Who The Heck Cares About Trade?

Exploring the importance of the U.S.-China trade relationship

A Kearny Alliance - Arizona State University Publication

The Kearny Alliance

AID THROUGH TRADE

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Acknowledgements

In 2008, Arizona State University and the nonprofit Kearny Alliance partnered to convene the *Kearny Alliance - ASU Forums on Trade, China, and the World Economic Order*. The first forum, titled "**21st Century Trade Challenges: How can the world's two economic superpowers lead together**?" was held February 26-27, 2009 in Phoenix, Arizona. Forum discussions were captured and served as a backdrop for the white paper that follows.

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See **http://kearnytrade.asu.edu** for background on the *Kearny Alliance - ASU Forums on Trade, China, and the World Economic Order* and the Phoenix Forum.

For more information on the sponsors, please visit their websites:
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August 2009

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The Kearny Alliance, a nonprofit 501 (c) (3) foundation based in Scottsdale, Arizona, partners with other international organizations to further its mission of "Aid through Trade," to advance international development and poverty alleviation through trade-related business education, training and applied research.

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EXECUTIVE SUMMARY

Global trade isn't a new phenomenon. It has ebbed and flowed as long as history has been recorded (and earlier, surely). The principle has always been the same: one group of people has something that another group wants, and is willing to give it up in exchange for something that the other group has. It's a mutually beneficial – win-win – process.

Though there have been periods in the long history of global trade during which those involved suffered painful losses – during the pepper boom and bust of the 1600s, for example – over its history, trade has been profoundly beneficial, making the world more prosperous. A world without trade, to put it another way, would be a far worse world – for everyone.

And while all countries that seek to engage with other nations have important roles to play in the future of world trade, the United States and China – the world's two economic superpowers – should be leading the way toward a more integrated global society.

The Benefits of Economic Integration

The word "trade" does not accurately describe the depth and breadth that characterizes relationships between countries in today's globally-integrated world. A better term is "economic integration," which reflects an economic coming together – a movement from distinct parts toward a common whole. Economic integration occurs at many different levels – at the highest macroeconomic level and at the lowest microeconomic level. And trade is one mechanism by which economic integration occurs.

A number of benefits arise from economic integration:

- It allows us to obtain the goods and services we want that we might not otherwise have.
- It enables sustained economic development – helping make people prosperous in countries that are open to economic integration – including the U.S., China, and other forward-looking countries.

How does economic integration with China benefit the U.S.?

1. From Microsoft and Motorola to Wal-Mart and KFC, there are a number of American and multinational companies that operate in China and are more successful because of it. (And while these companies benefit from manufacturing in China for export elsewhere, they also benefit from selling to China's consumer market.)
2. Because economic integration makes the people in China more prosperous, they purchase more – and they purchase, in part, what U.S. companies make.
3. "Made in China" products are often less expensive than products manufactured elsewhere – allowing consumers in America access to less expensive goods, from

Those who say that economic integration is not positive are looking at a narrow group of stakeholders over a short timeframe.

sweaters to computers.

4. While economic integration may lead to job losses in the short-term, in the long run a greater number of higher-quality jobs are created as a result of integration than are lost.[1]

How does economic integration with the U.S. benefit China?

1. China's economic integration – marked in part by the dramatic rise in China's goods exports to the U.S. and the rest of the world – has lifted China's per capita GDP relative to the U.S.' 312 percent in thirty years.
2. Perhaps the greatest benefit of China's integration into the global economy has been the diffusion of knowledge and technical know-how from the foreign-invested enterprises (including American and multinational corporations) operating in China.
3. At the same time, China has made substantial progress in protecting human rights, intellectual property, and the environment. Because economic integration makes developing countries, like China, wealthier, it gives the people there more freedom to focus on important issues like human rights and environmental protection.

Short Term v. Long Term

Those who would say that economic integration is not positive are looking at a narrow group of stakeholders (employees who lose jobs as non-competitive U.S. industries move overseas, for example) over a short time frame (say, the time during which those workers are unemployed as they train to work in more competitive, and often higher-paying, industries). It is true that, *in the short run*, integration is not always positive for everyone affected by it. In the long run, though, we *all* benefit from greater economic integration.

Short-term issues v. long-term opportunities

In the short term, there are a number of issues – the negative environmental impacts of industrial development, for example – that make trade negotiations incredibly difficult. But considered over the long term, those issues become opportunities – for example, to work together to craft a more sustainable and mutually beneficial way of doing business.

The key lies in balancing the short-run issues – which often tend to drown out discussions of the benefits of freer trade and inhibit successful negotiations on the terms of U.S./China economic integration – and consider them instead as long-run opportunities to make the world a better place to live for everyone.

Short-term and long-term strategic behavior

To say that nations, businesses and people behave strategically is not to say that they behave immorally or against the interests of others. In fact, both the United States and China – and the businesses that operate there – behave strategically, in their best interest.

Over the short term, both the U.S. and China engaged in protectionist policies designed to help them "catch up" economically. The key is that those policies should remain tools used *only* in the short term – because in the long run, protectionism is negative for

1 See page 10

everyone as it hinders growth and competition.

American and multinational companies that want to do business in China today also have to think – and act – strategically. Instead of fixating on a “What’s good for me?” strategy, firms must also focus on “What’s good for China?” As companies like Motorola, Emerson Electric and ON Semiconductor have proven, the two are not mutually exclusive.

Crafting an Agenda for Economic Integration Discussions

For those who seek to facilitate trade discussions, how can the psychological barriers that so often prevent strategic thinking about the long term be overcome? How can the agenda for discussions about U.S./China integration be constructed to realize long-term opportunities while avoiding the short-term issues that constantly threaten to derail the entire process? There are five important steps in overcoming those psychological barriers to craft an agenda for economic integration discussions:

- Step 1: Acknowledge that economic integration is positive on the whole and over the long term, and that trade is critically important to both the U.S. and China’s economies.
- Step 2: Acknowledge the forces that drive the U.S. and China toward, or away from, more effective economic relationships.
- Step 3: Recognize that the U.S. and China’s views of the world differ.
- Step 4: Determine the line of moral tolerance that can’t be crossed.
- Step 5: Determine which issues must be resolved and which can be let go.

