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China's Challenge to the West in the 21st Century

> millennium buttresses rather than erodes the international system we have constructed with such difficulty in this century. To that end, we must urgently consider how to speed up China's integration into existing institutions on acceptable terms.

Again, I would argue that the contrast with the USSR is mistaken: the anti-Western posture of prior contenders was always a product of the contender experience itself. Its failures and frustrations in one stage guide it to a more militant, radical confrontation in the next. We may look at France under Richelieu and then Napoleon; Germany under Bismarck and then under Hitler. In that light, the Russia under Witte and Stolypin which transforms itself into the USSR after World War I is less

David Kowalewski writes (1997: 87), 'Chinese elites, with their transnational connections, are the cutting edge for the outflow of na holdings, the historic British trading firm in Hong Kong. He developed valuable ties with the Deng family, as well as with the Thatchers in the UK.

Investment into China from the former British crown colony often represents capital from mainland enterprises seeking to evade taxes and other restrictions by 'investing' in Hong Kong and then 'investing' back again - a laundering process called 'round-tripping' (Zhou and Lall 2005: 45). The size of the property passing from state to private hands in these and other ways is such that the key handlers can attract major Western firms as partners. Thus, Huang Yantian, president of Guangdong province's GITIC investment corporation, forged links with McDonalds, PPG Industries, and Pabst Brewing from the US. Morgan Stanley of the US in October 1994 set up a joint international investment bank with the People's Construction Bank of China (with smaller participations from Singapore and Hong Kong investment companies), etc.

The decision to transform the large public corporations into joint stock companies with state majority ownership has further facilitated the transfer of public into private property and given the aspiring bourgeois element grounds to challenge the state's remaining prerogatives. Foreign capital is made part of the transition because of the requirement of a local partner if investments are made in China; this locks transnational corporations into an embrace with the state sector and its privatising offshoots, hotbeds of favouritism, corruption, and incompetence. It is perhaps a sign of things to come that senior executives have already spoken out for a further reduction of the state role and want the communist party to withdraw from the scandal-ridden, bankrupt banking sector (Hochraich 2003: 59).

The position of the overseas Chinese in Asia as a mercantile, 'market dominant' ethnic minority, all through their history has made them vulnerable to popular discontent, not least when an indigenous bourgeoisie finds the high grounds of the economy already occupied. Mainland China today wields the one's own. The process certainly crossed a crucial threshold when US politicians began to be paid by Asian sponsors, which really took off under Reagan and Bush I. The Chinese entered this game when Clinton began reaching out to them and various operators of Chinese background reciprocated to the point where their access to the Clinton White House broke into scandal. But then, as former Undersecretary of commerce Jeffrey Garten noted later (*Newsweek*, 31 March 1997), the push into emerging markets like China, India, and Brazil 'attracted a lot of foreigners who wanted to play in the new game... Our firms needed partners, local suppliers, help setting themselves up'. It was from these quarters that emerged shady sponsors of the Clinton re-election campaign such as former Commerce official John Huang, and an entire ring of Asian contacts of the Democratic Party as exposed in a scandal in 1996.

2. The Asian Crisis and the Disruption of the Japan-Centred Order

The Asian crisis of 1997-98 marks the moment in which the rise of the new Chinese economy overturned the cold war order in Asia. As I will argue in this section, it was this crisis that allowed Western capital to breach the barriers imposed by state-monitored economies of the Japanese type. Of course this does not mean the West therefore 'engineered' the crisis. The twists and turns by which contender states manoeuvre to engage in the catch-up effort, send shock-waves through the global political economy which create situations that are, as such, unpredictable. In each case, the test is not whether a positive theory predicts/explains in detail what happens on the ground, but whether a core structure like the heartland/contender one developed in this study, can still be developed to meaningfully account for the evolving complex of forces—acknowledging the new and the unexpected at the same time. Western investors were able to exploit the new openings in the Asian economies because they sensed that the tectonic shifts produced by the rise of China were working in their favour.

