

China

The U.S.–China relationship has many facets, but it runs primarily on trade and investment. In 2008, GDP for the two economies together comprised about 30 percent of the global total. The U.S. buys more goods from China than any other country and, not coincidentally, China



buys more American bonds than any other country. Both domestic and foreign critics have condemned this relationship for costing American jobs, contributing to the financial crisis, and other failings. Although there has been poor policy on both sides, these errors do not indicate that the U.S. should move toward protectionism and closed markets. Rather, the financial crisis has raised the stakes for getting the relationship right.

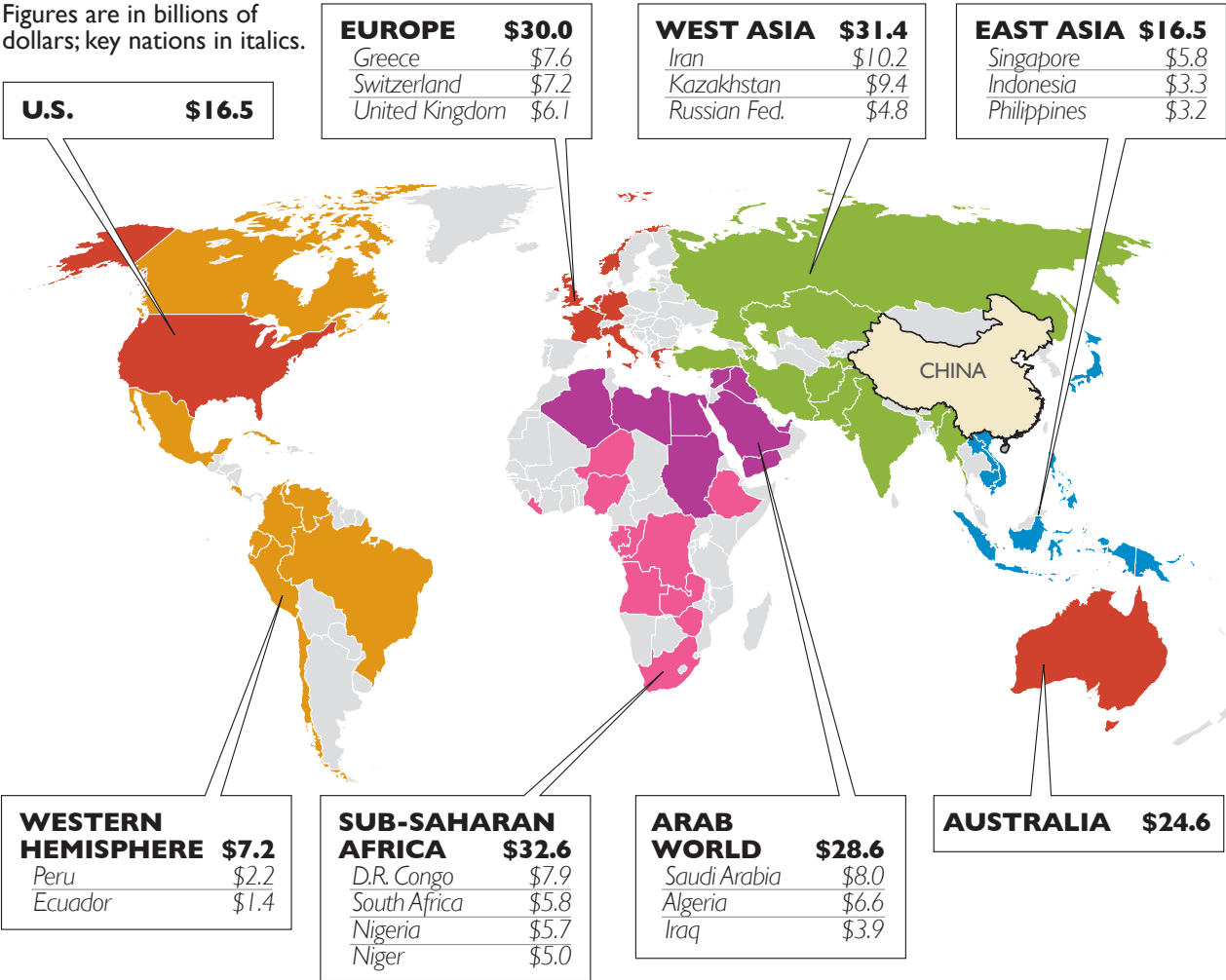


A major issue is the massive trade imbalance. China’s overall trade surplus ballooned from \$32 billion in 2004 to \$295 billion in 2008. Behind this is the PRC’s nonmarket economy, featuring a variety of subsidies for state-owned enterprises. Complementing the trade imbalance is a capital imbalance. Chinese investment and business contracts span the globe, but the bulk of China’s money ends up in U.S. dollar assets. Official Chinese holdings of Treasury bonds stood at \$776 billion through June and the PRC’s total dollar assets may be \$1.5 trillion.

