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U.S.-China Friction: Why Neither Side Can Afford a Split

By Zachary Karabell

It hasn't been a banner few weeks for U.S.-China relations. In mid-January, Google announced that it was contemplating pulling out of China because of repeated attacks on its network as well as censorship constraints. In the past week, the U.S. government authorized \$6 billion in arms sales to Taiwan, and the White House announced that President Obama would meet with the Dalai Lama after having postponed that visit last fall on the eve of Obama's trip to China.

Beijing's response has been increasingly unfriendly, even hostile. A senior Communist Party official announced that any meeting between the President and Tibet's spiritual leader would "seriously undermine the political foundation of Sino-U.S. relations" and would lead to "corresponding action" — a phrase made more ominous by its utter vagueness. Then, in response to the proposed Taiwan arms sales, the Chinese threatened sanctions against U.S. defense companies, which include conglomerates doing substantial nonmilitary business in China such as United Technologies, which has seen booming demand for its Otis elevators in Chinese skyscrapers, and Boeing, which has staked its future growth in part on demand from China's air carriers. Most recently, on Feb. 5, China's Commerce Ministry accused the U.S. of dumping chicken on the China market. ([See the worst business deals of 2009.](#))

This increasing truculence is a direct reflection of a rapidly shifting economic balance of power. One of the consequences of the financial crisis of 2008-09 was the catapulting of China to the forefront of the global economic system. That trend wasn't created by the crisis, but the crisis certainly accelerated it. As the U.S., Europe and Japan contracted sharply, China registered its own brief, if scary, dip and then proceeded to use its trillions in foreign reserves to undertake a massive spending program. More effective than similar stimulus packages in the United States and elsewhere, the approach by the Chinese government not only halted the swoon but propelled China to even more robust growth.

China's relative strength has attracted considerable attention. From Washington to Tokyo to Davos, global business leaders are hailing China's resilience and calling on Beijing to take a greater role in governing the global economy. Its model of state-driven capitalism, having weathered the storm, has won widespread praise (as well as criticism), and slowly Chinese leaders have taken note. Now there are signs that all the talk of the Chinese miracle has started to have an effect — and not a good one. ([See TIME's special report on Davos.](#))

The recent flurry of hostile words was capped by a haughty rebuttal of U.S. Commerce Secretary Gary Locke's criticism of Chinese economic policies that favor domestic companies over American and foreign competitors. Said the [official Xinhua news agency](#): "Ironically, the United States is now turning around and accusing China of protecting its domestic companies. Burdened by high unemployment and facing mid-term elections in November, some people in the U.S. are trying to shift public attention from thorny political and economic issues to other countries. However, such irresponsible moves will prove to be unhelpful, and China will not accept being a scapegoat."

In short, China is brimming with confidence, and in recent weeks that self-confidence has turned into arrogance, with scorn for the U.S. There is a long legacy of Chinese distrust of the West. Today, Chinese nationalists cannot explicitly criticize Beijing, but they can indirectly attack the government by challenging the close relationship between the U.S. and China. For many in China, the U.S. is a corrupt nation that bears China no goodwill and will drag China down if Beijing doesn't find a way to distance itself from the American economic embrace.

But while many Chinese take delight in America's plight and would like to end the close embrace that has brought China such prosperity over the past two decades, they are falling prey to delusions of grandeur. The fact remains that as much as China may want to go it alone, it cannot. ([See pictures of the global financial crisis.](#))

To begin with, it holds more than \$1 trillion in U.S. assets, mainly in U.S. Treasuries. No other country or entity in the world could absorb those assets if China wanted to sell them, and with China's currency value pegged to the dollar, any massive sale would lead to a steep decline in the Chinese currency and economy. China's holding of U.S. debt is leverage only in a theoretical world where it could dump its U.S. assets or stop buying more. What's more, even a hobbled America is the world's largest economy and the most significant market for Chinese goods. In 2009, a supposedly bad year, Chinese exports to the U.S. were approximately \$300 billion, about the same as in 2007. That is a vast source of income for China — and one that no other part of the world can provide.

The U.S., meanwhile, has been a source of billions of dollars in direct investment in China, from thousands of American companies big and small. While it's true that China doesn't need any one of these companies as much as each one needs China, China needs all of them and depends on them for

everything from brand-name goods to know-how and capital. Beijing can't just snap its fingers and go it alone; its domestic economy is far too entwined with that of the U.S., its companies, its capital and its consumers.

There's little question that neither China nor the U.S. wants to be dependent on the other. China's rhetoric of late is proof, and you could easily demonstrate the same attitude coming from Americans. But each country has tied its economy to the other, and buyer's remorse notwithstanding, there is no immediate exit from this relationship. It remains a source of stability and prosperity for both countries. Two decades ago, China cast its lot with the United States, and until recently, that has brought it affluence. Now that things have gotten difficult, the Chinese want out. But when the heady intoxication of these weeks wears off, they will find that they have nowhere else to go. One day, perhaps, but not today.

Karabell is the author of Superfusion: How China and America Became One Economy and Why the World's Prosperity Depends on It (Simon & Schuster 2009) and president of River Twice Research (rivertwice.com)

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