Japan is the linchpin of the Western position in Asia, the Pacific vassal in the contest with the Soviet bloc and until the 1970s, China. I already noted that there has been no integration process in East Asia comparable to that in Europe to guide the uneven development of capital into peaceful channels; it was left to the Japanese state and capitalist classes to organise the wider region themselves. Like all contender states pursuing a capitalist strategy, catch-up industrialisation in post-World War II Japan operated through finance capital structures (the *keiretsu*, the resurrected form of the pre-war *zaibatsu*), which had the domestic market very much to themselves thanks to an extensive system of quotas, tariffs, and import restrictions. The state ensured that industrial activity was spread across the economy but otherwise allowed the leading firms

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Ruigrok and Van Tulder 1995: 39-62). The corporations then organised the actual distribution of productive activity. Japanese capital in this way built up a regional socialisation of labour on a cost base that gave it a competitive edge over the United States. By the 1980s, it had also achieved a technological edge into which US capital sought to tap to secure its own development through joint ventures and consortia. Kenichi Ohmae at the time (1985) called this negotiated market structure, in which Europe was the third partner, 'Triad Power'.

The United States was never going to accept such a triangular structure in the longer run. The competitive side to its attitude towards Japan was evident in the 1970s already, and the legislative weapons forged to combat OPEC and the NIEO, were also deployed against Japanese textiles, consumer electronics, and steel exports to the United States. With the Carter administration, Japan agreed to an 'orderly market agreement' of voluntary export restrictions in 1977. Under Reagan, protectionist forces became more pronounced. The US pressured Tokyo into opening the Japanese market for computers, auto parts, interest rate ceilings and barriers between deposit banking and security firms, were first among foreign buyers of US treasury bonds. Japan would continue to meet American deficits in this way, but of course it also gained a weapon to defend itself against US pressure. Meanwhile Japanese capital was pouring into the United States at a rate between 25 and 50 billion dollars a year, with landmark take-overs such as Columbia Pictures by Sony and of MCA by Matsushita leading a wave of tariff hopping investment to maintain market positions in the US. The Japanese ministry of finance reported in May 1987 that of total Japanese FDI, 35 per cent, or $ 37.4 billion, had been invested in North America (against 21.7 billion in Asia, and 20.4 billion in Latin America) (Tolchin and Tolchin, 1989: 8-9, 185).

At this point, feeling was widespread that th corporations were equally cash-rich, leaving the banks with unused liquidity which then began to pour into real estate. Three-quarters of all lending for real estate purchases

But when Washington in early 1994 stepped up pressure on Tokyo to liberalise imports now that a falling dollar gave the US a competitive edge, the Japanese ministry of finance threatened in an oblique way that it might begin to divest itself of US treasury bonds. This unprecedented gesture of defiance showed that the Japanese ruling class was not going to capitulate.

Scattering the Flying Geese

The emergence of China in the global political economy as the new 'world factory' is the deeper cause of what became known as the 'Asian Crisis' of 1997-98. This is not a simple mechanism. The neoliberal globalisation drive entailing hedge fund exploitation of 'emerging markets'; the targeting of Japan by the Clinton administration; the Japanese position within the Asian economies and its history of rivalry with China; as well as the position of the overseas Chinese in the 'flying geese' economies organised by Japan and geared to exports to the US, all have to be entered into the equation to understand how the rise of China as the new contender and the financial crisis that spread across East Asia as far as Indonesia, are interconnected. But an important bottom line was the tacit deal struck between the United States and China to operate a transnational machinery that links American over-consumption to Chinese over-exploitation, a deal that includes the undervaluation of the Chinese currency, pegged to the dollar. This has the perverse effect of a downward trend in overall world consumption and production, because at the consuming end, only the United States can sustain demand by using its structural advantages as the organiser of the world economy and provider of its reserve currency; whilst at the producing end, the downward pressure on wages and working conditions worldwide by cheap Chinese exports (low wage costs plus an undervalued currency) depresses demand and production everywhere else. This accounts for the overproduction/under-consumption aspect of the Asian crisis that was exposed by the currency collapses as a result of short-term financial flows.

