

China's economic
expansion:
implications for u.s.
trade and hegemonic
stability



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A Changing Global Landscape

China is very rapidly approaching economic parity with the United States, which may lead to significant global shifts in power. Hegemonic stability theory suggests that an international system is more likely to remain stable if a single player is a dominant world power, thus the global equilibrium tends toward a hegemonic state.[1] The United States emerged as the global hegemon after World War II, specifically in terms of economic power, and has largely provided stability for the global economic system since that time. While the U. S. has been able to maintain this position throughout most of the 20th Century, China is rapidly rising as an influential economic player and could potentially displace the United States as the global economic leader. China's ambitious economic expansion projects, including the New Silk Road initiative and Made in China 2025, have the potential to shift the nexus of economic power from the United States' and the West

toward a Europe-China-centric scenario. Additionally, the rise of populist-nationalist political rhetoric within the United States could portend a policy shift toward economic protectionism, which would further accelerate the demise of the U. S. economic hegemon and the rise of China as its successor. It would be in the best interest of the United States to engage with China in a cooperative and mutually beneficial way, perhaps even as a partner in China's economic development initiatives, in order to preserve American economic prosperity.

China's Economy: An Historic Overview

Insight into China's modern strategy for economic expansion is only possible within the context of China's past. Throughout most of China's history, the Chinese economy was barely able to meet the basic needs of the country's huge population, including its basic nutritional needs.[2] Drought, war and social unrest often led to periods of famine and mass starvation before 1949, when the Chinese Communist Party came to power.[3] After this transition, food storage became centrally controlled by the government. This method allowed the country to successfully avert famine, and food production grew rapidly after 1949. This increase in productivity was largely matched by population growth until the one-child policy was instituted in the 1980's, thus the increased production capacity was not able to outpace essential consumption needs, and very little surplus was produced.[4]

The long-term goal of the Communist party was to transform China into a modern, industrialized nation with improved living standards and minimal economic disparity (i. e. a classless society), and to modernize military equipment. The government leadership initially adopted the Soviet

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economic model, which focused on achieving a high rate of economic growth that emphasized industrial development at the expense of agricultural development. Through this process, a solid foundation was created in iron and steel manufacturing, coal mining, cement making and other modern industrial technologies. Although the government also endeavored to facilitate the mobilization of agricultural resources by encouraging farmers to organize into increasingly large and socialized collective units, the results were not as dramatic as the level of growth within the industrial sectors.[5]

In response to the tepid growth in the agricultural sector, in 1957 the Chinese government largely shifted authority for economic decision making to the provincial, county, and local level. During this time, the Chinese leadership abandoned the Soviet model and instead adopted an approach that relied on spontaneous efforts by the entire population to induce a “great leap” within all economic sectors at once, which helped to stimulate agricultural growth. The initial problem with this approach was the lack of sufficient capital to invest in both industrial development and agriculture simultaneously. To overcome this problem, the leadership attempted to create capital within the agricultural sector by building vast irrigation systems, employing huge teams of underemployed farmers.[6]

Despite these advances, the Cultural Revolution of the 1960s under Mao Zedong severely stifled technological innovation within China.[7] This was largely a political phenomenon, where the Communist Party attempted to consolidate power by expelling any hint of budding capitalist ideas, Chinese traditionalists, and intellectuals. However, it had a pronounced effect on the growing Chinese economy. Factory managers were largely replaced with <https://assignbuster.com/chinas-economic-expansion-implications-for-us-trade-and-hegemonic-stability/>

Communist Party operatives who had very little knowledge of management or of the enterprise they were supposed to run. Engineers, scientists, and other professional personnel were sent to the countryside as laborers, or were jailed as dissidents. Additionally, the Cultural Revolution forced the closing of Universities, which severely hindered China's ability to develop new technology. This loss of key knowledge resulted in a 14% decline in industrial production by 1967.[8]

In the late 1970's, after the death of Mao, the Chinese government reaffirmed the modernization program espoused prior to the Cultural Revolution.[9] The Chinese leaders determined that the centrally planned economy had failed to produce sufficient economic growth, and had caused China to fall behind the industrialized powers of the West and the newly industrialized Asian nations. While the Communist leadership did not want to completely abandon the centrally planned economy idea, it strived to make it work better by increasing the role of market mechanisms and by reducing the level of centralized government control. For industry, this included increased autonomy and the ability of managers to keep profits instead of remitting everything earned to the state. While some key industries were still centrally controlled, individual enterprise was allowed (to an extent) as a means to incentivize economic growth and to reduce unemployment.[10]

