FINANCIAL TIMES

Hollywood movies
Sony and MGM clash over 007
Letter from LA, Page 5

Origin of life
Volcanic stirrings beneath the sea
Technology, Page 12

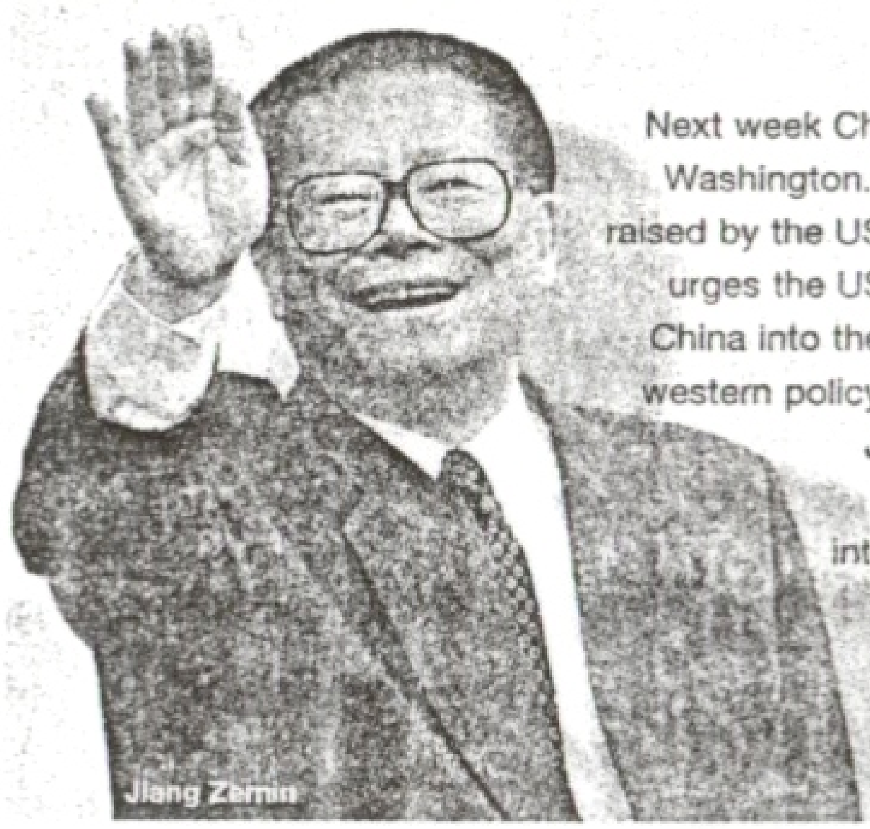
Trade with China
Rogue elephant or cuddly panda?
Personal views, Page 14

Today's surveys
Venezuela
Bulgaria
Separate section; Pages 25-28

Personal Views · Robert Hormats and Jeffrey Garten

China: friend or foe?

Next week China's President Jiang Zemin visits Washington. These two articles explore issues raised by the US-China summit. **Robert Hormats** urges the US to take a leading role in bringing China into the world economy, and argues that western policy could help reform in China itself. **Jeffrey Garten** questions whether China's international economic integration would benefit others and concludes that while it would be better to have China as a friend than an enemy, the process of integration will be painful.



Jiang Zemin

Opportunity knocks

The visit of President Jiang Zemin to Washington presents Bill Clinton with an extraordinary opportunity to strengthen US ties with the world's fastest-growing economy and to restore momentum to Washington's flagging efforts to sustain international trade liberalisation.

Mr Clinton should use the occasion – the first state visit by a Chinese leader since that of Deng Xiaoping in 1979 – to forge a partnership for prosperity with Mr Jiang. By doing so, he could give a powerful impetus to further integration of China into the world market economy. That would advance not only China's reforms, but also the prospects for freer global commerce generally. US trade relations will be tested in the coming months. Differences with Beijing over World Trade Organisation membership remain unresolved. The US trade imbalance with China is growing and Congress is pressing for a harder line.

More broadly, the US deficit with Japan is widening and legislation to provide "fast track" trade negotiating authority is resisted in Congress by opponents of further liberalisation. In south-east Asia officials question why the US, having pressed the region to open capital markets, did not provide funds to Thailand when it got into trouble.