American and multinational companies are already successfully engaging in China – that’s the “economics works” principle at its best. Yet it is nevertheless critical for policymakers in both countries to also come to the table, to craft a path for economic integration that will allow people in China, America, and the rest of the world to realize the benefits that economic integration has to offer – and to take advantage of those unique long-term opportunities to create a better world for all of us.

The paper that follows aims to lay a foundation for the discussions that will have to take place as policymakers in China and the U.S. come together to plan the way forward – toward a more integrated world. The principles outlined here – broadly, that economic integration is overwhelmingly positive on the whole and over the long term – should form the bedrock that guides discussions about how best to go about that economic integration.

As the Chinese proverb goes, “When is the best time to plant a tree? A hundred years ago. When is the second-best time to plant a tree? Yesterday.” In other words, the time is now.

IMAGINING A WORLD WITHOUT TRADE

Imagine the scenario:

The year is 2023. The current President of the United States has been in office for six years. He campaigned on a platform of protectionism and has followed through on his promise to close all U.S. borders to trade. Everything bought (legally) in the U.S. is made in the U.S. The unemployment rate is 16 percent. Per capita GDP – a proxy measure for people's standard of living – has fallen 20 percent in four years. Americans are all much poorer; there are fewer jobs for those who want them; the things you buy are more expensive and lower quality – and some things you can't get at all.

It's in this environment that you wake up each morning, at 3:00 a.m. You walk down the short hall to your kids' bedroom – they share a room because your home is only 800 square feet, with two bedrooms, one bathroom, a small living room and a kitchen. All new houses are this small because the demand for construction materials – wood, for example – is far greater than the U.S. alone can supply, making those materials very expensive.

You gather with your kids – your son is 8 and your daughter is 5 – at the kitchen table. Breakfast is oatmeal, milk and water. Orange juice is a luxury you can only afford on special occasions – the demand for oranges is far greater than the orchards in Southern California, Arizona and Florida can supply, so one piece of the fruit costs $10. You don't drink coffee anymore because it's not grown in the United States.

You glance at the clock on the oven – a clock that works only half the time because it's so old (you can't buy a new one because consumer electronics are so expensive). Before the U.S. closed its borders to trade, there were an average of 3 TVs and 2 computers in every American home. Now, only the richest few can afford such luxuries. You realize that you're running late, so you rush the kids to finish breakfast. They dress in hand-me-down clothing and you notice that your son's shoes are developing holes in the toes. You cringe, but you can't afford to buy new shoes except once a year – the selection of kids' tennis shoes is poor, the quality is worse, and prices are outrageous.

You don't drive a car anymore – the safety and reliability of many new cars is abysmal and even a two-door jalopy costs $40,000. Not to mention that gas is $7.50 a gallon. Instead, you walk your kids to school, then continue on for another mile to the express bus stop, which takes you and your neighbors (those fortunate enough to have jobs) into the industrial center of the city. Your bus ticket costs $10 – a good chunk of your day's take-home pay.

You have a master's degree in computer science, and just seven years ago you were a mid-level manager at IBM making $125,000 a year. Today, you work at a textile factory sewing together children's sneakers – you earn $10 an hour. During your lunch break, you work on the birthday present you've been making for your son. It's a remote-controlled car that you've been piecing together with scrap parts. It only makes right-hand turns – but to your son, it will be the coolest birthday present he can remember.

On your way home from work at 5 p.m. – you work six 12-hour days a week now – you overhear another bus passenger talking about a letter he got from family in China. It read:

Dear Li,

We hope you are well – we hope that life in the United States is better than it is here in China. Since the U.S. closed its borders to trade – and the rest of the developed nations, like the EU and Japan, followed suit – life has been very bad here. Our economy used to grow at 9 percent per year as new businesses sprung up to make things from toys to electronics for consumers in Europe and America. Now, factories sit idle. Unemployment is 40 percent.

We're the lucky ones – we have jobs working on the farm, planting rice, picking tea leaves, feeding the pigs and digging ditches. The other day, we were awarded bath towels and wash basins for being such model workers. Forty-five years ago, Deng Xiaoping told the farmers to "work hard and get rich" – and many did. Today, we just work hard.

We receive a meager wage from our work on the farm – it's hard to believe we used to be engineers for one of the world's largest electronics manufacturers. Most of what we earn we use to purchase ration coupons – which are required to get even the most basic supplies, like clothes, rice, and cooking oil.

In the city, life is quiet again. We no longer hear the honking of car horns – that's been replaced by the "ding ding" of bicycle bells – and only the best-off among us have that luxury. I've been saving each week to buy another coveted luxury – a radio. Mother would prefer I save to buy a sewing machine, so we can start a small clothing shop, but it's almost impossible for entrepreneurs to succeed here anymore.

Your cousin Wen works at a factory in Beijing making clothes now – he had to drop out of business school when the multinational company he was working part-time for left the country. He says that he can make more shirts in one hour than any of the other workers at the factory – not that it really makes a difference. Most of the other workers, like Wen, are highly educated. He seems miserable.

We hope you'll write us back, but we may not be able to write you again for a while, as paper and ink are very scarce here – and postage is a week's pay. Anyhow, we're sending you hugs and kisses.

Love,
Your family in China[2]

You arrive home at 6 p.m. and your children are sitting at the kitchen table doing homework. You wonder, sometimes, what the point of learning math and science is anymore, if most jobs are industrial labor jobs like yours. You sigh and hope, like you do every day, that one day the United States will be an open market economy once again and your children will have a better, happier, freer life.

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2 The picture of life in China without trade is based in part on CNN.com, "Looking back over China's last 30 years," 19 Dec. 2008. Available at http://edition.cnn.com/2008/WORLD/asiapcf/12/18/china.reform.florcruz/index.html

WHY TRADE

Economic integration is "the path to riches and peace."

Edward Prescott
2004 Nobel Laureate;
W. P. Carey Professor of Economics, Arizona State University

At its most basic, trade is an exchange – a giving of something in return for something else. People have been trading for thousands of years – as early as 3000 B.C., trade flourished in Mesopotamia as people used boats to access farther-away trading partners (the boat was, at the time, an amazing technological development – one in a line of many that has allowed trade to progress).

The principle then was the same as it is now: one group of people has something that another group wants, and is willing to give it up in exchange for something that the other group has. Five thousand years ago in Mesopotamia trade centered on grain and metal. Today, it might be TVs, toys, or trucks.