In recent history, China has been less of an innovator and more of an imitator of foreign technology and innovations. China's modern industrial development paradigm lags behind that of the developed world. While the Chinese government has policy initiatives to encourage internal research <https://assignbuster.com/chinas-economic-expansion-implications-for-us-trade-and-hegemonic-stability/>

and development and technology transfer from outside economies, shortcomings from the pre-reform, planned economy era have constrained China's ability to efficiently innovate.

China's Modern Innovation Strategy

In order for any economy to innovate and grow, individual firms must focus on a combination of internal research and development efforts and external technology acquisition. In this context, the definition of "technology" is expanded from the vernacular to include processes and ideas that enhance a firm or organization's ability to compete.[11] Establishing a strategy that combines these efforts most efficiently is necessary to maximize overall economic development.[12] In modern microeconomic theory, internal research and development and external technology acquisition are considered to be complimentary innovation strategies. Economic activities are complimentary if the adoption of one does not preclude the other, and if the sum benefit of implementing both activities concurrently is greater than the benefit of implementing just one or the other.[13] Assuming the complementarity of internal research and development and external technology acquisition, authors Fu, Pietrobelli and Soete argue that the *absorptive capacity* of any small or medium firm within a developing economy is the limiting factor to successfully executing technology transfer. [14] The authors define *absorptive capacity* as "a firm's ability to recognize the value of new information, assimilate it, and apply it to commercial ends." [15]

In another study, Authors Hou and Mohnen[16] tested the complementarity of internal research and development and external technology transfer in <https://assignbuster.com/chinas-economic-expansion-implications-for-us-trade-and-hegemonic-stability/>

Chinese firms and found that the two technology acquisition strategies are indeed complimentary, but that external technology acquisition yielded higher returns than internal research and development for small and medium firms. Additionally, the authors found that state-ownership of firms correlated with both product and process innovation, presumably because of increased access to financial and policy support from the central government. This relationship would likely increase the absorptive capacity of the firm. This suggests that small and medium firms with no government connection may be at a disadvantage due to a reduced absorptive capacity, and may be incentivized to work closely with the central Chinese government in order to acquire the necessary resources to compete within the Chinese and global marketplace.[17] Thus, while China's modern economic development strategy is ostensibly about supporting the expansion of small, private firms, state-connections are highly incentivized by the market.

The New Silk Road

China's New Silk Road initiative is a logical extension of China's economic expansion and modernization efforts. This initiative is an allusion to its namesake trade network stretching from China to Central Asia and the Middle East, which was established over 2,000 years ago.[18] In 2013, China proposed establishing a modern analog to the ancient Silk Road; however, instead of transporting silk and spices, this would build a network of railways, pipelines and utility grids to link China to the Middle East and Eastern Europe via Central Asia.[19] Also known as the One Belt One Road Initiative (OBOR), this massive infrastructure project aims to create the

world's largest network for economic cooperation. This development would make it much more efficient for China to trade with 65 countries, representing 60 percent of the global population.[20] China markets the initiative as a net win for all parties involved, and host governments see the New Silk Road as an opportunity for job creation, economic development, and participation in the global supply chain.[21] The New Silk Road initiative would allow China to more efficiently project soft power within Asia, Africa and Europe, which could have significant trade and national security implications for the United States.

Chinese firms have increased their foreign investment within partner countries in order to pave the way for the New Silk Road. According to *the Economist*, several economic research organizations predict that the total Chinese investment abroad could rise to \$2 trillion USD by 2020.[22] For comparison, this figure was less than \$800 billion USD at the end of 2014. [23] As stated previously, Chinese firms are strongly incentivized to maintain connections with Chinese state-owned entities (or to be state-owned entities themselves), thus it stands to reason that much of the value earned through this investment will directly benefit the Chinese government. The Chinese regime's entanglement within the region will likely introduce significant hurdles to U. S. activities, and may diminish U. S. influence in Central Asia, the Middle East, and possibly Europe. It is worth noting that Beijing established \$100 billion USD Asian Infrastructure Investment Bank (AIID), a multinational funding body, to support New Silk Road investments. [24] The AIID currently has 57 members, including

Germany, the United Kingdom, France and Russia.[25] Notably absent is the United States.