Yet the US has many good reasons to welcome Mr Jiang's visit. China has achieved remarkable economic growth, cut inflation dramatically, and raised 200m-300m people out of poverty. The 15th Party Congress gave Mr Jiang a mandate for significant reforms and elevated his team of modernisers. US-China trade and investment flows are growing rapidly and Beijing is committed to further market opening.

It would be a mistake, however, for the US to conclude that China is without serious economic problems. More than 100m people live in poverty. Tens of thousands of inefficient, highly subsidised state industries need market reform. Jobs must be found for many millions of workers who will be displaced. A troubled banking system needs to be overhauled.

The US should not believe that a deterioration in economic conditions in China would affect only the Chinese. China's failure to overcome these problems would slash US exports and investment there, costing thousands of US jobs. It could also lead to international economic and political instability. On the other hand, China's success would increase US trade, employment and investment, contributing to growth for years.

A looming question is whether the world's strongest economic power can forge a constructive relationship with the world's most rapidly emerging one. Or will the US and China view each other with mutual suspicion and become locked in a prolonged series of bilateral economic conflicts?

The overriding goal should be the integration of China into the network of market-based rules and institutions that make up the international trade and financial system. China should receive benefits and assume responsibilities commensurate with its economic importance, level of development and trading strength. That would enhance Beijing's domestic reforms and support a more open global economy. Such a partnership would provide a framework for sustained engagement of US and Chinese economic officials bilaterally and in regional and international forums. It would also improve US-China co-operation on social, political and security issues.

The partnership for prosperity would have several components. Initially, Mr Clinton should present a coherent China policy to the American public, and stress the importance of relations with Beijing. Bipartisan agreement must also be reached to rid the agenda of the annual US threats to withhold "most favoured nation" status. High-level visits must not be held hostage to the latest US grievance with Beijing.

Highly charged economic, political and security issues are interwoven in US-China relations. Nothing less than annual presidential summits are required during this period of transition. The summits would aim to reach agreement on principles to guide the relationship. Committees of cabinet and sub-cabinet financial and trade officials would implement policies. That structure would engage future generations of leaders in building the relationship.

An initial challenge is to prevent debate about China's membership of the WTO from becoming a prolonged test of wills between Washington and Beijing. As an important trading power, China wants others to follow WTO rules, so it has a growing interest in doing likewise.

Moreover, these rules give China's reformers additional clout to reduce subsidies, liberalise state controls, ensure greater scope for the rule of law and move towards greater market openness. Membership of the World Bank, International Monetary Fund and Asia Pacific Economic Co-operation (Apec) have bolstered China's reforms. So can WTO membership.

But China fears unrest if it displaces millions of workers by quickly shutting too many large factories or removing their subsidies. The US should not push China to move so rapidly as to produce instability.

Common ground exists. China could implement WTO rules in such areas as market access, as well as investment and intellectual property protection on a schedule similar to most other nations. It could slowly phase in certain internal adjustments, such as subsidies to certain industries, reducing the adverse impact on jobs.

Participation in annual Group of Seven summits on terms similar to Russia would enable China's leaders to draw support for reforms from the leading market economies and encourage Beijing to assume increasing responsibility for the global economy. China's impact on world trade and finance exceeds Russia's and is growing rapidly; exclusion is difficult to justify and US support for inclusion increasingly appropriate.

These steps do not guarantee the US and China untroubled economic relations. Problems will emerge, some serious. Nonetheless, a well-structured US-China partnership would promote sustained high-level contacts. It would support China's reforms and overcome recent setbacks to trade liberalisation in Asia. Agreement on a partnership for prosperity would turn the Washington summit into an enduring success for both presidents.

RH

The author is vice-chairman, Goldman Sachs (international), former deputy US trade representative and assistant secretary of state for economic and business affairs

Rogue elephant rampant?

When Bill Clinton meets his Chinese counterpart in Washington next week, high on the administration's agenda will be the importance of helping China become more integrated into the mainstream of the world economy.

The underlying assumption is that, as China further opens its trade and financial systems, and as it eventually accepts the rules of the International Monetary Fund and the World Trade Organisation, the west will no longer have to fight with Beijing about everything from textiles to intellectual property rights. Instead, the task will be to nudge China along to ensure it becomes a fully fledged member of the international community.

It is an appealing thought, but it is deeply flawed. China is likely to change the global capitalist system as much as it will be disciplined by it. And the west is not remotely ready for the tumultuous dislocations ahead.