The absence of institutionalised regional integration in East Asia and the specific ethnic heterogeneity of the ruling classes within the separate states lend a particular fragility to the regional economic structure that crumbled in the crisis. The 'flying geese' arrangement was never a process of integral replication of the Japanese state-led economic development pattern; unlike the extended reproduction of state socialism, for instance, the different Asian societies and their conception of authority and the state role are incomparably more divergent (Bernard and Ravenhill 1995: 199). Yet in all cases we are looking at state classes controlling their economies to varying degrees through their political power. The Kuomintang in Taiwan controls a vast financial and commercial empire; Mahathir Mohamad's ruling party in Malaysia has links to large network of businesses; the Suharto children were on the boards of many companies; the People's Liberation Army of China ran a host of large corporations. However, 'as Asia's middle class becomes larger and more affluent, it will increasingly demand respect from its masters, more say in policy and more transparency in government's relations with

established in 1994 and run by a former senior official of the Federal Reserve Board along with two Nobel Prize winning economists; it went bankrupt in 1998. Although LTCM had its capital base in an offshore location for tax reasons, former colleagues at the Federal Reserve bailed out the operation at the cost of $ 3.6 billion of taxpayers' money—'as good an example of pure "crony capitalism",' comments Chalmers Johnson (2002: 216), 'as any ever attributed to the high-growth economies of East Asia.'

Capital inflows into the Southeast Asian countries were encouraged by the liberalisation of bank lending in the early 1980s (first in Malaysia, last in Thailand), stable (i.e., dollar-pegged) currencies and high interest rates. Japan in late 1996 decided to liberalise its financial markets too; a 'Big Bang' that brought a wave of Western investment bankers to Tokyo and led those who had offices there already, to upgrade their operations. All the hype about the Pacific Century after all seemed to be confirmed, in spite of the recent crisis of the Tokyo stock market. Indonesia was estimated to be the world's largest importer of private capital in 1996, Malaysia the 4th. However, money was no longer being invested in the export industries (which were stagnating), but diverted into the property sector, in a repeat operation of the Japanese bubble a decade earlier. Real estate loans accounted for an estimated 25 to 40 per cent of bank lending in Thailand, Malaysia and the Philippines in 1998, in large part funded by short-term credit (Nesvetailova 2002: 232-5).

In the summer of 1997, Western fund managers became distrustful of the levels of debt of some of the companies they had invested in, and began to withdraw capital. The mass flight out of the fragile Southeast Asian economies and South Korea that has gone down in history as the Asian Crisis, ensued. Thailand led the way with a net private capital outflow of 10.9 per cent of GDP in 1997 compared to an almost equal *in*flow the year before; followed by the Philippines which saw net private capital flows come to a standstill in 1997 compared to a 9.8 per cent (of GDP) inflow the year before. Short term capital ... andstw -21.31Tandst-21.Snet pri 5 i120(a)117117(pv511

destination of FDI in 2002, $ 53 billion flowed into the mainland economy alone. In 1990, the ASEAN countries, South Korea and Taiwan still attracted four times the direct investment flowing into China; in 2002, this had been completely reversed (Kim 2004: 158, 171; Zhou and Lall 2005: 42).

Two-thirds of FDI inflows into China are in manufacturing, with an upward trend of high-value added sectors such as semiconductors. I mentioned already that a large slice of the investment into and from Hong Kong is 'round-tripping' by operators from the mainland, and tax haven routing; according to one estimate (Zhou and Lall 2005: 45), official Hong Kong investment figures into China should be discounted by 40 per cent to skim off this moving around of funds from actual FDI. Along with the overseas Chinese and Taiwan, Hong Kong investment and (not through investment) US contract production, typically seeks to engage in low-wage manufacturing for export; Japanese capital goes to intermediate goods production for export to Japan; whereas US and European investment is typically in firms that are expected to cater to the Chinese market. Estimates of the share of foreign firms in China's exports range from one-quarter to half. China, then, is now part of the regional 'flying geese' formation, not as the organiser, as Japanese capital was before, but as a big goose somewhere in the middle, struggling to move up in the flight. The growing trade deficit with Singapore, South Korea and Taiwan between 1994 and 2004, and the parallel growth of the export surplus with the United States, support the thesis of a growing socialisation of labour in the region with elements of complementarity notably in electronics, which as a sector lends itself best to parcelling out different production stages.

