

Who gutted international trade? Hint: It is not Trump

A book review of “Schism: China, America and the fracturing of the global trade system” by Paul Blustein

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Paul Blustein was a journalist with ‘The Washington Post’ and with ‘Wall Street Journal’. His coverage of the Asian financial crisis of 1997-98 gave us very good insight into how the International Monetary Fund was dictating terms to the Asian sovereigns in distress. The Treasury in turn was coordinating its suggestions/recommendations/instructions with Wall Street. Blustein’s book, ‘The Chastening’ had an apt title indeed. The Fund that emerged after the crisis was a chastened one. It instituted the Independent Evaluation Office and toned down the conditionalities attached to IMF programmes. A large portion of the credit should go to Paul Blustein.

Blustein’s most recent work, ‘Schism’ was published nearly two years ago. That seems like a long time ago. But the last year and half have been consumed by the global pandemic and, moreover, the reality of global trade has seen the dynamics outlined in ‘Schism’ played out.

It is recommended reading for those animated by issues such as global trade and geopolitics. While Blustein could not fully resist the temptation to lay all the blame for the fractured global trade regime on President Trump and tensions with China, he had not fully succumbed to it either.

If anything, I would wager that if Blustein were to write the book now, his conclusions would be more forthright on China’s culpability for the polarised world of trade and much else. I say so because events since the book was published in September 2019 have established beyond reasonable doubt that China would regard reasonable attitudes on the part of others as weakness and would deem aggression an invitation to respond in kind and disproportionately. The net result is the same. More confrontation and more unilateralism.

Notwithstanding the author’s predilection to assign a good deal of blame on the United States, the book gives us good insight into what has shaped China’s emerging attitudes towards the West. As much as it has to do with Mr. Xi Jinping’s background, his belief in Mao and his determination to see that the Communist Party is not contaminated by the West, it also has a lot to do with the Western failure of capitalism.

Before we get into some of its interesting contents, some words on the book: It is well written. Easy on the reader. Paul Blustein’s style is fluid and lucid. Trade is a dry topic and he makes it interesting.

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We do get a good glimpse of the processes of WTO appeals. We also understand the naivete of some of the WTO appellate members when they ruled that the Chinese government's ownership of state-owned enterprises did not mean that the government dictated their functioning. How nice and innocent!

Also, we do learn how hard America negotiated on China's admission into the WTO. It should not be a surprise if the very process itself made China determined to game the system in its favour. It can be, and it was, humiliating and condescending.

2008 heralded a geopolitical seismic shift

Early on in the book, Paul Blustein cites Charlene Barshefsky saying that China's attitude changed in 2008. She led the negotiations from the American side on China's accession agreement for membership into the WTO:

In the years since striking that agreement, Barshefsky, now back in private law practice, has outspokenly criticized the direction of China's economic policies. "The environment in China has shifted negatively for foreign businesses," she said at a 2016 event on the fifteenth anniversary of China's WTO accession. "Multinationals saw enormous gains in China...from roughly 1999 to 2007-08. But at that juncture, opening began to sputter...and in the place of reform and opening, increasingly what is seen [are] zero-sum, mercantilist policies. (p.99)

Not surprising. That is when Hank Paulson, the Treasury Secretary in the George W. Bush administration, was pleading with the Chinese to bail the American banks out. Honestly, it is difficult to expect to dominate the world and a relationship after such a plea for assistance. It is either delusional or chutzpah to think that one can beg China for a bailout and then try to put China in its place. Most would respond with snigger and derision as China did:

"He (Wang Qishan) wanted me to know that the financial crisis in the U.S. had affected the way he and others in the senior ranks of the Party saw us," recalled Paulson, who quotes Wang as saying: "You were my teacher, but now here I am in my teacher's domain, and look at your system, Hank. We aren't sure we should be learning from you anymore." (p.203)...

