

Rethinking the Sino-American relationship

Stephen Roach | Yale University | 27 June 2014

In early July, senior US and Chinese officials will gather in Beijing for the sixth Strategic and Economic Dialogue. With bilateral frictions mounting on a number of fronts – including cyber security, territorial disputes in the East and South China Seas, and currency policy – the summit offers an opportunity for a serious reconsideration of the relationship between the world's two most powerful countries.

The US and China are locked in an uncomfortable embrace – the economic counterpart of what psychologists call "codependency." The flirtation started in the late 1970s, when China was teetering in the aftermath of the Cultural Revolution and the US was mired in a wrenching stagflation. Desperate for economic growth, two needy countries entered into a marriage of convenience.

China was quick to benefit from an export-led economic model that was critically dependent on the US as its largest source of demand. The US gained by turning to China for low-cost goods that helped income-constrained consumers make ends meet. It also imported surplus savings from China to fill the void of an unprecedented shortfall of domestic saving, with the deficit-prone US drawing freely on China's voracious appetite for US Treasury securities.

Over time, this marriage of convenience morphed into a full-blown and inherently unhealthy codependency. Both partners took the relationship for granted and pushed unbalanced growth models too far – the US with its asset and credit bubbles that underpinned a record consumption binge, and China with an export-led resurgence that was ultimately dependent on America's consumption bubble.

The imbalances only worsened. China's three decades of 10% annual hyper-growth led to unsustainable strains – outsize resource and energy needs, environmental degradation and pollution, and mounting income inequality. Huge Chinese current-account surpluses resulted from too much saving and too little consumption. Mounting imbalances in the US were the mirror image of those in China – a massive shortfall of domestic saving, unprecedented current-account deficits, excess debt, and an asset-dependent economy that was ultimately built on speculative quicksand.

Predictably, in keeping with the pathology of codependence, the lines distinguishing the two countries became blurred. Over the past decade, Chinese subsidiaries of Western multinationals accounted for more than 60% of the cumulative rise in China's exports. In other words, the export miracle was sparked not by state-sponsored Chinese companies but

by offshore efficiency solutions crafted in the West. This led to the economic equivalent of a personal identity crisis. Who is China – them or us?

In personal relationships, denial tends to mask imbalances – but only for so long. Ultimately, the denial cracks and imbalances give rise to frictions and blame, holding a codependent partner responsible for problems of one's own making. Such is the case with the US and China.

The US blames China for its trade deficits and the pressures they inflict on US workers, citing a massive accumulation of foreign-exchange reserves as evidence of an unconscionable currency manipulation. China counters by underscoring America's saving shortfall – a gap that must be plugged by surplus saving from abroad, a current-account deficit, and a multilateral trade imbalance with more than 100 countries. China blames the US for fixating on a bilateral imbalance as the source of America's multilateral problem.

The same blame game of codependency is apparent in the cyber-security controversy. The US contends that China steals intellectual property for competitive reasons, inflicting grave damage on companies and workers. China, for its part, claims that the US is guilty of equally egregious violations – widespread cyber spying on international leaders, trade negotiators, and foreign firms.

Equally worrisome are the security disputes that have flared up in the East and South China Seas, which, via treaty obligations, directly involve the US. Its strategic "pivot" to Asia adds more tension. The longer these frictions fester, the greater the risk of an accident or miscalculation leading to a military response, culminating in the ultimate break-up nightmare.

The US and China could escape the potentially destructive endgame of a codependent relationship by recasting their ties as a more constructive and sustainable interdependency. An interdependent relationship fosters healthy interaction between partners, who satisfy their own needs rather than relying on others to do so, and maintain their own identities while appreciating the relationship's mutual benefits.

The upcoming Strategic and Economic Dialogue provides the US and China a platform of engagement to seize their collective opportunities. Both countries should press ahead with a bilateral investment treaty, which would enhance rules-based market access and eventually foster greater trade liberalisation. That would allow the US, the world's preeminent services economy, to seize the opportunity that is about to be provided by the emergence in China of a services-led consumer society. And, it would enable China to draw on the US's expertise and experience to help master its daunting economic rebalancing act.

At the same time, the upcoming dialogue should aim to restart the military-to-military exchanges on cyber-security issues that were launched a year ago. These efforts were recently suspended in the aftermath of the US Justice Department's decision to file criminal charges against five members of the People's Liberation Army. Here as well, the goal should

be a rules-based system of engagement, especially vital for all modern economies in an era of IT-enabled globalisation.

Progress on these fronts will not be possible if the US and China remain stuck in the quagmire of codependency. Only by embracing the opportunities of interdependency can the hegemon and the rising power reduce tensions and focus on the benefits of mutually sustainable prosperity.

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