

## What's to Fear?

### What's to Fear?

I've met few Americans and practically no Europeans who have any big concerns about China. Americans are generally much more concerned about procuring another credit card so they can go buy more stuff than they are about what is happening out in the world, especially with a country so far away and foreign as China. Europeans are almost entirely consumed with finding a way to herd the cats of the nations of the European Union (EU) into a unified state, and have little time for Asian concerns when there's German dominance and the Premier League Championship to worry about.

With the Islamic world vacillating between battling for its soul with the Islamists and blaming the non-Islamic world for all its troubles and sub-Saharan Africa busy dying of AIDS, there really aren't many outside of Asia paying much attention to the Chinese these days.

That suits China just fine, since they've been busy quietly sucking up 33 to 60% of the world's construction materials, becoming the world's second largest consumer of oil, dominating world manufacturing, accumulating \$470 billion USD in foreign currency reserves, growing their economy at between 7 and 9.5%, finding jobs for over 150 million under- and un-employed workers, increasing exports at over 20% annually, and in short, completing the next step of their internal agendas and preparing for their global coming out party with the 2008 Olympics.

My big questions coming into China were 1) can the Chinese government maintain control of 1.3 billion people, 92% of them Han and the rest spread out among 55 other ethnic groups, as they grow in wealth and knowledge; 2) can the Chinese government find a way to employ their estimated 150 million under- and un-employed workers; 3) can the Chinese society find something to do with their estimated 100 million un-marry-able men; 4) is China destined for the same breakup and Balkanization that befell the Soviet Union; 5) can the Chinese government keep the people in the relatively undeveloped heartland happy as the people in the developed areas along the coast enjoy wealth and an increased standard of living; 6) what are the strategic geopolitical implications of China's rise to economic superpower status; and, perhaps most ominously, 7) what is the ultimate fate of the 380 million males available for military service.

After being here for a month, I've found that some of my big fears still rank as important questions, while others have ascended to join the top of the list.

For instance, after riding for days through choking, eye burning air pollution the crisis around China's insatiable appetite for energy became apparent. Since the communists came to power in 1949, China's Gross Domestic Product (GDP) has increased more than 10 fold, but its energy consumption has risen more than 40 fold in the same period.

There isn't much relief in sight for air pollution. It is estimated that China will discharge 1.4 to 1.9 billion tons of carbon dioxide by the year 2020, earning the dubious honor as the top polluter in the world.

Most of that discharge will be associated with electricity generation. China has been failing to meet demand for electricity since 2000. Last year 23 provincial power grids experienced blackouts and brownouts. This year the gap between electrical supply and demand will reach 17 million kilowatts. The installed capacity of electricity generators at the end of 2003 was 385 million kilowatts. China expects to need generation capacity of at least 1.5 billion kilowatts of electricity by 2010.

## What's to Fear?

Unfortunately, China is an inefficient user of energy, trailing the U.S. by a large margin in amount of GDP produced per unit of energy utilized. (While the U.S. is often criticized for using 30% of the world's energy, it is usually omitted that the U.S. produces 35% of the world's goods with that energy.) China's energy consumption per capita (5.8) is currently more than double India's (2.3).

China's growth rate of demand for oil over the last five years is the highest in the world (2.19 mmb/d, versus 2.13 for North America, .94 for the Middle East and 1.83 for the rest of the world). There isn't much relief for oil demand in sight for China, with 500,000 new cars sold in Beijing last year alone.

Even while its demand for oil is leading the world into an oil crisis, China is not making much headway on alternative forms of energy. India has moved Delhi's entire fleet of busses, taxis and auto-rickshaws to Compressed Natural Gas (CNG). In comparison, China currently has about 300 CNG stations serving fewer than 100,000 CNG vehicles, while the world as a whole has about 70 countries using CNG for fuel for approximately 3.67 million vehicles.

China also remains addicted to its dwindling supplies of coal, with Shanghai alone consuming 67 million tons of standard coal in 2003 with an annual consumption growth rate of 6.9% since 2000. Consequently, China is facing the same grim energy end game as the rest of the world, with its 193 billion tons of domestic exploitable coal projected to last for 83 years at current utilization levels, but only 20 years if consumption doubles, which is inevitable at current growth rates.

Already, supply limitations are beginning to restrict growth. Annual energy consumption is rising by up to 17%, while imports of crude oil and refined products are growing even faster. China has become the world's leading single consumer of cement, steel and coal, and imports of oil, copper and nickel are all rising quickly. Global limitations in supply have contributed to a slowdown in domestic fixed investment growth which slowed from 43% in the first quarter of this year to 22.3% in the second quarter.

Even so, in the first half of 2004 China's exports rose by more than 35% to \$258 billion USD and imports grew even more, rising 42% to nearly \$265 billion USD.

