

**May 19, 2005**  
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**Before the US-China Economic and Security Review Commission**  
**China and the Future of Globalization**

Honorable Members of the Commission:

The following are my very brief observations regarding China's influence on globalization as well as the impact it is having, and is likely to have in the future, on other nations, their economies and their geo-political standing. In my remarks, I will make specific references to the impact a rising China will have on the United States, its economy and geo-political situation. More detailed information can be found in my book, *The Chinese Century*, as well as in previous written testimony to the Commission on IPR violations by China.

**Introduction**

My starting point is that the rise of China is an event of enormous proportions that has much in common with the rise of the United States to become an economic and political power in the latter part of the nineteenth century. When the United States rose to prominence, the initial response from the United Kingdom and the rest of the world has been a mixture of disbelief and complacency, a sentiment that was soon replaced with a feeling of vulnerability and threat. Only years later came the realization that the competitive landscape has been changed for good, and that nations and companies had to adjust their policies and strategies in accordance with the new realities. Today, the world may be facing a similar situation, presenting opportunities as well as risks.

Of course, there are also remarkable differences between the rise of the United States and that of China. At the time of its ascent, the United States was a relatively new nation and a new force to reckon with, while China is an ancient civilization that during many centuries was the leading world's economy and is seeking to restore that status. The United States is a democracy which brought to the world ideals and institutions supportive of freedom and open markets, while China is ruled by an unelected Party dictatorship which shows no signs of letting go of its powers.

These differences and China's many remaining obstacles on its way up notwithstanding, the analogy between the rise of China and that of the United States is plausible and we would be ignoring it at our peril.

### **China and Globalization**

Once one of the most open civilizations on its cosmopolitan cities and adventurous seafarers, China has become under Communist rule an isolationist and xenophobic nation that feared foreign influences and sought self sufficiency at almost any cost. The launch of China's reforms in late 1978 signaled the return of China to the family of nations, its borders slowly opening to foreign tourists, trade and investment. Today, China is the largest recipient of foreign investment in the world, having displaced the United States. It is increasingly integrated into the global economy, its share of global trade and investment rising rapidly. In this respect, China today is already more global than Japan or South Korea, two nations it is often compared with but two that have embraced a different path to progress.

Through over a century, the Chinese ideal remained that of "foreign technology without foreign values". The idea was to learn from the foreigners who have shown their technological superiority in the battlefield as well as on the factory floor, yet avoiding the absorption of foreign, especially Western ideas in politics, society and culture. Judging by the current combination of a political dictatorship coupled with a relatively free market --a combination most Western economists thought to be implausible-- the Chinese have been successful in defending this ideal. This is not to say that China's increasingly permeable borders during a period of unprecedented globalization do not yield a slew of foreign influences. Western ideas are coming into the country via foreign movies (pirated as they may be), foreign invested enterprises, foreign visitors, and returning students and business people, to name a few. However so far China has resisted the political and social ramifications of Western style modernization, and it is my belief that solutions "with Chinese characteristics" will be sought in those realms as an alternative to those available from the West.

China has already defied the prediction of most observers that it was impossible to have a free market system without a democratic regime, and my own forecast is that China will not evolve

into a democracy in the foreseeable future. Instead, I see two possible scenarios. The first, a gradual evolution into a Singapore style system, democratic in name but patriarchal in nature, where elections are held but their result is never in doubt. This will imply selective permission for alternative minor political parties that will be kept under close watch and starved of substantial resources and massive membership. The second possible scenario is the development of limited democracy at the local level (something the Chinese have already been experimenting with), with the center continuing to retain a monopoly of power on all major national issues as well as on key legislative and judicial matters. I call this “the Imperial model” because it is similar in many ways to the traditional system under the Chinese empire where the court and the bureaucracy yielded local power to kinship based clans.

At the same time, from a global perspective, the integration of the most populous country into economic, social and geo-political webs is likely to accelerate the process of globalization as we know it. This means greater and more rapid movement of people, goods and services across national boundaries and a broader flow of ideas. I should caution however that it is a serious error, in my mind, to equate globalization with increased similarity of values, norms, institutions and practices across borders. The superficial replication of the golden arches and other global corporate symbols in foreign locations masks fundamental differences in culture and institutions across the planet. China, with its combination of huge scale and marked differences with the West, will prove this point beyond doubt. Thus, expecting globalization to bring about a Western-style advance in thinking and systems in China and beyond is, by and large, wishful thinking.