However, signalling the ambition of a true contender, the Chinese state class is not content with being the recipient of investment. China aims to become a major foreign investor itself, with a vice premier announcing that Chinese firms must 'go global'. This strategy, which according to the leadership will benefit not only 'China's development but also the prosperity of the whole world', has already resulted in more than $2 billion government authorised foreign investment outflow in 2003. The acquisition by Chinese companies of IBM's PC arm and a French perfume retail chain, are spectacular instances of their aspirations and the current wave of sovereign wealth funds picking investments across the globe, not least in the hard-stricken financial sector in the West, only confirms that this is a real trend. The Chinese are becoming an active force in the global political economy in their hunt for resources across the continents—energy from Saudi Arabia, Kazakhstan, Sudan, and Angola; Cuban nickel, Brazilian iron ore and soy beans, et cetera. This inevitably restricts, to name but one aspect, US options in dealing with challenges in Latin America, and thus becomes part of global rivalries generated along the heartland/contender fracture.

Now as we have seen, every contender at some point faces the problem of having to adjust its political system to the class structure that emerges along with the modernisation emulating the heartland. The antagonism with the West can develop into a dynamic of its own in the process; Chinese nationalism thus can precipitate, but not solve, the transition problems that occur when a society finds itself in the 'wrong' type of state/society configuration, unable to merge into the expanding liberal universe. China is already experiencing specific difficulties in restructuring its society to an Asian capitalist format. Thus the aim of the Chinese state class is to create powerful business groups of the finance capital type, like the zaibatsu/keiretsu of Japan and the family-owned chaebols of Korea. But apart from the class of tycoons composed of overseas Chinese and privatising party leaders, an educated middle class is lacking, due to the shortfall in higher education. In combination with the limited size of the foreign-trained 'MBA' element referred to earlier, this may force the Chinese state class to forego its finance capital strategy and instead seek to follow Taiwan, where the state and the ruling party own or control some 50 per cent of corporate assets, accounting for around 30 per cent of the island's GNP. But that would only further consolidate the contender state configuration and complicate any further transition.

In the Asian crisis, China, itself insulated from currency speculation by capital controls and non-convertibility of its currency, was a tactical ally of the West. Japan on the other hand posed an acute threat to heartland hegemony when it proposed, in September 1997, to create an Asian Monetary Fund (AMF) to deal with the crisis. It offered to put up half of the initial $ 100 billion of the fund's capital. The US promptly rejected the proposal, calling it a way of prolonging Asian 'crony capitalism' and an invitation to fiscal imprudence in the stricken countries, given that the Japanese proposals departed from neoliberal orthodoxy. What Washington feared most, however, was the prospect of Japan assuming a larger political role in the Pacific region; earlier proposals that Asian 'super-exporters' shift their energies to 'unification projects in their own region' had been dismissed for this reason. Robert Rubin's deputy at the Treasury, former World Bank economist Lawrence Summers, was sent on a mission to ensure that the IMF was put in charge of dealing with the crisis. Officially this was intended to maintain overall policy

challenging Washington. In one gesture, Tokyo criticised the priority accorded to Eastern the same class as the EU or NAFTA; but intra-regional trade was only 20 percent of total trade of the three countries, against the EU's 60 and NAFTA's 47 per cent (Park 2004: 81). On its own, Japanese preferences on how to organise the world economy carry little weight. As John Braithwaite and Peter Drahos write (2000: 478), '[the] most ironic feature of Japan's consistent comparative impotence across [global business regulation] regimes is that it is a quintessentially unitary realist state actor.' The Pacific Business Forum, set up in 1994 by the president of Itochu corporation of Japan as a private planning network for the APEC region, champions increasing investment and area-wide product standardisation; but attempts to stabilise markets are inimical to the neoliberal mind-set prevailing in the West. Newspaper reports on the February 1998 WEF meeting in Davos provide several illustrates that at no level Open Door policies pursued from the liberal heartland were allowed to be compromised by Asian proposals for long-term stabilisation.