But the word "trade" does not accurately describe the depth and breadth that characterizes relationships between countries in today's globally-integrated world. A better term is "economic integration," which reflects an economic coming together – a movement from distinct parts toward a common whole. Economic integration occurs at many different levels – at the highest macroeconomic level and at the lowest microeconomic level. And trade is one *mechanism* by which economic integration – the ultimate goal – occurs. According to 2004 Nobel Laureate and W. P. Carey professor of economics Edward Prescott, economic integration is "the path to riches and peace."

Why do people engage in economic integration and trade?

Simply put, because economic integration advances trade, which in turn allows us to obtain things we want that we would not otherwise have – perhaps because we don't have the resources to make those things; we don't have the technology to make those things; or we can't make them efficiently enough (so we can't afford them).

The data bear out the fact that economic integration drives economic development; in lesser-developed countries that integrate economically with advanced developed countries, GDP per capita (a common proxy measure for a country's level of development or standard of living) rises farther and faster than in non-integrated countries – and begins to catch up to the GDP per capita of the advanced developed leaders.

After the U.S., for example, opened its borders to economic integration in the late 1800s, per capita GDP began to rise dramatically relative to the per capita GDP of the UK, then the leading industrial nation. In 1868, per capita GDP in the U.S. was only 79 percent of the UK's – by 1908, the U.S. had just surpassed the UK and by 1928 U.S. per capita GDP was 123 percent of the UK's.

The correlation between economic integration and development in China has been similar: in 1981, three years after the end of China's Cultural Revolution and the beginning of its period of increasing economic integration, per capita GDP in China was only 6 percent that of the U.S. Just 27 years later, China's per capita GDP was 22 percent of the U.S.' Clearly, China still has a lot of catching up to do, but its progress over the last 27 years has been dramatic.

In other words, people in countries that are economically integrated are wealthier as a result of their integration. There are four reasons why:

1) ***Economic integration gives the less-developed trading nation (e.g., China relative to the U.S.) access to foreign know-how (technological capital), which it can then adopt to become more productive***. That access comes from foreign companies doing business in the less-developed nation. Examples abound of multinational companies that use their technological know-how (even if it's not their latest-and-greatest) in their foreign subsidiaries. That's why multinational relationships are a key element of successful economic integration – because they lead to a vested interest in both countries to remaining open.

2) ***With economic integration, barriers to adopting better technologies are lower.*** If technological development is constrained within a single country's borders (because the country is not economically integrated), then productivity increases generated by better technologies do not lead to increased output, but rather to decreased employement. Why? Because the single country only needs so much output. And given a fixed demand for output, productivity increases mean fewer employees are needed to create that output.

   If, on the other hand, development is not constrained within the single country's borders (because the country is economically integrated with others), then productivity increases that come from adopting more advanced technologies lead to increased output and increased employment. Why? Because there are other countries to buy the increased output, and productivity increases mean that more output can be generated more effectively (and, often, more cheaply) *and* employment can increase.

3) ***Economic integration allows more rapid diffusion of knowledge.*** The diffusion of knowledge is key to productivity growth – for productivity improvements to occur, a lot of technological capital has to be absorbed person-to-person, and that happens more quickly if countries are economically integrated. When countries integrate, businesses from the more developed nations locate in the developing countries – just as U.S. businesses have located in China. Being on the ground in China, U.S. companies have been able to share their knowledge with their Chinese partners more rapidly than if knowledge-sharing were confined to formal educational settings, for example.

4) ***More economic integration leads to more competition.*** And more competition is good because it leads to more technological progress (think of it like a race: the fastest runner in the world might only run a 4-minute mile if racing by himself; throw some competition into the race and the runner crosses the finish line at 3:45). In terms of economic integration, when markets are open technological progress leads to higher standards of living for people in all open countries. Why? Because technological progress allows countries to either 1) make more advanced goods to sell to other countries for higher prices; or 2) make a greater number of goods with the same number of resources – both of which result in greater income

and availability of capital.

"But why," some people ask, "should the U.S. care about integration if the country could be self-sufficient?" It's a reasonable question: if reasons for economic integration include a lack of the resources or technology to make the things we need, then the U.S., it might seem, doesn't "need" to be economically integrated with other countries in order to survive. In thinking about the question, it's important to consider:

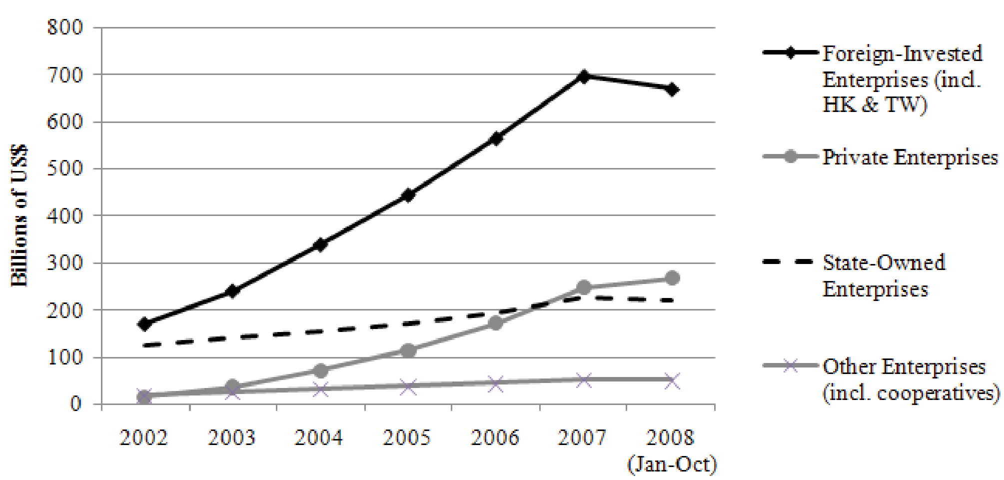
1) ***What do the terms "need" and "survival" mean to people in America?*** Economic integration has made people in America far wealthier – as measured by per capita GDP – than if the country had remained a closed-border, protectionist nation. That wealth has allowed people in America to drive cars, own homes, travel the world, send their children to college, and to pursue other activities one might consider part of the "American dream."

2) ***Are there goods or services that the U.S. doesn't have the resources or technology to produce?*** The U.S. could likely be "self-sufficient" in the sense that people in the U.S. could survive – feed, clothe and shelter themselves – without economic integration. But the resources we import from other countries – not the least of which is oil – allow people in the U.S. to live lifestyles that we would most certainly not be able to live without trade.

