Photo by Brent Finnegan.

A Chinese-made American flag at a July 4th parade in Harrisonburg, Virginia.

U.S.–MEXICO FUTURES FORUM: CHINA

Can Eagles Fly With Dragons? China, Mexico and the U.S.

by Julie Michelle Klinger

China's remarkable economic growth has benefited millions of people in China, as well as in the United States and Mexico. However, the current economic challenge posed by China's globalizing influence demands robust and far-reaching action on the part of both North American countries.

When it comes to China, the United States has more in common with Mexico than with its other North American neighbor, Canada. Canada can continue to prosper as a primary commodities exporter — much like Brazil — but the U.S. and Mexican economies have both relied heavily on domestic industry and therefore have been particularly affected by changing trade profiles with China. Both countries experienced capital flight and job losses as firms migrated toward China in the 1990s, while Chinese imports have significantly displaced domestic production since the turn of the millennium.

An international panel on China and the Americas at the 2011 U.S.–Mexico Futures forum agreed that, without losing sight of the important differences between the United States and Mexico, there are several key areas within which coordinated actions should be prioritized. Presenters included Enrique Dussel Peters of the Center for China–Mexico Studies at the Universidad Nacional Autónoma de México and Clyde V. Prestowitz, founder and president of the Economic Strategy Institute and former counselor to the Secretary of Commerce during the Reagan Administration. Participants included a range of political, academic and business leaders from the United States and Mexico.

Although considerable attention has been paid to the challenges and opportunities presented to the West by

China's rise, little headway has been made to establish coordinated, long-term strategies to engage the Asian power. In both the United States and Mexico, trade and industrial policy are in critical need of attention. A coherent trade policy that goes beyond the question of currency manipulation and particular trade practices to consider the functioning of the countries' diverse domestic economies would be an important first step.

Most conspicuously, both countries lack a robust trade policy response to China's economic ascent. However, addressing trade policy alone is not enough to change the current economic course. To be effective, a strong trade policy requires a strong industrial and manufacturing base. According to the panelists, rebuilding the industrial foundation of both countries is critical to reviving the domestic economy through providing secure employment and correcting trade imbalances, with the attendant benefits of reviving the middle class, reducing social inequality and balancing national budgets.

Rebuilding a strong industrial base in the United States and Mexico requires an industrial policy, which the U.S. arguably has not had since the decade following World War II. Reviving U.S. industry means much more than revamping the Rust Belt. It means reinvesting in education and infrastructure, which is another means of incentivizing firms to stay in the United States and hire U.S. workers. Harley Shaiken, Professor and Chair of the Center for Latin American Studies at UC Berkeley and co-convener of the Forum, maintained that U.S. industrial policy extended far beyond the 1950s: "What was the Interstate System or the educational response to Sputnik but an industrial policy? Putting a person on the moon was also an industrial policy." An important first step to meeting the challenge of China is broadening the terms of the debate; evaluating the various political, economic and social tools available; and harnessing the interests common to both the U.S. and Mexico.

