Review of *Unbalanced: The Co-Dependency of America and China*. By Stephen Roach. Yale University Press. 326 pp. $32.50

The United States and China are political and economic rivals. They are also joined at the hip in many ways. A source of inexpensive products and surplus financial capital, China sustained consumer-driven economic growth and low inflation in America despite a lack of domestic savings. In turn, as the world’s largest market, the United States fueled China’s remarkable export-led economic expansion.

While initially beneficial, Stephen Roach, a senior fellow at the Institute for Global Affairs and School of Management, Yale University, and the former chairman of Morgan Stanley Asia, reminds us, this marriage of convenience was not sustainable. It helped produce a "lethal combination" of bubbles and structural distortions that resulted in the "Great Recession" and threatened "the very fabric of globalization." In *Unbalanced*, Roach analyzes the dynamics of the "relationship addiction" of co-dependency, its impact on China and the United States, the risks (identity crisis, denial of responsibility, a tendency to blame others, and world-wide recession or depression) of inaction, and the obstacles to re-balancing. He concludes by identifying a pathway forward in which both countries can emerge stronger.

*Unbalanced* is lucid and accessible, immensely informative and insightful. It is, most certainly, one of the most important books on the relationship between the United States and China to be published in at least a decade.

To encourage Americans to stop fixating on China as a bilateral threat, Roach clears away a thicket of misconceptions about "America's favorite scapegoat." Acknowledging that China is the United States’ largest foreign supplier of goods, he notes that it is increasingly less a factory than the final stop on a chain of production, an "assembly line drawing on inputs from other nations." Although U.S. trade data assign 100 percent of the value of imports to the country which sends them to their destination, foreign produced components and parts account for 40 percent of China's exports. And 60 percent of those exports come from foreign-funded enterprises. Indeed, the direct investment position of U.S. companies in China in 2012 was over $51 billion. Contrary to conventional wisdom, moreover, China is a relatively open economy, whose import share of GDP has averaged 28 percent since 2002, three times more than Japan's historical ratio and well above that of most of the world's major economies.

Roach also warns against a preoccupation with bilateral currency exchange rates and trade sanctions. Without addressing the real source of America's trade imbalance, "the chronic saving problem," he points out, forcing the renminbi sharply upward against the U.S. dollar and/or imposing tariffs would raise prices for American consumers, de-stabilize the economies of both countries, and prompt retaliation.

The good news, according to Roach, is that a mutually advantageous re-balancing is feasible. China must move from export and investment-led growth to a model based far more on domestic consumption. To generate more jobs, it should shift from labor-saving manufacturing to labor-intensive service industries, which are currently under-developed, and boost wages. And China should use its vast surpluses to fund a social safety net, providing health care and retirement income to its aging population.

Roach recommends that the United States become a producer-led economy. It should rely far less on personal consumption, which now accounts for about 70 percent of Gross Domestic Product; reduce artificially low interest rates and government deficits; encourage exports and business capital spending and restore American competitiveness; rebuild infrastructure and invest in education; and incentivize savings.

The bad news, however, is that each of the two countries may not have the political will to take the steps that are necessary. Roach believes that China, which "thinks and acts strategically" and has pragmatic leaders who "excel in implementation," is more likely to adjust to the new realities. And that the United States, whose policy makers (exemplified by Alan Greenspan and Ben Bernanke) prefer market based systems (and not meddlesome government planners) to address employment, income generation, wealth creation, and resource allocation, could opt for muddling along, its "preferred course of inaction in recent years." Should that mindset prevail, an asymmetrical re-balancing by China, with its attendant impact on interest rates and the dollar, will add to the pressure to act, with a very real prospect that the "Next America" would resemble "the Last America -- saddled with the excesses of domestic demand, a persistent shortfall of savings, never-ending current account budget deficits, and the risk of another wrenching crisis."

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It is always tempting, Roach writes, to dismiss Nightmare Scenarios as unthinkable. And to conclude that the Smoot-Hawley Tariff of 1930, which pushed the world into the Great Depression, and the excesses that produced the Great Crisis of 2008-2009, cannot happen again. Mindful of protectionist and punitive measures introduced in Congress these days, the lesson, he believes, "is painfully clear: Never say never, especially when there are plenty of warning signs that the unthinkable, is, in fact, become dishearteningly, thinkable."