In response to the Asian Crisis, Japan suspended liberalisation of its economy in order to prevent further fall-out. Indeed, the country 'has been intensifying, albeit as quietly as it regional integration and the unwillingness of the US to allow such integration to proceed, there was also no need for Japan to admit war guilt. With the emperor allowed to stay on, 'Japan and the Asian victims of Japan's continental war and brutal colonial rule did not have a chance to resolve the problems of fear and mistrust, which deeply underlie and perpetually mar the international relations in the region' (Park 2004: 85). There was no Japanese Willy Brandt to go to Nanjing, the place of the worst wartime massacre of civilians, kneel down, and apologise. On the contrary, Prime Minister Koizumi's ceremonial visits to the Yasukuni shrine, where Japan's war dead, including the leadership hanged for war guilt, lie buried, continue to insult its former victims, notably China.

This obviously is not a personal quirk on the part of a Japanese politician, but a political gesture catering to a new public mood. Nationalism is on the rise again now that economic crisis and the loss of the lifetime employment guarantee have exposed the Japanese population to insecurity to a degree not seen since the Second World War. Ishihara, the mayor of Tokyo and the man who wants Japan to say 'no', enjoys a growing popularity with his calls for the Japanese government to speak up. But the 'no' isn't aimed primarily at the United States any longer; it is directed *against China*. This does not so much resonate with the older generation, which remains faithful to the pacifism that settled with the dust of the atomic attacks on Hiroshima and Nagasaki. But among the young, this counts for less. A poll amongst 20 to 30 year olds held in 2004 by Japan's leading newspaper, *Asahi Shimbun*, revealed a 63 per cent majority in favour of revising the constitution to legalise a regular army. Of course, Japan was part of the Western defence set-up all along. With 240,000 men under arms and a defence budget of $ 40 billion, it is today second only to the US. North Korea's nuclear policy was one reason why it embarked on a policy of military normalisation already in 1996, effectively abandoning the pacifist principles of the constitution. But in the new context that has emerged in the aftermath of the Asian Crisis, Japan's policy, as Chalmers Johnson has noted (2002: 61), is 'to do everything in its power to adjust to the re-emergence of China on the world stage.' The United States in the circumstances ha temporarily eclipsed by the Global War on Terror. The United States, in the words of one of its ambassadors, has 'never accepted a deterrent relationship based on mutually assured destruction with China' (quoted in *The Guardian*, 13 September 2002), in the way it accepted the balance of terror with the USSR; the Bush administration certainly would not allow China to develop militarily to the point where the US would have to accommodate to such a balance in the way it did in the cold war with the Soviet Union in the 1970s.

In the first intelligence memo Bush Jr. received as president-elect, three strategic threats were identified: first, al-Qaeda terrorism, secondly, the proliferation of weapons of mass destruction, and the rise of China as a military power, third—but third only because it still 'was 5 to 15 or more years away.' Soon after, Paul Wolfowitz in an echo of the statements on the USSR made by Richard Pipes in Reagan's days, stated that 'over the long run the Chinese political system is going to have to change' (Woodward 2004 : 12). Beijing was not intimidated; a few weeks after the inauguration of the second president Bush, Chinese aircraft forced a US spy plane to land on the island of Hainan. The Americans had to engage in humiliating negotiations to get the plane and its crew back, but only after the Chinese had thoroughly inspected it. The September 11 attacks deflected attention, but they did not stop the Quadrennial Defence Review of the US defence department shortly afterwards from defining Northeast Asia and the East Asian littoral as 'critical areas' for American interests; areas which cannot be allowed to fall under 'hostile domination'. Given that Asia is 'emerging as a region susceptible to large-scale military competition' in which rising and declining powers produce dangerous instab0.00 ft32 Tanstinstab0.0ompetitlong Twmto fere t955 0 Td[o5 -1.31a wrIttathe first inte4c 0.04

Ultimately, like all contender states before it, and if it does not turn towards socialist democratisation, China may come to face the hazardous internal transition from a directive state guiding the development of society, to a Lockean configuration. This would involve the dispossession of sections of the state class, transnationalisation, and exposure to the working classes in its own society clamouring for improvement of their lot. It must be expected that this transition will destabilise the wide-ranging geopolitical and economic webs which China's rise has created in the last few decades.

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