How does economic integration with China benefit the U.S.?

There are substantial benefits that accrue to the U.S. as a result of its trading relationship with China. For one, there are a number American companies that operate in China and are more successful because of it. In fact, a far greater percentage of Chinese exports come from foreign-invested enterprises than any other enterprise in China, as Figure 1 makes clear.

Figure 1: China Exports by Enterprise Type



Source: Ministry of Commerce of the People's Republic of China

“The question is not whether China will continue to grow while the U.S. ceases growing, but rather: Are we going to keep growing together or cease growing together?”

Art Blakemore
Chair, W. P. Carey Economics; University Vice Provost, Arizona State University

The high level of Chinese exports produced by foreign-invested enterprises contradicts the notion that most Chinese goods are produced by state-owned, state-run companies. U.S. companies like Wal-Mart, GM, Microsoft, Motorola, and Intel are all successfully operating in China, exporting from there as well as selling to consumers in China, and doing better business because of it.

The opposite is also true: as China develops, with its businesses becoming increasingly sophisticated in technological know-how and capability, those companies will locate abroad (including in the U.S.); that’s positive for China *and* for the countries where those firms are locating (their presence boosts competition, increases employment, and raises tax revenues – among other benefits).

Secondly, economic integration is making people in China more prosperous, which means they purchase more – and they purchase, in part, what the U.S. makes. According to the December 2008 *United States Trade Representative Report to Congress on China’s WTO Compliance*: “China was the United States’ second largest goods trading partner in 2007, with two-way trade totaling $387 billion and on track to increase by 9 percent in 2008 based on data from January through September, while two-way services trade totaled $23 billion in 2007.”[3]

And, finally, Chinese manufacturers typically produce goods at a fraction of the cost of U.S. manufacturers. That means consumers in America pay less for items ranging from canned food to computers. According to the USTR report, “Each year since China joined the WTO in 2001, U.S.-China trade has expanded dramatically, providing numerous and substantial opportunities for U.S. businesses, workers, famers and service suppliers and a wealth of affordable goods for U.S. consumers.”[4]

How does the U.S. stay a leader? High school history taught us that the UK led the Industrial Revolution, was the most advanced – and richest – country in the world, then went flat. The U.S. rose to take Britain’s place and has since reigned as the most advanced – and richest – country in the world. But is the U.S. destined to follow Britain’s path, ceding the leadership position to another up-and-comer – maybe even China?

No.

It was neither laissez faire – “hands off” – trade policies nor competition from the U.S. that led the UK to fall out of first place. Instead, it was the fact that the UK stopped innovating. Technological innovation is the key that creates productivity improvements and economic development – and makes us all richer. As W. P. Carey economics department chairman Art Blakemore put it, “The question is not whether China will continue to grow while the U.S. ceases growing, but rather: Are we going to keep growing together or cease growing together?”

There are benefits to integration with China. But someone gets hurt, right? Another reasonable question. Clearly, economic integration offers profound benefits to both the

3 United States Trade Representative, “2008 Report to Congress on China’s WTO Compliance,” December 2008, p. 4.

4 United States Trade Representative, “2008 Report to Congress on China’s WTO Compliance,” December 2008, p. 4.

United States and China. But it's easy to believe that as one country becomes richer, entering the "club" of industrial leaders, some countries in that club get poorer. Not so. In fact, we all gain from having more people in the club.

That is because ***economic integration is not a zero-sum game. In other words, everyone can win.*** In reality, over the long term economic integration benefits us all. Contrary to popular opinion, global wealth is not a fixed-size pie, where when one country wants a bigger slice, another country has to settle for a smaller slice. Instead, economic integration increases the size of the pie – so that everyone at the table can have a bigger piece. In fact, by Ed Prescott's estimation, the whole world will be rich by 2100 – because of economic integration. "In the category of economic superpowers, more is better than less – the more technology the leaders develop, the more productive they become, the more we all benefit."

Critics of economic integration argue that it hurts American workers. Yet the data refute that claim. Between 1978 and 2008, the real value of goods and services imported to the United States increased 482 percent, from $328 billion to $1.9 trillion (in 2000 dollars) – reflecting the dramatic increase in global economic integration. ***At the same time***, people in America got much richer; real GDP expanded by 132 percent and total civilian employment rose by 49.3 million jobs.

To be fair, the massive benefits that accrue to American businesses, consumers and workers from economic integration don't mean that there is never any pain involved. In the transitions caused by integration – industries like textile manufacturing moving to other countries where they can be run more efficiently, for example – workers do lose jobs. But those jobs were in industries in which the United States was not competitive on a global scale. And they are more than replaced by jobs in industries in which the U.S. is competitive – most often, industries that pay workers more money.

Those 49.3 million new jobs and 132 percent more income created during the 1978-2008 period of expanding integration reflect the fact that technological advancements and productivity improvements raise not only the *number* of jobs for U.S. workers but also the *quality* of those jobs. Those improvements are made possible by economic integration, by the fact that U.S. workers are freed to move from uncompetitive industries like textiles to competitive industries like high technology.

> "By allowing Americans to specialize in what they produce best, free trade raises productivity, wages and living standards for the large majority of workers. Like technology, it leads to new products and new industries while enabling workers to produce more in a given hour of effort."[5]

In the early 1800s, textile workers in Britain revolted against the Industrial Revolution by destroying labor-saving weaving machines because they believed that those machines would lead to job losses and lower wages. Imagine if those textile workers – now famously now known as "Luddites" after their mythical leader – had been successful in preventing the development of the weaving machine? Standing against economic integration in the name of protecting domestic jobs and wages would be to impede the very

5 United States Trade Representative, "2008 Report to Congress on China's WTO Compliance," December 2008, p. 4.

technological progress and productivity enhancements that make all our lives better.