Shipping containers handled by Chinese ports rose from 15.59 million in 1999 to 48 million last year, meaning China dealt with approximately 25% of the world's marine shipping containers in 2003. In the first half of 2004, China's import and exports totaled \$523 billion USD, up 39.1% from the same period last year. During the same period, cargo handled by Chinese ports totaled 1.568 billion tons, up 26.2% compared to the same prior-year period.

In addition to moving more products, China is also moving more people, specifically the migrant mingong (rural workers), who are a key component of the low cost worker pool in China's factories. There are an estimated 125 million mingong in China today, and are expected to rise to 160 million in 2010. The mingong are a critical component in wealth distribution in China, sending over \$12 billion USD in earnings from their jobs in the urban factories back to their rural villages. Without this critical pressure relief valve, it is unlikely the Chinese government could contain social unrest in the face of the vast income disparities between the relatively developed urban areas and the undeveloped agrarian portions of the country.

The rising imports, the mingong phenomenon, along with China's accumulated \$470 billion USD in foreign exchange reserves (with well over half in U.S. dollar denominated instruments) and nearly \$34 billion USD in new foreign direct investments in the first half of 2004, are the key to understanding the real things to fear in China: 1) The end of cheap labor, 2) China's control of the U.S. economy, 3) Taiwan, and 4) The stealth superpower.

## What's to Fear?

**1) The end of cheap labor.** The world in general and the United States in particular, have become addicted to cheap labor and the resulting cheap consumer products. The U.S., with a savings rate of less than 1% and over \$2 trillion USD in consumer non-mortgage debt (over \$18,700 per household), has spent its way into an economic position that is beyond precarious. And even worse than its drunken-sailor spending, America has squandered its temporary spot in the sunshine of wealth on disposable and depreciable assets such as consumer electronics and automobiles instead of expanding or updating its crumbling infrastructure. Consequently, America is particularly vulnerable to the impending end of the developing world's cheap labor pool that has enabled this phenomenon.

China is rapidly developing, and as its standard of living rises, factory workers are increasingly unwilling to accept the \$800 to \$1,200 USD annual earnings currently offered. Manufacturers in China's southeast are already experiencing labor shortages, with an estimated 5 to 10 million jobs going unfilled because rural workers are unwilling to accept the low wages offered. Unfortunately, the next logical place for the world to find large pools of low cost labor, Africa, is unavailable, as that continent is losing multiple generations of workers to the AIDS pandemic. As wages in China inevitably rise, prices for the manufactured goods will follow. The drunken party of consumer spending on low priced consumer goods that has fueled the U.S. economy will also end.

In addition, China's internal demand for manufactured goods is also rapidly rising. With a burgeoning middle class, China's consumption of domestically produced goods will soon surpass exports as the primary business opportunity. At the point that China's domestic demand approximately matches manufacturing capacity currently dedicated to exports, the government will have the flexibility to cut off exports to any country it chooses to.

**2) China's control of the U.S. economy.** Additional levers of power, control and influence are China's massive stockpiles of foreign reserves of over \$470 billion USD and effective control of U.S. dollar values and interest rates. In recent years China has been one of the leading purchasers of U.S. treasury bonds, in effect financing America's headlong rush into its consumer and national debt crisis. The world bank now ranks China's economy as #2 in the world, and if China chose to link its currency to the Euro instead of the dollar, trigger a run on the dollar by dumping its dollar denominated assets into the market and simultaneously stopped buying U.S. bonds, thus driving U.S. interest rates skyward, the U.S. economy would instantly be shoved over the cliff into a deep recession, if not outright depression. In this sense, China holds a sword of Damocles over the U.S. economy, its people and its government.

Couple China's ability to trigger U.S. economic collapse with Europe's very effective campaign to position the U.S. as the world's greatest enemy to provide a unifying cause for E.U. expansion and its easy to see how America would be left standing when the music stops in the global game of dwindling oil supply musical chairs.

**3) Taiwan.** In the near term, the next scheduled international crisis in China is the re-unification of Taiwan shortly after the 2008 Olympics are held in Beijing. At every opportunity, in every international forum, every Chinese representative and leader repeat the same messages: "Taiwan is an inalienable part of the Chinese territory, and China is ready to work towards a peaceful reunification with 'utmost sincerity and effort,'" "Peaceful reunification and one country, two systems;" "We will never tolerate Taiwan independence, nor will we allow anyone to separate Taiwan from the rest of China in any way." These messages are usually followed by a very blunt demand such as "We expect you to continue supporting the Chinese Governments efforts for peaceful reunification and join us in containing the pro-independence activities in the interest of stability in the [Taiwan] Straights and world peace."

## What's to Fear?

The only nation at risk when China re-takes Taiwan, either by exercising its levers of economic control or by outright military invasion, is the U.S. The American congress passed a law, the Taiwan Relations Act, in 1979, which guarantees U.S. protection of Taiwan if attacked. Since Richard Nixon first codified America's current "One China" policy, the U.S. has been walking a diplomatic tightrope of mollifying domestic right wing Taiwan protectors while tacitly acknowledging the inevitability of re-unification.

