chases its required labour. No sooner had China opened its economy to the global marketplace, three decades ago, American capital rushed in to capture Chinese workers. World capitalism rejuvenated. But soon an irony surfaced.

America at home faced an economic decline not only in older manufactures such as textiles, iron and steel, shipbuilding, and basic chemicals, but also in global shares of robotics, aerospace, automobiles, machine tools, and computers. The second sector of decline was agriculture. At present the American economy is but a service sector show. Meanwhile, entry of one billion workers worldwide into factories reduced wages, inflation, and interest rates. In the US, cheap imports provoked conspicuous consumptions, and sucked vast wealth from profuse luxury of the wealthy. Personal savings dropped to zero, leaving nil of the national income for productive investment. The economy fell into a chaos.

America follows the economics of capitalism which had led it to near bankruptcy. With great candor, China has adopted a historically archaic approach known as Mercantilism, that prevailed during the feudal period of Middle Ages in Europe, and yet remains evidently effective for an economy with massive unemployment as in China. The three tenets of mercantilism are: export monopolizing, exchange control, and trade-surplus maximization. Judicious exchange control is the key instrument to achieve the other two objectives. China has handled the key very well.

China has in effect become banker to the United States. It has the world's largest foreign exchange reserves, valued at two trillion dollars, with more than half of those holdings estimated to be made up of United States Treasuries and other dollar-denominated bonds. Foreign direct investment in China, mostly by the US, now totals about 40 percent of Chinese national income per year.

The dual country of "Chimerica"–China plus America–accounts for a tenth of the world's land surface, a quarter of its population, a third of its economic output, and more than half of global economic growth in the first decade of this century. How are the prospects of Chimerica? Is China's growth sustainable?

America : Scapegoat Hunting

After two secure decades of tranquil progress since World War II, American economy entered into turbulence, both domestic and international. Vietnam War had begun. Bursts of accelerating inflation, higher chronic and cyclical unemployment, bankruptcies, and crushing interest rates were mixed with periods of troubled expansion. A deep recession in 1975 was followed by financial crisis every ten years. In 2000, American economy plunged at the brink of depression.

Music of blame game started. Chairman of the central bank of America laid the responsibility for America's economic mess at the door of Asia. "If you want to know where the global crisis came from, then, think of it this way. ... The causes lay not in America, but in Asia,'' sang Ben Bernanke and Paul Krugman in chorus.

In the aftermath of the financial crisis of 1997-98, a number of East Asian countries began to build up large quantities of foreign exchange reserves. These 'war chests' of foreign reserves have been used as a buffer against potential capital outflows. Additionally, reserves were accumulated in the context of foreign exchange interventions intended to promote export-led growth by preventing exchange-rate appreciation. Many East Asian countries seeking to stimulate their exports had high domestic *rate* of savings. As a result, there arose what Bernanke calls a 'global saving glut', dollar-denominated and accumulated in Asia.

Bernanke's conclusion is based on the data of 1996-2003, whereas the Asian crisis took place in 1997-98. The emerging market-economies of Asia have a comparatively high *rate* of savings; but given the size of the economies, the *volume* of savings over as short a period as five years between 1999 and 2003 could hardly be large enough to overwhelm the global economic order, contrary to the Bernanke-Krugman thesis that the Asian 'saving glut' is at the root of the global recession.

Where is the glut, the oversupply, of savings? The US saving rate is, to begin with, low in comparison with that of Asia, and shrinking since the 1960s at an almost constant speed through the decades. In the sixties the ratio between saving and national income in America was 12 percent. It eroded more than two-percentage points per decade.

America's savings lagged behind investment all along since the sixties, and the distance between the two widened. The gaps were filled with loans from overseas. Foreign borrowing by the US was not an innovation recently introduced, nor was it an evidence of the existence of a 'glut' of any kind.

Meanwhile, income distribution in the US had skewed in favour of the rich. Wages and salary to the working class had descended from 57 percent of national income to 53 percent in five decades. Thus the share of profits, interest and rent in national income had gone up. No surprise, the affluent class had enjoyed lavish luxury at the expense of the American economy.

As the saving-glut theory fell apart, the pundits changed the track to thrash the alleged mercantilism of China. Unlike dollar, euro, or yen, whose values fluctuate freely, China's currency is pegged by official policy at about 6.8 yuan to the dollar. At this exchange rate, Chinese manufacturing has a large cost advantage over its rivals, leading to huge trade surpluses.

But, why would anyone blame China's trade policy? After all, Paul Samuelson, no less, approved mer-cantilism under certain circumstances, i.e. unemployment. 'With employ-ment less than full ...all the mercan-tilistic arguments turn out to be valid.' The iconic economist had warned that persistently fixed exchange rates might create 'genuine problems for free-trade apologetics.' For the next couple of years, China's exports may end up reducing US employment by about 1.4 million jobs. But traders in a free market cannot be held guilty for their legitimate business.

