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China Policy, Not Prosperity, the Risk

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WASHINGTON — Obsessed with rankings, Americans are bound to see the Beijing Olympics as a metaphor for a larger and more troubling question. Will China overtake the United States as the world's biggest economy? Well, stop worrying. It almost certainly will.

China's economy is now only a fourth the size of the $14 trillion U.S. economy, but given plausible growth rates in both countries, China's output will exceed America's in the 2020s, projects Goldman Sachs.

But this is the wrong worry. By itself, a richer China does not make America poorer. Indeed, because there are so many more Chinese than Americans, average Chinese living standards may lag behind ours indefinitely. By Goldman's projections, average American incomes will still be twice Chinese incomes in 2050.

The real threat from China lies elsewhere. It is that China will destabilize the world economy. It will distort trade, foster huge financial imbalances and trigger a contentious competition for scarce raw materials. Symptoms of instability have already surfaced, and if they grow worse, everyone — including the Chinese — may suffer. China is now "challenging some of the fundamental tenets of the existing (global) economic system," says economist C. Fred Bergsten of the Peterson Institute.

This is no small matter. Growing trade and the cross-border transfers of technology and management skills contributed to history's greatest surge of prosperity. Living standards, as measured by per capita incomes, have skyrocketed since 1950: up 10 times in Japan, 16 times in South Korea, four times in France and three times in the United States. Significantly, these gains occurred without serious political conflict. With the exception of oil, world commerce expanded quietly. The chief sources of global strife have been ideology, nationalism, religion and ethnic conflict.

Economics could now join this list, because the balance of power is shifting. The United States was the old order's main architect, and China is a rising power of the new. Their approaches contrast dramatically.

Economically dominant after World War II, the United States defined its interests as promoting the prosperity of its allies. The aims were to combat communism and prevent another Great Depression. Countries would make mutual trade concessions. They would not manipulate their currencies to gain advantage. Raw materials would be available at non-discriminatory prices. These norms were mostly honored, though some countries flouted them.

China's political goals differ. High economic growth and job creation aim to raise living standards and absorb the huge rural migration to expanding cities. Economist Donald Straszheim of Roth Capital Partners estimates the urban inflow at about 17 million people annually.

As he says, China sees export-led economic growth as a magnet for foreign investment that brings modern technology and management skills. Prosperity is considered essential to maintaining public order and the Communist Party's political monopoly.

At first, China pursued its ambitions within the existing global framework. Indeed, the United States supported China's membership in the World Trade Organization in 2001. But as it grows richer, China increasingly ignores old norms, Bergsten argues.

It runs a predatory trade policy by keeping its currency, the renminbi, at artificially low levels. That stimulates exportled growth. From 2000 to 2007, China's current account surplus — a broad measure of trade flows — ballooned from 1.7 percent of gross domestic product to 11.1 percent. The biggest losers are not U.S. manufacturers but developing countries whose labor-intensive exports are most disadvantaged.

Next, China strives to lock up supplies of essential raw materials: oil, natural gas, copper. If other countries suffer, so what? Both the United States and China are self-interested. But the United States has seen a prosperous global economy as a means to expanding its power, while China sees the global economy — guaranteed markets for its exports and raw materials — as the means to promoting domestic stability.

The policies are increasingly on a collision course. China's undervalued currency and massive trade surpluses have produced $1.8 trillion in foreign exchange reserves (China in effect stockpiles the currencies it earns in trade). Along with its artificial export advantage, China has the cash to buy big stakes in American and other foreign firms. Predictably, that's stirred a political backlash in the United States and elsewhere.

The rigid renminbi has contributed to the euro's rise against the dollar, threatening Europe with recession. China has undermined world trade negotiations, and its appetite for raw materials leads it to support renegade regimes (Iran, Sudan).

The world economy faces other threats: catastrophic oil interruptions; disruptive money flows. But the Chinese-American schism poses a dilemma for the next president. If we do nothing, China's economic nationalism may weaken the world economy — but if we retaliate by becoming more nationalistic ourselves, we may do the same.

Globalization means interdependence; major nations ignore that at their peril.