The depths that America plumbed — and the crisis in Europe that followed — thoroughly discredited Western-style capitalism in the eyes of many Chinese. (pp. 203-204).

In that regard, it will be interesting to speculate on whether the IMF delay in issuing its Article IV report on China, with the inclusion of a judgement that its exchange rate was 'fundamentally misaligned', prevented a big adjustment in China's exchange rate. A Board meeting was scheduled for September 22, 2008. On September 15, Lehman Brothers' collapse was announced to the world.

Everything changed after that:

Here is the crucial wording from the report's executive summary: "There are significant concerns that the exchange rate may be fundamentally misaligned and exchange rate policies could be a significant contributor to external instability...Accordingly, staff recommends that the executive

board initiate an ad hoc consultation with China that would be expected to be concluded within about six months.” The September 22 board meeting was never held. The Article IV report was buried. Indeed, the US Treasury lost interest in prodding the IMF to label China. (p. 170).

Now, even if the report was released a week before that, America’s desperation and its turn to China for assistance would have sealed the fate of that report in any case:

Paulson’s book, *On the Brink*, offers helpful insight regarding the reasons for that seismic shift. In his chapters about events immediately following the Lehman bankruptcy, the former Treasury secretary recounts numerous phone calls to Beijing in which he and other Treasury officials were essentially imploring Chinese leaders to see that it was in their own self-interest to help keep the rest of the US financial system afloat. (p. 171).

It is hard not to think of the reasons for America to turn to China, and not to the Persian Gulf countries, for infusion of capital into their financial institutions. Did America under Bush and Paulson really believe that China would throw a rope to haul them back to safety without demanding its pound of flesh, in return? Whether it is the excuse of the moment of desperation or something else, the beseeching of China on bended knees amounts to a colossal misreading of history. America might yet pay the price for it.

Nothing captures the changed geopolitical power balance more starkly than this paragraph:

Humiliating retreat for the IMF came almost exactly two years after the board’s approval of the 2007 rule change, when the Fund essentially vowed to abandon the term “fundamental misalignment.” Only then, in July 2009, did China allow the long-delayed completion of its Article IV report — and the report placed before directors contained much softer language on the RMB than the one that had been drafted in the fall of 2008. This was emblematic of the elevated geopolitical status with which China emerged in the wake of the crisis. (p. 173).

Obama administration tried to wrest back the initiative

Given all of that, frankly, it is creditable how much initiative the Obama administration wrested back. That the Obama administration was not squeamish about dealing with the Chinese or tackling their trade practices comes through loud and clear from the book. There is enough information to make the case that the Obama administration in fact pushed back, including through aggressive and unilateral changes to the appellate body of the World Trade Organisation. It did not convey the ‘Market Economy’ status on China despite China’s strong insistence.

That conveys two things. Contrary to what was thought, the Obama administration was not too meek. I must add the following, however, from Blustein’s book:

The main economic policy heavyweights in the Obama White House — Geithner and National Economic Council Chairman Larry Summers — “were critical of the direction the Chinese economy had taken in recent years and were disturbed by the impact of its discriminatory practices on U.S. competitiveness,” so they laid out a variety of options for the president to consider “from relatively anodyne to draconian ones,” according to Bader’s book¹.

“But at the end of each discussion or memorandum, they consistently concluded that the impact of China’s practices on the U.S. economy was in fact quite small, and that even positive corrections would have considerably less impact in the United States than most people imagined. (p. 213).

Two, equally, it also means that the Trump administration did not take a wrecking ball to the trade relations with China or to the international body WTO. It was merely continuing to tread on the path paved by the previous administration. It imparted – in fits and starts – some more momentum and teeth to those efforts.

Trump re-negotiated NAFTA and it is illuminating to note that the Obama administration too thought that NAFTA conferred unfair advantage on Canada and Mexico.