Made in China 2025

Not only is China expanding its economic reach and soft power influence within Eurasia via the New Silk Road, but it is also working to shift its overall production upmarket from low level manufacturing to advanced technology development.[26] Made in China 2025 is an effort to completely upgrade Chinese industry. The Chinese government has outlined clear principles establishing the goals of the initiative, including a desire to comprehensively upgrade Chinese industry by making it more efficient so that it can participate in the highest-level global production chains. It also strives to create more innovation-driven manufacturing that emphasizes quality over quantity, environmentally sustainable development, and human capital management.[27] While these are worthy goals for any country, China's upmarket shift from manufacturing large quantities of inexpensive, low-quality goods to high-tech, high-quality products could disrupt the global market for high-tech goods because of China's large production capacity. In the same way that inexpensive Chinese manufacturing has shifted labor from the United States to China, an upmarket shift in China's manufacturing may have the same effect on highly skilled workers within the United States.

Implications for the United States

In order to mitigate the global effects of China's economic expansion that may be detrimental to the U. S. strategic position, it is imperative for the United States to engage with China in a cooperative and mutually beneficial way. President Donald Trump has been a vocal critic of trade deals, and has <https://assignbuster.com/chinas-economic-expansion-implications-for-us-trade-and-hegemonic-stability/>

been especially harsh on Beijing, effectively blaming low Chinese labor costs for the perceived lack of American jobs.[28] According to the United States Trade Representative, two-way trade with China was \$598 billion USD in 2015, thus making China the United States' largest trading partner.[29] If the anti-Chinese rhetoric manifests as higher tariffs on Chinese imports, China may focus its trade efforts away from the United States and toward its New Silk Road partners, thus significantly reducing U. S. international trade. [30]

The impact of arresting trade with China on U. S. gross domestic product (GDP) is difficult to ascertain due to competing variables, but it is likely to have a net negative effect. While tariffs would increase the net exports variable used in calculating GDP (the U. S. is a net importer from China), they may adversely affect other factors that contribute to GDP. For example, Chinese goods are less expensive to produce than U. S. and most European goods. Thus, if the United States diverts its import activities from China to Europe or increases domestic production, these goods will likely be more expensive than the Chinese alternatives, thus reducing overall domestic consumption within the United States. This new equilibrium would also affect the supply of domestic goods as demand decreases, thus also reducing U. S. investment in domestic production (and a subsequent reduction in demand for labor). Overall, this may lead to a net decrease in the U. S. GDP and a reduction in available jobs within the United States. This American jobs loss would be exacerbated further as China shifts its manufacturing capabilities upmarket via the Made in China 2025 initiative,

which may induce the offshoring highly skilled U. S. jobs in addition to skilled labor.

Not only would tariffs further incentivize China to focus its trade efforts on its New Silk Road partners, but they may evoke the second order effect of encouraging Europe to look to China for economic leadership. This could occur if China responds to U. S. tariffs by accelerating its economic expansion into Eastern Europe. This would likely reduce U. S. economic influence in Europe, and thus limit the U. S. ability to project soft power within the region. This would further shift the hegemon toward China as the global economic leader.

In conclusion, Chinese economic expansion activities, including the New Silk Road Initiative and Made in China 2025, could lead to a global hegemonic shift. This is especially true as China expands its influence toward Europe. As the United States' global influence wanes, Europe and U. S. allies within Central Asia may turn to China as the new hegemon – a new global economic leader. Global power structures are dynamic, and it is unlikely that the future global power landscape will encompass a unipolar U. S. hegemon as it has in the past. However, a multipolar hegemon including both the United States and China is surely possible. It would benefit the United States to engage China in a cooperative and mutually beneficial way by preserving economically liberal trade arrangements. Additionally, the U. S should strive to maintain its position as a major soft power player in Asia and Europe and work diligently to maintain its trade relationships within Europe and Central Asia, possibly through partnering with China on the New Silk Road. This is of

great strategic importance not only for the U. S. national security, but also for continued American economic prosperity.

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