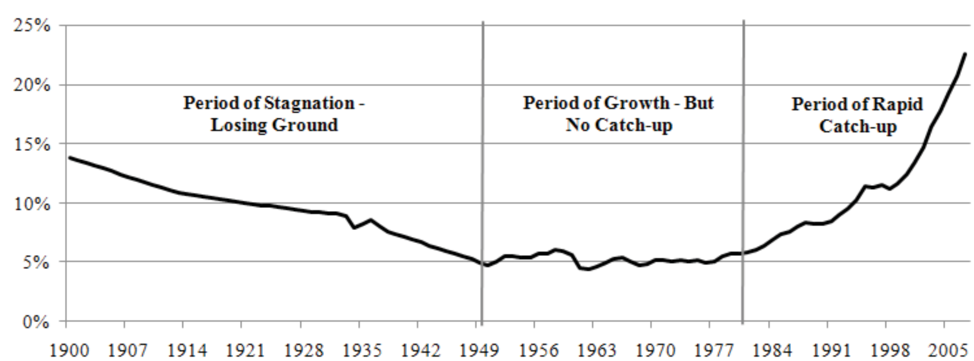
How does economic integration with the U.S benefit China?

Just as the benefits of economic integration that accrue to the U.S. are profound, so are the benefits that accrue to China. It has been thirty years since China began its move to a decentralized, market-oriented economy. In that time, the country has rapidly caught up with the world's economic leaders (from 5.5 percent of the U.S.' GDP per capita in 1978 to 22.5 percent in 2007). At the same time, China has made substantial progress in protecting human rights, intellectual property and the environment (though many believe that further changes are necessary). Why has the country been able to make that progress? Because it has become richer – through integration.

Thirty years ago, China was poor and isolated with little international trade. There were few cars but millions of bicycles. Clothes were unisex, baggy and came in blue, green or grey. People earned little money and there was little to buy. Who would have thought that China would in thirty years become the third largest economy in the world? Companies like KFC, Wal-Mart and Starbucks are highly visible there. The country boasts a 9.8 percent average annual growth rate. It is the largest single holder of U.S. government debt. Clearly, China has come a long way.[6]

Since the early 1990s both U.S. imports from China and foreign direct investment (FDI) in China have increased dramatically. At the same time, China's per capita GDP relative to the U.S. has quickly risen. Table 2 makes clear the relationship between China's level of economic integration with the rest of the world and the incomes of people in China – as soon as the Cultural Revolution ended and China adopted a policy of global engagement, per capita GDP (a proxy measure for a person's standard of living) took off.

Figure 2: Chinese GDP per capita Relative to U.S., 1900-2007



Source: Angus Maddisson, University of Groningen. Available at http://www.ggdc.net/maddison/

6 See CNN.com, "Looking back over China's last 30 years," 19 Dec. 2008. Available at http://edition.cnn.com/2008/WORLD/asiapcf/12/18/china.reform.florcruz/index.html

The rise in China's per capita GDP comes in part because economic integration has allowed Chinese companies to develop the capabilities to make and sell products that people in other countries (not least of all the U.S.) need and want. In her book *A Year Without "Made in China": One Family's True Life Adventure in the Global Economy* business journalist Sara Bongiorni said that attempting to find basic goods – like birthday candles or tennis shoes for her children – that were not made in China was a "terrific struggle." After three weeks of searching, she finally found Italian-made children's sneakers – at five times the cost of those made in China and sold in the U.S.

The dramatic rise in China's goods exports to the U.S. and the rest of the world has allowed its companies to invest in more capital, hire more workers, become more productive – and that has lifted the relative per capita GDP of the people in China 312 percent in thirty years.

Perhaps the greatest benefit of China's economic integration has been the diffusion of knowledge and technical know-how from the foreign-invested enterprises (including American and multinational corporations) operating in China. Through access to better technologies, improved management techniques and best practices, Chinese companies have become better able to compete. Recall that competition – even the threat of it – encourages companies to become more productive, which makes everyone better off.

China's economic development has also had the effect of shining light on the country's human rights abuses – and the government has, in many cases, responded by increasing human rights protections. China today certainly does not look at human rights issues the same way the United States does, but the relationship between China's economic development and human rights betterment is clear. That's in part because of pressure exerted by American and multinational corporations on their Chinese suppliers to improve working conditions – to "shape up or die."

It's also because, as countries become wealthier, they can afford to expend resources dealing with issues like human rights and the environment. When a country is low on the economic development curve its focus is often on catching up economically, sometimes at the expense of other concerns. But as countries move forward on that curve, they find the resources to pay attention to concerns like the environment and human rights.

There is evidence that is happening in China. The country's latest five-year plan (2006-2010) reflects more attention to humanity, society and the environment – in addition to the typical attention paid to the economy. Specifically, the plan provides for "an overall growth in the quality of life of urban and rural residents, and remarkable improvement of the conditions of housing, communication, culture and environment" and for "putting under control the deteriorating trend of ecological environment, reducing the total volume of released major pollutants by 10 percent, increasing the forest coverage to 20 percent, and controlling greenhouse gas emission."[7]

7 See http://chinaabc.showchina.org/chinaabc_en/economy/200701/t105748.htm

Is there anything negative about China's economic integration?

Yes. One of the largest downsides to China's economic development – fueled by its integration with the rest of the world – is environmental degradation. While steps can – and should – be taken to help China mitigate the adverse impact of development on its rivers, skies and people, it's important to consider that in the UK during the Industrial Revolution and in the U.S. during the first decades of its economic development, industry contributed to significant environmental degradation.

As economic development progressed in the UK and the U.S. (and other advanced industrial nations as well), those countries became wealthier. As they became wealthier, they could afford to adopt and enforce relatively expensive environmental regulations designed to mitigate industry's negative environmental impacts. Today, China seems poised to do the same.

SHORT TERM v. LONG TERM

The negative effects of economic integration – job losses in non-competitive industries in the U.S., for example – are short-term losses. They're painful, no doubt, but they are short-term, while the positive benefits associated with economic integration are long-term. Consider that economic integration has been progressing for thousands of years. There is nothing new about globalization – it is a trend that has been on its current trajectory for as long as history has been recorded. Over this history, economic integration has made the world more prosperous.

In the 1600s, one of the hot commodities was pepper – it fueled trade between the East, where it was cultivated, and the West, where demand for exotic spices was massive. Pepper was such a hot commodity, in fact, that a bubble developed from over-speculation. And, like all bubbles, it burst. People who had invested in pepper lost their fortunes. People who had been employed in the pepper industry lost their jobs.

Yet just two hundred years later, no one (save the trade history buffs) remembers the great pepper boom and bust – it's a blip on the chart of global economic development. Despite the fact that the losses associated with that boom and bust were extremely painful to those who were in the middle of it, today we're all better off because trade – of pepper and many other goods – progressed.