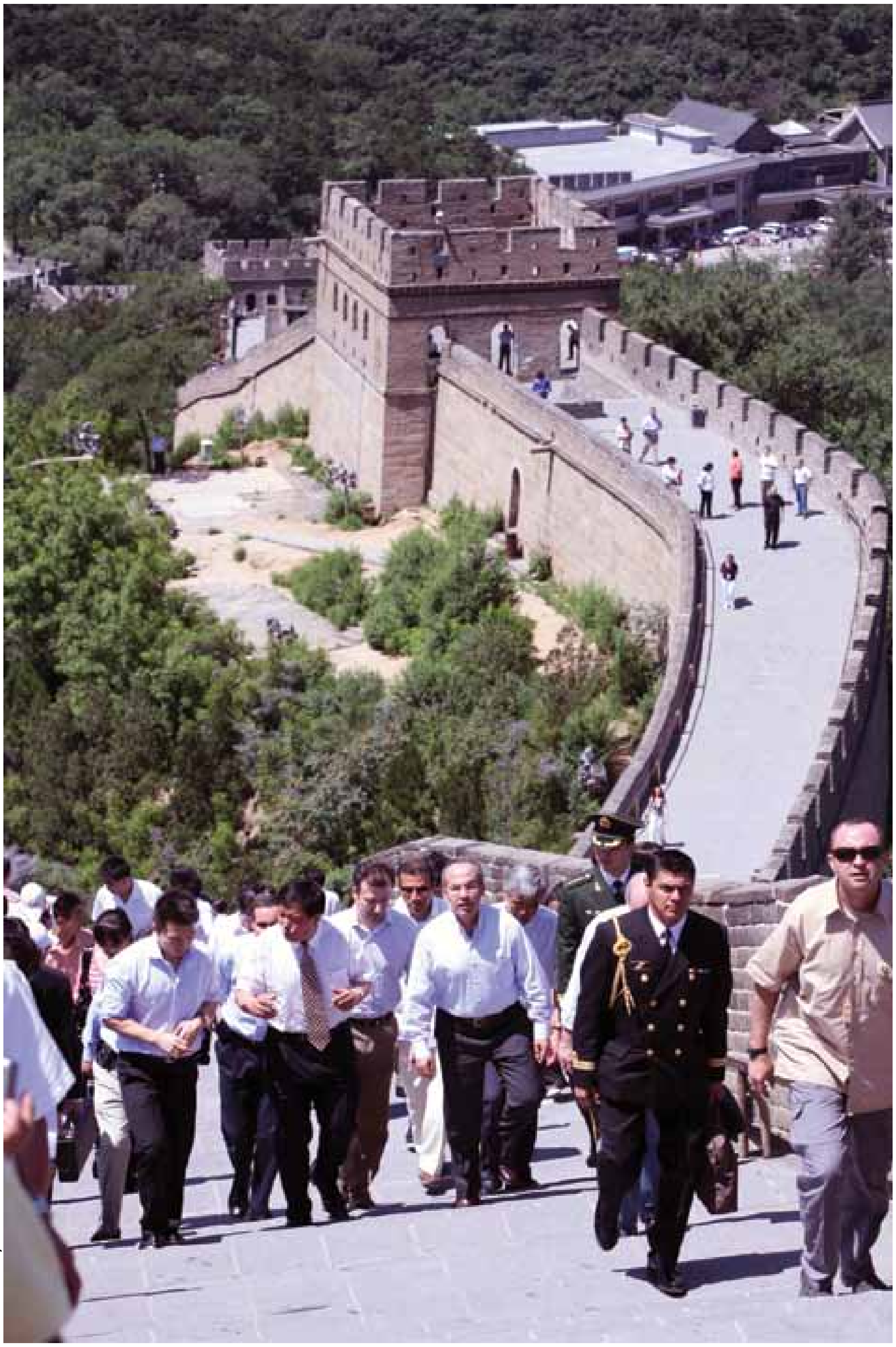

Photo courtesy of the Mexican Federal Government.

Mexican President Felipe Calderón climbs China's Great Wall, 2008.

Governance and Institutions

"We've been working a lot on the question of China," said Dussel Peters "and our analysis finds that the biggest weakness [in Mexico] is institutional." For example, China's political and economic relations with the rest of Latin America have profound impacts on the United States and Mexico, but analyses on the subject remain fragmented. "This

>>

From left: Adriana González Carrillo, Christopher Edley and California State Controller John Chiang.

weakness is present at all levels," Dussel Peters observes, "At the business level, the academic and the public."

"We need new solutions for which the past has not given us tools," observed Beatriz Paredes Rangel, a deputy in the National Assembly and the former governor of the state of Tlaxcala. "The problems of the United States in the 21st century cannot be solved the same way as the problems in the 20th century. It is a new world, a world in which we do not know how to give jobs to young people, whether in the EU, Latin America or the United States." Paredes Rangel's comment echoed a sentiment that has been growing in the Americas, which holds that China's explosive growth has undermined the economic, labor and geopolitical paradigms built up in the 20th century.

"Although lots of people are talking about China, there is no comprehensive national proposal on this topic," Dussel Peters continued. This observation applies equally to Mexico and the United States. While various actors are implementing short-term strategies, both countries are undermining their own economic and geopolitical standing by failing to develop a coherent, long-term policy, without which they are unable to take a more proactive approach with China to protect their national interests.