America faces the prospect of ignoring its own law and turning its back on the democracy of Taiwan or facing the consequences of opposing China, which are clearly implied in a recent statement by Chinese foreign minister Li Zhaoxing regarding U.S. arms sales to Taiwan, "However, we will never, ever allow anyone to use any means to separate Taiwan, which is an inalienable part of the Chinese territory, from the rest of our great motherland. [The arms sale] does not serve the interests of peace and stability across the Taiwan Straights, and *eventually it will not serve the interests of those countries who are prepared to sell weapons to Taiwan*" (emphasis is my own).

While visiting countries I always ask people I meet what the top challenges are that their nation faces. In China, despite the wide range of potential and viable answers such as pollution, population growth, energy supply, Balkanization, etc., the only answer I received was "war over Taiwan."

**4) The stealth superpower.** China's rapid and relentless rise, along with America's ongoing decline into social decadence and fiscal irresponsibility, leads to one inevitable conclusion: China is the world's lone superpower. America, in contrast, is a Hollywood set, a thin façade of military might backed by a hollow fiscal reality and a population with the most specious of national purposes, materialism. While the 19<sup>th</sup> century clearly belonged to the Europeans and the 20<sup>th</sup> the Americans, the 21<sup>st</sup> will be an Asian century, with China dominating all others.

This has interesting implications for the Korean peninsula, which historically was part of greater China, and Japan, which was built on a foundation of Chinese culture. In particular, Japan has yet to have its debts to China come due. The Chinese hold deep and long lasting animosity towards Japan for its atrocities in the Sino-Japanese war and WWII, with outright hostility common among the population, and carefully controlled and managed support for anti-Japanese groups by the Chinese government. As China's economic and military might surpasses Japan's, the fate of Japan as an independent state is open to question. At a minimum, the modern equivalent of paying tribute to the dominant state would seem inevitable.

In addition, bilateral relations between India, south Asia's growing giant of information technology (IT) capability, and China, Asia's undisputed manufacturing, economic and political 800 pound gorilla, will be very interesting. China recently became India's #1 trading partner in Asia, and if the two nations, who collectively boast over 1/3 of the world's population, can maintain positive relations, they will not only completely dominate their region, but the world.

The wild card is energy supplies. The world is facing more energy demand from China and India's rapidly developing economies than existing supplies can provide. When you add in the ongoing political uncertainties of the major oil producing counties of the Mid-East it is likely that the world will face an energy-driven, regional or global scale conflict within the next decade.

Although the U.S. has superior military capability, its population's complete lack of sustainable political will means that America will never be able to sustain the effort required to secure an ongoing supply of energy, much less make the societal commitment to an alternative energy "Manhattan Project" required to avert such a conflict and ensure domestic energy independence. The concept of personal sacrifice for the greater good or deferral of instant gratification for a more secure long term future are too alien to the modern "it's all about me" American experience for there to be any hope for real change in America's energy use rate, source of supply or form.

## What's to Fear?

In contrast, the large developing societies of the world demonstrate the societal political will to achieve societal wide goals, such as India converting the public transportation fleet of one of its largest cities to alternative fuel in less than five years. In China, with the majority of the population having only a middle school education and limited access to media, there is little doubt the government can rally the population around any societal or military goal it desires.

China is today's factory to the world. China has the world's fastest growing economy. China has more cell (mobile) phone users than America has people. Through debt instruments, foreign currency reserves and exports, China has effective economic control over America. China's dominance of the coming century is not in doubt. Its stealth domination of today's world is less apparent to most, but no less complete. China is the world's sole superpower, now, and for the foreseeable future.

China Daily, Monday, September 27, 2004

Zhengzhou: 60 foreign military leaders and observers were invited to observe a Chinese military exercise. The exercise, code named "Iron Fist 2004" was carried out by a reinforced mechanized infantry division in the Queshan Training Base of the Jinan Military Area Command of the Chinese People's Liberation Army (PLA) in Central China's Henan Province.

This was the first time the PLA invited so many foreign, high ranking military officers to observe a Chinese military exercise. It was also the largest-scale military exercise open to foreign observers.

"The exercise is very interesting and impressive," said Shahid Siddiq Tirmizey, director general of the Joint Staff of the Pakistani Army, "Pakistan will co-operate with the Chinese military more in the future."

What's to fear about China? The list could be long, ranging from rampant intellectual property theft to potential rifts between northern and southern China. You will need to create your own ranking, but as a society and as individuals, we will all need to answer this question in the coming years.

Douglas Hackney

Sources: Chinese Ministry of Trade, Chinese Ministry of National Defense, China Daily, Washington Post, Newsweek, The New York Times, The International Herald Tribune, U.S. Department of Energy, CIA Factbook, U.S. Library of Congress, CNN, Money Magazine, Simmons & Company International, Farlex, The People's Daily, The International Economy, The Economist, The state of Connecticut, The South China Post