America’s economic retreat threatens China’s rise

In US eyes, the new trade deals are looking more like a useful strategy to lock out the Chinese

China’s rise was made in America. The ingenuity and industriousness of its people aside, China’s extraordinarily rapid emergence as the world’s second-largest economy was made possible by an open international economic system designed and built by the US. Now Beijing has serious cause for concern. What America makes, it may also be able to break.

The fiscal stand-off in Washington has drawn sharp words from the People’s Republic. US President Barack Obama and Republicans in Congress have been told in no uncertain terms that China expects Washington to live up to its global responsibilities. Behind such words lie deep concerns. China’s growth rate has already slowed. Another shock and it could sink beyond the 6 or 7 per cent deemed necessary by the Communist party to underwrite political and social order,

These are not the best of times for American power and prestige. Mr Obama’s contortions over Syria and his willingness to talk to Iran have left traditional Arab allies seething, Turkey has chosen a Chinese over an American air defence system, while Israeli prime minister Benjamin Netanyahu rails that Mr Obama is too soft on Palestinians as well as Iranians. These countries have all made plenty of their own mistakes, but it is hard to think of a time when mistrust of the US in the Middle East was quite so high.

The government shutdown forced Mr Obama to cancel appearances at the Asia-Pacific Economic Cooperation forum in Bali and the East Asia Summit in Brunei. His absence and the fiscal farce playing out in Washington scarcely inspire confidence as to the administration’s much-vaunted “pivot to Asia”. Presence matters in this part of the world, and Mr Obama left the stage to Chinese President Xi Jinping.

For his part Mr Xi is left with a trinity of concerns about the direction of US policy. The first two are serious but cyclical. The third is the dangerous one – a structural shift that threatens China’s medium to long-term economic prospects.

The most immediate worry for Beijing is that a protracted stalemate in Washington would send the US economy back into recession and throw markets into a tailspin. If the holder of the world’s reserve currency cannot (or will not) pay its bills on time, what future for the global financial system? China would not escape lightly from a US default.
The second thing disturbing Beijing is that the continued weakness of the dollar is devaluing China’s huge stock of US debt. China held nearly $1.3tn of US Treasury securities in July 2013, putting it at the top of the international table – ahead of Japan. Chinese officials have long complained that the US is inflating away its debts, shifting the burden of economic adjustment on to those with large dollar holdings. There is little they can do. The US response to such complaints is a shrug of the shoulders that says no one is asking Beijing to buy US debt. It could always go elsewhere.

The big threat, though, comes in the third dimension of US policy: a shift that is seeing the US move from acting as the guarantor of broadly based multilateral rules to a preference for small coalitions with its friends. Washington is edging back from the liberal order it created after the second world war.

This order allowed western Europe to rise from the rubble, assured US hegemony and solidified the western alliance in response to the Soviet threat. America’s national interest was perfectly aligned with its international responsibilities as the world’s leading economic power. What was good for the Germany, for France, Britain and others, was also good for America, which needed strong and prosperous allies.

As Ashley Tellis of the Carnegie Endowment told a conference hosted by the International Institute for Strategic Studies in Bahrain this week, the postwar economic settlement is now fracturing. What the US had not reckoned on was that the emerging powers in general and China in particular would also be beneficiaries of this US-led system.

The rise of the rest has muddied the relationship between US interests and its provision of global public goods. China now looks set fair to become the world’s largest economy. Empowering a country that would then challenge US hegemony was not part of the postwar game plan.

So the US is swapping postwar multilateralism for preferential trade and investment deals with like-minded nations. As I heard Mr Tellis tell it, this means sideling comprehensive trade arrangements in favour of bilateral and regional deals where Washington can more readily identify its interests.

In an ideal world, the proposed Trans-Pacific Partnership and the Transatlantic Trade and Investment Pact would serve as frameworks for subsequent, inclusive trading and investment rules – a bridge back to multilateralism. But in US eyes, they are looking more like a useful strategy to lock out China. Of course, these negotiations could fail – on questions of trade there are formidable differences even among friends. But the trajectory has been set: just as the US is scaling back its provision of global security, so it is taking a more hard-edged view of its role as guarantor of the open economic system.

Beijing should be worried. However destabilising the present shenanigans in Washington are in the short term, sustained prosperity in China rests above all on access to a level international playing field. Without strong US backing, the multilateral order will fall into further disrepair and globalisation will give way to fragmentation. China, the biggest gainer from the liberal order, would be the biggest loser from its demise.

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