China and the World Economy

The Great Rebalancing

Trade, Conflict, and the Perilous Road Ahead for the World Economy

By Michael Pettis

Princeton University Press, 2013

216 pages, ISBN 978-0691158686, Paperback

The Globalization Paradox

Democracy and the Future of the World Economy

By Dani Rodrik

W.W. Norton & Company, 2012

368 pages, ISBN 978-0393341287, Paperback

The Leaderless Economy

Why the World Economy System Fell Apart and How to Fix It

By Peter Temin and David Vines

Princeton University Press, 2013

320 pages, ISBN 978-1400846641, Paperback

Reviewed by Edward Friedman

The global impact of China's rise, as presented by these informed and insightful authors, is counterintuitive. For educated people who lack expertise in international political economy, China's rise is simply a great success. China will soon be the world's largest economy. It is often described as the world's factory. Its exports have allowed China to amass more than the equivalent of three trillion US dollars in foreign exchange, a feat that puts China in a class of its own. For these authors, this unique China endangers the global economy.

In the conventional wisdom, feckless American consumers buy instead of saving, whereas disciplined Chinese save for the future. The Chinese state then invests those savings in Chinese industrialization and the virtuous rise. But international political economy and these authors dismiss this morality tale as economic nonsense. In fact, they all establish that Chinese policies create and deepen global imbalances and crises.

States that run industrial policies to artificially out-compete others in global industrial exports—especially China, Japan, and Germany—create impossible dilemmas for the industrialized democracies. The trade deficits and misaligned currencies that result from their industrial policies threaten to undermine the global trading system and the wealth it produces. Unless the currency surplus states, among which China is far and away number one, change their policies to facilitate growth for the deficit states, the world could find itself repeating the disasters that ravaged Europe for the quarter-century after World War I.

In deficit states where governments cannot grapple with the dilemmas created by China et al., stressed people historically turn to extremists and demagogues. After World War I, this led to fascism, Stalinism, the Great Depression, Nazism, World War II, and the Holocaust. Understanding the impossible dilemmas created by surplus states such as China, as all of these excellent books do, is vital for a world of peace with prosperity. Currently, China continues with its policies that imbalance and strain the world economy, creating worse problems than Germany did for Britain before World War I. Since Chinese industrial policies resemble German industrial policies on steroids, worst-case outcomes, then, are ever more likely.

Understanding the impossible dilemmas created by surplus states such as China, as all of these excellent books do, is vital for a world of peace with prosperity.

All the authors brilliantly illuminate these political dynamics of a dangerously imbalanced world economy. Pettis works hardest to make the material accessible. He is the only one of the authors with a sure grasp of China and Asia. Temin and Vines are more theoretically abstract. They are the least informed about China and Asia, even conflating Thailand and Taiwan. Rodrik covers the most ground and uniquely explores what these crises mean for democracy.

A key point is that savings to fund subsidized industrial exports do not result from frugal citizens. Instead, the state policies of Germany at the end of the nineteenth century and of China today repress consumption so that cheap capital is funneled into artificially low-priced industrial exports. This hurt exports and employment in Britain before World War I and hurts the US today.

Temin and Vines believe that China's refusal to change these export-led development policies will bring global economic crisis. The "destabilizing policy of China needs to change" (248).

Britain then and America now are placed on the horns of a painful dilemma. They can respond by cutting the price of their currency, which could unleash a global currency war that could wound world trade, or they could declare war on their own working people to decrease the cost of their exports—a policy that historically leads to the rise of extremists and demagogues. The cause of the impossible dilemmas is not a lack of discipline in the deficit states but the industrial policies of countries that imbalance the world economy to build huge surpluses. Today, this means—first and foremost—China.

In Rodrik's words, "The United States is no longer the dominant economic superpower, and major emerging markets (China especially) can no longer . . . be allowed to remain free riders" (236). To compete with China, other countries would have to end environmental and labor standards, leading to a race to the bottom: "China was globalization's greatest success story during the last quarter century . . . Yet it may prove to be the reason for its downfall during the next" (273). "The conflict that poses the greatest threat in the near term concerns China's trade imbalance" (274). "China's trade imbalance threatens the world economy, but so does a significant slowdown in its growth" (276). These examples make it obvious that Rodrik believes China's industrial policies foster impossible dilemmas on a number of counts.

China specialist Pettis views Beijing's distorted policies as creating global imbalances rather than stimulating world growth. Yet for Chinese ruling groups, their industrial policies are the source of China's rise and their legitimacy. Why, then, would they change policies that threaten the world trading system and global prosperity?

Finally, Temin and Vines see a disturbing similarity between China-US relations and those of contemporary Germany and southern Europe. The onus for reform to contain crisis rests with the surplus governments Berlin and Beijing. China must change its industrial policies, such as fixed renminbi-dollar exchange rates, that privilege Chinese industrial exports and create dangerous global imbalances. But what happens if China won't abandon export-led development policies based upon acute depreciation of Chinese real exchange rates, policies that affect US employment? Less demand in China, caused by "repressed costs and prices of a number of factors of production," which act as industrial "subsidies" (237), means continued current account surpluses between China and other countries. Europe and America are "unable to adjust vis-à-vis China ... because of the pegged renminbi-dollar exchange rate" (233). Temin and Vines believe that China's refusal to change these export-led development policies will bring global economic crisis. The "destabilizing policy of China needs to change" (248).

The other authors agree with Temin and Vines that if China promoted domestic consumption instead of export-oriented growth, the world economy would be healthier. So far, however, all Chinese policy initiatives in that better direction have been blocked by vested interests. Still, the authors hold out hope that at some point, having to choose between global disaster and China's entrenched policy interests, China's ruling groups will be forced to do the right thing. Whether that turning point is reached before global crises become extraordinarily destructive cannot be predicted by any known economic science. ■

EDWARD FRIEDMAN, who specializes in Chinese Politics and in International Political Economy, is Professor Emeritus in the Department of Political Science at the University of Wisconsin, Madison. He was Chief Editor of the 2012 *Tombstone* (FSG), written by Yang Jisheng, condensing and reorganizing a translated version of the 1,100+ page Chinese-language original.