China is not Argentina or Poland. Its birth as an economic force will not be plain sailing for the rest of the world. Its geographical size (roughly the same as the US), its population of 1.2bn, its dizzying economic progress, its extensive system of advanced education, its technological and military potential and its geopolitical goals mean China's emergence as a full participant in the global marketplace will be as disruptive as the rise to power of the US at the turn of the century, or Germany and Japan in subsequent decades.

"China enters the world economy from a position of enormous strength," says Kenneth Courtis, a Tokyo-based global economic strategist at Deutsche Bank. "Its growth rates have been in double digits. Its trade is soaring. Counting Hong Kong, its reserves equal nearly a quarter of a trillion dollars. The issue isn't just how to integrate China – it's how to make room at the top."

Since at least 1622, when a European named Adam Schall landed in the Middle Kingdom to convert Chinese people to Roman Catholicism, westerners have attempted to remake China in their own image. As Jonathan Spence, the Yale historian, writes in his classic book, *To Change China*, they have consistently failed. It wasn't that China didn't change, but that it always fought to retain the right, precious to all great nations, of "defining her own values, dreaming her own dreams without alien interference".

Consider the potential economic tensions that the rest of the world will face as China emerges in accordance with its own rhythms and aspirations.

First, China will become a phenomenal export machine. The pace of its exports has been growing at three times the world average. China is set to displace much of the sales of low-cost manufactured goods from Thailand, Malaysia, Indonesia and the Philippines, worsening their economic problems. Moreover, it is fast moving upmarket, selling more sophisticated manufactured products, such as computer parts. Already China is closing in on Japan as the country most responsible for the growing trade deficit of the US. Within 25 years, the World Bank expects China to be the second-largest exporter in the world next to the US, and dwarfing Japan.

Second, China will become a bottomless pit for foreign capital, creating problems for countries that desperately need foreign investment. In the 1990s alone, there has been a five-fold increase in capital flows to China. Last year, flows reached $42bn (£26bn). After the US, China receives more foreign investment than any other country and accounts for 40 per cent of all direct investment in the developing world. That is on top of the fact that China is the largest borrower from the World Bank, the Asian Development Bank, and the world's largest recipient of foreign aid.

All this incoming money is potentially only the beginning. So far, nearly all this capital inflow has gone only to the coastal provinces, and most has come from Hong Kong companies. As China's investment policies become more open, as other parts of the country begin to stir, as a $600bn programme of physical infrastructure takes shape, a flood of new foreign money can be expected.

Third, China will continue to play by different rules, as Japan has done for so long. Pushing exports and holding down imports is characteristic. In the first seven months of this year, exports are up 26 cent, while imports have increased only 1.9 per cent. China continues artificially to manipulate its currency, keeping it weak in order to stimulate exports. It continues to use the lure of its market to play off companies such as Boeing against rivals such as Airbus, and to award contracts only if proprietary technology is surrendered.

Following in the footsteps of Japan and South Korea, Beijing is organising much of its industrial structure – such as electronics, petrochemicals and autos – into gigantic state-directed conglomerates. To the extent that these maverick policies succeed, they will provide an alternative to the American model of capitalism, the search for which is becoming intense in big emerging markets from Brazil to Indonesia.

Fourth, China will tear at the fabric of the new WTO once it is admitted. Beijing will require at least a decade's grace to evolve into a real market economy. During this transition, the west will confront unrelenting problems when pressing Beijing to uphold commitments on issues ranging from privatisation of state companies to currency convertibility, let alone tariffs, subsidies and quotas. That could consume the WTO's energies, at the expense of essential new global trade agreements covering high-technology trade, foreign investment and anti-competitive practices.

None of this means that China shouldn't be encouraged to join the western club. After all, the alternatives are worse. But as Nicholas Lardy, China expert and senior fellow at the Brookings Institute in Washington, asks: will China conform to western values or will it force the west to change? In the face of powerful capitalist currents in the global economy, the answer is that both will happen. Engaging with Beijing will surely be a much longer and more painful process than western leaders now contemplate.

At the forthcoming bilateral summit, there will no doubt be the usual round of statesman-like rhetoric. But the west should remember that, hitherto, China has been an elephant dipping its trunk into the water. Now it is about to jump into the pool.

JG

The author is dean of the Yale School of Management and author of The Big Ten: The Big Emerging Markets and How They Will Change Our Lives (Basic Books 1997)