'Perhaps, too, it will be a financial crisis that signals the twilight for the American supremacy,' forecasted Naill Ferguson. Britain's decline from the status of world power was, indeed, driven by bad economics. Its capita-lism was old-fashioned and rigid; its industries set up as small cottage-scale enterprises with skilled craftsmen rather than the mass factories that sprang up in Germany and the United States. The goods it was producing represented the past rather than the future. There were signs of broader cultural problems as well. A wealthier Britain was losing its focus on practical education, and British society retained a feudal cast, given to it by its land-owning aristocracy.

Despite some eerie parallels (in hegemony, military campaign) between the position of the United States today and that of the British Empire a century ago, there are key differences. Manufacturing has, of course, been leaving the country, turning the US into a service eco-nomy. America still retains the privilege of being at the forefront of research, innovation, and enterprise, capable of leading the next revolution in science, technology, and industry. Its universities, academic institutes, and scientific laboratories are superb.

Historians have found a very significant correlation over the long term between a country's productive and revenue-raising capacity on the one hand and its military strength on the other. America spends more on the defense and research-and-development than the rest of the world put together. Military expendi-ture has become comparatively affor-dable. Price tags, so far, for Iraq and Afghanistan together measure less than one percent of America's national income (GDP), as against nearly double of that much in the war in Vietnam alone.

Meanwhile, an unprecedented factor has intervened: America has unilaterally imposed upon itself a formidable ‘responsibility’, i.e. ‘to fight against negative stereotypes of Islam wherever they appear’ (vide the speech of the president in Cairo, July, 2009). This project would absorb an enormous magnitude of resources, monetary as well as human.

America is thus caught in a double malady : 'imperial overstretch' of global commitment to mend people's faith (fight against negative stereotypes wherever they may appear) on the one hand, and cronically unbalanced domestic finances on the other. Thanks to its strategic maneuver, British Empire could linger for a while even after having crossed the peak of its economic prowess. One doubts if America could receive such respite.

China : Boom Sustainable?

China has become a major financial and trade power. Its state-owned banks have become a main engine of the global recovery, financing the construction of copper mines, purchase of airplanes, expansion of retail stores and other projects, even as their US and European counterparts scale back lending.

The bulk of loans from Chinese banks are staying in the country; they are a key part of China's 586 billion dollar stimulus package. While the stimulus is largely directed at domestic infrastructure projects, it is also helping inject large amounts of liquidity in other countries around the world. As the amount of dollars flowing in from trade continues to increase each year, the need for the dollars to be recycled out of China grows with it.

On top of the billion-dollar stimulus money, the state-run banks were told to increase their lending by double that amount. It seems to have had two effects—domestic, and foreign. A spree of easy money fueled rises in the price of assets, like stocks and real estate, with the danger of possible speculative bubbles in the economy. Japan, a historical example, still suffers the pains of asset-bubbles that burst upon it two decades ago.

Chinese banks made top headline deals with foreign borrowers. South Africa's Standard Bank Group singed with four banks for a one-billion-dollar loan. The lenders were generous in debt spreading. Several companies received loans from Chinese banks much more than they had sought. The APA Group in Australia asked for 90 million dollars—got an extra of 20 million. Trafigura, a Dutch commodity trading company, wanted 505 million, ended up with 700 million.

It resembles an episode in Latin America not long ago. In the 1980s, awash with petro-dollar deposits, north American banks *pushed* prolific loans into south America. Overburdened with loan-repayment default, Latin America had to write off 1980s as its 'lost decade'.

China's markets may be full of bubbles ripe for a speculator. James Chanon, one of America's most suc-cessful short-sellers, is now warning that China is 'Dubai times 1,000 - or worse', and looking for ways to fish in troubled waters. But he may be fooling himself.

First of all, it is absurd to think of pulling down an economy such as China's that has 2.3 trillion dollars of foreign currency reserves (highest in the world), most of it in US dollars, and rising.

Second, China's economy may have bubbles, recessions, turbulence at the moment; but consider its long-term investments of last two decades in infrastructure, industries, education, together with the reverse-brain drain of innumerable Chinese talented scholars, scientists, engineers, businessmen, financial managers from abroad, not excluding America. China also now has 400 million Internet users, one-half of whom have broadband - America has less than one-half of China's number of broadband users.

More and more Chinese students educated abroad are coming back to work and start new businesses in China. Tony Chan, a Hong Kong-born mathematician, has returned home after twenty years in the United States, leaving his position of Assistant Director of the US National Science Foundation in charge of the mathematical and physical sciences. He joins now as the new president of the Hong Kong University of Science and Technology (HKUST). Tony Chan is one of many coming home.

Given its present situation, American economy would slow down for some time: its growth rate falling between one-and-two percent, as against the usual three-to-four percent. China need not worry about that market as it has mastered the technique of exporting inexpensive merchandise that assuages American appetite. Confronted with the blizzard of Chinese imports, Europe and America would resort to protec-tionism, i.e. levy import duties or fix quota. A trade war with China would be disastrous and bound to escalate around the world.

With nearly a billion people still clawing to advance beyond peasant status, they say, China's growth story has many chapters ahead. □□□