So those who would say that economic integration is not positive are looking at a narrow group of stakeholders over a short time frame. It is true that, *in the short run*, economic integration is not always positive for everyone affected by it. In the long run, we all benefit from greater integration. For those who decry economic integration in the name of saving American jobs or protecting China's environment it is important to remember a number of points:

1) ***Job losses, while painful, are short-term.*** In the long run, more, higher-quality jobs are created as a result of economic integration than those that are lost.

2) Citizens in countries that are open to economic integration, including people in America and China, are wealthier – ***we have higher standards of living – because of that integration***.

3) ***Economic integration makes the goods and services we need and want less expensive.*** For all the rhetoric passed around about "buying American," consumers in the U.S. have expressed their preferences – with their cash every time they buy a less expensive computer, pair of tennis shoes or bottle of cranberry juice that is "made in China."

4) Economic integration makes developing countries, like China, wealthier, which ***gives the people there more freedom to focus on important issues like human rights and environmental protection***.

In the short term, there are a number of issues that make trade negotiations incredibly difficult. But considered over the long term, those issues become opportunities.

Short-term issues and long-term opportunities

In the short term, there are a number of issues that make trade negotiations incredibly difficult. But considered over the long term, those issues become opportunities. The negative environmental impacts of China's relatively dirty industry are, over the short term, issues that can hinder successful trade negotiations. But viewed from the perspective of global sustainability, that short-term issue becomes a long-run opportunity to craft a healthier, more sustainable way of doing business – together. In fact, the Pew Center on Global Climate Change and Asia Society recently released a report, *Common Challenge, Collaborative Response: A Roadmap for U.S.-China Cooperation on Energy and Climate Change* outlining just that kind of opportunity.[8]

The key lies in balancing those short-run issues – which often tend to drown out discussions of the benefits of greater integration and inhibit successful negotiations on the terms of U.S./China integration – and consider them instead as long-run opportunities to make the world a better place to live for everyone.

Short-term and long-term strategies

To say that nations, businesses and people behave strategically is not to say that they behave immorally or against the interests of the others. In fact, both the United States and China – and the businesses that operate there – behave strategically, in their best interest. Yet that strategic behavior can sometimes cause tensions between nations, businesses and people. As Clyde Prestowitz, founder and president of the Economic Strategy Institute, put it, "There is tension between countries that have strategic economies – not necessarily government-controlled but government-influenced." Of course, that's every country on the planet.

The United States' trade strategy

The U.S. certainly takes a less actively-strategic position on trade than it did, say, a hundred years ago. When America began its economic integration, it did so on its own – strategic – terms. Between 1816 and 1940, the country pursued "catch-up" policies that look quite similar to China's catch-up policies today. The U.S. imposed highly protective tariffs – Lincoln increased tariffs 60 percent – and professed a preference for domestic protectionism (Teddy Roosevelt's "Thank God I'm not a free trader!"). Yet trade was still an important part of the United States' plan to catch up to then industrial leader Britain.

By the middle of the 20th century, the U.S. had surpassed the UK to become the leading industrialized economy in the world. Then, its strategy changed. After World War II, the U.S. developed a "Trade not aid" program designed to help war-torn countries get back on their feet through exports to the U.S.; the focus in America turned to developing domestic consumption to lead growth and stimulate exports from other countries.

That the U.S. is less actively strategic than in the past doesn't mean the country isn't still strategic when it comes to global economic integration. In the early 1980s, for example, the U.S. Congress sought domestic content restrictions on imported autos. Japan accepted "voluntary" limits on the number of finished cars it would import to the United States.

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8 Available at http://www.asiasociety.org/taskforces/climateroadmap/US_China_Roadmap_on_Climate_Change.pdf

Then, the Japanese auto manufacturers adapted their strategies, determined to sell as many cars as possible to the eager U.S. market. They began locating their plants here in America. Instead of retreating or crying "trade war" the Japanese companies played within America's rules – working around American protectionism because they saw the enormous benefits of trading with the U.S. Today, Japanese automakers and the workers employed at their U.S. plants, as well as American auto consumers, benefit from Japan's economic integration with the U.S.

> "Ford produces cars in 17 countries – nearly three-fourths of its production now occurs outside the United States. GM exports more cars from Germany than does BMW. Half of all Toyotas and three-fourths of all Hondas sold in America are built here. 75 percent of the 2001 Honda Civic coupe is 'Made in the USA' domestic content; the Ford Escort, 60 percent.
>
> What's the message in all this? A highly globalized and competitive auto industry gets vehicles to consumers any which way it can. That's how markets work.
>
> At the time of the protectionist legislation, in the early 1980s, foreign-based imports were 26 percent of U.S. auto sales and domestically made foreign cars were just 2 percent. Imports made up 23 percent of the nation's luxury car market. In 2001, 23 percent of U.S. sales were imports, but 26 percent were foreign cars built in this country. Imports comprised 58 percent of the U.S. luxury market."[9]

China's trade strategy

Like the U.S. in the late 1800s and early 1900s, China is pursuing a catch-up strategy designed to rapidly boost the nation's GDP – and it is working. Between 1978 and 2006, per capita GDP in China rose 518 percent.[10] The country's annual per capita GDP growth has averaged about 9 percent – far above the 2 percent that is common in the advanced industrialized economies.

China has accomplished that massive wealth building by behaving strategically – which is clearly completely rational (whether America likes it or not). If American businesses want a place in China's rapidly expanding economy they will have to play by China's rules (and, indeed, they have) – just like Japanese businesses played by America's rules in the 1970s.

According to the December 2008 U.S. Trade Representative's Report to Congress on China's WTO Compliance:

> "China has taken many impressive steps over the last seven years to reform its economy, while making progress in implementing a set of sweeping WTO accession commitments that required it to reduce tariff rates, eliminate non-tariff barriers, provide national treatment and improved market access for goods and services imported from the United States and other WTO members,

9 Federal Reserve Bank of Dallas, "The Fruits of Free Trade: 2002 Annual Report," p. 20. Available at http://www.dallasfed.org/fed/annual/2002/ar02f.cfm

10 Source: Angus Maddisson, University of Groningen. Available at http://www.ggdc.net/maddison/

“The West should encourage, promote, and enhance China’s move toward a market economy.”

