

CHINA AND US IN THE NEW GLOBAL ORDER: The Role for the EU?

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China's long positive economic run is now coming to an end, with the prospect of great uncertainty and economic and political danger for all. Unfortunately for the Chinese Communist Party, continuous economic growth has become part of its 'performance legitimacy' without which it will have significant difficulties in maintaining its political authority and control over the country. The prospects of a more menacing China, aggressive abroad and repressive at home, place Washington and Brussels facing a much more dangerous and challenging future relationship with China than has been the case over the last three decades.

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The China we have got to know over the last 30 years is the rising China of boundless economic growth and endless economic optimism. However, the China which the US and the EU will face between now and 2050 is an economically stagnant China. A China where Beijing is a flagging competitor with the US. In many ways such a China will be a much more difficult state for the US and the EU to manage than the optimistic and rising power of the last thirty years. A rising China is, at least in theory, much easier to integrate into the international order. By contrast, a stagnant China which is much more externally aggressive seeking to create victories abroad to maintain support at home, while engaging in zero-sum mercantilist economic strategies, is much more difficult for Washington and Brussels to handle. In addition, increasingly severe internal repression will pose a range of human rights and values issues for the US and EU to deal with. In such a context, the principal relationship is likely to be between the US and China, with Washington seeking to use the carrots of market access and trade relationships to incentivise Beijing to work with the existing international order. The US in parallel will seek to militarily underpin the security of its Asian allies and bind them securely into a broader economic network unpicking much of the network of China reliant supply chains built up over the last three decades. The EU will not be unaffected by China's status as a flagging but aggressive competitor to the US. For instance, the underlying threat perception is likely to result in an even greater pivot to Asia by Washington, with deployment of more US naval forces to the Pacific.

Losing Competitive Advantage

China has had a great and long positive economic run but it is now coming to an end, with the prospect of great uncertainty and economic and political danger for all. China nominal GDP grew up from \$173 billion in 1979 to \$14 trillion in 2018, with a 12% year on year growth since the 1980s. It was fuelled by cheap credit from Chinese State Owned Banks (SOBs), a market of over 1 billion people with rising incomes and a huge demand for basic and consumer goods, favourable demographics, foreign investment and technology and increasingly open international markets. This opening was crowned by entry to the World Trade Organisation in 2001. Chinese economic growth continued to surge after WTO entry until the global financial crisis in 2008. At that point demand for Chinese products collapsed and the Chinese Communist Party (CCP) sought to replace demand by massive credit expansion. The post-2008 consequence resulted in a quadrupling of the debt to GDP ratio which now stands at over 300%.

This debt overhang would create a serious risk for the management of the Chinese economy even if its other competitive advantages had remained in place. One of the major drivers of Chinese economic development was increased access to foreign markets. Faced, with increasing Chinese protectionism which has steadily deepened since China joined the WTO, other states have begun to restrict trade access. This goes beyond the imposition of tariffs by the Trump Administration, to greater use of anti-dumping duties, to the imposition of tougher foreign investment rules and scrutiny of existing Chinese investments. Another major driver was Chinese self-sufficiency in food and energy both of which have now been lost due to rising demand and resource depletion. A further major driver was the late twentieth century demographic dividend since the number of young workers available in the market has fallen. The median age will have gone from 25 in 1990 to 48 in 2040. No country has aged so fast in modern history.

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In 2018 the leadership sought to begin to debt deleverage. However, by early 2019 falling demand compounded by the effect of 18 months of Trump's tariff had begun to decelerate the Chinese economy. As a consequence the CCP returned once again to the stimulus pump, despite the fears of adding to the debt pile and the increasing ineffectiveness of credit stimulus.

Reform or Aggression?

China could reform its economy. It could dismantle the stimulus machine, liquidate the State Owned Enterprises (SOE) and local government mechanisms which pump ever more credit into the economy. It could encourage a shift to greater consumption, privatise the banking sector and encourage lending to more credit worthy private businesses. However, if it were to do any of this at scale it would cause a ma-

job recession, unemployment and a large number of bankruptcies. This would be politically unacceptable. Thirty years of economic growth have seduced the population into the belief that continuous economic growth is normal. Unfortunately for the CCP such continuous economic growth has become part of its 'performance legitimacy' without which it will have significant difficulties in maintaining its political authority and control over the country. Furthermore, from a strategic perspective, undermining the SOEs, SOBs and local government entities and empowering non-party controlled private enterprise and permitting private banks would weaken the hold of the CCP on the levers of political and economic power.

It is best to judge the 'Belt and Road Initiative' (BRI) in the light of this Chinese elite economic desperation. The primary aim is to build roads and railways across the globe to keep the industrial-political complex in business. But such projects fundamentally depend on third states being willing to take on debt themselves. Few states however are going to be willing to take on Chinese levels of debt to keep the Chinese industrial-political complex going.

The other more menacing Chinese options that the world may face are aggression abroad and repression at home. Aside from rhetoric against the West such aggression is likely to be felt primarily by its Asian neighbours with Taiwan and Japan.

Internally, faced with a slowing economy and too few means to maintain significant levels of economic growth the CCP is likely to respond by increasing repression against any signs of dissent. It will also take more steps to bring the population under surveillance and social control. The CCP's willingness to undertake severe repression is underlined by the establishment of 're-education camps' for over a million Muslim Uyghurs in Xinjiang province, and with the willingness to adopt severe measures of repression in respect of the Hong Kong protests. This unwillingness to tolerate dissent will be underlined if repression in Hong Kong leads to the abandonment of the one country two systems agreement and the end of Hong Kong as a major centre for international finance.

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The US and EU Response

For reasons of geography and capacity the United States is likely to have the principal role in dealing with the new China. The Trump administration approach is probably an outlier of the strategy that US administrations will take to 2050 following a two track approach. First, given that mercantilist policies are highly unlikely to provide the growth China needs, the US is likely to trade market access for less aggression, but on

US terms. These could include some reciprocal market access, protection of intellectual property rights, and observance of the rules of the international trade order, including running down of China's predatory dumping by its SOEs. The second track involves working with the US's Asian allies, providing economic and military guarantees. This would include building alternative dense networks of supply chains. The US would also pivot further militarily into the Pacific to underpin its security guarantee to its Asian allies. This would include substantially more naval forces being based in the region than heretofore.

For the EU one major likely consequence of the US response is that there will be much greater pressure on the EU Member States to increase their own defence expenditures. This particular pressure from the Trump administration will continue beyond the end of the Trump presidency. It is also likely that the EU will ultimately see the value of offering greater trade access to China on the same terms as the US. A double offer on strict terms is much more attractive, underpins the terms and stops Beijing playing Washington and Brussels off against one another. The EU may also give greater consideration to the extent to which it can use its open regulatory standards to encourage Chinese companies to adopt EU standards. In an era of a stagnant China and with a need for greater market access, Chinese firms may be much more willing to adopt EU standards.

It may well be that the most difficult issue both the EU and the US have in grappling with the new China is dealing with the impact of growing internal repression. From 're-education camps' in Xinjiang province to the streets of Hong Kong, greater repression will create Western public and media calls for sanctions which will be hard to morally and politically resist. Washington and Brussels will be caught between the need to manage the trade and security relationship with China on one side, and on the other growing demands for sanctions against Beijing. In any event, what Washington and Brussels face is a much more dangerous and challenging relationship with the Middle Kingdom in the future than has been the case over the last three decades.