SECTION 4: CHINA'S ROLE IN A GLOBALIZED ECONOMY AND THE UNITED STATES RESPONSE

Key Findings

- While many U.S. firms have addressed their global competitiveness challenges through outsourcing and offshoring,[155] these individual corporate decisions do not address, and in some cases may conflict with, efforts to maintain productive capacities in industries important to U.S. economic leadership and vitality. This distinction between private and national interests is particularly pertinent with regard to the U.S. economic relationship with China, where the market may produce outcomes that are contrary to the U.S. national interest.

- The opening of the Chinese, Indian, and former Soviet bloc economies has led to more than a doubling of the global market's work force and likely will put downward pressure on U.S. wages for workers at all levels, including higher levels of the wage scale. Increasingly mobile capital and technology flows accelerate this trend.
- China has adopted an economic growth strategy that emphasizes strategic accumulation of productive capacity and access to resources. An important part of this strategy is attracting foreign investment and know-how to assist China's export-led growth.
- China obtains a competitive advantage from political and economic systems where workers are often denied fundamental workers' rights. China's paucity of environmental protections similarly functions to benefit some Chinese industries.
- The U.S. international tax regime favors investment abroad in comparison to domestic investment, providing a disincentive to companies for maintaining production facilities in the United States.

Overview

U.S.-China economic relations have become central to the development of global economic trends. As trade and investment between the two nations have expanded in importance and scope, the impact of this relationship on the U.S. economy—and the global economy—has grown to enormous proportions. As the Commission noted in its 2004 Report to Congress, "the U.S.-China economic relationship is of such large dimensions that the future trends of globalization will be influenced to a substantial degree by how the United States manages its economic relations with China" and that "[i]t is reasonable to believe that U.S.-China economic relations will help shape the rules of the road for broader global trade relations."

Economic Theory in a Globalized Economy

Broadly speaking, U.S. trade policy favors relatively free international trade because policy makers accept economic theories that predict benefits from trade. These theories demonstrate that the United States should prefer trade to absolute economic isolation.[156] However, it is still possible for U.S. interests to suffer if changes occur in the terms of trade.[157] The United States needs to carefully consider and answer the question of how changing trading relationships affect the U.S. economy and national interest and how the United States should position itself in those relationships.

Changing trade relationships also involve an adjustment period that must be addressed. When inputs are adjusted in an economic model, the model demonstrates how a new equilibrium will develop. When replicated in actual economies, the transition to a new equilibrium can stretch out over years or decades, raising social and economic problems that the government must confront.

A Global Influx of Labor Has Reshaped the Global Economy

China, India, and the states of the former Soviet Union have commenced active participation in the global economy in the past ten to twenty years. In this short time span, the global market work force has therefore doubled.[158] The result is major downward pressure on wages around the world, including within the U.S. economy. The effect of the rapid entry of so many workers will likely persist for decades—one Commission witness offered an estimate of thirty to forty years.[159]

The pressure for wages to equalize is a result of what has been termed the "law of one price." When capital is relatively unencumbered, it will gravitate to regions with the highest rate of return, which in practice are likely to be areas with comparatively high labor-to-capital ratios.[160] China, India, and the former Soviet states brought more labor than capital into the global economy. As a result, U.S. workers will find less capital to support their work, their firms will be less productive, and the workers will be more poorly compensated as a result.[161]

Globalization Forces New Industries into Competition

The reduction of costs and time associated with communication, information transmission, and physical transportation is a prominent characteristic of globalization.[162] The globalization of information and logistical systems has made it possible to trade previously untradable commodities and services, forcing U.S. companies into new competition with foreign rivals.

Globalization also coincides with a shift toward ever-higher percentages of the economy comprising goods and particularly services with no connection to the natural resources or environmental conditions of the production locale. It follows, then, that comparative advantage between and among nations is not based as frequently on immutable circumstances. Instead, comparative advantage can be changed rapidly by private sector actions and government policy.[163]

This observation is directly linked to the issue of economic competitiveness policy. In the 19th Century, when Ricardo developed his theory, natural and enduring factors meant that it was unlikely that production of either Portuguese wool or English wine suddenly would become more efficient. This is no longer the case for modern industries, and countries can more easily enter new business areas by acquiring or promoting the necessary skills, knowledge, and infrastructure. U.S. industries thus can be expected to face quickly varying patterns of competition.