Merle A. Hinrichs
Chaiman and CEO, Global Sources

> protect intellectual property rights, and improve transparency.
>
> Nevertheless, in some areas is appears that China has yet to fully implement important commitments, and in other areas significant questions have arisen regarding China’s adherence to ongoing WTO obligations, including core WTO principles. Invariably, these problems can be traced to China’s pursuit of industrial policies that rely on excessive, trade-distorting government intervention intended to promote or protect China’s domestic industries. This government intervention, still evident in many areas of China’s economy, is a reflection of China’s historic yet unfinished transition from a centrally planned economy to a free-market economy governed by rule of law.”[11]

Today, China is at a tipping point, where it will either move forward toward a more open market economy or backward to a more closed state-run economy. According to Global Sources chairman and CEO Merle Hinrichs, “The West should encourage, promote, and enhance China’s move toward a market economy.” We’ll all be better for it in the end.

Over the short term, both the United States and China engaged in protectionist policies designed to help them “catch up” economically. The key is that those policies remain tools only used in the short term – because in the long run, protectionism is negative for everyone as it hinders growth and competition.

Yet keeping protectionism at bay need not necessarily be a policymaker’s job. The “economics works” principle suggests – and experience proves – that the United States, China, and the companies that do business there will be sufficiently motivated by the economic gains that come from being more open – more and more so as, for example, China and its domestic firms develop.

The evolution of “made in China” quality is a good example of that “economics works” principle. When it is in Chinese companies’ interest to improve quality (because consumers demand it), they’ll do it. Consumer product safety is another issue that Chinese companies – and Chinese regulators – are eager to address because tainted products from China threatens to dissuade consumers from making “made in China” purchases.

And as Chinese companies become more sophisticated – the result, in part, of influence from the multinational companies that have operated in China for three decades – they have become eager to patent their own inventions and promote their own brands. Of course, patenting an invention or protecting a brand involves intellectually property (IP) rights – an area that U.S. companies have long struggled with in China. Today, we see Chinese IP regulations becoming stronger – because strengthening them is good for Chinese companies now, too.

Clearly, China does what is good for China (just as the U.S. does what is good for the U.S.). The beauty of economic integration is that as developing economies move up the value chain, becoming more economically developed, what’s good for them comes into much closer alignment with what’s good for all of us. So we can all sit down at the table and have our pie – and eat it, too.

11 United States Trade Representative, “2008 Report to Congress on China’s WTO Compliance,” December 2008, p. 3.

Businesses' trade strategy

Just like Japanese automakers that sought to import cars into the United States in the 1970s, American and multinational companies that want to do business in China today have to think – and act – strategically. Simply put, companies have found that they cannot ignore the immense market opportunities China presents – despite the challenges that come with doing business there. That's the "economics works" principle at its best.

Motorola, for example, first entered the Chinese market in the 1980s. They brought with them not their cutting-edge cellular phone technology but their pager technology, which was on the decline in the United States as consumers began to convert to cell phones. At the time, the company's strategy was to manufacture pagers in China for export to other countries. In 1991, China's annual demand for pagers was 1 million. By 1993, it had skyrocketed to 4 million – and Motorola had a corner on the market. The U.S.-based electronics giant ended up selling more pagers in China than in the United States.

Microsoft had to reinvent its corporate strategy to succeed in China – for years the company struggled to make inroads in the nation of 1.3 billion consumers until the company realized that the problem was their culture. Finally, Microsoft figured out that you can't fight with the Chinese government (like the company had always done with the U.S. government). Instead, they had to pursue a strategy of coordination.

According to W. P. Carey Associate Dean of Asia Programs Buck Pei, "Cooperation wasn't in Microsoft's cultural DNA, so they hired a relationship manager from Motorola to help." In four years, that new strategy had completely turned around Microsoft's business in China. The bottom line: instead of fixating on a "What's good for me" strategy companies must also focus on "What's good for China." As Motorola and Microsoft proved, the two are not mutually exclusive.

ON SUCCEEDING IN CHINA

The rapid rate of change in China makes doing business in China different than doing business anywhere else. Seasoned business veterans from Motorola, Emerson Electric, and ON Seminconductor offer their advice for successfully doing business in China.

Gary Tooker, Former Chairman of Motorola

Invest your time, your money, and your talent in your Chinese operations - it will be worth it.

- To be a successful global company, you've got to be in China.
- But don't get started there if you're not willing to make a long-term commitment.
- Invest your time, your money and your talent in your Chinese operations – it will be worth it.
- Build long-term relationships (that's important everywhere, but especially in China).
- Put good leadership in place.
- Things move fast in China; be ready.
- Put someone in place at your corporate headquarters that will fight the boardroom battles for the people on the ground in China.
- Avoid joint ventures if you can. If you can't, retain a majority share and develop a clearly-defined path for increasing that share. Don't ever form a JV with a competing company.
- Don't put your cutting-edge technology in China first; intellectual property rights do remain an issue there.

Peter Yam, Chairman of Emerson Electric (China) Holding Co. Ltd.

To effectively compete, you must have the ability to learn fast through local connections.

- Understand the Chinese market; that will require a lot of effort, because information is not readily available.
- Have people on the ground in China who can interact with the government and move quickly. Delegate responsibility to those senior decision makers in China.
- Don't underestimate rapidly rising domestic players; Chinese companies are becoming sources of technology.
- To effectively compete, you must have the ability to learn fast through local connections.

Bob Mahoney, Executive Vice President of ON Semiconductor

Build yourself into China's future.

- Understanding the Chinese culture and how to build relationships within that culture is critical.
- Chinese companies must trust you first or they won't do business with you.
- It's American companies' responsibility to learn how to compete in China.
- Embrace the Chinese business processes instead of fighting them.
- Embrace long-run trends in the Chinese economy. Build yourself into China's future.

CRAFTING AN AGENDA FOR ECONOMIC INTEGRATION DISCUSSIONS

Given the fact that economic integration is, on the whole and over the long term, positive; given the forces that drive the U.S. and China toward, or away from, more effective trade relationships; what topics should be on the agenda for discussions between the U.S. and China on economic integration?

The idea of short-run issues and long-term opportunities is important here. For those who seek to facilitate trade discussions, how can the psychological barriers that so often prevent strategic thinking about the long term be overcome? How can the agenda for discussions on U.S./China trade be constructed to realize long-term opportunities while avoiding the short-term issues that constantly threaten to derail the entire process? ***There are five important steps in overcoming those psychological barriers to craft that agenda.***

Step 1: Acknowledge that economic integration is positive on the whole and over the long term, and that trade is critically important to both the U.S. and China's economies.