Bush administration was insufficiently alarmed

As mentioned earlier, the administration that missed more than a trick or two is the Bush administration. It was partly ideological and partly convenient. They were either naive in their belief that China would change or become a little more liberal, or they believed that they should not interfere with market forces, or that recourse to both of those positions was simply convenient.

Perhaps China would have, but for the repelling effect of the chaos of American democracy and capitalism. We should not forget how America damaged its own credibility with its war on Iraq on phoney grounds, as it turned out. So, the Bush administration, in many respects, turned out to be the one that prepared the ground for the political polarisation in America, its diminished economic clout and fiscal wherewithal too, forcing the country to rely on monetary policy snake oil.

The decision of the Clinton administration to negotiate with China for its integration into global trade via membership in the World Trade Organisation was not wrong. The Chinese government and its record up to 2000 from 1979 made the case for a punt on its economic integration, notwithstanding Tiananmen in 1989.

America’s failure to foresee the turn that China would take under Xi is a lesser failure than the failure to foresee the collapse of its own capitalist model which has turned overwhelmingly predatory. America continues to be weighed down by it. American finance and technology czars are pushing the country into an abyss and are hamstringing its policy flexibility for they are putting their selfish interests ahead of the nation, as they did before 2008.

The failure of American capitalism and the failure to foresee that failure are both hubristic. Well, history tells us that empires have always collapsed thus.

Just as George Bush paved the way for the collapse of American clout, prestige, influence and geopolitical advantage over China, on China’s side, the understated Hu-Wen combination facilitated the return of the public sector, state control and party control over the commanding heights of the economy and even of the society under Xi. Paul Blustein does well to document that.

One man who comes across as being very astute about Chinese intentions and methods is Tim Stratford, former Chairperson of the American Chamber of Commerce in China:

“There’s an ambiguity that China’s government delights in fostering — they like to have it both ways,” (p.214)

Would multilateralism have worked? Perhaps

Perhaps, where Paul Blustein errs, in my view, is that he thinks that China could have been handled better or more effectively through WTO rather than through the bilateral and arbitrary mercurial methods of President Trump. He may be right about his criticism of the Trump approach which was not consistent. In fact, Robert Lighthizer was more consistent than Trump was. But for Covid, we cannot be sure of how Trump would have dealt with China. He might well have cut some deals and touted it as victory. But that does not mean that multilateralism or globalism would have succeeded.

Tim Stratford tells him that China thrives in ambiguity and in mixed messaging. They want to have the cake and eat it too and they do it very well:

Recounting his numerous interviews with managers of technology-intensive multinationals based in China, Lee Branstetter, an economics professor at Carnegie Mellon University, stated: “I have heard personal and detailed accounts of the lengths to which Chinese companies and the Chinese government have gone in their collective efforts to extract technology from foreign multinationals,” and although the transactions might technically be “voluntary,” they are “only voluntary in the sense that the business transactions engaged in by the fictional gangster of the Godfather series, Vito Corleone, were voluntary. China is effectively making an offer multinationals cannot refuse.” (p. 296).

While many tactics of China in the international arena are not worthy of replication, either out of civility or out of a sense of fairness and mutual respect, people from many developing countries would wish their politicians and bureaucrats would negotiate as hard and devise as many ways as China does to get the best technology, knowledge and skills for their country.

To be fair to Blustein, he does not simply stop with admonishing Trump for his unpredictable and inexplicable policy zigzags. He cites two specific avenues through which the United States could have assembled a ‘coalition of the willing’ to take on China through WTO. Developing countries should focus on the second one at least as long as WTO is still around:

(i) But the heart of the case she (Jennifer Hillman) proposed involved Article XXIII of GATT/WTO rules, called “nullification or impairment.” Obscure and seldom used though it may be, this provision might be the perfect ace in the hole for playing against China Inc. Under this provision, a WTO member can be found in violation of its obligations and subject to sanctions if its policies nullify or impair the legitimate expectations of its trading partners by violating the overall intent of the rules — even if no specific rules are being broken. (pp. 398-399).