### **China’s Economic Impact**

China’s economic impact is already felt; it will be felt much more in the coming years. As with the rise of the United States more than a century ago, the economies affected will be both in the developing and developed world. Developing economies will find themselves hard pressed to compete with an economy that matches their wages but offers substantially higher productivity and superior infrastructure and capabilities. These economies compete with China not only for export markets but also for foreign investment, an area where China now garners more dollars than all other developing economies *combined*. Economies competing on labor costs, e.g.,

Bangladesh and Lesotho, where garment manufacturing is the dominant export, will be hard hit as China is capturing market share at lightning speed. These countries will have a problem generating the foreign exchange needed for the importation of basic necessities and will have to depend much more on the generosity of others, from developed country governments to international organizations. This will bring, in turn, increase in illegal migration from countries such as Honduras, and it is not at all clear that current initiatives such as CAFTA will be sufficient to mitigate the problem. Thus, it is important to consider not only China's direct, bilateral impacts, but also secondary and tertiary impacts that will flow from its ascent.

Developed economies, in the meantime, will find themselves competing with a new phenomenon – an economy that is rapidly climbing the technological ladder but without concomitant respect for intellectual property rights, one that moves aggressively into capital intensive sectors but without relinquishing the labor intensive segments on which its initial economic launch has rested. In a previously written statement to the Commission, I have noted that the United States is the nation most adversely affected by the rampant Chinese violations of intellectual property rights (IPR) because it is the world's largest producer and exporter of IPR. In the short to medium term I do not foresee an improvement in IPR infringement by China; on the contrary, I see the problem spreading across the globe. IPR infringing goods are now exported from China to many parts of the world, especially, but not only, to developing markets where compliance is either not feasible or not viewed as desirable by local authorities. In a worst case scenario, we may see the development of a world divided into two parts, one IPR-compliant, the other not. Such a development will have ominous consequences not only for the global trading system but also for the global economy as we know it and for the process of innovation which underlies economic growth and improvement in the standard of living. This again suggests the possibility that a China-driven globalization may differentiate rather than harmonize national economies.

### **China-related Opportunities**

The opening of China creates numerous opportunities for US manufacturers and service providers. China is the fastest growing market for many US manufacturers (e.g., Boeing), and is likely to become the fastest growing service market as well, which is of considerable importance to the United States, whose competitive advantage today lies more in the service than in the

manufacturing sector. For example, thanks to its one child policy, China has a huge demographic problem of an aging society that will have to be supported by a rapidly shrinking workforce. Given the lack of a funded safety net, opportunities in the savings and insurance realms will be substantial.

One key opportunity is the growth of tourism from China. Tourism is a major industry in the United States, but one wonders if the proper preparations are being made in anticipation of this influx. Such preparations should include not only visa issues (which since 9/11 have become a major stumbling block), but also other measures. Being located in the Midwest, my impression is that this opportunity does not yet register on the screens of most states in the region. I believe that incoming Chinese tourists will have major interest in observing the US hinterland, providing an economic boost to precisely those areas which have been adversely affected by the advent of Chinese manufacturing exports.

Opportunities will also continue in the realm of higher education, though here too visa and other problems may slow down the influx of Chinese students. Chinese students, especially in science and engineering, have made a major contribution to the US economy, but their repatriation rate has started to go up and is likely to continue to climb rapidly. Should current trends continue, I expect the repatriation rate for Chinese students to reach 50% by the end of the decade (up from less than 20% at present).

All in all, I must say that I do not see the changes that will permit US exports to China to grow at the level one would need in order to compensate for China's growing exports into the United States. It is beyond the scope of this testimony to explain why this is the case. Suffice is to say that I do not believe that the modest revaluation I predict will fundamentally alter the pattern of a growing US trade deficit with China, a deficit I believe is politically unsustainable. It is hence my humble recommendation that the Commission, if it had not done so already, will consider discussing this topic in one of its future meetings.

### **Geo-Political Ramifications**

On a geo-political level, China sees itself as a counterbalance to what it sees as US hegemony, and will leverage its growing economic clout to score geo-political points, from military build-up to the targeting of developing nations all over the world for trade, investment and other assistance. The Chinese are only beginning to flex their geo-political muscle, which is likely to grow in tandem with their economic clout. While their short-term interest is in gaining foothold in energy producing regions such as Venezuela and Canada, China is already showing signs of active involvement in the developing regions of the world, e.g., Africa, where they provide assistance in building infra structure among other forms of support.

A return to a bipolar world where China replaces the Soviet Union is not impossible, even if it is not highly probable in the short term. Rising levels of military expenditure and the growing economic base with which to fund them suggest that China is serious about establishing itself as a geo-political power. While the country currently lacks the technological know-how necessary for cutting-edge weapon systems, there is no reason to believe that it cannot replicate in the military domain what it did in the manufacturing realm --a combination of technology transfer via imports, foreign investment, indigenous development and knocking off others' technology.