China, in contrast, has been very successful in adopting a proactive international trade strategy that safeguards domestic interests. Several participants observed that governments in the Americas should take a cue from the tough negotiating style of their Chinese counterparts and adopt an approach that is more assertive and less concessional.

Prestowitz supported this view with a critique of President Obama's November 2009 offer to Chinese President Hu Jintao to help China build its first commercial jet. "When I asked [the White House] why we would be offering to help China build one of the few remaining high-value goods that we still sell to them, the response was: 'Well, we need to demonstrate our commitment to China.'" Prestowitz went on to observe that the trade and investment volume between China and the United States for the past two decades should be a strong enough indication of U.S. political and economic commitment to China.

While forging an assertive policy response is crucial, it is also important to avoid extremes when discussing China. Those working closely on the question of China and the Americas are in agreement: China-bashing distracts from the structural issues, which include growing trends of domestic inequality, social polarization and under-investment in education and infrastructure. "We need to think long term," advocated Maria Echaveste of Berkeley Law. "China, the master of long-term thinking, is doing this. If we don't put these pieces together, we won't have any chance of changing this story."

But what if the business sector is relatively unconcerned, as several delegates observed? "The key question is whether the business sector in the U.S. is worried," remarked Paredes Rangel. "Because if it is simply a matter of the business community moving wherever it is most profitable, it seems that the economic problems in the U.S. will continue."

Prestowitz suggested that it would be more useful to think of U.S. corporate giants, like GE and Boeing, as global firms rather than U.S. companies, regardless of where their headquarters may be located. Whatever the patriotic inclinations of the CEO, a company cannot afford to treat its engineers in Boston differently than its engineers in Bangalore. In other words, neither U.S. nor Mexican workers can expect preferential treatment from national firms gone global in the absence of effective policy measures to secure such protections. Furthermore, the assets of global firms are greater than all but a handful of states, but the interests of those firms are much more straightforward. Prestowitz proposed a strategy for dealing directly with "the bottom line" that drives capital flight: establish a "war chest" bargaining fund for the express purpose of making attractive counter-offers to keep firms rooted in North America.

Why is a war chest composed of public funds to incentivize private industry worth considering? Because it is often the initial incentives, rather than long-term variables such as lower labor costs or weaker regulations that stimulate capital flight out of the Americas. For major firms such as Intel — which recently opened its first microprocessor producing plant in Dalian, China — labor accounts for less than 1 percent of the cost of production. That is hardly enough to compensate for giving up the quality and productivity found in the United States — at times at lower cost — unless a healthy capital subsidy and a tax break is offered by the host

>>

The ground-breaking ceremony for Intel's plant in Dalian, China.

Photo from Associated Press.

country to make up the difference. That is precisely the strategy employed by China, Singapore and other masters of attracting foreign direct investment from the West. If offering a subsidy or a tax break is truly all it takes to seal the deal, as Prestowitz maintained, then establishing a bargaining fund to help North American governments keep skilled, well-paying jobs in the region is worth some thought.

Any such action would, of course, have to be pursued with care. While this is a pragmatic proposal to directly address China's bidding prowess, the strategic value of such an initiative would be undermined if investment in an industrial war chest meant further disinvestment from other vital areas of the economy, such as education and infrastructure.

In short, in order to harness the positive potential of major corporate firms to shape the North American economy for the 21st century, it is important to first reckon with their position as semi-sovereign entities without national allegiance. Going forward, "if we want nations to be relevant," said Maria Echaveste, "we need to take steps for them to be relevant." That includes crafting a strong industrial policy and making the investments necessary to rebuild the North American economy.

Several panelists proposed that these crucial investments should be oriented toward reinvigorating the manufacturing sector and supporting unionized labor, both of which have seen a precipitous decline since the mid-20th century. "In 1955," noted Shaiken, "if you graduated high school and walked into a Ford plant, you stepped into the middle class." This is no longer the case.