Implications for the United States

China's Economic Growth Strategy Threatens U.S. Interests and Global Economic Stability

China has adopted an economic growth strategy that emphasizes strategic accumulation of productive capacity and access to resources. An important part of this strategy is export-led growth, which constitutes a modern form of mercantilism.[164]

Export-led growth is an economic strategy in which a country seeks to promote its industrial growth through a variety of policy devices that promote exports while strategically restricting imports to items needed for domestic growth or export production, such as technology and raw materials. Policy mechanisms include wage repression, industrial subsidies, targeted tax holidays, domestically-oriented government procurement policies, closed distribution systems, performance requirements on foreign investors, and an undervalued exchange rate. All these policies are evident in China.

China's export-led practices are fundamentally contrary to the spirit of an open and balanced international trading system. Such practices create imbalanced trade, as they necessitate trade deficits in other countries, including the United States.[165] The United States and China have reached a state of co-dependence under which the United States receives cheap consumer goods and China obtains jobs.[166] This equilibrium cannot last forever, as it piles up debt on the U.S. side and excess production capacity in China.[167] The global economy and global trading system cannot permanently sustain unbalanced practices by a country with China's economic heft, and the longer the imbalances persist, the more severe the correction will be.[168]

The United States cannot wait for a correction to be made voluntarily and cleanly by the Chinese side. Notwithstanding China's accession to the WTO, there is no reason to assume that China intends to abandon its growth strategy once certain growth targets are reached.[169] The imbalance created by China's growth strategy also helps to accelerate de-industrialization in the United States, with the concurrent loss of higher wage jobs.

China Contributes to the Increasing Leverage of U.S. Retailers Over U.S. Producers

The retail sector in the United States has undergone profound changes in the last half century as the shopping locus shifts from Main Street to malls to "big box" discount retailers. The emergence of big box discount retailers led to an enormous increase in market concentration in the retailing sector. With this increase in concentration there has been a shift of bargaining power away from manufacturers to retailers. Not only have these retailers acquired increased buying power relative to manufacturers, they also have driven a reorganization of the structure of manufacturing production—both accelerating and capitalizing on globalized supply chains. In particular, these retailers have become global buyers, scouring the globe for the lowest-cost producers. The big box discount retailers have thereby served as a vehicle for putting countries—and workers in those countries—in competition with each other. In effect, big box retailers can be viewed as a critical mechanism that accelerates shifts of global production to take advantage of low-cost labor.

China has not been the prime mover in the retail sector's transformation saga, but the emergence of inexpensive Chinese goods on the market coincided with the rise of big box retailers. Even as the United States grapples with whether and how to respond to the declining power of production companies and, secondarily, labor, the retail revolution contains the seeds of another shift for the U.S.

economy. Distribution networks, previously tied more intimately to large manufacturers, are now dominated by the big box retailers. This provides a ready pipeline for Chinese companies, which may eventually seek to sell products under Chinese brands in the U.S. market.[170] Such a development would cut out the remaining U.S. role in the supply chain, shifting design, management, and marketing functions to China.

U.S. Economic Competitiveness Requires Active Maintenance

The combined effect of these facets of China's role in the globalized economy is to threaten U.S. economic competitiveness.[171] The accumulation of productive capacity in China is due in part to the ability of the Chinese government to deploy effective incentives for U.S. and other companies to locate and expand production facilities in its country. Private companies cannot be faulted for pursuing their own interests within the confines of accepted legal and moral structures, but the U.S. government must consider the net effect of private decisions on the national interest.[172] Not all of China's competitive advantages are enviable, however. China continues to suppress labor rights as well as broader human rights;[173] China's environmental standards are also insufficient and inadequately enforced, providing a short-term competitive advantage to polluting firms.[174]

The current structure of the U.S. international tax system is inefficiently complex, including sourcing rules to determine whether income was earned in the United States or overseas. These rules were developed when tangible products accounted for most trade, but they are not readily workable in a system of global business operations and intangible property.[175]

The U.S. tax system also is favorable to offshore, as opposed to domestic, investment. For example, when a U.S. firm conducts its foreign business through a foreign-chartered subsidiary corporation, it generally can defer U.S. taxes as long as it does not repatriate the income.[176] This encourages overseas production, as does a WTO ruling preventing the United States from waiving corporate income taxes on export profits, in a manner similar to export credits on value-added taxes in competing countries.[177] U.S. corporate tax rates also have grown less competitive as other major competitors have lowered corporate tax rates.[178]