(ii) section 15 (b) of the protocol (he is referring to the China WTO accession protocol), states that if distorted market conditions in the Chinese economy cause “special difficulties” to trading partners in estimating Chinese subsidies, the calculations can be made using prices and costs for comparable goods and inputs in other countries — which makes it much easier to conclude that subsidization is occurring and high duties are warranted. This provision doesn’t expire, unlike other discriminatory rules that China accepted (for example, the special China safeguard, which had a 12-year duration, and the non-market economy status for anti-dumping cases, which was supposed to last 15 years). (p. 401).

Paul Blustein's coverage of America's handling of Huawei and 5G, under Trump, borders on naivete. It is disappointing. His defence is that a Bloomberg article on how the rise of Huawei coincided with the decimation of Nortel (through spying and hacking) came out after his book was published².

In conclusion

China lost all respect for the United States after 2008. That is why China decided to up the ante in the race for global dominance, with its own global 'institutions' and 'initiatives' such as the BRICS Bank (New Development Bank), Asian Infrastructure Investment Bank (AIIB), Shanghai Cooperation Organisation, Regional Comprehensive Economic Partnership and the Belt and Road Initiative.

China is not interested in such a world that the West has created. It is determined to create a world on its own terms where all other countries will be its tributaries. Considering how much America has made a meal of its economics, capitalism and politics, it is hard to fault China for harbouring such ambitions, no matter how unviable its own model is. On present evidence, the former stands more discredited than the latter.

That said, I think America was wrong to withdraw from the Trans-Pacific Partnership. Trump made that call. Not because it would have mattered in economic terms. It would not have. At the very least, it would have been an irritant for China just as the Quad is, for example. That irritation would have made them commit some errors and antagonise some more countries even more spectacularly than they have done so far.

Wall Street had a big hand in bringing America to its knees in 2008, making its government beseech China for support. It continues to romance China³. Wall Street might have played a big role in bringing Didi's Initial Public Offering to America, even as it appears increasingly likely that the company was indeed warned by Chinese regulators to postpone the IPO and address their security concerns. Analysis disclosed that Bytedance heeded precisely such a warning and postponed its public offering in America⁴. It may be a coincidence (or not) that Jean Liu, the president of Didi Chuxing, was previously a Managing Director in Goldman Sachs. Simply put, it appears that Wall Street has encouraged a Chinese company to raise money from Americans by withholding critical information from them. Just think about it.

In the end, too much of finance is behind America's decline which, in turn, is behind the story of the schism that Blustein tells. Too much finance continues to stalk America.

Schism: China, America, and the Fracturing of the Global Trading System by Paul Blustein, CIGI, September 2019, 409 pages.

Notes and References:

¹ The book he is referring to is ‘Obama and China's Rise: An Insider's Account of America's Asia Strategy’ by Jeffrey A Bader, 2013, Brookings Institution Press.

² Did China steal Canada’s edge in 5G from Nortel, Bloomberg Quint, 01 July 2020: <https://www.bloombergquint.com/businessweek/did-china-steal-canada-s-edge-in-5g-from-nortel>. The UK should bar Huawei from its 5G network, John Sawers, former chief of MI6, Financial Times: <https://www.ft.com/content/4fe3a612-f430-43dd-ad89-8f319ca80e8b>

³ China has one powerful friend left in the US – Wall Street, Wall Street Journal, 2 December 2020: <https://www.wsj.com/articles/china-has-one-powerful-friend-left-in-the-u-s-wall-street-11606924454>. Wall Street’s love affair with China, Financial Times, 29 May 2021: <https://www.ft.com/content/d5e09db3-549e-4a0b-8dbf-e499d0606df4>

⁴ ByteDance Shelved IPO Intentions After Chinese Regulators Warned About Data Security: <https://www.wsj.com/articles/bytedance-shelvedipo-intentions-after-chinese-regulators-warned-about-data-security-11626078000>