Unionized labor was responsible for securing many of the benefits that enabled workers to support their families, their communities and achieve upward mobility. David Bonior, veteran congressman and former House whip, observed, "When I started out in Congress in the late 1970s, we still had a good union density in this country." Contrary to the anti-union sentiments that have gained political traction in some camps, strong unions and a strong economy actually go hand in hand. States in which collective bargaining is illegal have lower GDPs, higher poverty rates and greater incidences of on-the-job injury.

"While we didn't have an industrial policy in the 1970s," Bonior continued, "there was a strong commitment to the manufacturing sector, which people saw as an engine for the middle class, which had spillover effects into other sectors. Manufacturing jobs were well-paying jobs because people organized around them." Shaiken underscored this point: "This created the virtuous circle of a growing economy." Strong unions are far from the remnants of a bygone era. Rather, according to several participants, unions are a vital part of economic competitiveness going forward.

Currently there is little to stop domestic or international firms from pitting several states against each other in search of the most lucrative deal, perpetuating the "race to the bottom." This concept describes the pressure on governments to lower taxes and reduce social and environmental regulations in order to attract investment. While it is commonly used to describe competition between countries, the same process drives down the lowest common denominator within countries as well, unless those countries possess strong national investment policies.

21st Century Cooperation and Prosperity

"China's economic growth presents an important lesson to Latin American countries," observed Dussel Peters, "because — and note the irony — China did everything wrong." China did not follow the Washington Consensus, nor did it accept any aspect of Western economic doctrine in its entirety. This reality is important in terms of policy instruments; it is important for the future of decision-making in the Americas; and it is important in terms of how Mexico and the United States envision their shared and respective futures.

As Prestowitz and Dussel Peters pointed out, there is a strong similarity between what is happening between Mexico and China, and what is happening between the United States and China. The Import-Export ratio between China and Mexico is 11:1, and China is Mexico's second-largest trading partner after the United States. For the United States, the import-export ratio with China is 4.5:1, and China is the second-largest trading partner after Canada. Both Mexico and the United States tend to import higher value-added goods from China, while their exports consist of more basic commodities. For example, in 2009, the single greatest U.S. import from China was computers, while the United States' greatest export to China was scrap metal and waste paper.

Although Mexico and the United States have important differences in their histories, cultures and economies, there are many respects in which the interests and fates of the two countries are closely intertwined.

Rather than considering comparative advantage in terms of winners and losers in a global economic game, Mexico and the United States should collaborate around their respective strengths. Ambassador Luis Alfonso de Alba, Mexico's Permanent Representative to the United

Nations in Geneva, highlighted Mexico's capacity for negotiating directly with China on sensitive human rights issues. "The point," Ambassador Alba emphasized, "is that we have to accept that we need to work together and engage our comparative advantages. The U.S. should take advantage of Mexico's proven capacity for negotiating not only with China but also in the WTO, with Korea and with Indonesia."

The future of decision-making must be directed by sharper analytical capacity as well as a stronger ability to think long term. Thinking long term is not just a matter of seeing beyond the next election cycle. It is also a matter of knowing the past. "If we look into the past," noted Prestowitz, "There are some tools that we have forgotten about." While it is true that the United States and Mexico need to develop new tools to face the challenges of the 21^{st} century, there is also a lot that both countries can learn from their own history, especially the periods that laid the foundations for Mexico's industrial strength and for the United States' 20^{th}-century emergence as an economic super power.

"Between 1800 and 1950," Prestowitz remarked, "the U.S. looked a lot like China. The U.S. was protectionist. The U.S. had an industrial policy. The government worked together with organized labor and identified sectors that it wanted to strengthen. And we did it. So we just need to first read our own history and then decide what we are going to do."

The panel "North America, China and the Global Economy" was part of the U.S.–Mexico Futures Forum held in Berkeley, California, April 15-16, 2011. Enrique Dussel Peters, Coordinator of the China–Mexico Studies Center at the Universidad Nacional Autónoma de México and Clyde Prestowitz, President of the Economic Strategy Institute in Washington, DC., were the presenters.

Julie Michelle Klinger is a Ph.D. student in the Geography Department at UC Berkeley.

The Mexico Pavilion at Shanghai's World Expo, 2010.

Photo by ©Virginia & Josh — TwoFatBellies.com.