A significant portion of this paper has been devoted to explaining why economic integration is positive on the whole and over the long term. Especially in the United States, we need more of this kind of education to counter the misperception that China is a threat. We need to help the populace understand that economic integration is in everyone's best interest and that China is an important business partner, not a threat. Both the U.S. and China would be well-served to:

- Teach people what culture is about in the other country (based on fact, not TV).
- Help people – both policymakers and voters – understand the other country's perspective.
- Help people understand the value of economic integration and why the American/Chinese interrelationship is so critical.

Step 2: Acknowledge the forces that drive the U.S. and China toward, or away from, more effective economic relationships.

To tout the substantial benefits of economic integration is not to deny the fact that there are very real issues that restrain economic integration – just as there are very real issues, in addition to the economic benefits of integration, that drive it. Understanding that those issues exist – and what they are – is key to developing effective relationships.

It's also important to remember that the fact that there are forces restraining economic integration is an issue not of broad philosophy; it's not a question of whether integration is positive or whether the United States or China wants to engage economically but rather a difference of opinion concerning the "how" – the mechanics of that integration.

Step 3: Recognize that the U.S. and China's views of the world differ.

Culturally, the United States and China are quite different. The kind of discussions that center around economic integration require a deep understanding of the differences between America's view of the world and China's view of the world. According to W. P. Carey's Buck Pei, "Economic integration also involves openness to other countries' value systems."

Many – indeed most – of the difficulties associated with economic integration at the country and company levels spring from an inadequate understanding of cultural and worldview differences. From views of self, the role of the boss, and the best way to handle problems, Western and Asian views are dramatically different. For example, in the West, the individual reigns supreme; in Asia, the group does. In the West, the boss is just another one of the rest of us; in Asia, he or she is a true "superior." In the West, problems are handled with a bull-like approach; in Asia, the approach is more circuitous.

Understanding these differences can make working out the mechanics of economic integration much easier. While it's not reasonable to expect the U.S. and China to begin to think alike culturally, it is reasonable to expect that through understanding cultural differences, the two countries can work together toward the common goal of economic integration.

Step 4: Determine the line of moral tolerance that can't be crossed.

The United States has its own sometimes dark history of labor rights development. In 1914, in one of America's "most dramatic confrontations between capital and labor" – the Ludlow massacre – two women and eleven children, families of miners striking at the Colorado Fuel and Iron Company, were killed when the state militia set fire to striking miners' tent colony.[12]

It wasn't until 1949 that child labor was directly prohibited in the United States, by an amendment to the Fair Labor Standards Act of 1938. Yet some in the U.S. would insist that China – still much farther behind on the economic development curve than the U.S. was 60 years ago – develop similar child worker protection laws today.

Perhaps this issue – illuminated by the understanding that the U.S. and China are simply in very different places developmentally – might be best left to China to deal with, rather than be dictated by the U.S. as part of trade negotiations. Perhaps it is best resolved by companies that face increasing pressure from consumers to improve labor conditions. (That's the "economics works" principle again – if consumers decided to buy only from companies that could prove healthy working conditions, then companies would quickly ensure that their working conditions were healthy – or lose market share to companies that did.)

Yet there are clearly other behaviors that the U.S. can't tolerate in its trading partners. Perhaps female infanticide or extrajudicial torture and killing would make that list. Both the U.S. and China should candidly discuss the "moral line" before which issues are left to the individual countries to resolve as they see best fit. Beyond that "moral line" the trading partners have a right to expect action toward a resolution.

12 See http://www.pbs.org/wgbh/amex/rockefellers/sfeature/sf_8.html.

Step 5: Determine which issues must be resolved and which can be let go.
Clearly, there are some issues that reflect deep cultural differences – issues that may never be resolved. Perhaps, then, taking those issues off the table would allow discussions of economic integration between the U.S. and China to proceed more smoothly. Furthermore, understanding that trading partners are very often at different points on the economic development curve is an important part of deciding which issues should be ignored in trade discussions. Some issues should be ignored in the short-run – they can be addressed over the long term as China develops.

Determining which issues need to be resolved and which can be let go is not about deciding what's right or wrong – or more right or more wrong. Instead, it is about acknowledging that the benefits of integration are so substantial, economic integration so important for our well-being, that some contentious issues need be let go, for the sake of preserving the dialogue. Care must be taken, of course, to avoid putting every issue in the "defer resolution" bucket. There are clearly some issues – those beyond the "moral line," for example – that must be addressed.

WHO THE HECK CARES ABOUT TRADE?

The acknowledgement that we all would be far worse off without economic integration between the U.S. and China should form the bedrock of trade discussions between the two countries.

Who the heck cares about trade? We all should.

For those who say that protectionist (anti-integration) policies should be enacted to "save" American jobs, consider what the American labor market would be like in the "Imaging a World Without Trade" scenario: far fewer people in America would have jobs, and those who did, would work in labor-intensive industries. Because everything consumed in the U.S. would have to be made in the U.S., people in America would no longer have the luxury of a large, productive service industry. Most workers – even highly educated ones – would be consigned to tough, hands-on work.

For those who say that the U.S. should hold back economic integration with China unless the country complies with America's current standards on issues like human rights, for example – consider what life would be like for China's people in the "Imagining a World Without Trade" scenario: unemployment would skyrocket, standards of living would crash, people would once again have very little choice about what to buy (and little money to buy it with). Entrepreneurship would cease and people would return to hard, manual labor on farms.

Clearly, we would all be far worse off without economic integration between the U.S. and China. That acknowledgement should form the bedrock of trade discussions between parties in the two countries. At the same time, acknowledging the importance of economic integration is not to deny important issues that should be a part of trade discussions – those issues that are beyond the "moral line" as well as those long-term opportunities, like sustainability, that we can work together to realize.

Acknowledging the benefits of integration is not to deny the fact that, in terms of economic development as well as human rights and environmental protection issues, China is a work-in-progress. It is, instead, to acknowledge the important role that integration has played in fostering China's economic development, its increasing openness, and its steps forward on human rights and environmental protection.

At the end of the day, it is economic integration and trade that make cooperation toward those mutually beneficial end goals possible. Understanding what's at stake – what we all have to gain from free trade, or lose from protectionism – should help stakeholders overcome the obstacles that too often needlessly derail trade discussions. And overcoming those obstacles opens the door to greater economic integration – and a better world for all.