China’s Worldwide Reach

The United States is second to Australia in drawing Chinese non-bond investment.

Figures are in billions of dollars; key nations in italics.



Source: Heritage Foundation dataset, China’s Outward Investment: Non-bond Transactions over \$100 million, from 2005 to the first half of 2009 (excluding Hong Kong), available upon request from The Heritage Foundation.

Many Americans worry that these holdings will enable China to wield influence over us. However, the PRC has created for itself a system in which it has no choice but to buy U.S. bonds. Deputy Governor of the People's Bank Yi Gang acknowledges, "These reserves are unavoidably invested abroad." The only market large enough to absorb China's reserves is the U.S.

The growth of its economy is the main force behind China's political stability, its military and technology improvements, and its increased role in international affairs. Many Chinese political and security policies and actions clash with American interests and do not help promote peace and liberty. Violence in Xinjiang in 2009, the crackdowns on Tibetan protests in 2008 and numerous other demonstrations throughout China, and unwillingness to relinquish any control of the judiciary indicate the lengths to which the Chinese Communist Party will go to maintain its grip.

Internationally, China uses opportunities to demonstrate its growing presence and reduce concerns about its rise. China has the highest number of U.N. peacekeepers among the five permanent members of the Security Council, sent naval ships to the Horn of Africa to help fight pirates, and launched men into space.

China continues to lay claim to neighboring territory, in the South China Sea, along the border with India, and in the East China Sea (Japan). China's yearly increases in military spending combined with the actions taken against the USNS *Impeccable*, a submarine surfacing close to the USS *Kitty Hawk* carrier group in 2006, and another submarine colliding with the sonar of the USS *John S. McCain* raise concern that China's rise is not all benign, but aimed at displacing American predominance in the Western Pacific. The Chairman of the Joint Chiefs of Staff, Admiral Michael Mullen, indicated China's intention saying, "they're developing capabilities that are very maritime-focused—maritime and air-focused—and, in many ways, very much focused on us." Diplomatically, China has cultivated relationships with countries, such as North Korea and Iran, which pose security threats to the U.S. and its allies.

RECOMMENDATIONS

1. Remain engaged with China. The Sino-American Strategic and Economic Dialogue (S&ED) could be a fruitful mechanism for the U.S. to obtain a Chinese commitment to economic liberalization. Discussions should be tightly focused and based on open-market, not protectionist, principles. Although the PRC will not give up state intervention quickly or fully, the U.S. should encourage greater competition, price liberalization, and the freer movement of money in and out of China.

2. Fix our own house. The PRC is not the only one pursuing a harmful and unsustainable course. For the sake of American leadership, we must be willing to make hard choices. In particular, the federal government should stop spending trillions of dollars it does not have. In addition, reduced and simplified corporate tax rates would sharpen our global competitiveness and cut deeply into the trade deficit.

3. Honestly evaluate Chinese “cooperation” to date. China and the U.S. can work together on a lot of issues; however, the U.S. should not credit China’s help on security issues where progress has not been made.

4. Develop and maintain a strong, comprehensive response against bad Chinese behavior. Progress in one area does not excuse China’s shortcomings in other areas. China should not get away with the pretense of “responsible stakeholder” when it provides diplomatic cover for authoritarian regimes that abuse their own people and/or threaten American security, i.e., Burma, North Korea, Iran, Sudan.

FACTS AND FIGURES

■ Official Chinese holdings of Treasury bonds increased by \$240 billion in the 12 months ending June 30, 2009.

■ In 2008, U.S.-PRC bilateral trade stood at \$409 billion, dwarfing the \$206 billion between the U.S. and Japan.

■ The Department of Defense estimates China’s total military-related spending for 2008 to be between \$105 billion and \$150 billion, using 2007 prices and exchange rates.

■ China has 2,153 U.N. peacekeepers involved in Africa, Asia, and the Middle East.

ADDITIONAL RESOURCES

“Major Foreign Holders of Treasury Securities,” United States Department of the Treasury, at <http://www.treas.gov/tic/mfh.txt>

Derek Scissors, “Deng Undone,” Heritage Foundation Commentary, at <http://www.heritage.org/Press/Commentary/ed042909a.cfm>

Derek Scissors, “China Global Investment Tracker,” Heritage Foundation White Paper, at <http://www.heritage.org/Research/AsiaandthePacific/wp052609a.cfm>

"Military Power of the People's Republic of China 2009," Department of Defense, at http://www.defenselink.mil/pubs/pdfs/China_Military_Power_Report_2009.pdf

Stephen Yates and Walter Lohman, "Secretary Clinton's Asia Trip: Getting China Right," Heritage Foundation *WebMemo* No. 2301, February 18, 2009, at <http://www.heritage.org/Research/AsiaandthePacific/wm2301.cfm>

HERITAGE EXPERTS



Walter Lohman



Derek Scissors,
Ph.D.



Dean Cheng